U.S. Strategy Snapshot

S&P 500 Returns 20.4% Through 8/31; History Points to Single Digit Returns in 2022

Summary

The S&P 500 returned more than 20% from the start of 2021 through August 31st. The YTD performance ranked 9th highest among all January to August returns going back to 1928. Along the way, the S&P 500 compiled a list of 54 new all-time closing highs so far in 2021. However, markets are growing anxious with the S&P 500 currently trading near a record high, and investors are understandably questioning if there is more upside. A growing list of thematic headwinds is adding to worries, including the delta variant, Fed taper talk, decelerating economic recovery, and disrupted supply chains.

Where does the market trade from here? History indicates both the S&P 500 and Russell 2000 can trade higher through year end in 2021 and generate positive returns during 2022. However, history also indicates their upside potential is limited and they are reliant on EPS growth to overcome P/E multiple contraction.

The next 12 months will require a shift in portfolio strategy. The strongest returns are most likely in the rearview mirror, which implies additional gains will likely be driven by EPS expansion and places importance on positioning in market segments with strong growth expectations. Finding pockets of relative value, such as developed Asia and China, will also be important as the bull market matures. From an implementation perspective, higher win rates and median returns for Large (**Fig 4**) and Growth (**Fig 6**) give the two a statistical edge over their Small (**Fig 7**) and Value (**Fig 6**) counterparts. Within credit, rising yields favor beginning to shorten duration in corporate IG and remaining OW corporate HY.

Main Points

- The S&P 500's +20.4% YTD price return through 8/31/21 is the 9th strongest YTD return since 1928 (**Figure 1**).
- During the 20 years with the strongest S&P 500 returns through 8/31, the S&P 500's median return through year end is +5.3% with positive returns 74% of the time (**Figure 2**).
- History shows strong S&P 500 YTD returns in a given year do not necessarily point to negative returns the following year. However, returns are historically muted, as evidenced by the S&P 500's median return of +4.5% the following calendar year (**Figure 4**).
- While the S&P 500 can trade higher, data indicates it is reliant on EPS growth to offset contracting P/E multiples (**Figure 5**).
- Compared to the S&P 500, the Russell 2000's returns are more challenged with less attractive win probabilities (**Figure 7**).
- History points to a rising 10Y Treasury yield (**Figure 8**) and marginal USD strength (**Figure 9**).

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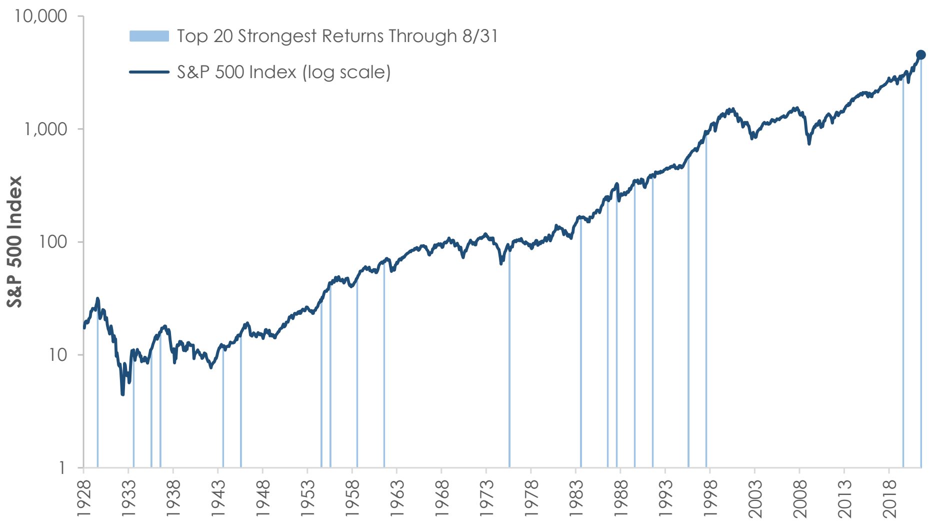
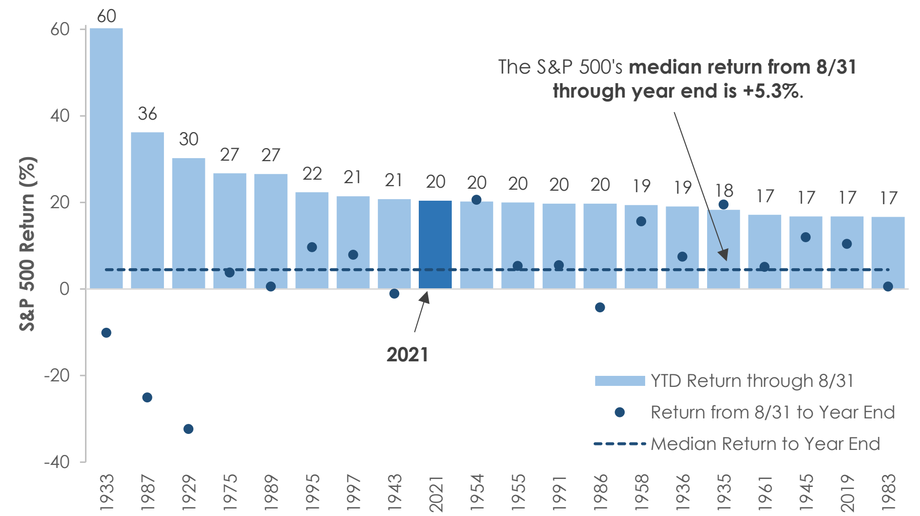
Putting the S&P 500's Strong YTD Returns into Historical Context …

FIGURE 1: S&P 500 Price Index (1928-Today) -- Logarithmic Scale



Source: MarketDesk. ***Note*** *: The S&P 500 price index is charted in logarithmic scale, which utilizes a nonlinear scale, on the y-axis in order to display the wide range of numerical values.*

FIGURE 2: Top 20 S&P 500 YTD Returns Through 8/31 (1928-Today)



Source: MarketDesk. ***Note*** *: Return data represents price returns.*

FIGURE 3: Statistics Across the Years With the Top 10 Strongest YTD Returns Through 8/31

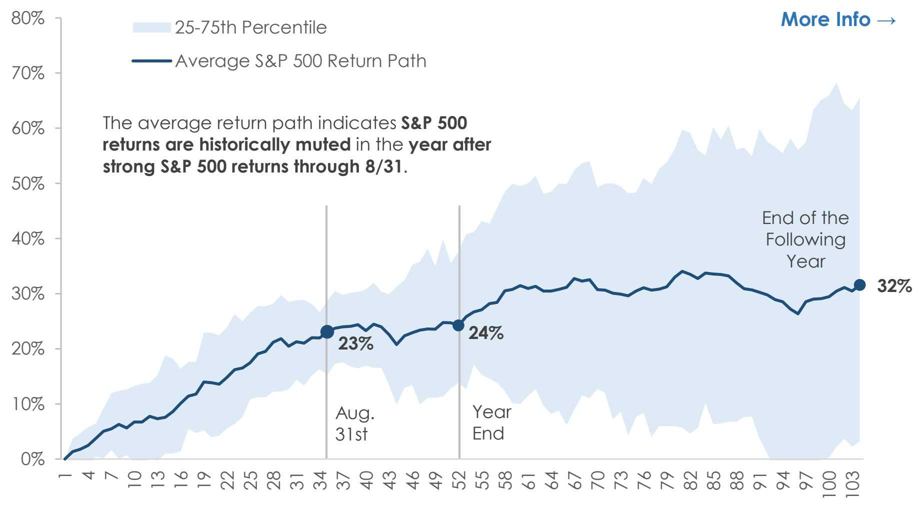
Rank	Year	S&P 500 YTD Return Thru 8/31	S&P 500 Return 8/31 to Year End	# Months Since Last Bear Market	Time to Next Bear Market (# Months)	Commentary
1	1933	60.3%	-10.1%	14	43	Early bull market rally
2	1987	36.2%	-25.1%	62	0	Black Monday occurred Oct. 1987
3	1929	30.2%	-32.4%	-	-	Great Depression starts Aug. 1929
4	1975	26.7%	3.8%	11	64	Early bull market rally following 1973-1975 recession / stagflation environment
5	1989	26.5%	0.6%	21	11	Economic cycles peaked during July 1990
6	1995	22.3%	9.6%	60	56	Fed raised rates during 1994
7	1997	21.4%	7.9%	84	31	Early stages of late 1990s dot-com bubble
8	1943	20.8%	-1.1%	16	33	Early bull market rally
9	2021	20.4%	0.0%	18	??	Covid-19 economic recovery
10	1954	20.2%	20.6%	64	23	Stock market rally after 1953 recession
Median			**0.3%**	**21**	**32**	
Max			**20.6%**	**84**	**64**	
Min			**-32.4%**	**11**	**0**	

Source: MarketDesk. ***Note*** *: Return data represents price returns.*

- Figure 1 charts the S&P 500 price index from 1928 through today on a log scale. The blue vertical lines mark the 20 years with the strongest S&P 500 price returns from the start of the year through 8/31. The S&P 500's +20.4% YTD price return through 8/31/21 is the 9th strongest YTD return since 1928.
- Figure 2 ranks the S&P 500's 20 strongest year-to-date returns through 8/31. The dark blue box highlights 2021's YTD return, and the blue dots overlaying the bar graphs plot the S&P 500's return from 8/31 through year end for each year. The S&P 500's median return through year end is +5.3% with positive returns 74% of the time. The maximum and minimum returns were +20.6% (1954) and -32.4% (1929), respectively.
- Figure 3 provides underlying statistics for the top 10 years in Figure 2. Not surprisingly, the S&P 500's strongest returns generally occur early in bull markets (i.e., 1933, 1975, 1989, 1943, 2021). The median number of months since the last bear market is 21, while the median number of months to the next bear market is 32. While the S&P 500 traded higher 5 out of the 9 prior instances, its median return through year end was only +0.3% for the top 10 (vs +5.3% for the top 20 in **Fig 2**). Even though history indicates the S&P 500's upside is limited through year end, its downside also appears limited barring an unforeseen shock (i.e., 1987's Black Monday or 1929's Great Depression).

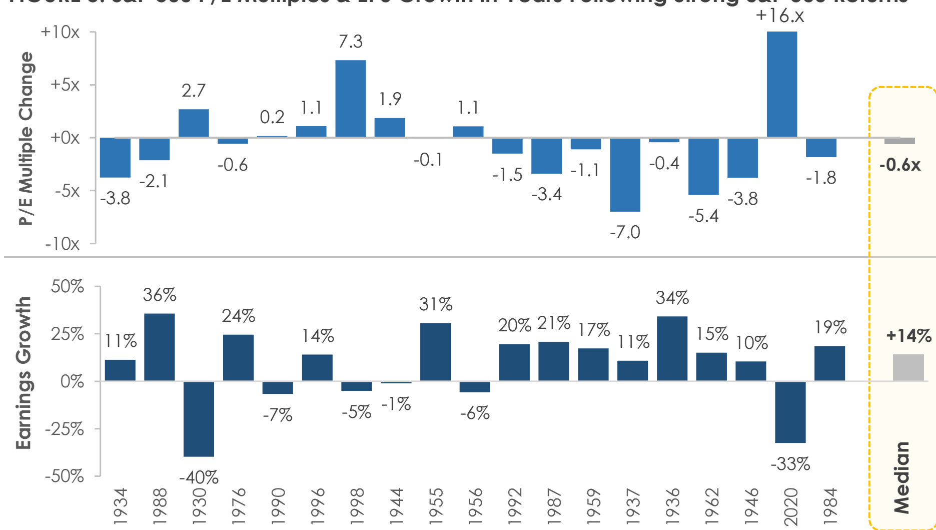
History Points to More Upside for the S&P 500 as Long as EPS Continues to Grow ...

FIGURE 4: S&P 500 Return Path During Periods of Strong S&P 500 Returns



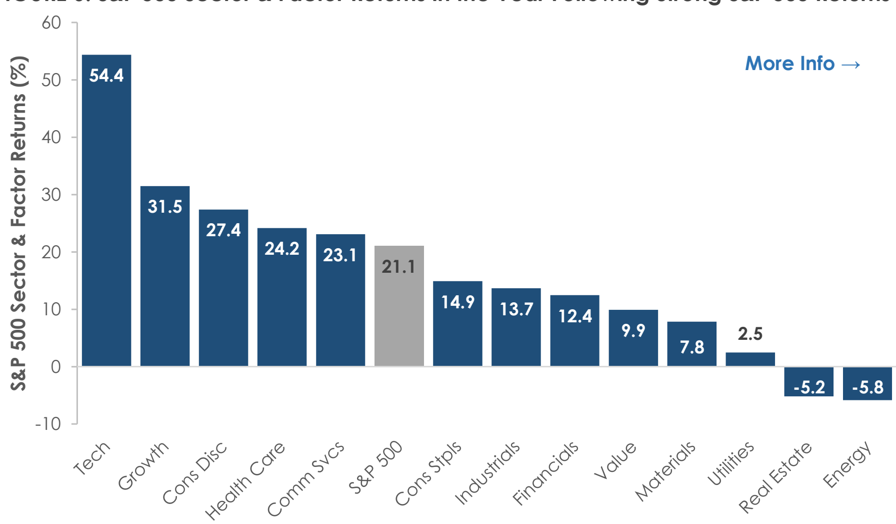
Source: MarketDesk. **Note** : Return data represents price returns.

FIGURE 5: S&P 500 P/E Multiples & EPS Growth in Years Following Strong S&P 500 Returns



Source: MarketDesk, Robert Shiller, Yale

FIGURE 6: S&P 500 Sector & Factor Returns in the Year Following Strong S&P 500 Returns



Source: MarketDesk. **Note:** S&P 500 sector and factor return data is available going back to 1995, which makes the sample size small at 3. Return data represents price returns.

History Indicates the S&P 500 Can Trade Higher During 2022, but EPS Growth is Key ...

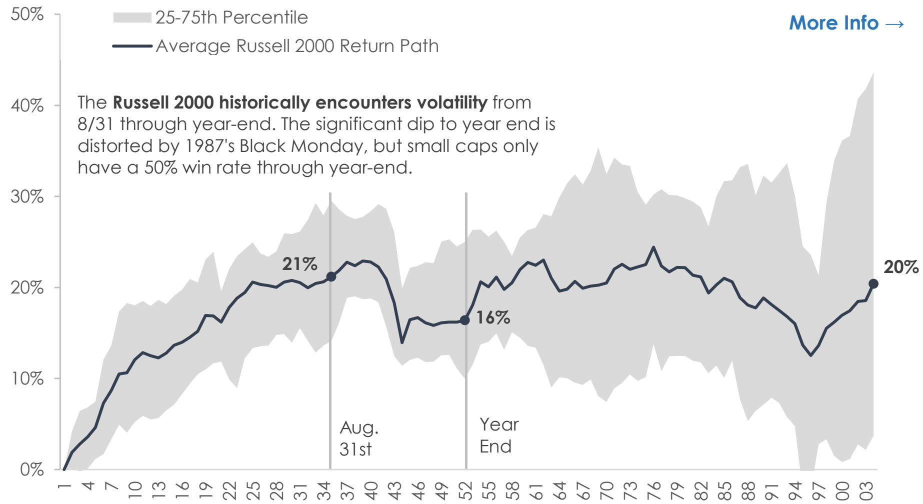
● History shows strong S&P 500 YTD returns in a given year do not necessarily point to negative returns the following year ("Year 2"). However, returns are historically limited. Figure 4 builds on Figure 2 by plotting the S&P 500's average price return path for the top 20 years. The S&P 500's Year 2 return has been positive 68% of the time with a median of +4.5%. Click 'More Info' to see S&P 500 returns after the strongest 20 returns through 8/31.

● While the S&P 500 can trade higher, data indicates it is reliant on EPS growth in Year 2 to offset contracting P/E multiples. The top chart in Figure 5 tracks Year 2 P/E multiple changes, and the bottom chart tracks Year 2 EPS growth. The S&P 500's P/E multiple contracts by a median -0.6x during Year 2, while its EPS grows by a median +14%. Only 37% of Year 2's experienced expanding P/E multiples, while 68% of Year 2's experienced positive EPS growth. The positive news -- the **8/20/21 *Strategy Snapshot*** points to continued EPS growth, which could offset potential P/E multiple contraction during 2022.

● Figure 6 graphs the median Year 2 price return across S&P 500 sectors and factors. A word of caution -- sector pricing data only goes back to 1995, which leaves 3 of the top 20 years (i.e., 1996, 1998, 2020) to analyze. For example, Tech is the top sector, but it is distorted by strong Year 2 returns during the dot-com bubble (i.e., 1996, 1998) and Covid-19 (i.e., 2020). One trend worth highlighting -- Growth and 'Growth-like' sectors outperform, while most cyclical and defensive sectors, as well as Value, underperform the S&P 500. Click 'More Info' to see sector and factor returns across prior Year 2's.

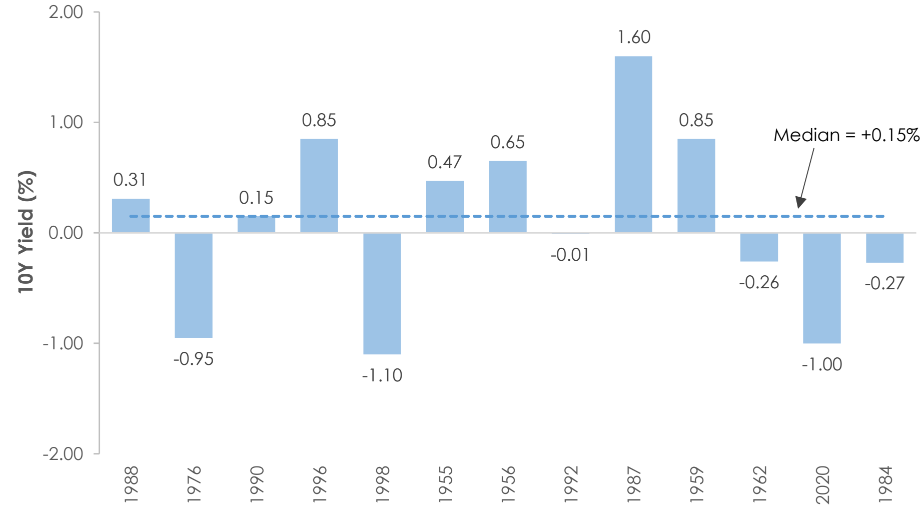
History Indicates the Russell 2000 Trades Sideways and the 10Y Treasury Yield Drifts Higher …

FIGURE 7: Russell 2000 Return Path During Periods of Strong S&P 500 Returns



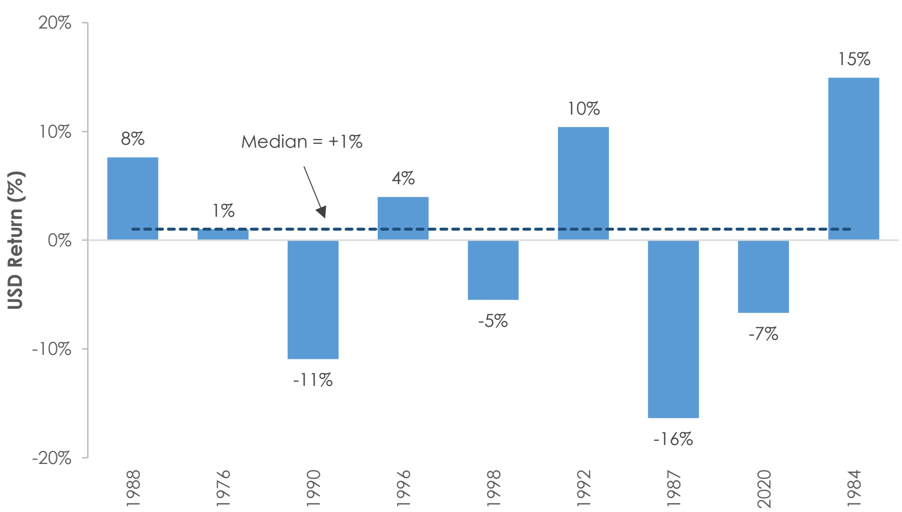
Source: MarketDesk. ***Note*** *: Russell 2000 pricing data is only available back to the start of 1978. Return data represents price returns.*

FIGURE 8: 10-Year Treasury Yield Movement Following Strong S&P 500 Return Years



Source: MarketDesk, U.S. Treasury. ***Note:*** *U.S. 10-Year Treasury yields only available back to 1950s.*

FIGURE 9: USD Movement Following Strong S&P 500 Return Years



Source: MarketDesk. ***Note:*** *U.S. Dollar index only available back to 1970s.*

History Points to Limited Upside for Russell 2000; 10Y Treasury Yield Likely to Drift Higher …

- Compared to the S&P 500, the Russell 2000's (R2000) returns are more challenged with less attractive win probabilities. Figure 7 graphs the R2000's return path during the S&P 500's strongest YTD returns referenced in Figure 2. The line charts the average return path for the strong S&P 500 return year and following year, and the light grey band shows the 25th and 75th percentile paths. Neither the 8/31 to year end nor the following calendar year periods is especially attractive, with Small Caps' win/loss probability 50/50 for both periods. Small Caps' median return is +0.2% from 8/31 through year-end and +5.5% during Year 2's. Click 'More Info' to see the R2000's individual return paths.

- History indicates interest rates are likely to drift higher in 2022. Figure 8 graphs the 10Y U.S. Treasury yield's Year 2 movement for the strong S&P 500 return periods referenced in Figure 2. The 10Y yield rises by a median +0.15% during the next year with the 10Y yield ending higher 54% of the time. We continue to position slightly OW long duration to earn a higher yield, but the data and Fed tightening plans suggest the path of least resistance is higher for interest rates. As a result, the +0.15% median is probably an understatement. We anticipate gradually shortening duration in the months ahead. From a credit quality perspective, we remain OW HY due to its shorter duration.

- There is no clear path forward for USD. Figure 9 graphs USD's Year 2 returns during the strong S&P 500 return periods referenced in Figure 2. USD's median Year 2 return is +1% with USD strengthening 56% of the time.

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