Market Strategy
by STRATEGAS A BAIRD COMPANY

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With the vaccine rollout gaining serious momentum, a durable economic recovery seems not just closer at hand than it did at the start of the year—it also looks primed to be more propulsive than we previously expected.

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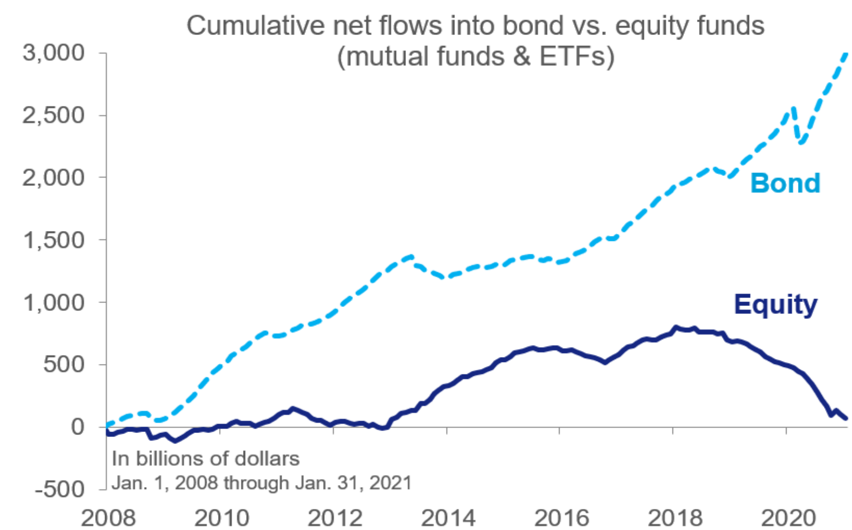
BLOCKBUSTER GROWTH MEANS HIGHER EARNINGS, BUT WILL INVESTORS FOLLOW?

Looking beyond recent volatility, we return to a topic we've discussed often over the last few months—the building blocks of recovery. A durable recovery requires a catalyst—in the current case, economic reopening—that leads to an increase in activity, demand, output, revenue, investment, and profitability. With the vaccine rollout now gaining momentum, we have a medical solution to our medical problem—the catalyst for our catalyst. With ~$700 billion of last year's fiscal stimulus not yet spent, personal savings ~$1.3 trillion greater today than a year ago, and a ~$1.5+ trillion stimulus bill imminent, it's not hard to assume that near-term economic growth will surpass even the most optimistic forecasts. ***Chips on the table: Our forecast for nominal GDP growth this year is 8.5%+ and our S&P 500 earnings outlook is moving higher as well.***

We are revising our estimate for 2021 S&P 500 earnings per share up to $185 from $161. Our 2022 estimate moves to $197 from $183 (2019 was $165 and 2020 should end up ~$143). ***We expect strong economic growth to translate directly into higher sales while expenses such as wage costs remain restrained enough to result in a big profitability bounce.*** We have some concern that this exaggerated expansion could borrow from future activity (especially in the absence of an organic growth driver) and result in a midcycle slowdown, but only time will tell (and that point would be a ways off).



With our belief in underlying fundamentals firmly in place, we begin to wonder over the question of investor positioning. Since the Great Financial Crisis, inflows into bond and money market funds have climbed steadily ($3+ trillion in ~12 years, despite historically low rates), while equity inflows over the same period are barely positive. ***Most investors, it might seem, were too scarred by the two financial crises in the first decade of the millennium to seek refuge in anything other than relatively safe assets.*** This despite over 13% a year annualized from the S&P 500 over the last decade.

However, we may now be on the precipice of a great rotation. Forecasting bond yields is a dicey proposition (for example, while historically large government spending would seem to argue against the attractiveness of bonds, the more-than-$12.5 trillion in negative-yielding government debt globally might make America's low-but-positive yielding debt look downright appealing). ***For the time-being, we are merely content in forecasting bond yields with one word—higher.*** If this bears out, will losses in fixed income *finally* prompt a rotation out of bonds and into stocks? We'll keep our eyes on it.

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