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Equities

Similar to May, June, and July, the S&P 1500 Index dipped in the middle of August but then rebounded and moved higher. The upward trend makes sense to our valuation system as stock prices, on average, are still below ICON's estimate of fair value. We ended August with a market value/price (V/P) ratio of 1.13 suggesting $1.00 invested is buying $1.13 of value.

The primary supportive condition for the advance in stock prices is corporate earnings. Late in 2020 analysts who forecast earnings began to revise their forecasts substantially higher for 2021. Some critics claimed the upward revisions were unrealistic and excessive. They expected companies could not deliver earnings in line with the upwardly revised forecasts, but they were wrong. 1446 of the 1500 companies in the S&P 1500 Index have reported second quarter earnings and, on average, they have beaten forecasts by 17.29%. More impressive is their average year-over-year growth from the same quarter in 2020. At 101.5%, it indicates earnings have doubled in 12 months which is more than just a rebound from the 2020 pandemic-induced recession. For the full year of 2021, analysts are predicting earnings for the S&P 1500 to be 36% higher than they were in pre-pandemic 2019.

The mid-month dips mentioned in the first sentence have all featured sector theme reversals in which the cyclical, economically sensitive stocks dropped more than the broad market. During the rebounds, however, they returned to their leadership role, which we believe is sensible. During the market advance off the August 18 low, Communication Services, Information Technology, Consumer Discretionary and Energy were the four best performing sector indexes. The defensive, so-called recession proof sectors were sluggish. Although the precise ranking can change, we expect the cyclical, economically sensitive leadership to remain throughout the remainder of 2021.

Bonds

The yield on the 10-year Treasury note began 2021 by continuing the upward trend from late 2020. It hit a high of 1.74% on March 31, 2021. Then it dropped to a low of 1.17% on August 3, then finished August by moving back a little higher to 1.31%. It is too early to tell if this is the beginning of a trend toward higher yields or simply a sideways path which began in early July. We are puzzled why investors are content getting a negative real return (below the rate of inflation). Because even if the inflation surge of 2021 is transitory, as labeled by Federal Reserve chairman Powell, and settles back down to around 2%, we would expect the yield on the 10-year Treasury to move up more in line with inflation.

Summary

With earnings growth, we see fair value as an upwardly moving target for stock prices. We see conditions and behaviors that suggest to us the market can move higher. Investors still have a healthy dose of bearish sentiment and appear to be clinging to the perceived safety of Treasury notes and money market assets. Analysts are calling for earnings growth in 2022, closer to the historic normal pace, which can support higher valuations. As value moves higher, we would expect prices to try to keep pace.

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The unmanaged Standard & Poor's Composite 1500 (S&P 1500) Index is a broad-based capitalization-weighted index comprising 1,500 stocks of Large-cap, Mid-cap, and Small-cap U.S. companies. Total return figures for the unmanaged sector indexes do include the reinvestment of dividends and capital gain distributions but do not reflect deductions for commissions, management fees, and expenses. The 10-year yield is the benchmark 10-year yield to maturity reflected by the current issue 10 year U.S. Treasury note.

Sources: Bloomberg

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