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Reading The Markets | The Week Ahead

Mott Capital Management, LLC

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MARKET STRATEGIST

The Equity Market Faces A Growth Risk In The Second Half of 2021

As we enter June, we will quickly be approaching the end of the first half of 2021, and with that, investors are likely to begin turning their attention to 2022. As that happens, investors may quickly learn that equities face more than just interest rate and inflation risk. Growth risk is likely to become an overwhelming issue for equities and as the high earnings growth rate of 2021 moves to a much slower pace in 2022.

Consensus analysts' estimates using a bottom-up approach suggest that earnings growth rates in 2022 will sink to 11.9% from 36.5% in 2021 and 10.6% in 2023 (Figure 1). I believe this is likely to result in the PE multiple of the S&P 500 compressing in the second half of 2021. This process may have already started. The PE multiple of the S&P 500 has not expanded since the beginning of 2021. More recently, it began to decline in April.

Looking back to the late 1990s and early 2000s, another period of high PE multiples, we saw that the cycle only lasted for as long as the growth rate held up. Once growth rates in 2001 began to roll over the PE multiple, and the broader S&P 500 began to roll over with it. Based on that cycle, it would appear that the current cycle has now peaked, and from here, the PE should continue to compress (Figure 2, 3 & 4).

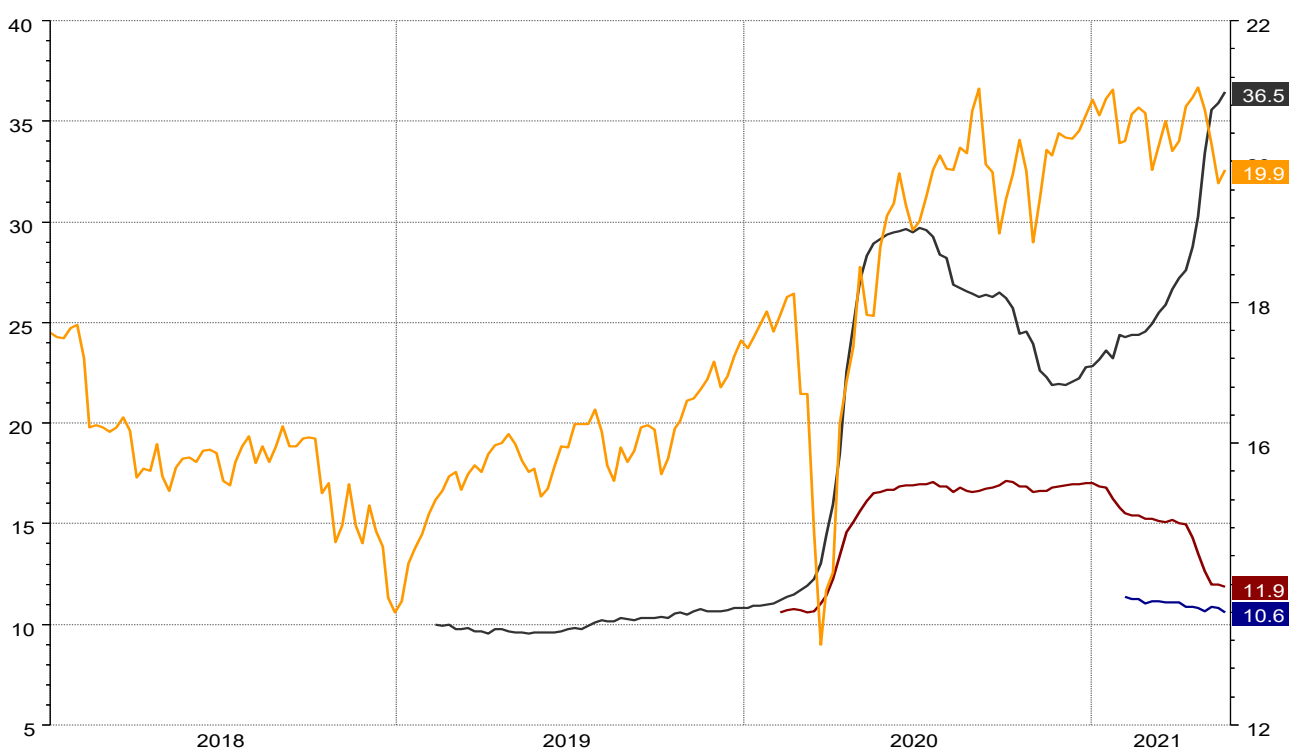
Additionally, the earnings recovery cycle seems to be following 2003, 2004, 2005, and 2006. This would suggest that after a long earnings upgrade cycle, we may also be approaching a period of earnings flattening for 2022 and 2023 while 2021 continues to be upgraded. This is likely to result in growth continuing to be pulled forward, reducing growth rates for 2022 and 2023 even further, thus reducing the PE multiple to a greater extent.

Overall, the risk as we enter the second half of the year for the S&P 500 and the broader equity market will become a double-edged sword. Higher interest rates are likely to persist while slowing growth rates will likely compress PE multiples and hurt equity valuations.

Given these facts, I continue to believe that upside valuations are limited and that multiples are likely to compress going into 2022 to something that approaches 17 to 18 times 18-month forward earnings estimates. Using the mid-point of the PE multiple expectations and consensus analysts' estimates of \$201.73, I come to a fair value on the S&P 500 of 3,530.

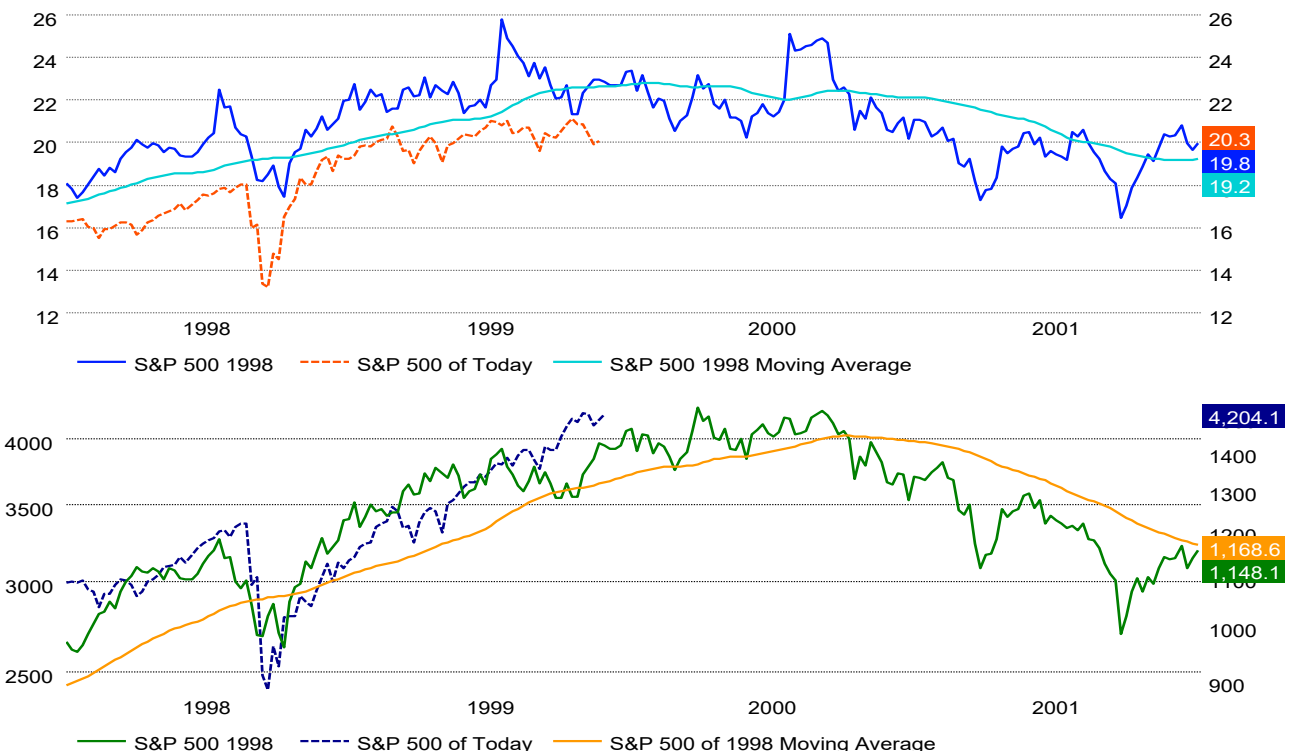
Enjoy your long-holiday weekend.

Figure 1: The growth rate in 2022 is expected to slow dramatically



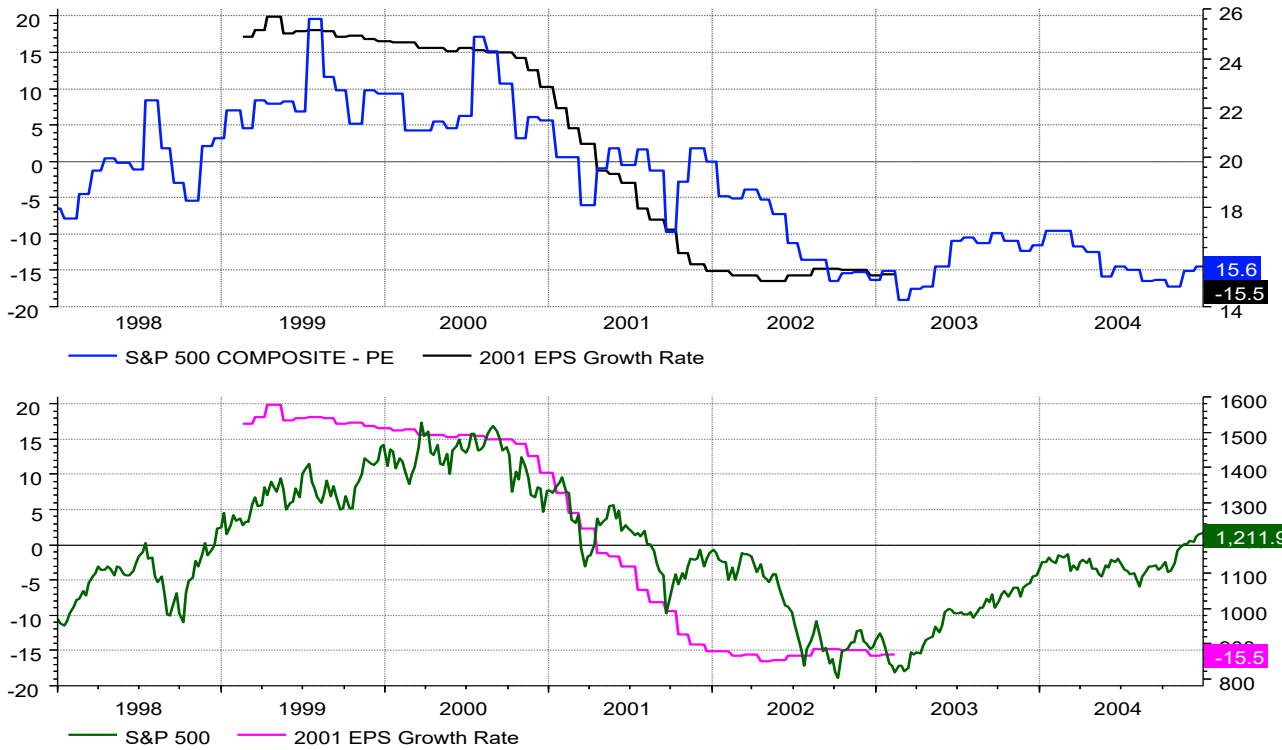
Source: Refinitiv Datastream / Mott Capital Management, LLC

Figure 2: The cycle of the 2020's is following that of 1990's



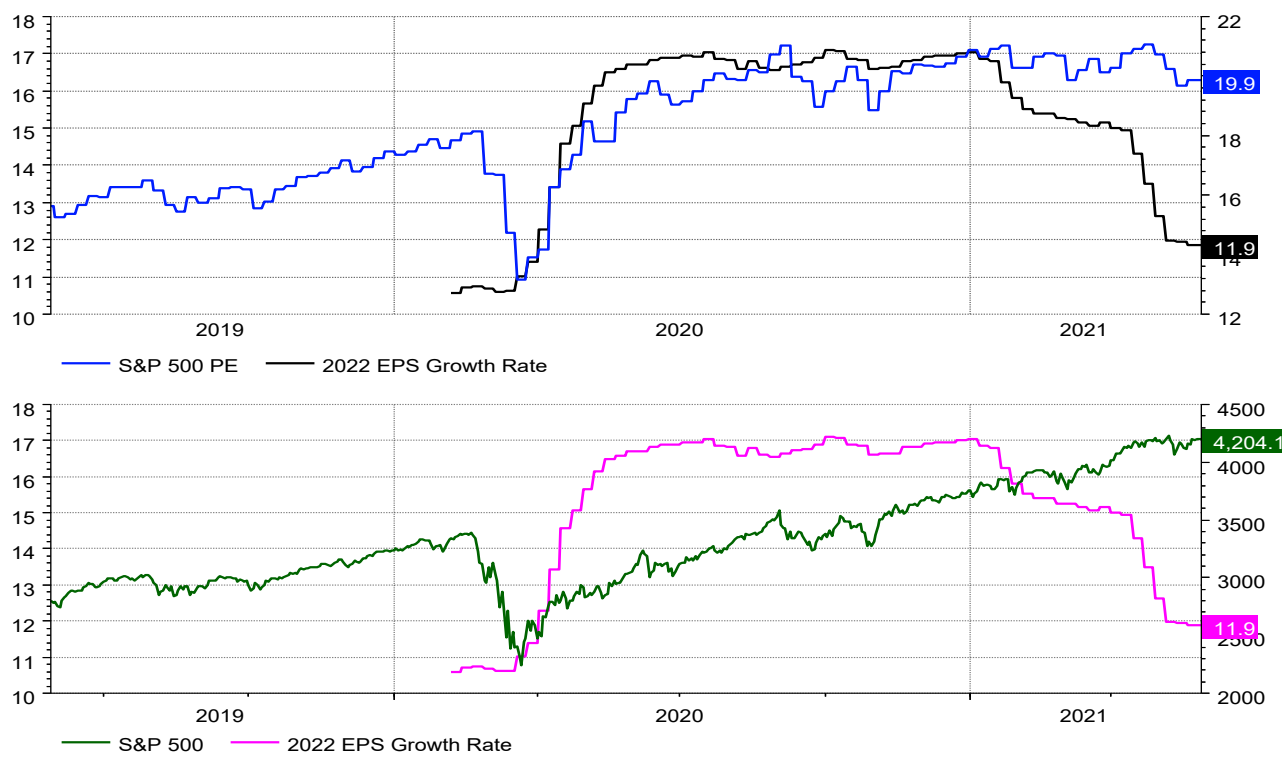
Source: Refinitiv Datastream

Figure 3: When growth rolled over in 2001 so did the S&P 500 and the multiple.



Source: Refinitiv Datastream / Mott Capital Management. LLC

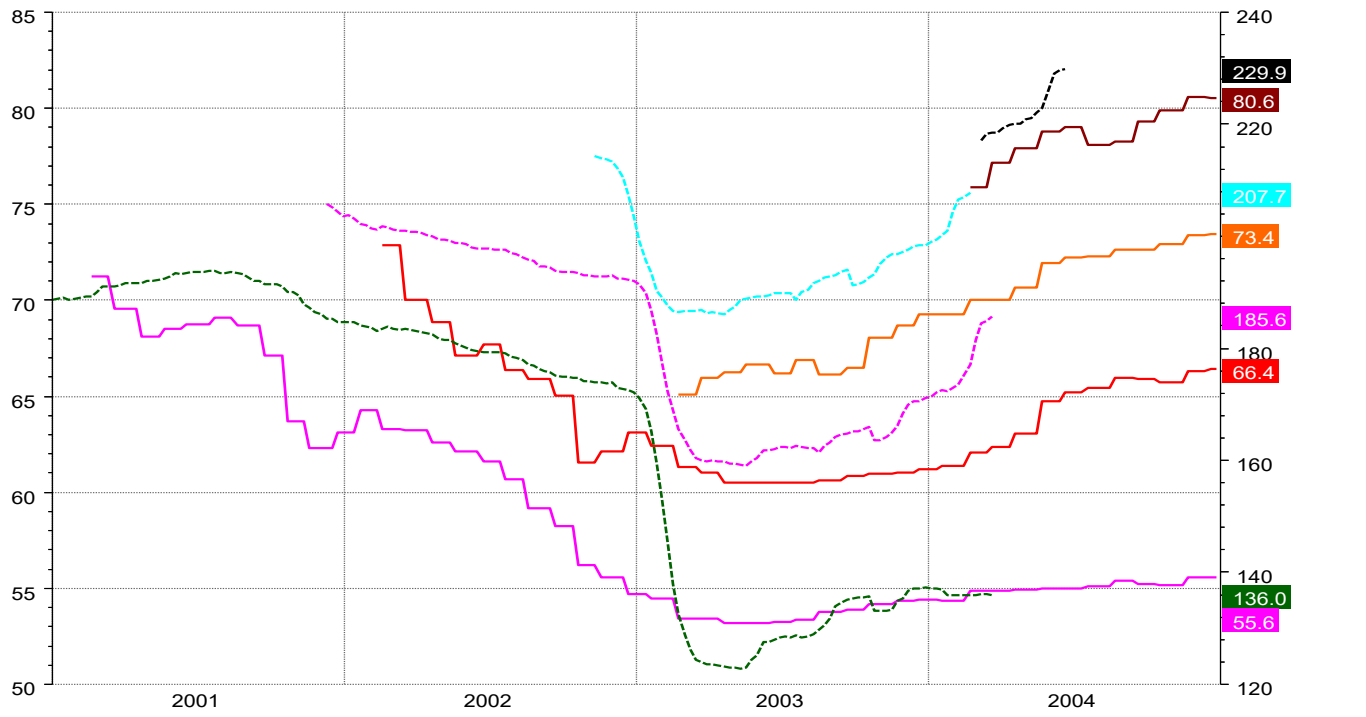
Figure 4: 2022 maybe following a similar path to 2001.



Source: Refinitiv Datastream / Mott Capital Management. LLC

Figure 5: The current earnings cycle of 2020, 21, 22, 23 appears to be following 2002, 03, 04, 05

S&P 500 Earnings Estimate Trends 2001 - 2005



Source: Refinitiv Datastream / Mott Capital Management. LLC

Economic Calendar – Data From Refinitiv

RIC	GMT Start Date	GMT End Date	Local Time	Country/Region	Relevance	Indicator Name	Period	Reuters Poll	Actual	Prefix	Unit	Prior	Revised	Min	Max	Count	SmartEstimate®	Predicted Surprise
USMPMF=ECI	1 Jun		09:45	United States	High	Markit Mfg PMI Final	May 2021				Diff.Idx	61.5						
USTCNS=ECI	1 Jun		10:00	United States	Medium	Construction Spending MM	Apr 2021	0.6			Percent	0.2		-0.5	1.5	25	0.53	-0.07
USISME=ECI	1 Jun		10:00	United States	Low	ISM Manuf Employment Idx	May 2021				Index	55.1						
USISMN=ECI	1 Jun		10:00	United States	Low	ISM Manuf New Orders Idx	May 2021				Index	64.3						
USPMI=ECI	1 Jun		10:00	United States	High	ISM Manufacturing PMI	May 2021	60.7			Index	60.7		59	64	46	60.81	0.11
USISMP=ECI	1 Jun		10:00	United States	Medium	ISM Mfg Prices Paid	May 2021	89.8			Index	89.6		88.5	90	6	89.65	-0.15
USTEX=ECI	1 Jun		10:30	United States	Low	Dallas Fed Mfg Bus Idx	May 2021				Index	37.3						
US3MAB=ECI	1 Jun		11:30	United States	High	3M Bill Auc - BTC	01 Jun				Ratio	2.88						
US3MAA=ECI	1 Jun		11:30	United States	High	3M Bill Auc - HAP	01 Jun				Percent	24.63						
US3MAH=ECI	1 Jun		11:30	United States	High	3M Bill Auc - HR	01 Jun				Percent	0.015						
US3MAT=ECI	1 Jun		11:30	United States	High	3M Bill Auc - TA	01 Jun				USD	62296484100						
US6MAB=ECI	1 Jun		11:30	United States	High	6M Bill Auc - BTC	01 Jun				Ratio	2.78						
US6MAA=ECI	1 Jun		11:30	United States	High	6M Bill Auc - HAP	01 Jun				Percent	71.84						
US6MAH=ECI	1 Jun		11:30	United States	High	6M Bill Auc - HR	01 Jun				Percent	0.03						
US6MAT=ECI	1 Jun		11:30	United States	High	6M Bill Auc - TA	01 Jun				USD	59015936500						
USMG=ECI	2 Jun		07:00	United States	Low	MBA 30-Yr Mortgage Rate	W 28 May				Percent	3.18						
USMGA=ECI	2 Jun		07:00	United States	Low	MBA Mortgage Applications	W 28 May				Percent	-4.2						
USMGPI=ECI	2 Jun		07:00	United States	Low	MBA Purchase Index	W 28 May				Index	269.8						
USMGM=ECI	2 Jun		07:00	United States	Low	Mortgage Market Index	W 28 May				Index	693.7						
USMGR=ECI	2 Jun		07:00	United States	Low	Mortgage Refinance Index	W 28 May				Index	3168.8						
USREDEY=ECI	2 Jun		08:55	United States	Low	Redbook YY	W 29 May				Percent	13.6						
USTXR=ECI	2 Jun		10:30	United States	Low	Dallas Fed Services Revenues	May 2021				Index	26.1						
USTXS=ECI	2 Jun		10:30	United States	Low	Texas Serv Sect Outlook	May 2021				Index	34.9						
USCHAL=ECI	3 Jun		07:30	United States	Low	Challenger Layoffs	May 2021				Person	22,913						
USADP=ECI	3 Jun		08:15	United States	Medium	ADP National Employment	May 2021	650			Thou Person	742		300	900	25	568.1	-81.9
USIOBN=ECI	3 Jun		08:30	United States	Medium	Cont Jobless Clm	W 22 May	3,614			Min Person	3,642		3.6	3,674	6	3,611.7	-0.0023
USIOB=ECI	3 Jun		08:30	United States	High	Initial Jobless Clm	W 29 May	395			Thou Person	406		345	430	18	394	-1
USIOBA=ECI	3 Jun		08:30	United States	Low	Jobless Clm 4Wk Avg	W 29 May				Thou Person	458.75						
USLCA=ECI	3 Jun		08:30	United States	Medium	Labor Costs Revised	Q1 2021	-0.4			Percent	-0.3		-0.6	1.4	17	-0.33	0.07
USPROR=ECI	3 Jun		08:30	United States	Medium	Productivity Revised	Q1 2021	5.5			Percent	5.4		5.4	5.7	18	5.53	0.03
USPMIP=ECI	3 Jun		09:45	United States	High	Markit Comp Final PMI	May 2021				Diff.Idx	68.1						
USMPFS=ECI	3 Jun		09:45	United States	High	Markit Svcs PMI Final	May 2021				Diff.Idx	70.1						
USOPMI=ECI	3 Jun		10:00	United States	Low	ISM N-Mfg Bus Act	May 2021	66.5			Index	62.7		63.1	68	5	65.75	-0.75
USEPMI=ECI	3 Jun		10:00	United States	Low	ISM N-Mfg Employment Idx	May 2021				Index	58.8						
USDPMI=ECI	3 Jun		10:00	United States	Low	ISM N-Mfg New Orders Idx	May 2021				Index	63.2						
USNPMI=ECI	3 Jun		10:00	United States	High	ISM N-Mfg PMI	May 2021	63			Index	62.7		60.8	65	40	62.82	-0.18
USPPMI=ECI	3 Jun		10:00	United States	Low	ISM N-Mfg Price Paid Idx	May 2021				Index	76.8						
US4WAB=ECI	3 Jun		11:30	United States	High	4W Bill Auc - BTC	03 Jun				Ratio	4.06						
US4WAA=ECI	3 Jun		11:30	United States	High	4W Bill Auc - HAP	03 Jun				Percent	54.01						
US4WAH=ECI	3 Jun		11:30	United States	High	4W Bill Auc - HR	03 Jun				Percent	0						
US4WAT=ECI	3 Jun		11:30	United States	High	4W Bill Auc - TA	03 Jun				USD	43205612100						
USAVGE=ECI	4 Jun		08:30	United States	Medium	Average Earnings MM	May 2021	0.2			Percent	0.7		-0.3	1	35	0.24	0.04
USWRKW=ECI	4 Jun		08:30	United States	Medium	Average Workweek Hrs	May 2021	34.9			Hour	35		34.8	35.1	18	34.93	0.03
USGOV=ECI	4 Jun		08:30	United States	Low	Government Payrolls	May 2021				Thou Person	48						
USLFBF=ECI	4 Jun		08:30	United States	Low	Labor Force Partic	May 2021				Percent	61.7						
USMFP=ECI	4 Jun		08:30	United States	Low	Manufacturing Payrolls	May 2021	25			Thou Person	-18		12	95	14	27.4	2.4
USNFAR=ECI	4 Jun		08:30	United States	High	Non-Farm Payrolls	May 2021	650			Thou Person	266		400	1000	51	663.5	13.5
USPRP=ECI	4 Jun		08:30	United States	Medium	Private Payrolls	May 2021	600			Thou Person	218		350	800	21	571.3	-28.7
USUDEP=ECI	4 Jun		08:30	United States	Low	U6 Underemployment	May 2021				Percent	10.4						
USUNR=ECI	4 Jun		08:30	United States	High	Unemployment Rate	May 2021	5.9			Percent	6.1		5.7	6.1	51	5.91	0.01
USDGR=ECI	4 Jun		10:00	United States	Low	Durable Goods, R MM	Apr 2021				Percent	-1.3						
USDGNR=ECI	4 Jun		10:00	United States	Low	Durables Ex-Def, R MM	Apr 2021				Percent	0						
USDGNT=ECI	4 Jun		10:00	United States	Low	Durables Ex-Transp R MM	Apr 2021				Percent	1						
USFXTR=ECI	4 Jun		10:00	United States	Low	Factory Ex-Transp MM	Apr 2021				Percent	1.7						
USFORD=ECI	4 Jun		10:00	United States	High	Factory Orders MM	Apr 2021	-0.2			Percent	1.1		-0.8	1.5	22	-0.13	0.07
USNDCG=ECI	4 Jun		10:00	United States	Low	Nonfed Cap Ex-Air R MM	Apr 2021				Percent	2.3						

Fed Speakers– Data From Refinitiv

Local Start Date	Local End Date	Local Time	Country/Region	Event Name
1 Jun 2021	1 Jun 2021	09:00	United States	OECD Secretary-General Mathias Cormann and U.S. Economic Affairs Deputy Assistant Secretary hold joint presser to conclude OECD ministerial council in Paris
1 Jun 2021	1 Jun 2021	10:00	United States	Federal Reserve Vice Chair for Supervision Randal Quarles participates in discussion on the economy and financial regulation before virtual POLITICO Live event
1 Jun 2021	1 Jun 2021	14:00	United States	Federal Reserve Board Governor Lael Brainard speaks on the economy and monetary policy before virtual Economic Club of New York webinar event
2 Jun 2021	2 Jun 2021	12:00	United States	Federal Reserve Bank of Philadelphia President Patrick Harker speaks on the economic outlook before virtual Women in Housing and Finance Public Policy Luncheon
2 Jun 2021	2 Jun 2021	12:00	United States	Federal Reserve Bank of Chicago President Charles Evans speaks on current economic conditions and monetary policy before virtual "Racism and the Economy: Focus on Entrepreneurship" event hosted by the Federal Reserve Bank of Minneapolis
2 Jun 2021	2 Jun 2021	12:00	United States	(pre-taped remarks) Federal Reserve Bank of Philadelphia President Patrick Harker speaks on "Entrepreneurship and Minority-Owned Business" before virtual "Racism and the Economy: Focus on Entrepreneurship" event hosted by the Federal Reserve Bank of Minne
2 Jun 2021	2 Jun 2021	14:00	United States	Federal Reserve issues the Beige Book of economic condition
2 Jun 2021	2 Jun 2021	14:00	United States	Federal Reserve Bank of Minneapolis President Neel Kashkari, Federal Reserve Bank of Atlanta President Raphael Bostic (from Atlanta), Federal Reserve Bank of Dallas President Robert Kaplan (from Dallas) and Federal Reserve Bank of Philadelphia President P
2 Jun 2021	2 Jun 2021	15:25	United States	Federal Reserve Bank of Atlanta President Raphael Bostic gives closing remarks before virtual "Racism and the Economy: Focus on Entrepreneurship" event hosted by the Federal Reserve Bank of Minneapolis
2 Jun 2021	2 Jun 2021	18:05	United States	Federal Reserve Bank of Dallas President Robert Kaplan moderates a conversation on national and global economic issues before a virtual Global Perspectives series hosted by the Federal Reserve Bank of Dallas
3 Jun 2021	3 Jun 2021	12:30	United States	Federal Reserve Bank of Atlanta President Bostic gives welcome and introductory remarks before virtual "National launch event for Workforce Realigned: How New Partnerships Are Advancing Economic Mobility, a book from the Federal Reserve Banks of Atlanta a
3 Jun 2021	3 Jun 2021	13:00	United States	Federal Reserve Bank of Dallas President Robert Kaplan participates in moderated question-and-answer session before virtual Economy and Monetary Policy Webinar hosted by Rice University Jones Graduate School of Business
3 Jun 2021	3 Jun 2021	13:50	United States	Federal Reserve Bank of Philadelphia President Patrick Harker speaks on "Building an Equitable Workforce Recovery" before virtual "Workforce Realigned: How New Partnerships Are Advancing Economy Mobility" event
3 Jun 2021	3 Jun 2021	15:05	United States	Federal Reserve Vice Chair for Supervision Randal Quarles speaks on financial regulation before virtual SIFMA and Bank Policy Institute 8th Annual Prudential Regulation Conference
4 Jun 2021	5 Jun 2021		United States	Finance ministers from across the G7 nations will meet at Lancaster House in London
4 Jun 2021	4 Jun 2021	07:00	United States	Federal Reserve Chairman Jerome Powell participates in panel before virtual Bank for International Settlements "Green Swan Conference - Coordinating Finance on Climate,"
10 Jun 2021	10 Jun 2021	12:00	United States	Federal Reserve issues quarterly financial accounts of the United States
11 Jun 2021	11 Jun 2021		United States	U.S. President Joe Biden will meet Queen Elizabeth II when he visits the UK for the G7 summit
11 Jun 2021	13 Jun 2021		United States	U.S. President Joe Biden will visit UK to attend the G7 summit in Cornwall, England
14 Jun 2021	14 Jun 2021		United States	U.S. President Joe Biden will visit to Brussels to take part in NATO summit in BRUSSELS, Belgium
15 Jun 2021	15 Jun 2021		United States	EU-US summit, Brussels
15 Jun 2021	16 Jun 2021		United States	U.S. Federal Reserve's Federal Open Market Committee (FOMC) starts its two-day meeting on interest rates
16 Jun 2021	16 Jun 2021		United States	U.S. Federal Reserve chairperson holds a news conference
16 Jun 2021	16 Jun 2021		United States	Russian President Vladimir Putin and U.S. President Joe Biden will hold a summit in Geneva
16 Jun 2021	16 Jun 2021	14:00	United States	U.S. Federal Reserve's Federal Open Market Committee (FOMC) announces its decision on interest rates followed by statement
22 Jun 2021	22 Jun 2021	08:30	United States	Federal Reserve Bank of Philadelphia issues Nonmanufacturing Business Outlook Survey for June

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