Coming in Like a Lion

January 11, 2021

After a rather quiet finish to last year in the stock market, (going out like a lamb), the first week of this year came in like a lion. Putting this scenario into perspective shows that you cannot keep a great bull market down. Pundits feared that the political turmoil in the Capitol would have been enough to unnerve stock investors, but it did not. The rapidly rising number of COVID-19 cases across the globe could have triggered another stock market meltdown, but it did not. The emergence of several virus variants (mutations of the disease) should strike some fear in sensitive investors, but it did not. The sudden increase in long-term interest rates could have suggested that inflation was right around the corner and the economic outlook would threaten the stock market advance, but it did not. By Friday, January 8th, major stock market indices (DJIA, S&P 500 and NASDAQ) were hitting all-time highs!

So far, the S&P 500 is up 1.8% in the first five days of the year. That return is tied for the 19th best start to a year since 1950, according to "The Stock Trader's Almanac." According to this source, the size of the gain is not what matters but the direction. The S&P 500 ended the year higher 82.2% of the time following a gain in the first five days of the year. And the outlook is even better following a U.S. presidential election. "In the last 17 post-presidential election years, 13 full years followed the direction of the first five days." Moreover, research from Wilshire Associates states that investors have already made nearly $1 trillion in stock market wealth in just a week.

Yet, the well-known stock market indices were not the only stars of the show as the New Year got underway. The surprise of last year was the performance of small cap stocks as measured by the Russell 2000 index. After trailing the well-known indices for most of last year, the index surged 31% in the fourth quarter probably benefiting from the announcement of not one but several vaccines that could be administered to thousands of people early in 2021. Any indication that the battle against the virus was being won was likely to send this index higher. The trend continued into the first week of 2021 as this index surged almost 6%.

Surprisingly, even with the world engulfed in the Coronavirus, the first week of the year was great for emerging markets as the MSCI Emerging Markets index rose 4.8% for the week following a 15.8% gain last year. However, the best performing index last week was the S&P Energy sector with a gain of 9.3% aided by a sharp rally in oil prices. This broadening out of the market suggests that the bull market is likely to continue. Many of the groups that have suffered due to the virus rallied as the number of vaccinated people surged. Economic data are likely to continue the move upwards and companies are beginning to revise earnings estimates higher.

One unusual fact is that fund flows continue to be negative for domestic equities while bonds continue to attract most investors' money. At some point, investors will desire higher returns from stocks, especially when positive earnings expectations become a reality. While we do expect to see some temporary pauses in the stock market rally that could be triggered by fears of tax increases from the incoming administration or an unwinding of the record level of margin debt, the real fear for equity investors would be a change in the Fed's policy of easy money and low interest rates. We do not expect to see any change in that direction and applaud the roar of the lion in the first week of this year. Remember: the trend is your friend.