January Markets Predict a Positive 2021

Markets resumed their uptrend today after Friday's selling and the Martin Luther King Jr. holiday. The broad indices recovered last week's losses and are again positive for the month. January is considered a good barometer for the rest of the year. If markets are positive to start the year, they usually end the year positive as well. According to The Stock Trader's Almanac, a positive start in January has resulted in a positive annual return for the S&P 500 75% of the time since 1945. While I wouldn't bet the farm on this theory, the fact remains that important fundamental and technical signs are pointing to the cyclical bull market resuming.

We touched on many of these signs last week and pointed out that all the "boxes" mentioned in the fall have been checked. Although tech continues to run, we are seeing important rotation into areas of the market associated with the real economy and jobs. We are in the middle of earnings season and initial reports are beating estimates. We also received some very clear direction from the Federal Reserve last week stating that it was in no hurry to stop buying bonds. It has learned its lesson about raising rates too quickly after the financial crisis. This stance should keep downward pressure on short term rates, while long term rates may rise in anticipation of demand side growth on the horizon. This will steepen the yield curve and be good for banks. It should come as no surprise that the financial sector (XLF) has been outperforming other sectors.

We recently discussed the fact that interest rates have risen dramatically over the past several weeks and that has caused some short-term underperformance in more conservative portfolios that are overweighted in bonds, dividend payers, real estate, utilities, and other interest rate sensitive assets. The good news is that yields are at or near a point of resistance and bonds are oversold. This should result in a pullback in yields and a bounce in bond prices over the next few days or weeks. Make no mistake about it, yields are likely to move higher over the next 12 months in response to improving business conditions and a large stimulus package out of Washington, but the current rally in yields is looking a little long in the tooth. At the end of the day, a return to positive earnings YOY and some accompanying moderate inflation will be good news. Cyclical sectors such as financials, energy, industrials, and emerging markets should do well.

Last week's commentary can be found here.

G. Chadd Mason
CEO, The Cabana Group

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