DELTA
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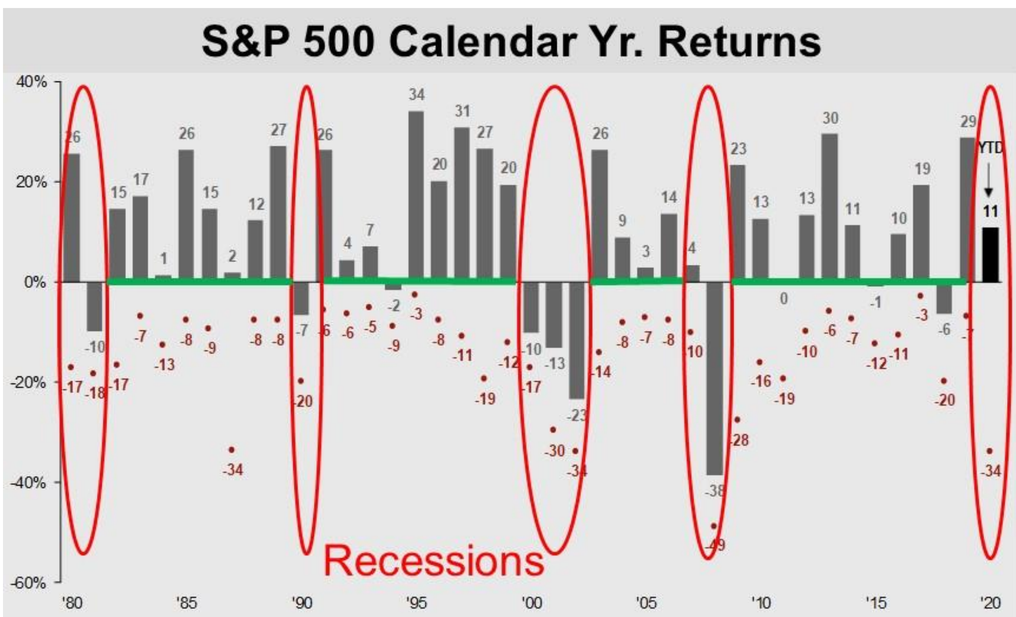
Delta Insights
a weekly commentary on investing

Delta Investment Management is a registered investment advisory firm. Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new turnkey asset management solution.
Delta manages portfolios at TD Ameritrade and Schwab.
Please contact Delta at info@deltaim.com or 415-249-6337 to learn more.

November 20, 2020

Delta 2021 Outlook

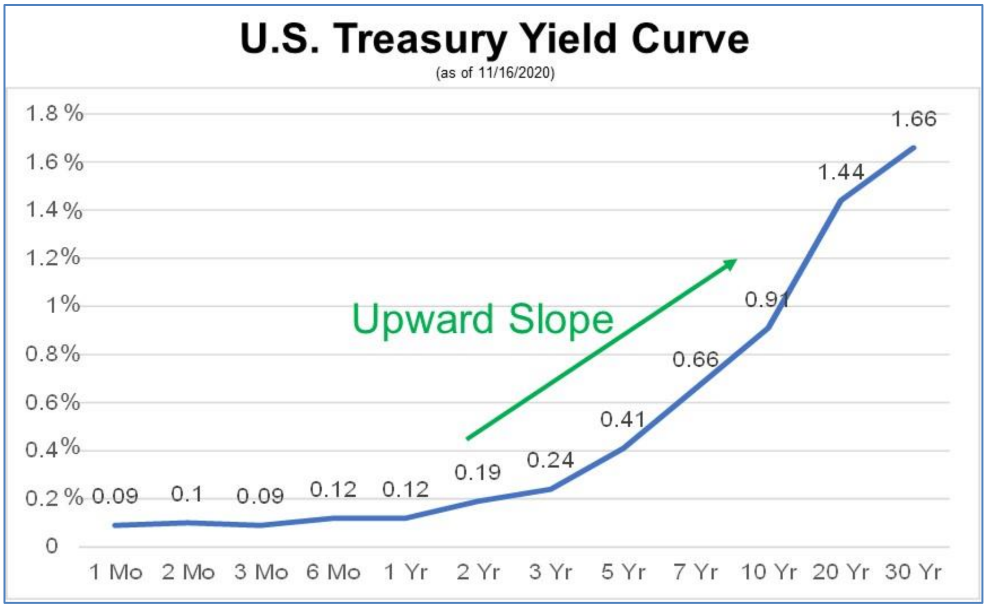
The stock market almost always has positive calendar year returns during years the economy does not experience a recession. We do not foresee a recession in 2021 making the probability of enjoying a positive investment year in U.S. equities high.

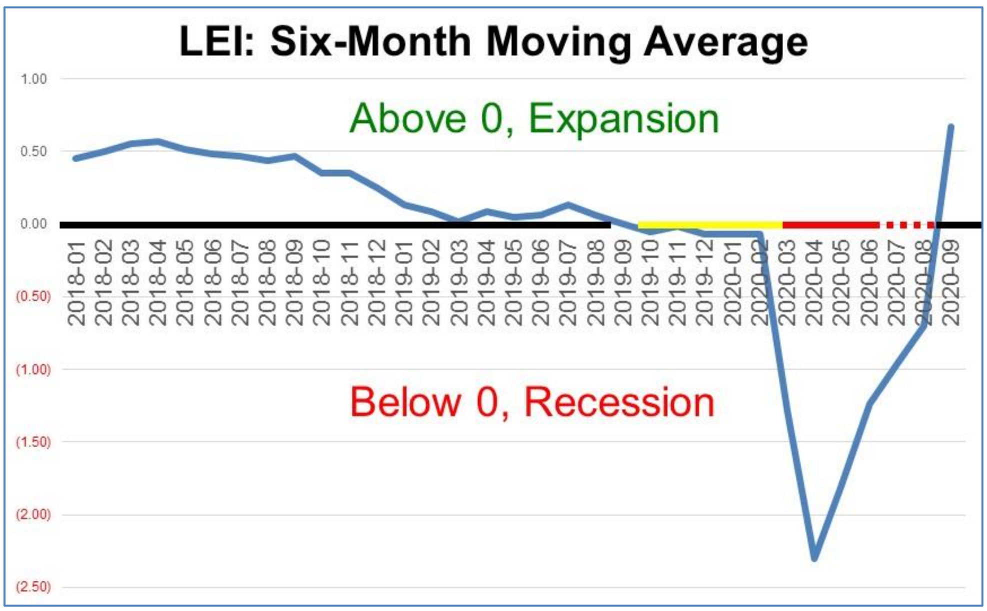


Two primary leading indicators of recession are the treasury yield curve and the Leading Economic Index (LEI). Recessions typically follow:

1. The inversion of the treasury yield curve whereby the 2-year interest rate is higher than the 10-year rate, and
2. The six-month moving average of the LEI turns negative.

Neither of these criteria are true today.





We just completed a presidential election. The combination of a Democratic president with a split congress has offered the best returns in the year after the election than any other combination of federal government political party control since 1944.

Stock Market Return Year After Election

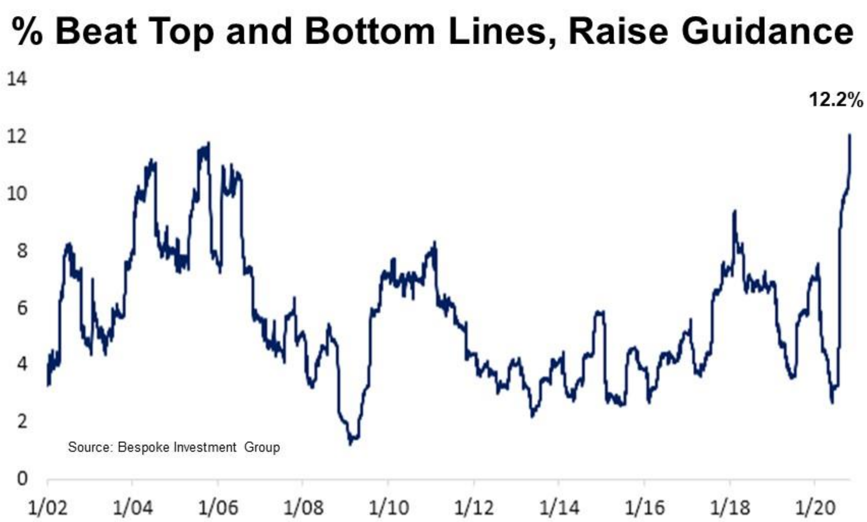
Political Scenarios	Avg. Chg.	Years	FoA
Unified Government	**10.6%**	**30**	**77%**
>Democratic President	9.8%	22	77%
>Republican President	12.9%	8	75%
Unified Congress	**7.4%**	**32**	**66%**
>Dem. Pres./Rep. Congress	13.0%	10	60%
>Rep. Pres./Dem. Congress	4.9%	22	68%
Split Congress	**8.6%**	**14**	**69%**
>Democratic President	13.6%	4	75%
>Republican President	5.8%	10	70%
All Years	**8.8%**	**76**	**71%**

Source: S&P DJ Indices. Data: 12/31/44-10/30/20. FoA: Frequency of advance.

Going into 2021, we anticipate:

1. a new COVID-19 economic relief bill passed by the end of February
2. lessening of the trade war
3. continued low corporate and personal tax rates for the next two years
4. further economic reopening
5. robust consumer spending driven by an unwinding of some of the $2 trillion that has been placed in savings account balances at commercial banks and thrifts in the past eight months

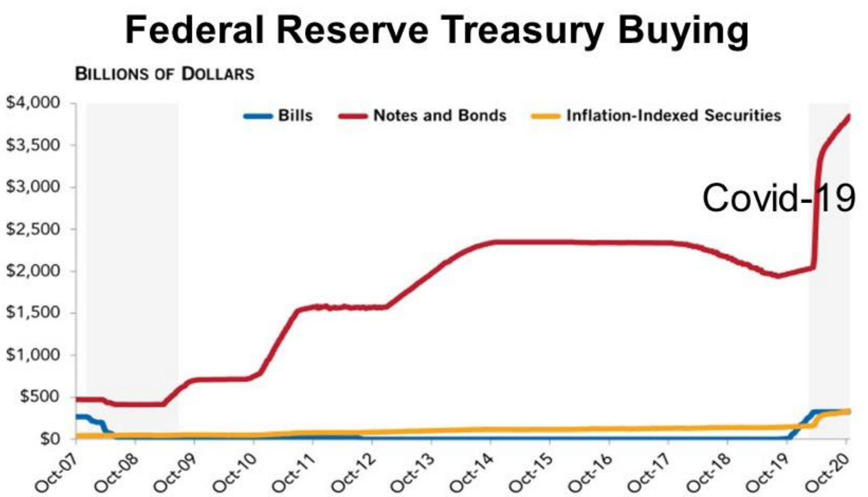
Over long periods of time, stocks generally follow earnings. With the 92% of the S&P 500 companies having reported earnings for the third quarter, 78% of companies beat revenue expectations and 84% beat income expectations. The percentage of companies that beat both the top and bottom lines is the highest beat rate in the past 20 years. The percentage of companies that beat the top and bottom lines and raised guidance (earnings triple play) is also the highest this century at 12.2%.



Goldman Sachs raised their S&P 500 earnings forecast for calendar year 2021 from $170 to $175. JP Morgan Asset Management is projecting $178. The consensus estimate for 2021 is currently $168.64.

The 2020 consensus earnings estimate for the S&P 500 is currently $137. This suggests that earnings growth through next year falls in the range of plus 23% to 30%. The consensus earnings estimate for 2022 is roughly $195. The upward trajectory of earnings supports the thesis the stock market should trade higher through 2021.

How much higher stocks trade may be impacted by interest rates. If interest rates rise, Price/Earnings (P/E) multiples may compress and vice versa. The fed funds futures market shows the probability the Federal Reserve will increase the Fed Funds rate between now and September 22, 2021 (the farthest out the futures market trades) is 0%. In addition to holding short-term rates down, the Federal Reserve purchased $1.6 trillion worth of longer-term treasury notes from March 18, 2020 through October 2020. This has been a major driver in causing the 10-year Treasury rate to trade below 1% for most of this year.



SOURCE: Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances*, October 2020.
NOTES: Data are measured weekly; X-axis labels represent data for the beginning of each fiscal year. The greys shaded areas represent economic recessions and are based on the National Bureau of Economic Research's classification. NBER has not provided an end date for the recession that began in February 2020.

Market drivers of interest rates are economic growth and inflation expectations. The Federal Reserve calculates an expected inflation rate for the next ten years. Their current 10-year average projection is 1.72%, below their target level of 2%.

Avg. Inflation Expected Next 10 Years

The 10-year Treasury rate is roughly 0.85%. Given the inflation expectation of 1.72%, the real interest rate (nominal less inflation) is -0.87%. It is unusual for interest rates to remain negative for long periods of time. At some point, especially if the Federal Reserve slows its bond buying program, we would expect to see the 10-year treasury rate migrates toward the inflation expectation. It is also possible the inflation expectation drifts lower as unemployment remains high and COVID-19 creates long-term adjustments in economic activity.

The S&P 500 is currently trading at 22x its forward 12-month consensus earnings expectation of $165. If it retains this multiple through the next year, the S&P 500 would reach 4,300. Again, a substantial risk to this forecast comes from potentially rising rates and P/E contraction.

To mitigate the risk of rising rates, the winning formula for 2021 may be to overweight low-multiple stocks that benefit most from a further economic reopening. Some companies do better with rising rates including many financial companies. High multiple, large-cap technology stocks that are benefiting from the current sequester at home environment may lag the economic reopening revival stocks.

Off the lows at the end of October, financials (XLF) and energy (XLE) are up 15% and 29%, respectively versus the S&P 500 advance of 9%. From a relative valuation standpoint, this trade may continue to work into 2021.

The Bottom Line

We are bullish for 2021. Earnings estimates are trending higher and the economy is returning to a full reopening, albeit in fits and starts. Generally, earnings revisions continue for longer and are greater than expected. If interest rates remain low, we should expect the stock market to perform very well over the next year.

Let Us Help You Position for 2021 – Give Us a Call Today

Give us a call or send an email if you would like to schedule an annual account review. If you do not currently have an investment account with Delta, we invite you to contact us to schedule your free portfolio review at **(415) 249-6337** or email us at info@deltaim.com.

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

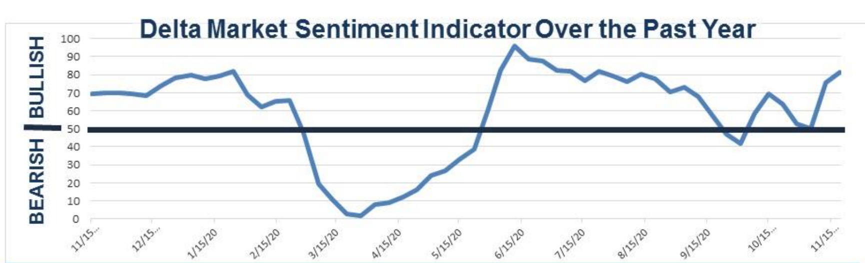
81.5

Our technical indicator increased from 75.6 to 81.5 this week

INDICATOR STATISTICS

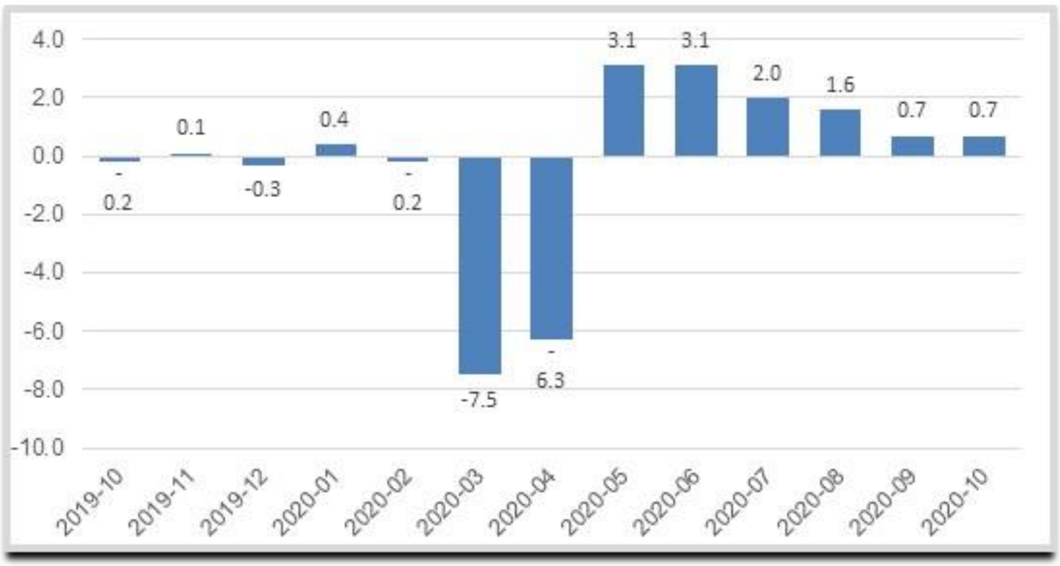
Consecutive Bullish Weeks:	7
Cycle Inception Date:	10/8/2020
Range:	50.0 – 81.5
Mean:	64.5
Bullish Weeks YTD:	32
Bearish Weeks YTD:	15
*S&P 500	3.4%
*DJIA	3.4%
*NASDAQ	3.6%

** Percentage change during current cycle*



Leading Economic Index % Change Monthly

October 2019 – October 2020



Source: The Conference Board, updated monthly – last update 11/19/2020
