First Trust
Monday Morning OUTLOOK

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*
Andrew Opdyke, CFA – *Economist*
Bryce Gill – *Economist*

630-517-7756 • www.ftportfolios.com November 30, 2020

S&P 4,200 - Dow 35,000

In December 2019, we made a year-end 2020 forecast of 3,650 for the S&P 500. With the index closing Friday at 3,638, that looks like a very good call.

But we'd be fibbing if we didn't admit to getting whipsawed by COVID-19. In the spring the S&P 500 fell as low as 2,237, pricing in a massive drop in corporate profits. We remained bullish but revised our year-end forecast down to 3,100. Then, in August, after analyzing data on COVID-19 and assessing the actual impact of shutdowns on growth and profits, we lifted our year-end S&P target for 2020 back to 3,650.

For next year, the fundamentals continue to suggest a bullish outlook. Our year-end 2021 call for the S&P 500 is 4,200 (up about 15% from last Friday), and we expect the Dow Jones Industrial Average to rise to 35,000.

We rely on our Capitalized Profits Model. The model takes the government's measure of profits from the GDP reports, discounted by the 10-year US Treasury note yield, to calculate fair value. And, last week, corporate profits for the third quarter were reported at a record high, up 3.3% from a year ago.

The question is: what discount rate should we use? If we use the current 10-year Treasury yield of 0.84%, our model suggests the S&P 500 is grossly undervalued. But this is because the Federal Reserve is holding the entire interest rate structure at artificially low levels. Using these rates distorts valuations.

Using third quarter profits, it would take a 10-year yield of 2.8% for our model to show that the stock market is currently trading at fair value. And that assumes no further growth in profits.

Right now, in spite of Fed pressure to hold rates down, we expect the 10-year note to finish 2021 in the range of 1.25% to 1.5%. Nonetheless, we have chosen to use a more conservative 2% discount rate in our Capitalized Profits model. Using third quarter 2020 profits, that creates a fair value estimate for the S&P 500 of 5,150. And this does not take into account the highly likely boost to profits in the year ahead. As a result, we believe our year-end 2021 forecast of 4,200 is easily within reach.

Obviously, the year ahead is not without risk. Perhaps the various vaccines will be rolled-out more slowly than anticipated. Perhaps, the Georgia Senate elections in early January result in a House, Senate, and White House that all agree to more aggressive tax hikes than markets currently anticipate. Perhaps, perhaps, perhaps.

More likely, we anticipate the vaccines will work roughly as advertised, and businesses will continue to improve in handling the obstacles posed by the illness and government shutdowns alike. Meanwhile, the Senate should remain a check on aggressive tax hikes, and the federal courts may curb excesses in regulation. New entitlements? Highly unlikely. In addition, it looks like trade conflicts with other countries will ease.

We have been bullish since 2009, not because we are perma-bulls, as our detractors like to say, but because the fundamentals say we should be. Profits and interest rates drive stocks, we let these factors determine our outlook. Not politics, not fear, not greed…just math.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-30 / 8:45 am	Chicago PMI – Nov	59.0	**62.4**	58.2	61.1
12-1 / 9:00 am	ISM Index – Nov	58.0	**57.9**		59.3
9:00 am	Construction Spending – Oct	+0.8%	**+1.3%**		+0.3%
afternoon	Total Car/Truck Sales – Nov	16.1 Mil	**15.9 Mil**		16.2 Mil
afternoon	Domestic Car/Truck Sales – Nov	12.4 Mil	**12.4 Mil**		12.7 Mil
12-3 / 7:30 am	Initial Claims – Nov 30	765K	**765K**		778K
9:00 am	ISM Non Mfg Index – Nov	56.0	**56.0**		56.6
12-4 / 7:30 am	Non-Farm Payrolls – Nov	500K	**490K**		638K
7:30 am	Private Payrolls – Nov	608K	**590K**		906K
7:30 am	Manufacturing Payrolls – Nov	46K	**47K**		38K
7:30 am	Unemployment Rate – Nov	6.8%	**6.8%**		6.9%
7:30 am	Average Hourly Earnings – Nov	+0.1%	**+0.1%**		+0.1%
7:30 am	Average Weekly Hours – Nov	34.8	**34.8**		34.8
7:30 am	Int'l Trade Balance – Oct	-$64.8 Bil	**-$64.8 Bil**		-$63.9 Bil
9:00 am	Factory Orders – Oct	+0.8%	**+0.6%**		+1.1%