



Big Boom for Stocks

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The S&P 500 hit a low of 666 on March 6, 2009 and was up 213%, excluding dividends, through November 4, 2016. Since then, the S&P 500 is up another 4.6%, and closed just 0.5% from a new all-time high last Friday.

Get ready for more. We expect the S&P 500 to hit an all-time high soon as the bull market in US equities continues, and we expect equity values to boom in the years ahead.

This is hard for some to believe, especially those who think the bull market that started back in 2009 is a "sugar high." After all, the Federal Reserve has ended Quantitative Easing, lifted rates once last December and, according to futures markets, has 100% odds of lifting rates again in a few weeks.

But Quantitative Easing and zero percent interest rates were never the reason stocks rose. It's true that low interest rates can push stock prices higher. Future earnings are worth more today when discounted with a lower interest rate than they are with a higher interest rate. Lower interest rates can justify higher price-to-earnings ratios.

But, since 2009, our capitalized profits model, which uses economy-wide corporate profits and the 10-year Treasury yield to value stocks, consistently said US equities were undervalued. This was even true when we used a higher discount rate. These days we use a 3.5% 10-year Treasury yield (higher than the current 2.3%) and the model still says stocks are undervalued by almost 25%.

But that's just the beginning. Even though the Federal Reserve is on the verge of lifting interest rates, monetary policy is about to get much more accommodative.

Quantitative Easing never had much impact on the economy because with one hand government was shoveling money into the economy, but with the other hand was hammering banks with regulations, higher capital requirements, and fines. The result was that, in spite of QE, the growth rate of the M2 measure of money never accelerated. This is why inflation never accelerated and we can say QE was not the reason stocks rose.

However, with the election of Donald Trump as the 45th president of the United States, one of two things is certainly true. Either new regulation will be avoided or existing regulation will be rolled-back. Either way, the banking system will no longer be held back as much. This means that all those excess reserves should start to boost money supply growth and the economy.

Even before this, stock market analysts were already predicting that earnings growth for the S&P 500 in the next year would accelerate from the 3.1% year-to-year decline in earnings seen in Q2 2016, to a 14.4% gain for the same quarter in 2017. With money growth accelerating, economic growth and earnings growth are likely to grow even more than the consensus expects.

At the same time, as we wrote last week, we expect fiscal policy to move toward growth. No, we do not subscribe to the belief that more spending is expansionary. The bigger government becomes, the more it holds back economic growth. What will help growth is a reduction in corporate tax rates, and a rollback of regulatory burdens – not just on banking, but in many other areas of the economy as well.

Equally as important is a reduction in subsidies for areas of the economy that are not profitable on their own. For example, renewable energy production is subsidized at the federal government level and a Trump administration is likely to push those decisions toward the states. Because these industries require subsidies to exist, they actually drain economic energy from the rest of the economy. Removing these subsidies will boost growth, jobs and incomes in non-subsidized industries.

The bottom line is that, barring some major lurch into protectionism, with monetary policy, tax policy, and regulatory policy moving toward an even more expansionary phase, the stock market is set to soar.

The stock market was already rising in spite of the US federal government acting as a headwind to growth in recent years. This shows the power of the latest new wave of technology. The Cloud, Smartphones, Tablets, Apps, new genetic healthcare advances, 3-D printing, fracking, and so many more new technologies have been able to lift growth anyway.

Imagine what happens when policies get better? What we expect is a boom in the stock market as the US Plow Horse economy truly begins to trot and maybe even run.

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