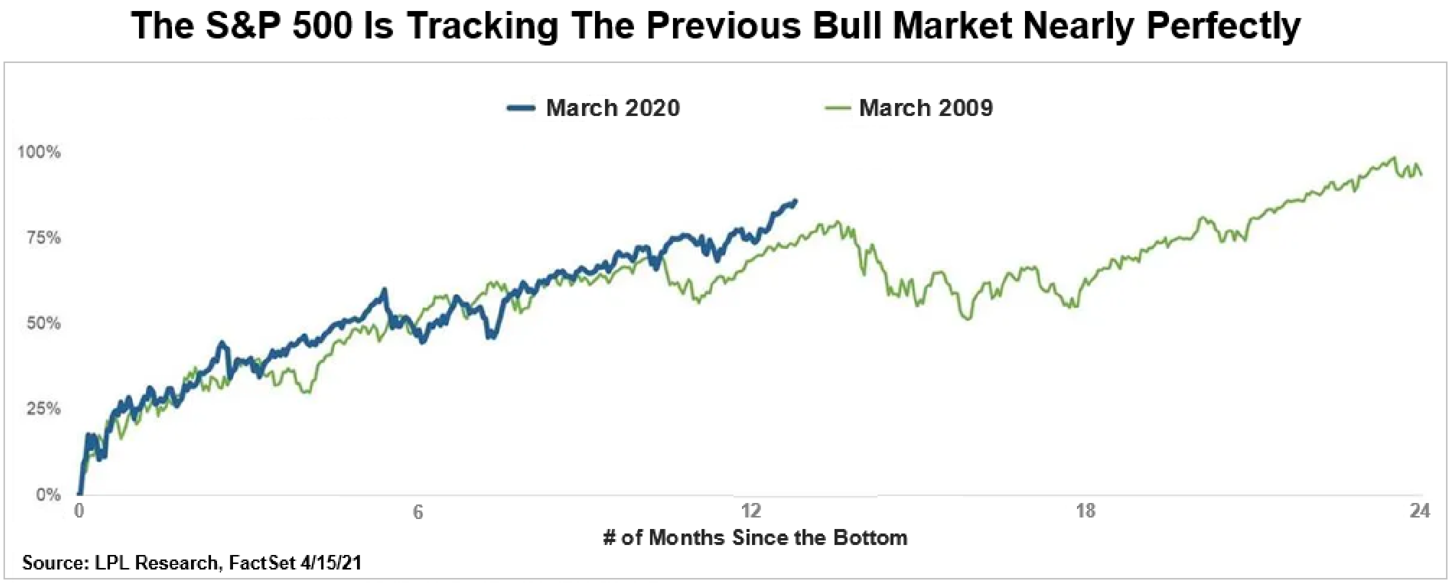
Chart of the Month

April 2021



The S&P 500 and Nasdaq made new all-time highs yesterday while the Dow Jones Industrial Average is hovering at 34,000 (just below its record two weeks ago). The next few days should determine whether the stock market continues to advance, pauses, or even reverses course.

More than a third of the companies in the S&P 500 will announce earnings this week, with the five biggest (AAPL, MSFT, AMZN, GOOG, and FB) reporting on Tuesday, Wednesday, or Thursday afternoon. In addition, the Federal Reserve is scheduled to wrap up its policy meeting tomorrow and President Biden will deliver the State of the Union that evening. These events should set the tone for the market over the near term.

Meanwhile, the S&P 500 has been tracking the previous bull market nearly perfectly (as shown in the chart above). If the pattern were to continue, the index may move a bit higher before experiencing a correction. As we have discussed many times over the years via our Charts of the Month, trying to time the market is always difficult, if not impossible. However, our guesstimate is that stock prices may be ripe for a pullback before the bull market resumes and goes on to higher highs.

We think a case can be made for even a stampede into a climactic top that is unlikely to end well as argued in January and February. A 2008-type plunge would probably be preceded or accompanied by a credit crunch or rising inflation meaningfully above the Fed's 2% goal. As a result, we continue to pay close attention to the actions (or inactions) of the Fed as a policy mistake will likely be the culprit that ends this bull market.

While we don't subscribe to the "sell in May and go away" adage popular on Wall Street, it is worth noting that the average returns from May through October (3.6%) have been well under half of those from November to April (8.7%) since 1963. The seasonal disparity has been worse (1.5% vs. 5.0%) over the past 20 years. At a minimum, it would be wise to lower one's expectations going forward.

We expect Biden will address his $2.25 trillion infrastructure package and $1.8 trillion "American Families Plan," as well as the corporate and individual tax increases (including a near doubling in the maximum capital gains rate), during his speech tomorrow night. If enacted, the new capital gains rate would be 43.4% (39.6% plus the 3.8% Net Investment Tax) on taxpayers earning over a million dollars. California treats all capital gains as regular income at a rate up to 13.3%. On a combined basis, the tax on profits would be 56.7%, meaning the government would become the majority partner on such gains. Hopefully, the final version will be less punitive.

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