

## S&P 3100, Dow 25750

In December 2018 with the S&P 500 at 2,500, we forecast it would hit 3,100 by the end of 2019 and then pushed our forecast to 3,250 as stocks soared. The S&P 500 rose 28.9% in 2019 and hit that revised target on the first day of trading in 2020.

We then raised the target to 3,650 for the end 2020, and the way stocks were moving higher in January and February made that forecast look reasonable. But then the world took a detour into the Coronavirus Contraction. As a result, we are adjusting our year-end 2020 target down to 3,100, with the Dow Jones Industrials average finishing at 25,750. That would be a moderate gain of 5.8% from the Friday close.

The range of plausible outcomes for the rest of 2020 is very wide right now. Key variables include factors that are normally irrelevant to forecasting markets such as the spread of the Coronavirus, how quickly the economy opens, the development of therapies or a vaccine to fight the disease, and how quickly people are willing to go back to normal.

With the economy getting crushed, some analysts are wondering how equities could have bounced so hard from the March lows. We understand their confusion. With unemployment likely above 15% and real GDP falling roughly 30% in Q2, how can equities be doing so well?

One key to understanding this is that investors don't buy shares of GDP, they buy ownership stakes in a distinct set of companies, many of which are doing quite well despite the general economic carnage.

Imagine a company that has a major competitor nearby. One day, completely out of the blue, the competitor's facilities are all destroyed by a meteor. Obviously, no one would celebrate

this catastrophe. However, when competitors go away the enterprise value of the surviving company rises, and you don't have to be an astrophysicist to figure that out.

In many ways, the spread of the Coronavirus has given larger well-capitalized companies, particularly technology companies and big box stores that were allowed to stay open, an advantage over Main Street competitors. And unlike Main Street businesses, a larger share of these companies are publicly traded.

Meanwhile, our capitalized profits model for equities, based on profits and interest rates, suggests a 3,100 level for the S&P 500 would not be overvalued. To put this in context, a 3,100 level assumes that profits fall by 60% AND the yield on the 10-year Treasury Note climbs to 1.25%. We forecast profits will fall about 25% this year and the 10-year Treasury will rise to just 0.9% by year-end. In other words, even at 3,100 we believe the S&P 500 will still be undervalued. And with profits rising in 2021, we think the S&P 500 can then rise to 3,650, a year later than we originally forecast.

One reason to be bullish on equities is that these days Quantitative Easing by the Federal Reserve is going straight into the M2 money supply and not into excess reserves. In the past three months, M2 has climbed at a 66% annualized rate, the fastest rate we know of in history.

Meanwhile, the federal government has ramped up deficit spending (with unemployment insurance and loans/grants to small businesses) to try to offset private-sector losses in income. Regardless of what we think of these policies, the effect will be to support equity prices in the year ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-12 / 7:30 am	CPI – Apr	-0.8%	<b>-0.8%</b>		-0.4%
7:30 am	“Core” CPI – Apr	-0.2%	<b>-0.2%</b>		-0.1%
5-13 / 7:30 am	PPI – Apr	-0.5%	<b>-0.4%</b>		-0.2%
7:30 am	“Core” PPI – Apr	0.0%	<b>0.0%</b>		+0.2%
5-14 / 7:30 am	Initial Claims – May 9	2,500 Mil	<b>2,500 Mil</b>		3,169 Mil
7:30 am	Import Prices – Apr	-3.4%	<b>-3.4%</b>		-2.3%
7:30 am	Export Prices – Apr	-2.3%	<b>-2.3%</b>		-1.6%
5-15 / 7:30 am	Retail Sales – Apr	-11.7%	<b>-11.0%</b>		-8.4%
7:30 am	Retail Sales Ex-Auto – Apr	-8.4%	<b>-9.0%</b>		-4.4%
7:30 am	Empire State Mfg Survey – May	-60.0	<b>-52.5</b>		-78.2
8:15 am	Industrial Production – Apr	-12.0%	<b>-11.5%</b>		-5.4%
8:15 am	Capacity Utilization – Apr	64.0%	<b>64.1%</b>		72.7%
9:00 am	Business Inventories – Mar	-0.2%	<b>-0.2%</b>		-0.4%
9:00 am	U. Mich Consumer Sentiment- May	68.0	<b>72.5</b>		71.8