First Trust
Monday Morning OUTLOOK

630-517-7756 • www.ftportfolios.com August 29, 2016

# Bull Market Has Further to Run

**Brian S. Wesbury** – *Chief Economist*
**Robert Stein, CFA** – Dep. Chief *Economist*
**Strider Elass** – *Economist*

Now, the pessimists can't stop talking about profits. Both S&P 500 reported earnings and the government's economy-wide measure of corporate earnings are down 4.9% from a year ago.

In hindsight, corporate profits peaked in 2014, just like they did in 1978, 1988, 1997, and 2006. So, they say, a recession and bear market are on the way, just like the ones that followed those peaks in profits as well. It's time to sell, again!

One problem with this theory is that it assumes the decline in profits is permanent. But profits have been hurt by the downdraft of energy prices, which crushed profits in that sector, while also hurting other related businesses. However, energy prices are rebounding while profits outside of energy are accelerating.

In addition, the ingredients for a recession are not yet there. Monetary policy is not tight, consumer and corporate balance sheets are healthy, and the recovery in home building has much further to go.

We use a Capitalized Profits Model (the government's measure of profits divided by interest rates) to measure fair value for stocks. A traditional measure using a 10-year Treasury yield of 1.62% suggests the S&P 500 is massively undervalued. Using a 10-year yield of 3.5% suggests fair value for the S&P 500 is 2667, which is 23% higher than Friday's close. Even a 4% Treasury yield suggests fair value is 2333. We'd have to use a 10-year yield of 4.3% to conclude that the S&P 500 was already at fair value and no one expects that!

And that's assuming no rebound in profits at all.

Alternative versions of the cap profits model using corporate bond yields suggest fair value for the S&P of around 3000; around 2900 if we use the Baa yield, 3200 if we use the Aaa.

None of this means the stock market must go up today, or this week, or even in the year ahead. But it does bolster our case for a continuation of the bull market.

We have been forecasting 2375 for the S&P at year end. At the bottom of the correction early this year, we stuck to our bullish forecast. As of Friday's close, we needed a 9.5% gain to get there. We only have four months to go, but that's not wildly optimistic by historical standards.

We're looking for a strong finish to 2016 as many of the investors who are now pessimistic realize their fears aren't justified by reality.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 8-29 / 7:30 am | Personal Income – Jul | +0.4% | **+0.4%** | +0.4% | +0.2% |
| 7:30 am | Personal Spending – Jul | +0.3% | **+0.3%** | +0.3% | +0.4% |
| 8-30 / 9:00 am | Consumer Confidence – Aug | 97.0 | **97.1** | | 97.3 |
| 8-31 / 8:45 am | Chicago PMI - Aug | 54.0 | **54.5** | | 55.8 |
| 9-1 / 7:30 am | Initial Claims – Aug 27 | 265K | **263K** | | 261K |
| 7:30 am | Q2 Non-Farm Productivity | -0.6% | **-0.6%** | | -0.5% |
| 7:30 am | Q2 Unit Labor Costs | +2.1% | **+3.8%** | | +2.0% |
| 9:00 am | ISM Index – Aug | 52.0 | **52.0** | | 52.6 |
| 9:00 am | Construction Spending – Jul | +0.5% | **+0.3%** | | -0.6% |
| *Afternoon* | Total Car/Truck Sales – Aug | 17.2 Mil | **17.1 Mil** | | 17.8 Mil |
| *Afternoon* | Domestic Car/Truck Sales – Aug | 13.5 Mil | **13.3 Mil** | | 13.8 Mil |
| 9-2 / 7:30 am | Non-Farm Payrolls – Aug | 180K | **160K** | | 255K |
| 7:30 am | Private Payrolls – Aug | 180K | **160K** | | 217K |
| 7:30 am | Manufacturing Payrolls – Aug | -4K | **-4K** | | 9K |
| 7:30 am | Unemployment Rate – Aug | 4.8% | **4.8%** | | 4.9% |
| 7:30 am | Average Hourly Earnings – Aug | +0.2% | **+0.2%** | | +0.3% |
| 7:30 am | Average Weekly Hours – Aug | 34.5 | **34.5** | | 34.5 |
| 7:30 am | Int'l Trade Balance – Jul | -$41.6 Bil | **-$41.6 Bil** | | -$44.5 Bil |
| 9:00 am | Factory Orders – Jul | +2.0% | **+1.4%** | | -1.5% |