Federated Hermes

Sometimes, it′s not that complicated

2021 risks are far more to the upside than downside.

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Steven Chiavarone, CFA®
Vice President
Portfolio Manager
Equity Strategist

As the major equity indexes continue to hit new highs, concerns the market is overbought and over its skis are commonplace. That's understandable. November was the best month in decades for stocks, lifting various sentiment gauges from the American Association of Individual Investors and Investors Intelligence surveys to CNN's Fear & Greed Index to ″extreme optimism″ levels that historically have presaged a pullback. Frankly, the Federated Hermes equity team would welcome such as it would make it cheaper to add to our equity overweight in our portfolio models, as we've been waiting to do.

Put simply, even after this year's record rally off March's bear-market lows, we see the risk in the year ahead as being far more to the upside than downside. The reasons are many. For one, a Morgan Stanley study suggests consumers are sitting on top of $1.5 trillion in "excess savings," unencumbered funds built in part on the positive wealth effect from both higher real estate and equity prices. This sum is akin to a "GI-returning-home-moment," when pockets are flush with cash and ready to be spent. As we think about 2021, we see a plethora of economic catalysts that will free consumers to do just that:

- **Vaccines are part of a mosaic** to manage the pandemic, and the first in a coming wave of global inoculations arrived this week. In no way do we mean to downplay the record number of cases and the damage they're causing to families and the economy. But we believe by the first-quarter's end, the positive impact from vaccines will be measurable.
- **Another sizable dose of fiscal stimulus** is coming regardless of the outcome of the two U.S. Senate runoffs in Georgia on Jan. 5. If Democrats win both races and thus control of both chambers of Congress, the package likely will be even bigger.
- **Tax increases are unlikely** in what essentially will be split government—even if Dems win the runoffs, their margins in both chambers will be razor thin. Besides, the appetite for higher taxes early in a recovery cycle is almost certain to be minimal on both sides of the aisle.
- **Janet Yellen's pending appointment** as Treasury Secretary has been well received by both parties. It also is welcome, and reinforces dovishness, at the Fed. The two almost assuredly will work hand in hand on stimulus, with an eye toward the lower rungs of the economy.

Moreover, the macro data we monitor—jobless claims, inflation, housing, yield curve, high-yield bond spreads (the yield gap relative to comparable maturity Treasuries) and manufacturing—aren't signaling potential recession until mid-2023 at the earliest. To be sure, these collective data at the start of 2020 didn't see one either. But the pandemic caught the world by surprise. Might another, different exogeneous event hit next year? We have learned to never say never, but the odds are against it.

So, short of a double-dip recession that appears exceedingly unlikely at this juncture or a black swan that no one sees, the economy is setting up for a multiyear recovery/expansion, with productivity on the rise and corporate cash flow, earnings, dividends, defaults and credit quality all continuing to improve. We expect this bullish scenario to lift S&P 500 earnings-per-share 20% next year to $180, taking the S&P above 4,000 to even higher levels. It's really not that complicated.

TAGS

EQUITY | MARKETS/ECONOMY | CONSUMER SPENDING | CORONAVIRUS

DISCLOSURES

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

CNN's Fear and Greed Index measures several indicators of investment sentiment.

High-yield, lower-rated securities generally entail greater market, credit, and liquidity risk than investment-grade securities and may include higher volatility and higher risk of default.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

Stocks are subject to risks and fluctuate in value.

The American Association of Individual Investors (AAII) Bulls Minus Bears Index is a measure of market sentiment derived from a survey asking individual investors to rank themselves as bullish or bearish.

The Investors Intelligence bull–bear ratio is a measure of market sentiment derived from a weekly survey of individual investors who are asked to rank themselves as bullish or bearish.

There are no guarantees that dividend-paying stocks will continue to pay dividends.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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