First Trust
Monday Morning OUTLOOK

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5,000

We've been consistently bullish on stocks since 2009. This bullishness has paid off, although not every year; stocks fell in 2015 and 2018. But, since 2009, the market has rebounded from every correction. Why have we stayed bullish? Because our Capitalized Profits Model has consistently shown the S&P 500 as "undervalued" since 2009. It still shows this today.

In the past twelve years we've set a forecast for the end of each year. When the market corrected, we often just reiterated that call for the next year. But, in a few of these years, we ended up raising our forecast during the year. For 2021, we set our year-end target at 4,200 for the S&P 500. By mid-April, however, the stock market was already flirting with 4,200. As a result, we raised our forecast to 4,500.

Now, once again, the stock market has outpaced our bullishness, surpassing 4,500. But that's not the only important information we got last week. We also got economy-wide corporate profits for Q2 and they were outstanding, up 9.2% from Q1 and up 15.8% from the pre-COVID peak in late 2019.

These figures let us update the capitalized profits model. As many of you know, we think the current 10-year yield of 1.3% is being held artificially low by the Federal Reserve. As a result, we discount current profits using a more cautious rate of 2.0%. Plugging that rate into the model with superb Q2 profits generates a fair value estimate for the S&P 500 of 6,133.

How robust is this fair value estimate? Well, if corporate profits ***fell*** 36% (and the 10-year was 2.0%) the market would be ***at*** "fair" value today – roughly 4,500. The same result would occur if the 10-year yield more than doubled to 2.7%. In other words, the market is rising for a reason…profits are up and the threat from higher interest rates remains low. As a result, ***we think it is prudent to raise our 2021 year-end forecast to 5,000 on the S&P 500.***

There are obviously risks to this forecast. 1) The US could "lockdown" the economy again over the Delta variant of Covid. 2) The Fed could raise rates more quickly. 3) President Biden, and the Democrats, could push through major tax hikes.

Rightly or wrongly, we don't think the US will lockdown again. At the same time, last week's "Jackson Hole" speech by Federal Reserve Chairman Jerome Powell made it clear that monetary policy is likely to remain very loose for the foreseeable future. The Fed may start to taper, but it will do so slowly, primarily because it thinks inflationary pressures are temporary. Also, the Fed views Delta as a risk to economic growth.

Yes, we are fully aware tax rates are likely to go up if Congress can pass an all-Democratic budget bill. But we think the kinds of tax hikes that would be likely to pass are already priced in, including a top regular income tax rate of 39.6% (versus 37%), a corporate tax rate near 25% (versus 21%), a top capital gains and dividends tax of 24% (versus the current 20% and President's Biden's proposed 39.6%). We don't think they have the votes to end the step-up basis at death.

The bull market in stocks will eventually come to an end, and some sort of correction is overdue, but we think the general trend remains up and optimistic investors will be rewarded.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-31 / 8:45 am	Chicago PMI - Aug	68.0	**70.9**		73.4
9-1 / 9:00 am	ISM Index – Aug	58.5	**59.0**		59.5
9:00 am	Construction Spending – Jul	+0.2%	**+0.6%**		+0.1%
afternoon	Total Car/Truck Sales – Aug	14.5 Mil	**14.1 Mil**		14.8 Mil
afternoon	Domestic Car/Truck Sales – Aug	10.6 Mil	**10.6 Mil**		11.0 Mil
9-2 / 7:30 am	Initial Claims – Aug 28	345K	**352K**		353K
7:30 am	Q2 Non-Farm Productivity	+2.4%	**+2.3%**		+2.3%
7:30 am	Q2 Unit Labor Costs	+1.0%	**+1.6%**		+1.0%
9:00 am	Factory Orders – Jul	+0.3%	**+0.1%**		+1.5%
9-3 / 7:30 am	Non-Farm Payrolls – Aug	750K	**750K**		943K
7:30 am	Private Payrolls – Aug	700K	**700K**		703K
7:30 am	Manufacturing Payrolls – Aug	28K	**27K**		119K
7:30 am	Unemployment Rate – Aug	5.2%	**5.2%**		5.4%
7:30 am	Average Hourly Earnings – Aug	+0.3%	**+0.3%**		+0.4%
7:30 am	Average Weekly Hours – Aug	34.8	**34.8**		34.8
9:00 am	ISM Non Mfg Index – Aug	62.0	**62.7**		64.1