Market Perspectives

PRIVATE CLIENT SOLUTIONS

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Mission Accomplished!

US markets have completed a historic comeback this week. After repeatedly kissing its record high close, the S&P 500 broke above 3,393 completing an astonishing turn around. The path of least resistance over the past months has been a move higher, so it seemed inevitable that the index would eventually achieve new heights and join the NASDAQ which crossed into record territory 71 days ago.

- In part, the turnaround can be attributed to the resiliency of US earnings. As we approach the end of Q2/20 reporting season (with 94% of the companies in the S&P 500 reporting), 83% of S&P 500 companies have reported a positive EPS surprise and 64% have reported a positive revenue surprise.

- As Q2/20 unfolded, consensus estimates for the broader index begun to drift higher in anticipation that the worst had past and fiscal and monetary stimulus would continue to support corporate earnings in the coming quarters. For the full year 2020, the S&P 500 earnings estimate bottomed on July 10 at $125.11 and has been revised higher by 3.9% over the following weeks.

- The S&P 500 trades at 25.9x current year estimates and 20.5x 2021 projected earnings. From a historical perspective, this is well above average; in fact it is more than two standard deviations above the mean. Stretched valuations should give investors pause as history often suggests buying into an expensive market limits future gains.

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Market Recoveries & US Earnings Season

US markets have completed a historic comeback this week. After repeatedly kissing its record high close, the S&P 500 broke above 3,393 completing an astonishing turn around. The path of least resistance over the past months has been a move higher, so it seemed inevitable that the index would eventually achieve new heights and join the NASDAQ which crossed into record territory 71 days ago. To put this recovery into context, the table below breaks down the six market recoveries from a 30%+ decline in the S&P 500 since WWII. The February sell off was the shortest in duration at 1.1 months followed by the 1987 crash as the next shortest 30%+ drop in the index. With the S&P 500 making a new high on Tuesday, it marks the quickest recovery from the lows at 4.7 months. Historically a recovery to the previous peak has taken a median of 48.6 months. History has been made!

S&P 500 30%+ Declines & Rebounds

Peak Date	Bottom Date	Peak to Bottom (mths)	Peak to Bottom Chg	Bottom Date to New High Date (mths)	Peak Date to New High Date (mths)
November 29, 1968	May 26, 1970	17.8	-36.1%	21.4	39.2
January 11, 1973	October 3, 1974	20.7	-48.2%	69.5	90.2
August 25, 1987	December 4, 1987	3.3	-33.5%	19.7	23.0
March 24, 2000	October 9, 2002	30.5	-49.2%	55.7	86.2
October 9, 2007	March 9, 2009	17.0	-56.8%	48.6	65.6
February 19, 2020	March 23, 2020	1.1	-33.9%	4.7	5.8

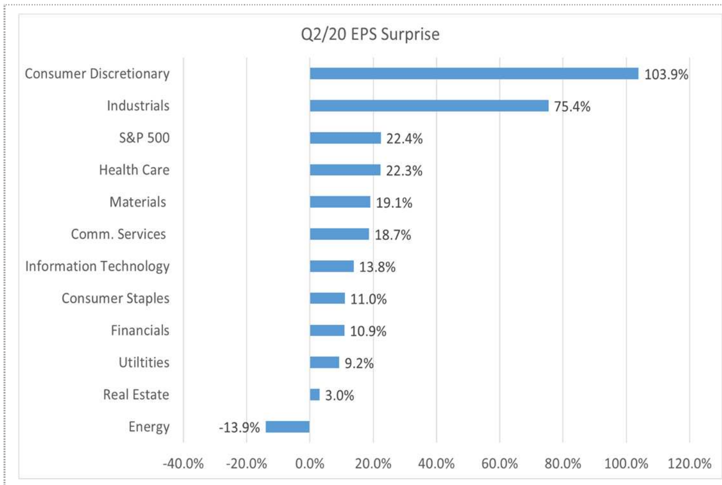
Source: FactSet, Raymond James Ltd.

In part, the turnaround can be attributed to the resiliency of US earnings. As we approach the end of Q2/20 reporting season (with 94% of the companies in the S&P 500 reporting), 83% of S&P 500 companies have reported a positive EPS surprise and 64% have reported a positive revenue surprise. These percentages are well ahead of historical averages, but the surprises don't stop there. The magnitude of the beat is running at 22.4% above consensus earnings expectations, one of the largest beats in the S&P 500 history.

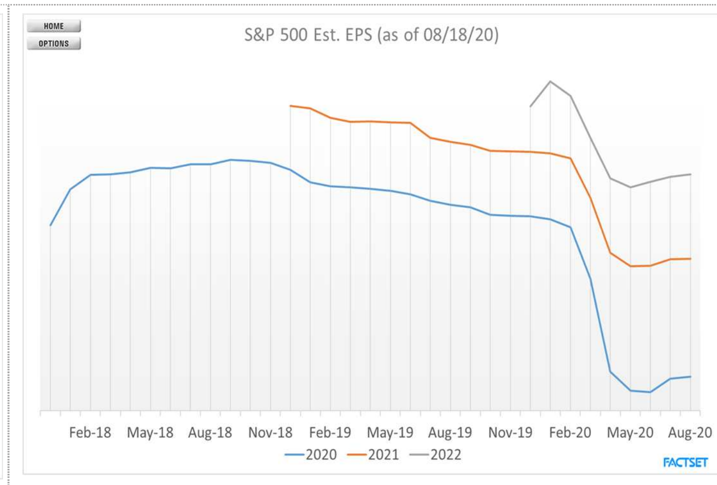
The consumer discretionary sector is the most significant contributor to the earnings surprise followed by industrials. Two tailwinds for these sectors, which may have caught analysts off guard, were the CARE relief act and US dollar. The significant US fiscal response directed towards individuals supported incomes and spending during the darkest days of the economic lockdown. This helped to buffer consumer discretionary companies' financial results. As for industrials, the weaker US dollar, which has slipped over 10% since March, has benefited industrial stocks making US goods cheaper for foreign buyers. The S&P 500 industrial sector generates ~33% of revenue outside on the US.

As Q2/20 unfolded, consensus estimates for the broader index begun to drift higher in anticipation that the worst had past and fiscal and monetary stimulus would continue to support corporate earnings in the coming quarters. For the full year 2020, the S&P 500 earnings estimate bottomed on July 10 at $125.11 and has been revised higher by 3.9% over the following weeks. Similarly, full year earnings estimates for 2021 and 2022 have followed suit and are now projected to be $162.04 and $185.00, respectively.

S&P 500 Earnings Surprise Led by Cons. Disc…



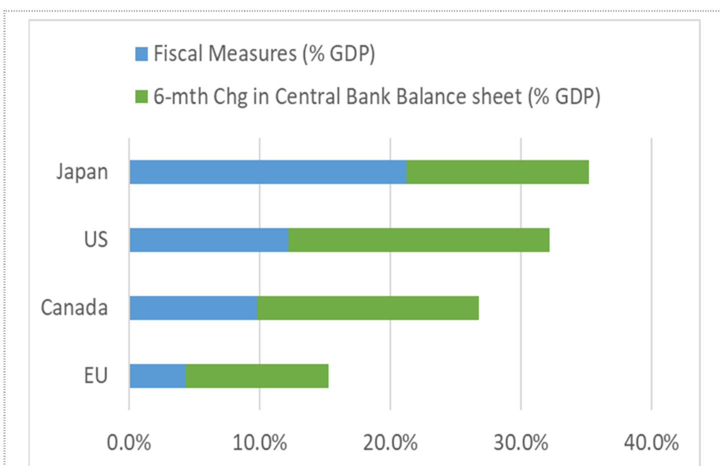
…S&P 500 Full Year Earnings Move Higher



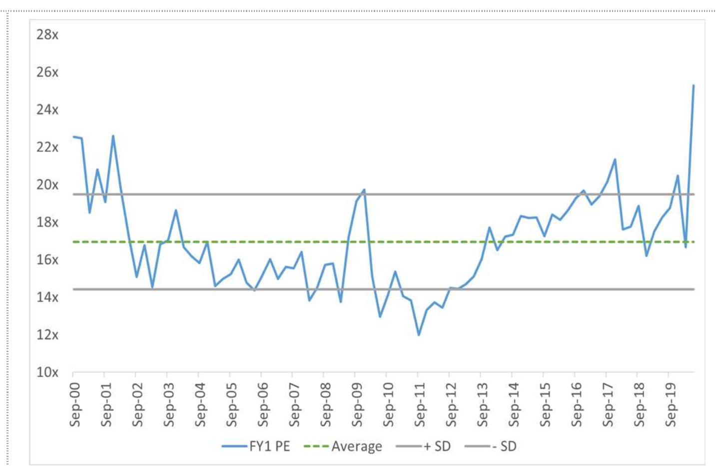
Source: FactSet, Raymond James Ltd.

Of course, the above only speaks to earnings relative to expectations. The actual decline in Q2/20 earnings was quite significant, down 32% yoy, marking the most significant drop in earnings since the financial crisis. The decline in earnings coupled with the market achieving new record highs has pushed valuation levels well into nose bleed territory. The S&P 500 trades at 25.9x current year estimates and 20.5x 2021 projected earnings. From a historical perspective, this is well above average; in fact it is more than two standard deviations above the mean. Stretched valuations should give investors pause as history often suggests buying into an expensive market limits future gains. However, at the same time, historical references do not capture the unusual environment that exists today – interest rates hovering near zero, central banks offering extraordinary support to credit markets, as well as open-ended asset purchase programs, plus all the significant global fiscal measures. These actions can serve to keep valuation levels elevated, despite the seemingly endless list of risks on the horizon.

Significant Stimulus Supports Economy…



…Pushing S&P 500 to Peak Valuation Levels



Source: FactSet, Raymond James Ltd.

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