S&P 500 3650, Dow 32,500

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by Brian Wesbury, Robert Stein
of First Trust Advisors

If you pay close attention to our stock market forecasts, the title of this piece will look familiar.

At the end of 2019 we made the same exact forecast for the end of 2020 — the strangest year in our lifetimes, and it's not even over. Compared to most analysts, this was a very bullish call. And then, when the market hit a pre-COVID19 peak of 3386 in mid-February, if anything we looked not bullish enough.

Then the bottom fell out of both stocks and the economy, struck by a combination of COVID19 and overly-strict government shutdowns. The S&P 500 bottomed at 2237 on March 23, pricing in an 80% drop in corporate profits from the year before, making our call of 3650 look obsolete.

About seven weeks later, on May 8, stocks had recovered back to 2930, but we figured 3650 was probably still obsolete, and so revised our year-end forecast for the S&P 500 to 3100. Still bullish, but from a lower base.

Then, only four weeks later, the S&P 500 had blown through our updated year-end target and was sitting at 3194. So we revised up our year-end target again, this time to 3350.

But, here we are at the end of August and once again stocks have blown through our updated target, closing last week at 3508. As a result, we're moving our target back up to exactly where we started: 3650.

The key lesson in all this should be that it is a fool's errand to try to time the market. Imagine being told on February 15 that the world was about to be hit by a widespread virus for which there was no known therapy or cure, that governments were going to react by shutting down massive swaths of their economies, and that US real GDP was about to drop at the fastest rate for any quarter since the Great Depression.

Then imagine you had to make a choice about how you would allocate your investments through year end. Many investors would have opted to sell their equities and not look back. But, as we now know, the better choice would have been to grit your teeth and stay invested.

In order to make a stock market forecast we use a model based on capitalized profits. Our model takes the government's measure of profits from the GDP reports, divided by interest rates, to measure fair value for stocks.

To be cautious, we're using the level of corporate profits in the second quarter, when they were down 20.1% from a year ago, and at the lowest level in nine years, a level from which they are very likely to recover in the third quarter and beyond. In addition, we are NOT using the current 10-year Treasury Note yield of 0.7%, which generates absurdly high targets for equity prices. Instead, we're using a 10-year yield of 2.0%. And at that yield, with profits remaining at second quarter levels, our model says the S&P 500 is fairly valued at 4052.

In other words, we would not be shocked if stocks went even higher than our year-end target of 3650 and barring a major shift in public policy as a result of the election in November, expect further gains in the 2021.
