Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

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The Post-Election Outlook for Stocks

The election that consumed the American public (and the world) – and also fueled the largest voter turnout in American history – is now over. I won't get into the weeds on the possible legal challenges to the outcome, and whether they are likely to be successful or not. I'll focus instead on what's next for equity markets, assuming the current election result stands.

For its part, the stock market appeared to be unfazed by the swirling uncertainty of the last three weeks. During election week, the S&P 500 clocked its biggest weekly gain since the early days of the new bull market, posting a stout +7.3% gain. For all the commentary about downside volatility surrounding a contested election, the stock market defied expectations – as it often does.

The stock market is arguably looking ahead to a post-pandemic economy and a Biden administration with a divided Congress. In 46 years when power was split between the White House and Congress, the average S&P 500 return was +7.26%. Interestingly, for investors looking for historical stock market data under a Democratic president, a Republican Senate, and a Democratic House, you won't find any – *this division of power has not occurred since 1886*.[1]

Wall Street may also be pricing-in some of the policy constraints a Biden administration may face with a divided Congress. In particular, there appears to be little chance we will see corporate and capital gains tax increases in at least the next two years, but perhaps for Biden's entire term. Any prospect of sweeping legislation that could change property rights or fundamentally alter a sector – like Energy and Health Care – also appear low.

Meanwhile, the prospect of more fiscal stimulus has risen, as Biden has a history of bi-partisan cooperation and both parties agree on the need for more spending (though the amounts vary greatly). The next few years may also feature an ease to trade tensions across the world, and more cooperation with allies in foreign policy affairs. We do not expect any change to monetary policy.

Don’t Forget About the Most Important Stock Market Driver

With all of the focus on the election and policy, perhaps the most important driver of stock market returns over the long-term – corporate earnings – has received very little attention. But that’s a mistake, in my view. I would argue a great deal of the stock market’s recent strength has been driven by earnings.

We now have Q3 earnings results from 447 S&P 500 members (as of November 6), with total earnings for these companies down -7.3% from the same period last year on -1.9% lower revenues.[2] Readers may note the negative performance and wonder how these results can be good. But what matters most with earnings, in our view, is whether a large share of companies are exceeding expectations.

They are! Of the 447 reporting companies, 85.2% of them beat earnings-per-share (EPS) estimates, and 76.3% beat revenue estimates. If 86% ends up being the final percentage of companies exceeding EPS expectations, it will mark the biggest positive EPS surprise since 2008. This metric is a big deal, in my view.

Looking ahead, estimates for Q4 earnings continue to move higher, as corporate America proves more resilient in the pandemic than just about every analyst anticipated.

Source: Zacks.com

When it comes to the stock market and earnings, the operative phrase is “better than expected.” And that’s what we’re seeing now.

Bottom Line for Investors

The stock market may also be responding to positive news related to the vaccine. According to reports last week, Pfizer’s vaccine candidate was more than 90% effective in preventing participants from contracting Covid-19 – a very good early sign. Though we are still likely months away from having a vaccine widely available, the light at the end of this pandemic’s tunnel is increasingly visible, in my view.

Stocks have somewhat of a hurdle to climb in the coming year to keep moving higher. As it stands today, the S&P 500 trades at a forward 12-month multiple of 21.6x. This valuation is well above the 10-year average of 15.5x, but as I’ve written before, near-zero interest rates arguably give valuations more wiggle room to the upside. If corporate earnings can catch up in the coming quarters, this bull market may have plenty of room to run.[3]

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] Wall Street Journal. November 8, 2020. https://www.wsj.com/articles/political-gridlock-is-supposed-to-be-good-for-stocks-the-data-dont-support-that-11604847910?mod=djem10point

[2] Zacks. November 6, 2020. https://www.zacks.com/stock/news/1098406/tech-leadership-reflects-earnings-power

[3] Fact Set. November 6, 2020. https://www.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_110620A.pdf

IN FOCUS THIS WEEK

- Stock market rallies on hopeful vaccine candidates
- Higher priced homes are in strong demand during this pandemic
- Current struggles spark in the airline industry
- Will saving during COVID-19 cause a new wave of big spending in the future?

Stock Market Rallies on Hopeful Vaccine Candidates

The market rallied sharply early last week, as Pfizer and German partner BioNTech announced hopeful early vaccine results. Though the results have not been peer reviewed and are not fully complete, they show to be 90% effective in protecting people from contracting Covid-19 – a very promising outcome indeed. Meanwhile, Moderna is releasing data from a large trial of its experimental Covid-19 vaccine, which could add another strong option into the mix. The stock market surged on the Pfizer news, only to give up some of the gains as the week wore on. Investors are looking for any sign of a timeline to the end of the pandemic, when vaccines can be widely available to the American public and economic activity can resume completely unrestricted. As for the promising early result from Pfizer and BioNTech, those shots could be available as early as this year, though the first batches will be reserved for front-line workers and the old and vulnerable. Some estimates peg the vaccine becoming widely available by the spring, perhaps April. In our view, getting the pandemic under control – and effectively and efficiently distributing the vaccine – remain the biggest risks to the nascent economic recovery.[1]

The U.S. Housing Story Continues Strengthening – Can it Last?

We have written many times in this space about the robust housing recovery, fueled in no small part by remote work and the need for more space. For the first time ever, millennials made up the highest percentage of new mortgage applications, a sign that a migration out of cities has taken hold in the wake of the pandemic. In particular, the last few months have seen strong demand for higher priced homes. According to the National Association of Realtors, nearly 25% of home buyers over the summer paid at least $500,000, which is up from 14% in the previous nine months.[2] Even as the pandemic has wreaked havoc on some parts of the U.S. economy, many of the high-skilled and white-collar workers who can work digitally and from home have emerged unscathed. The demand for more space is pushing up home prices, but once the migration runs its course and the pandemic risk fades, the question becomes: can it last?

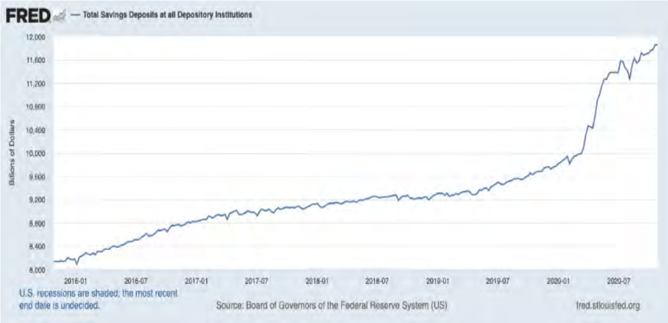
A Different Kind of Struggle in the Airline Industry

Airlines have taken a big hit in the pandemic, for obvious reasons. But the industry is also feeling pressure in other ways that are not so obvious – tariff wars. A little over a year ago, the United States imposed tariffs on $7.5 billion of Airbus jets (made in France), which received approval from the World Trade Organization on the basis that Airbus jets receive significant state subsidies. Just last week, the European Union retaliated, imposing $3.99 billion in tariffs on Boeing jets (made in the U.S.). The tit-for-tat tariffs will no doubt raise the prices of planes for airlines and other buyers, which may deliver a sting at just the wrong time.[3]

Americans Have Been Socking Away Cash – Is a Big Wave of Spending Coming?

Americans have accumulated some $2 *trillion* in new savings deposits over the last 10 months, even though banks have lowered deposit rates to basically 0%. The pandemic has played a big role in Americans' desire to sock away cash. For one, stimulus checks and boosted unemployment benefits gave many the ability to save the extra cash. But second, the crisis and associated lockdowns/restrictions also pushed many to stay home, cook meals, spend less on entertainment and travel, and cut back other discretionary spending over the spring and summer. The end result: Americans saved money (see chart). Total deposits at U.S. banks swelled to about $15.9 trillion, up from around $13.2 trillion at the start of 2020. In our view, it seems likely that this 'stashed cash' is a wall of liquidity waiting to be released back into the economy, especially once the risk of the pandemic fades completely. A spending boom feels possible – if not likely – in the second half of 2021.[4]

Total Savings Deposits Have Spiked in 2020



Source: Federal Reserve Bank of St. Louis

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[1] Wall Street Journal. November 9, 2020. https://www.wsj.com/articles/covid-19-vaccine-from-pfizer-and-biontech-works-better-than-expected-11604922300

[2] Wall Street Journal. November 11, 2020. https://www.wsj.com/articles/pandemic-boosts-upper-end-of-housing-market-coast-to-coast-11605106801

[3] Wall Street Journal. November 9, 2020. https://www.wsj.com/articles/boeing-jets-other-u-s-goods-worth-4-billion-face-eu-tariffs-11604927987

[4] Wall Street Journal. March 15, 2020. https://www.wsj.com/articles/fed-faces-crucial-decisions-to-alleviate-virus-shock-11584303662?mod=djemMoneyBeat_us

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