

Valuation outlook for 2021

The rapid reopen

With Philip Petursson

Chief Investment Strategist and Head of Capital Markets Research

June 2021

00:00:13 Many investors are bringing up the concern about market valuation today and fears that valuation might predict a coming correction in the marketplace. 00:00:23 We would argue that over the long term, while valuation is important over the short term, it really doesn't tell us anything about future market performance over the coming year to perhaps up to 5 years. 00:00:36

When we look at the historical valuation of the S&P 500 and compare it to forward one year returns, as you can see, the returns are actually all over the place. 00:00:48 So the predictability of valuation for one year return performance is actually very very poor despite the fact, when we look at valuation on a price to earnings basis for the S&P 500 or price to cash flow, price to sales or price to book, very popular measures, we can point to the fact that yes, valuation is at much higher levels than what we've seen in the last 20 years, but that alone really doesn't tell us anything about forward expectations for market returns. 00:01:18 Now what we need to do is look at valuation in the context of what drives market performance over the long term and this comes down to not only valuations we've highlighted, but earnings growth. 00:01:30 Now when we marry those 2 together, now the story becomes much more complete. 00:01:36

Comparisons between today's stock market level, the S&P 500 being at the level that it is to where we were in early 2000, are actually rather poor comparisons because you have to remember what followed from the tech rec that started in March of 2000 was a recession, was 9/11 and falling earnings overall. 00:01:58 So valuation in that sense wasn't supported by stronger earnings growth. 00:02:04 This environment that we're in today looks much more like where we were in the early 90s coming out of the 1990 recession and bear market. 00:02:13 We saw valuation move up to very very high levels compared to the historical norm, but did that predict that we would see weaker returns, negative market returns over the coming years? 00:02:25 No. 00:02:26 Why is this environment very similar to the early 90s? Because in 1992, 1993 and 1994, which followed a very strong period of valuation expansion, was an environment of stronger earnings growth, so the earnings growth supported the higher valuation and in fact what we saw between 1992 and 1994 is valuation at stock market level measured by price to earnings, came down back to the historical norm. 00:02:58 Now when we look at the environment that we're in today, in 2021 and going through 2022, we do see support for valuation with respect to a very strong earnings environment. 00:03:11 A number of the economic data that we rely on for our earnings assumptions are guiding us to believe that we can see earnings growth in 2021 of 30 to perhaps as much as 45% over where we were in 2020. 00:03:24

Now that would take us not only back to 2019 levels, but actually surpass them. 00:03:29 So we don't think that the markets will deliver returns of 30 to 45%, rather what we believe is that valuation will be moderated through earnings growth and similar to what we saw in 1992 through 1994, the stock market has the potential to deliver positive returns for the next couple of years. 00:03:49 When we look at valuation, we have to look at it in the full context of the market, not in isolation, not relative to its own historical perhaps measure, but also relative to the earnings environment that we're in and we're moving through over the coming years. 00:04:04

Copyright Manulife. The opinions expressed are those of Manulife Investment Management as of the date of this publication, and are subject to change based on market and other conditions. The information and/or analysis contained in this material have been compiled or arrived at from sources believed to be reliable but Manulife Investment Management does not make any representation as to their accuracy, correctness, usefulness or completeness and does not accept liability for any loss arising from the use hereof or the information and/or analysis contained herein. Manulife Investment Management disclaims any responsibility to update such information. Neither Manulife Investment Management or its affiliates, nor any of their directors, officers or employees shall assume any liability or responsibility for any direct or indirect loss or damage or any other consequence of any person acting or not acting in reliance on the information contained herein.

All overviews and commentary are intended to be general in nature and for current interest; the information provided reflects the views of the author and are not to be construed as investment advice. While helpful, these overviews are no substitute for professional tax, investment or legal advice. Clients should seek professional advice for their particular situation. Neither Manulife, Manulife Investment Management Limited, Manulife Investment Management, nor any of their affiliates or representatives is providing tax, investment or legal advice. Past performance does not guarantee future results. It is not possible to invest directly into an index. This material was prepared solely for informational purposes, does not constitute an offer or an invitation by or on behalf of Manulife Investment Management to any person to buy or sell any security and is no indication of trading intent in any fund or account managed by Manulife Investment Management. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Unless otherwise specified, all data is sourced from Manulife Investment Management.

This information does not replace or supersede KYC (know your client) suitability, needs analysis or any other regulatory requirements in any jurisdiction.

Manulife, Stylized M Design, and Manulife Investment Management & Design are trademarks of The Manufacturers Life Insurance Company and are used by it, and its affiliates under license.