"Stick To Your Guns"

Market Commentary – April 2021

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The third estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 4.3% in the fourth quarter of 2020. This is higher than the advance estimate of 4.0% and the second estimate of 4.1%. On March 17, the Federal Reserve revised its economic projections that were last released in December 2020. It now sees GDP growth of 6.5% in 2021, 3.3% in 2022, 2.2% in 2023, and 1.8% in the "longer run" (beyond 2023). Back in December the Fed predicted 2021 GDP at 4.2%, so economic growth has gained steam over the past several months. Note how the Fed projects growth to slow, which makes the current boost similar to a sugar high. This will become more important to consider over the next year or two.

As expected, the Federal Reserve maintained its accommodative monetary policy in its scheduled announcement on March 17. The target federal funds rate remains at 0% to 0.25%, and the Fed continues to expect this low level through 2023 (nearly 3 more years). It also continues to buy $80 billion of Treasury and $40 billion of mortgage-backed securities each month. As of March 25, the Fed had $7.77 trillion in assets on its balance sheet, up from $7.64 trillion one month ago (an increase of $130 billion). The stock market is experiencing nirvana, with a strong Fed tailwind supporting investors. We need to evaluate, however, what will happen when this support eventually ends…and it will end.

The annual update of our universe of stocks in March confirmed many of last year's choices and, as usual, revealed some new potential gems. We analyzed a total of 1,888 companies one at a time, with a cumulative market capitalization of $46.7 trillion. Our process allowed us to identify "our universe", which is comprised of stocks we believe have the best risk/reward prospects (based on a combination of low valuation, low beta, low debt to market cap, and, usually, high dividend yield). Only 65 stocks made the cut (a record low for Banyan), which is a sign that the stock market in general has overheated. Our stocks have the following market capitalization ranges: $55 million to $500 million (12 stocks), $500 million to $2 billion (10 stocks), $2 billion to $10 billion (12 stocks), $10 billion to $100 billion (20 stocks), and >$100 billion (11 stocks). In the coming months, we will perform in-depth fundamental research on the companies in our universe with attractive technical chart patterns to determine which ones to buy.

Technical factors of the market are bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) during 2021 is $172.27, which implies a price-to-earnings (P/E) ratio of 23.1 with the S&P 500 at 3,973. The earnings yield (E/P) of 4.34% represents attractive value relative to the 10-year U.S. Treasury note yield of 1.74%. Note how the 10-year Treasury has skyrocketed in yield since 0.84% at the end of November 2020. Given these higher interest rates, it is not a coincidence that technology stocks with nosebleed valuations have been struggling in 2021.

The S&P 500 has yet to break down and correct since October, although it could do so at any time. Support should be found near 3,885 (50-day moving average), 3,750 (near March 2021 low), and 3,550 (September and October 2020 closing highs and also 200-day moving average). A rally above 4,000 would unleash a new round of buying.

Value continues to trounce growth investing in 2021. An analysis of the major indexes in 2021 Q1 tells the story: S&P 600 Small Cap Value +24.2%, S&P 400 Mid Cap Value +18.4%, and S&P 500 Large Cap Value +10.8%. In comparison, the growth indexes lag: S&P 600 Small Cap Growth +12.3%, S&P 400 Mid Cap Growth +8.6%, and S&P 500 Large Cap Growth +2.1% (all value and growth index returns include dividends). The frothy Nasdaq 100, loaded with overpriced mega-cap technology stocks, is barely positive for the year. What a change this is from 2020! If history is any guide, value investors who stick to their guns will ultimately enjoy their sweet reward.