

Where Do We Go from Here?

The past 16 months have certainly been surreal. In February of 2020, global economies came to understand that COVID-19 was not like any other pandemic seen in modern times. From that moment until April 23, 2020, the US stock market [as measured by the S&P 500] dropped 34%. With economic activity grinding to halt, it felt like it might take many years to see a recovery.

Fast forward to today: the market is up 33% from just before COVID and 91% from the COVID bottom. Few would have believed the market could rise so much in a little over a year; and, fewer still would have expected it to rise without a signal pull back of 10% or more. So, what is next for the market?

Most of the returns we have seen in the stock market have come from P/E multiple expansion. Expressed another way, the price (P) of a company has gone up faster than its earnings (E). Putting numbers to it, the S&P 500 index rose from 3230.78 on December 31, 2019 to 4297.50 on June 30, 2021 while earnings for the S&P 500 went from approximately \$163/share to \$157/share during the same period. Stock market earnings have dropped 3.6% as stock prices have risen 33%. We see this as totally understandable given the market's proclivity to be forward-looking.

The good news is that US corporate earnings are now coming back strong as we learn to work within a COVID world. Earnings at the end of 2021 are projected to be \$195.00/share or 24% higher than they were before COVID became a household word.

If you are following the math above, you will notice the market has gone up 33% while earnings will have gone up 24% using end-of-the-year earnings estimates. Looking forward 6 months, the market will have gone up more than earnings have grown. Again, what does this mean for the stock market?

Earlier we mentioned that the market had moved up without a 10% pullback. This is unusual – from 2000 to today, the market has pulled back 5% or more at least once a year in every year except 2017. So far in 2021, there has not been a pullback of 5%; further, the market has not experienced a 10% pullback since the recovery began in April of 2020.

To us, it looks like it is time for the market to pull back. This would not only be healthy for the market, but it would take some of the froth out and allow valuations to migrate closer to their historical averages. The S&P 500 typically trades at 16-18x earnings; it is currently selling for 22x earnings. A pullback would take most of the excess out of the current market.

The question is: can a pullback of 10% happen in this market. With the Federal Reserve holding interest rates lower than normal and the Federal Government pumping money into the economy with stimulus packages, there is a lot of cash sitting around in portfolios looking for a home. If/when a pullback does happen, it will probably be short-lived with the economy doing well and companies projected to continue growing their earnings.

In investment terms we are a “*growth at a fair value*” money manager. After last year, most growth stocks have become a little expensive. We are not market timers but currently we are holding a bit more cash than normal. This is because it has been a challenge finding companies that fit our strict buy-disciplines. In the past we have been rewarded for our patience and added a good company or two to our portfolios, either because of a pullback in the market or because of corporate news. We are constantly looking for such an opportunity and will take advantage when one arises. Stay tuned.

Greg Robinson, President
greg@msinvest.com

Davis Miracle, Vice President
davis@msinvest.com

Washington State Long-Term Care Act

Last year Washington State created the WA Cares Fund. It will be funded by a tax on W-2 wages and provide a maximum lifetime benefit of \$36,000 adjusted annually. If you have long-term care insurance in place prior to November 2021 you may opt out of the program. We are not insurance experts but do anticipate that some of our clients will benefit from having an individual policy rather than participate in the WA Cares Fund. If you have W-2 income, we suggest you reach out to your life insurance agent to see what would be best for your situation. If you need a referral let us know.