2021 March Market Outlook

For much of last year, we had a K economy where certain sectors of the economy were growing/improving, but some sectors were struggling. With vaccinations ramping up and the potential of the economy opening up later this year we are starting to see the struggling parts (restaurants, brick and mortar retail, travel, entertainment…) of the economy start to recover. Economists, analysts, and the markets are anticipating a strong economic recovery. This is likely.

Even though the ending of the recession has not been declared, we are probably close.

Bullish Case

- Progress is being made in beating covid in the U.S. There is light at the end of the tunnel. Beating the virus is key to a broad, sustained economic recovery.

  Below are the latest numbers regarding covid:

  The Latest Numbers

  128,217,029 vaccine doses given so far in the U.S.

  52,878 new U.S. cases recorded yesterday

  894 deaths in the U.S. recorded yesterday

  543,849 total U.S. deaths

  29,922,911 total confirmed cases in the U.S.

  124,305,890 confirmed cases world-wide, and 2,736,298 deaths

  Sources: Johns Hopkins University as of 6:30 a.m. ET; Vaccination figures from the Centers for Disease Control and Prevention.

  Around 130 million people (about 30% of the vaccinated have had the 2 shots, the first shot is about 52% effective) have been vaccinated and about 30 million have had the virus and should have some immunity. We are probably about halfway to be at 70%.

- To achieve herd immunity we need at least 70% of the population to get vaccinated/been infected. According to polls, about 27% of the population do not plan on getting vaccinated. We should be close to 70% to get to herd immunity, but it would be better if we were over 80% vaccinated.

- Trillions of dollars in liquidity, relief, financial aid, and stimulus have been released into the U.S. economy. Similar liquidity has been provided by other global central banks to their economies. Our economy is doing better than most developed countries because of the fiscal and monetary aid, support, and now stimulus.

- The Fed has stated several times that they will do all they can to help the economy, especially those being left behind in terms of employment. The Fed has the economy and investors back. They have committed to keeping interest rates ultra-low until 2023.

  This administration, the Fed, and Treasury have stated several times they are concerned about the service industry and its high unemployment. They want to keep interest rates as low as possible for as long as possible to boost the economy and help those being left behind in terms of the millions that are unemployed due to the pandemic.

- Most economists are forecasting economic growth of around 5% or more. Earnings should also be strong this year.

  The service sectors (restaurants, brick and mortar retail, travel, entertainment…) have suffered the most during this pandemic and are expected to do very well this year because of pent-up demand. The stocks from these groups are up strongly and reflect the service sector recovery sentiment.

- Low-interest rates have allowed some homeowners to refinance their homes and the extra cash is spurring spending helping the economy.

- We were in a bear market last year, and we are now at the start of the next bull market cycle. See Technical/Price Analysis section.

- The National Bureau of Economic Research (NBER, the organization that officially declares when a recession starts and ends), declared that a recession started last February. It’s normal for the NBER to declare the start/end of a recession after the fact. They have not declared the end of this recession, but we are probably close to the end.

  It’s best to be fully invested at the start of an economic and market cycle. Most of the gains in a market cycle are at the start of a bull market. See Technical/Price Analysis section.

- TINA – **T**here **I**s **N**o **A**lternative to stocks. Bond yields are low and there is capital loss risk if rates continue to rise. See the Bearish section below and the bullet points about interest rates and inflation.

- Financial Planners, 401ks are not selling. I’ve written many times about these two participants of the market and both control trillions of dollars and they normally don’t sell but rebalance. This is a fairly new phenomenon that I’ve noticed for about the last five years.

- Another behavior of market participants has been that they consistently buy on pullbacks.

  Both phenomenons (key participants don't sell and participants buy on pullbacks) have kept the markets resilient compared to past market cycles. This is true despite the many headwinds (health and financial crisis, trade wars, conflicts with China, fears of rising inflation, and interest rates) the markets have faced.

  If these trends continue, we should feel relatively comfortable at the start of the economic and market cycle.

- Markets have been making new highs, this can continue. Below is a chart of the Dow 30 and S & P:

  I've written about markets, stocks that breakout to new highs can continue. The main reason is there is no resistance and little selling once prices break to new highs. New highs can continue until a new higher trading range is found. Round numbers tend to be invisible resistance levels.

  For the Dow 30, it could be 33,500 or 34,000. For the S & P, it could be 4,000. This could happen despite the markets being overvalued.

Bearish Case

- Markets are overvalued. See Valuation section below

- Europe, Latin America, India, and other parts of the world are having problems getting vaccines to their citizens. Some of the reasons include: cost, availability, lack of qualified people to manage and administer the vaccines, some of the drugs are sensitive to temperatures and go bad, citizens reluctance…

- Variants, mutations of the covid-19 virus have been identified in Great Britain, South Africa, and Brazil. We are seeing cases of some of these variants in certain U.S. cities. We have a chance to stay ahead of these variants with our current effort to get to herd immunity, but other countries could have spikes in these new variants. Some health experts are concerned we could also have spikes in these variants especially in states and cities that are opening up their economies.

- The new administration is talking about tax increases to help pay for an infrastructure bill. The proposed taxes are also promoted as making sure corporations and the rich pay their fair share of taxes.

- The markets have not adjusted to the major changes in the economic direction and policies of the new administration. The previous administration was focused on the markets and economy. This administration is focused on Main Street and workers, and not Wall Street. They are also focused on climate change. The market so far has not adjusted to these changes.

- Some analysts and investors are concerned about rising inflation and interest rates. I wrote about this in my 2021 Economic Outlook. Eail me if you would like a copy. Rising inflation is bad because the cost of living rises. Interest rates normally rise as lenders need to protect their investment dollars against inflation. Also, higher rates and higher-yielding investments give competition to stocks. Rising inflation and interest rates are bad for the economy, consumers, businesses, and investors.

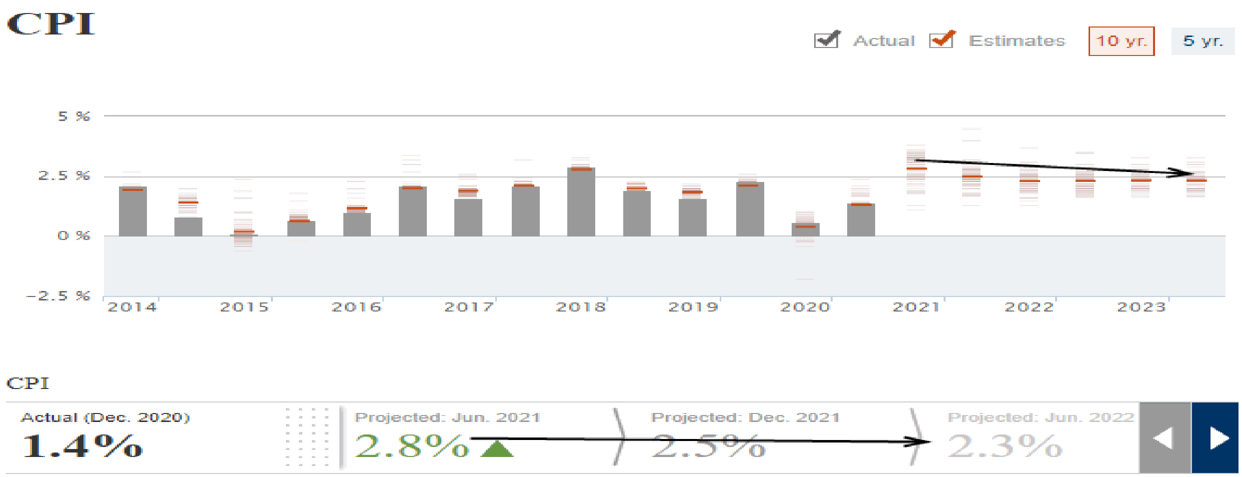
  Investors have been worried about rising inflation and interest for over ten years and so far inflation and interest rates have remained at historically low levels.

  Recently, interest rates have had a substantial increase:

The 10-year Treasury has increased from around .5% to about 1.7% an increase of about 300%. But, rates are still at historically low levels.

I started in the business in the early 1980s and until 1988 I sold millions of dollars of bonds at yields above 10%. None of us back then would believe rates would get this low. I would love to own some of those double-digit interest rate municipal bonds I sold.

The 10-year is finally paying close to the rate of inflation but there is not a time premium. Below are forecasts for CPI from a WSJ survey of over 60 economists:



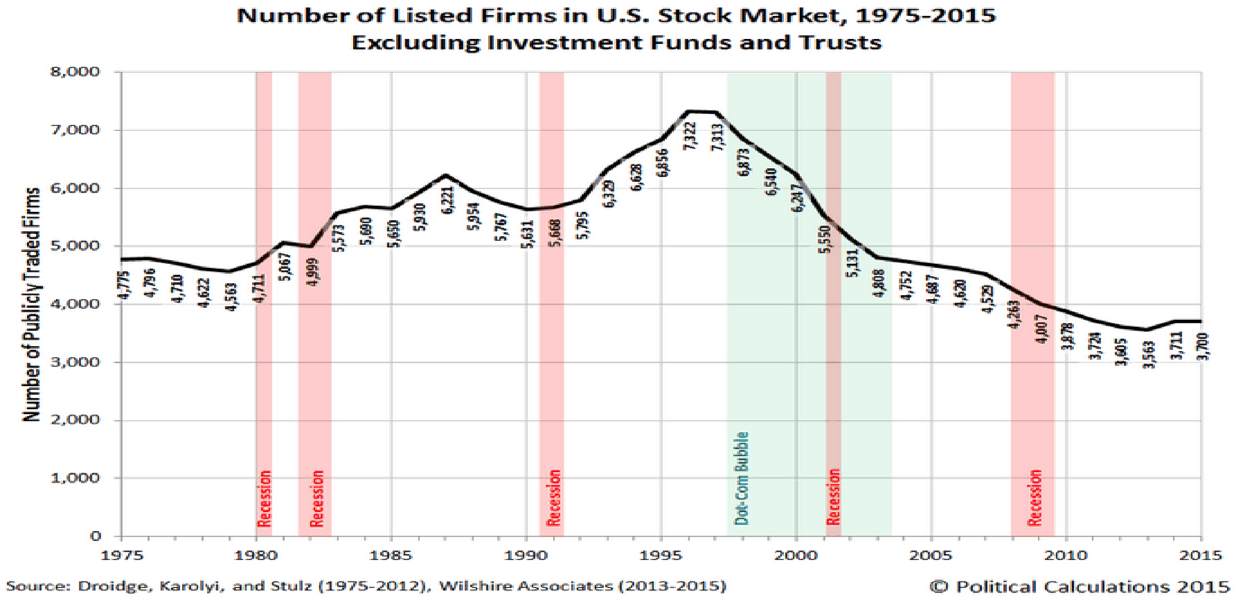
Source: WSJ

Currently, inflation is around 1.4% but is expected to double by this summer, then fall to the low 2% range. According to many economists and analysts, inflation and interest rates are shorter-term trends.

Because inflation and interest rates are so important to the economy and markets, I always keep a sharp eye on these two important variables.

- One of the dynamics that helped the markets in the last market cycle was the shrinking supply of stocks, but this may be changing.

  Below is a chart that shows the number of listed stocks was shrinking:



Source: NBER, Political Calculations

A rather new investment trend has developed – SPACs (Special Purpose Acquisition Company). A SPAC is basically an IPO that acquires existing companies with the intent of taking them public. There are about 300 SPACs. If each SPAC issues 3 IPOs, that would be close to 1,000, and also close to the historical average. Last year there were 480 IPOs of US stocks an all-time record. This is a 106.9% increase more than in 2019 with 232 IPOs. It is also 20% higher than the previous record in 2000 that had 397. We can expect more IPOs for this and maybe next year.

Again, the market will not have the advantage of a declining supply of listed stocks.

- Buybacks helped the last bull market cycle. There are normally fewer buybacks after a recession. We will probably see fewer buybacks at the start of this market cycle.

- "Sell in May and go away" is a saying among investors. The market is anticipatory. The market tends to start gravitating toward the next years' price targets and most investors are positioned for the next year. By May the markets have normally come close to price targets and the markets tend to go sideways until November.

Valuations

Below is a chart that shows the historical average of P/Es going back to 1870.

Chart | Table   Share

Current S&P 500 PE Ratio: 24.68 +0.00 (0.02%)
4:09 pm EDT, Fri Oct 14

Mean:	15.62	
Median:	14.64	
Min:	5.31	(Dec 1917)
Max:	123.73	(May 2009)

Source: WSJ

According to the above chart, the average historical P/E is about 15. Below are the recent prices and valuations for the markets. PEs normally spike during a recession when earnings (E of the P/E) collapse.

Dow Jones Industrial Average

33072.88
▲ 453.40
or 1.39%
All-time high
33072.88, 03/26/21

	Last	Year ago
Trailing P/E ratio	29.27	16.83
P/E estimate *	21.24	15.12
Dividend yield	2.04	3.02

Current divisor
0.15198707565833

S&P 500 Index

3974.54
▲ 65.02
or 1.66%
All-time high
3974.54, 03/26/21

	Last	Year ago
Trailing P/E ratio *	44.66	20.11
P/E estimate *	22.62	15.82
Dividend yield *	1.48	2.41

Source: WSJ

The historical average P/E is about 15, but current markets are above 21. The markets remain overvalued.

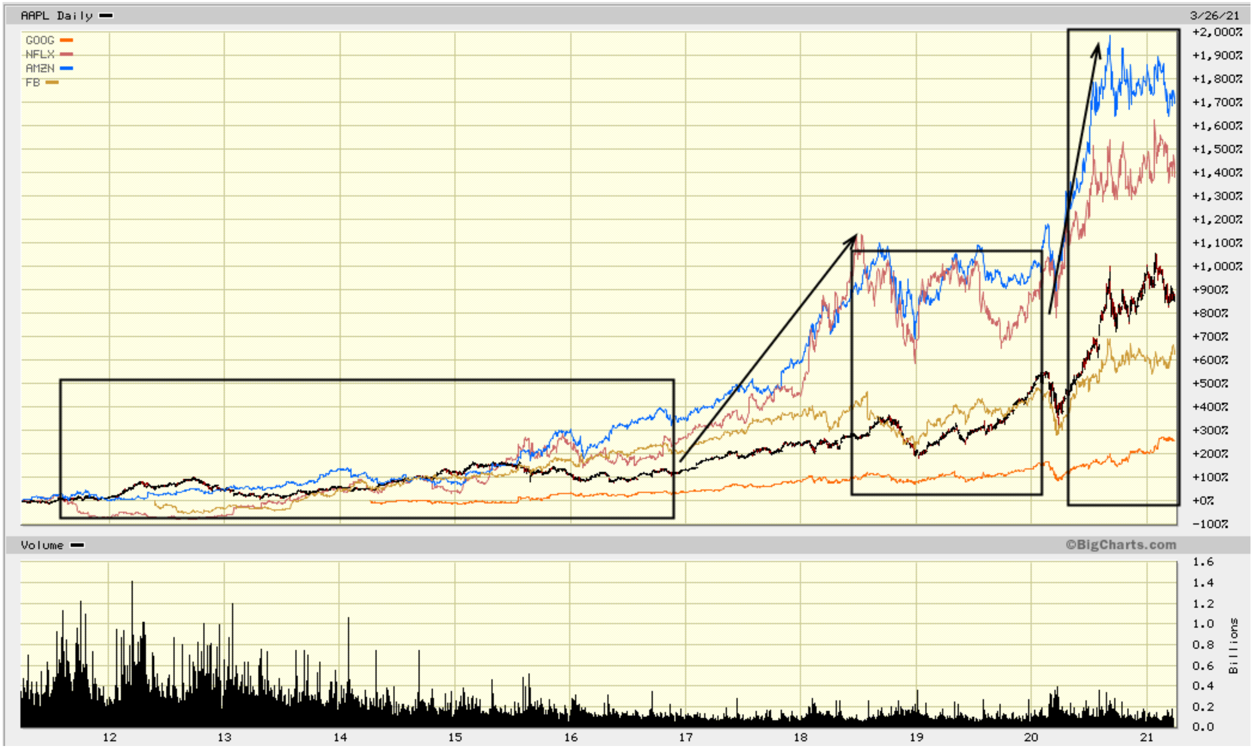
Notice in the table above that last year during the market crash the P/E dropped down to the historical averages. All the fiscal (lawmaker programs) and monetary (Federal Reserve massive liquidity to the economy and financial markets) aid caused the markets to have a big rally. See charts below in the next section, Technical/Price Analysis.

The market's performance should be close to its growth in earnings. Investors normally invest to grow their investment dollar faster than inflation to protect its purchasing power.

Earnings for the S & P in 2019 was about 139 and in 2020 it was about 91, about a 34% decline, but the S & P was up about 14%. The market thought that we would have a V-shaped recovery and President Trump would be re-elected. We did not have a V-shaped recovery. The market pulled forward performance. The consequence can be seen in the charts below.

Technical/Price Analysis

For the past few years, the FAANG stocks (Facebook, Amazon, Apple, Netflix, Google) were the market leaders and had excellent performance. These stocks have stalled.



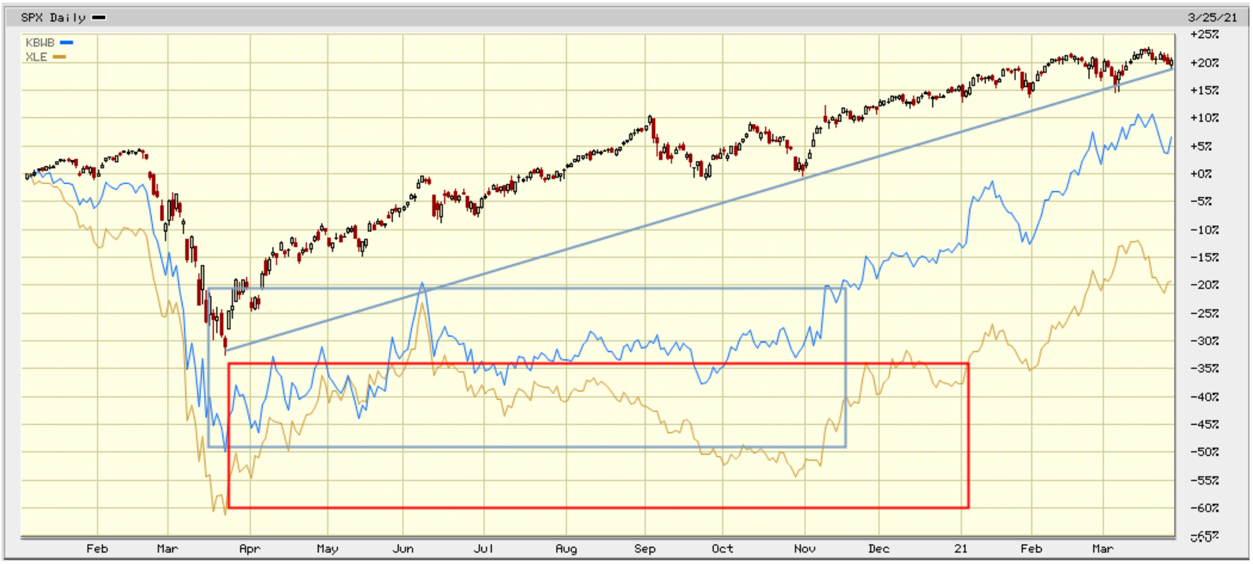
It's normal for stocks to go sideways after a move, see rectangle areas in the above chart. After the pause/consolidation stocks/markets resume its previous trend, see arrows in the above chart.

FAANG stocks took off when President Trump took office, and then consolidated until the market crash. Once the aid, support was enacted, prices took off again. FAANG stocks have been going sideways since last August.

Sideways patterns can last a long time, the first consolidation/sideways pattern lasted years, the second consolidation was about two years. Expect this consolidation to continue. These stocks remain very expensive because their prices led valuations, now valuations need to catch up.

Once the rest of the markets reaches their peaks and when economic and earnings comparisons become more difficult after 2021, we could see the market follow these leaders. I will write more about the prospects for the markets beyond 2021 in future Market Updates.

As the economy was in a K recovery, so was the market. Below is a chart of the S & P, the energy ETF (symbol XLE), and the banking ETF (symbol KBWB).



Let’s review this chart:

- Markets went into a bear market and bottomed in late March last year.

- The S & P made a V-shaped rebound thanks to all the Federal money pouring into the economy and worker’s bank accounts. From the bottom, the S & P is up over 50% even though earnings were negative. The S & P brought its returns forward and now the S & P is stalling. See “new high” section in the Bullish section above.

- Banking (blue trendline and rectangle) and energy stocks (gold trendline, red rectangle) did what normally happens during a bear market: 1. A bottom is found 2. Prices normally consolidate after a bottom is made and the consolidation is called a basing pattern. 3. During the basing period prices, will normally test the bottom at least once. 4. Most basing periods last about 7 months, enough time to see improvements in the economy and businesses.

- Last year bank and energy stocks were in bear markets.

- Bank stocks broke out of their consolidation pattern in November, about eight months after making a bottom.

- Energy stocks broke out in January, about 9 months after its bottom.

- Notice that the S & P has stalled and is up about 6% year-to-date. Banking stocks are up about 22% and energy stocks are up about 30% YTD.

Most of the gains for the markets are probably in, so “Sell in May and go away” may come true this year.

Psychology of the Market

Last year the markets were bullish because of a belief we would have a V-shaped recovery. FAANG stocks were the leaders because they were growing in a recession, but their stock performance was stronger than their actual earnings growth.

This year investors can see the economy opening and now most stocks are recovering from their bear markets as investors see growth in most sectors of the economy. Money has left FAANG stocks and moving into the areas that may have better earnings this year and the rest of this economic cycle.

Also last year the markets looked past the many problems of the pandemic, recession and, bad earnings. This year the market is concerned about rising interest rates and inflation.

So far variants don’t seem to be a worry for the markets. When we had our fourth spike in infections early this year, the markets barely pulled back and were met with buying.

Summary and Conclusion

- Most economists, analysts, and health experts believe we could get to herd immunity later this year. It’s not easy sailing, there could be several problems: variants, not enough people are getting the vaccines, and the rest of the world is struggling with the health crisis. In a mobile world, the virus can continue to spread.

- Lawmakers and the Fed have provided plenty of aid, support, stimulus, and, liquidity to the economy, businesses, and workers and is helping us out of our health, financial crisis

- We are at the start of a new market cycle. We are probably at or near the start of an economic cycle. Investors should be invested at the start of an economic and market cycle. Most sectors in the market are now off their lows and breaking out of their basing patterns.

- The market was strong last year despite earnings being down. FAANG stocks and the S & P performance were pulled forward, so now valuations need to grow into their prices.

- The market has faced many problems that last few years: a global health crisis; recession; bear market; trade wars; confrontations with China, North Korea, Iran, rising interest rates. Despite these many problems the market has stayed relatively resilient thanks to 401Ks, financial planners, and buying on pullbacks. The 401K and financial planner phenomenon will probably continue.

- Most economists and analysts forecast a strong economy with GDP growth of over 5%. Earnings are also expected to recover this year. The service sector (restaurants, travel, leisure, entertainment, brick and mortar retail…) was left behind last year but because of pent-up demand for these services should do very well this year. The stocks of these services have anticipated a strong recovery.

- Rising inflation and interest rates could be a headwind for the markets and economy. I normally keep an eagle eye on inflation interest rates and will update readers on these important trends.

- The strategy of "selling in May and going away" may work this year. Hedging may be a better strategy.