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Why It's Time To Toss Out Any Earlier Stock Market Forecasts

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Many investors are scratching their heads trying to figure out how the stock market can rise during the biggest economic contraction on record. Second quarter real GDP declined by 31.4%, the worst ever — even worse than any period during the Great Depression. Yet the stock market has gone up in recent months. As of Oct. 26, the Nasdaq Composite was up 27% for the year and had recorded many all-time new highs along the way. The S&P 500 was up 5% on the year.

On May 31, our company published a note on the new paradigm in the stock market, which discussed the have- and have-not companies. We went as far as to suggest abandoning the S&P 500 for index investing and adopting the Nasdaq-100 index for these reasons. The S&P 500 contains companies across a wide swath of industries, including the airline, restaurant, hotel, department store and cruise industries that have been made less relevant due to Covid-19. On the other hand, the Nasdaq is populated by many companies that conduct business remotely and not face-to-face. Many face-to-face businesses have been limited in their operations by government edict.

At the end of June, Stanford News estimated that 42% of the U.S. labor force was working remotely; much of this activity will continue after the arrival of a new vaccine to deal with the virus. Companies are learning that remote employees are more productive. For such companies, productivity is not only rising, but there is also opportunity to shrink fixed office costs. Google has already announced that its employees will work remotely until at least next summer. Make no mistake about this; this is not an isolated case, but the beginning of a trend.

Historically speaking, the worst economic downturns are followed by strong rebounds. The current downturn is among the worst and, if past is prologue, the ensuing recovery will be a strong one as business assets will be forced out of inefficient sectors of the economy into more efficient ones. When it comes down to it, both the country's economy and standard of living would not be as high as they are today without recessions.

Turning back to the stock market, as of Oct. 26, 10-year Treasury bonds were yielding 81 basis points, which means it will take nearly 80 years in a tax-exempt account for investors to double their money. The S&P 500 yield of 1.73% (as of Oct. 26) dwarfed that of the T-bond, and even if the stock market goes nowhere for 10 years, investors are better off in stocks than bonds.

Where is the stock market headed?

As mentioned, as of this writing, the T-bond yield is 0.81%. In the worst year during the Great Depression during 1932, the economy contracted by 13.8%. In that year, T-bonds were yielding almost 17%. Thus, it appears that with Treasury yields at historic lows, there is a massive amount of money on the sidelines. I think that, when all the money on the sidelines finds its way back into the market, the indices will rise to unforeseen levels in the new bull market and well above any stock market forecast.

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