Daily Macro Insights: The road to S&P 500 over 5,000

01/09/2021

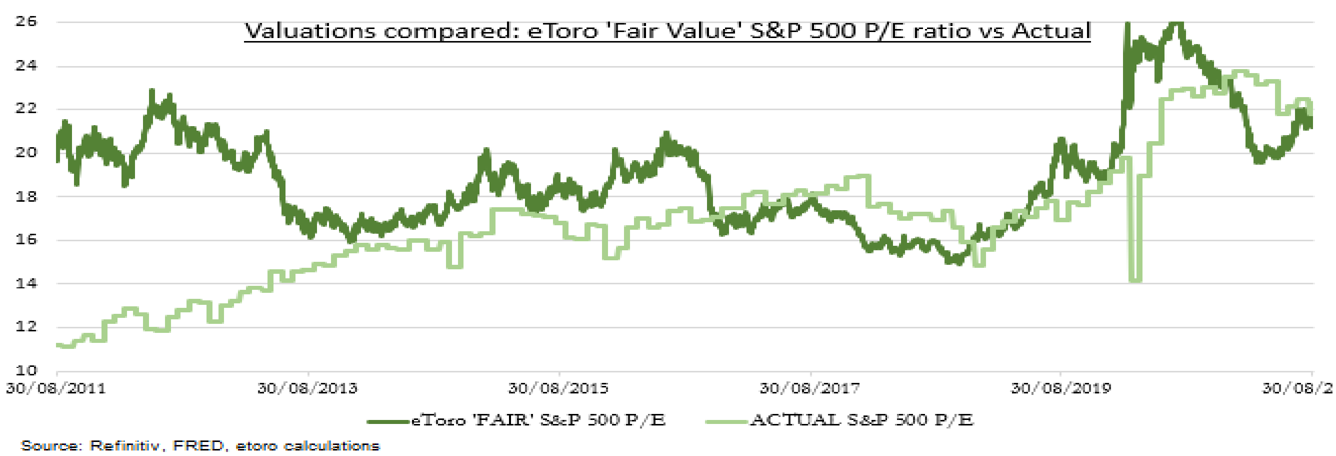
ROAD TO 5,000: Further earnings upgrades and lower US 10-year bond yields combine to boost our 'fair value' S&P 500 valuation, and give a clear roadmap to the index trading over 5,000. Higher-for-longer valuations and our above-consensus index earnings view of $210 (+50% vs 2020) this year and $240 next (+20%), gives a year-end S&P 500 target of 4,700, and 5,050 for next, over 10% from here. This implies a very rare 4th year of 10%+ returns.

FAIR VALUE: Our 'fair value' model uses bond yields, corporate profitability, and long-term GDP growth to set a S&P 500 (SPY) P/E. This is 21.5x, high vs history but in-line with current levels. We see the impact of only gradually higher bond yields, as Fed moves to taper bond purchases, offset by rising corporate profitability and GDP. For example, a return to the Fed's long term GDP view a decade ago (2.6% growth vs current 1.9%) would raise P/E 20%.

CHANGING INDEX: Valuations also benefit from long-term sector weight changes, with the rise of high-valuation tech. The 28% IT sector weight is +7 percent in only the last five years and to keep growing, whilst cheaper sectors like financials (-4 percent) get smaller. This is alongside still low earnings in reopening sectors, from industrials to discretionary. A recent analysis estimated these impacts account for 80% of the increase in S&P 500 valuations.

ROTATION: Higher yields cut the present value of future cash flows. 0.5% higher 10-yr yield lowers our P/E 10%. Financial (XLF) and commodity sectors are positively correlated to this, whilst Tech (XLK) has become negatively correlated; now less cyclical and valuations higher.

TODAY: US growth momentum focus with ISM purchasing manager's index. Seen stable at strongly growing 59, but with virus third-wave downside risk, and after weak China PMI.



Ben Laidler, Global Markets Strategist. Email: benla@etoro.com