First Trust
Monday Morning OUTLOOK

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4,500…Or Higher

Many are convinced that a US stock market correction, or even a bear market, is inevitable. So, when the S&P 500 was down 1.6% last Thursday, many thought it had arrived. Then, the S&P 500 rebounded and hit a new all-time high on Friday. Being bearish on equities has not worked for a long time.

This does not mean the market always goes up. It doesn't mean that the government is not creating future problems. But, we don't try to time the market. What we do is focus on fundamentals, like profits and interest rates. And right now, we believe the S&P 500 is still undervalued.

Late last year, when the S&P 500 was at 3,638, we used those fundamentals to project a year-end 2021 target of 4,200, for an increase of 15.4%. However, with profits returning toward normal even faster than we had anticipated, the S&P 500 hit 4,185 in mid-April and we upped our projection to 4,500, which would be a full-year gain of about 19%.

Now, with the S&P 500 just 3% from our target, we choose to stand pat. Why? We do not want to leave the impression that we are traders, shifting our target over and over. We are investors. It's the long-term that matters. The US stock market has been undervalued relative to our Capitalized Profits Model since 2009.

Our model takes the government's measure of economy-wide profits from the GDP reports, discounted by the 10-year US Treasury note yield, to calculate fair value. If we use a 10-year Treasury yield of 1.36% (Friday's closing yield) to discount profits (from the first quarter, the most recent available), then our model suggests the S&P 500 is 45% undervalued. And with profits likely to grow 20% or more this year, fair value will rise more as the year unfolds.

Right now, the Fed is artificially holding interest rates down across the yield curve. So, when we calculate our estimate of fair value, we use a 2.0% 10-year yield. Using this 2.0% rate gives us a fair value of 5,240. It would take a 10-year yield of about 2.4% for our model to show that the stock market is currently trading at fair value (with no increase in profits.) If rates do rise, because the economy is stronger than the Fed expects, it would likely be accompanied by even faster profit growth.

We fully understand that current monetary policy is inflationary, and that past government spending, plus what some politicians are asking for right now has lifted US Federal debt above 100% of GDP.

These policies could shift economic growth, the level of interest rates and our estimate of the fair value of stocks in the years ahead. But for the foreseeable future, re-opening, easy money and deficit spending are all pushing economic growth and profits up. With the Fed holding rates down and profits booming, and with our model saying stocks are undervalued, we are still bullish. And right now we think if our 4,500 target is wrong, it is likely too low.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-13 / 7:30 am	CPI – Jun	+0.5%	**+0.5%**		+0.6%
7:30 am	"Core" CPI – Jun	+0.4%	**+0.3%**		+0.7%
7-14 / 7:30 am	PPI – Jun	+0.6%	**+0.6%**		+0.8%
7:30 am	"Core" PPI – Jun	+0.5%	**+0.4%**		+0.7%
7-15 / 7:30 am	Initial Claims Jul 10	350K	**370K**		373K
7:30 am	Import Prices – Jun	+1.1%	**+0.6%**		+1.1%
7:30 am	Export Prices – Jun	+1.4%	**+0.9%**		+2.2%
7:30 am	Empire State Mfg Survey – Jul	18.0	**20.0**		17.4
7:30 am	Philly Fed Survey – Jul	28.0	**30.0**		30.7
8:15 am	Industrial Production – Jun	+0.6%	**+0.7%**		+0.8%
8:15 am	Capacity Utilization – Jun	75.6%	**75.7%**		75.2%
7-16 / 7:30 am	Retail Sales – Jun	-0.4%	**-0.5%**		-1.3%
7:30 am	Retail Sales Ex-Auto – Jun	+0.4%	**+0.3%**		-0.7%
9:00 am	Business Inventories – May	+0.5%	**+0.6%**		-0.2%
9:00 am	U. Mich Consumer Sentiment- Jul	86.5	**87.0**		85.5