Quarterly Market Review

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So again, I think you can see how this situation might still be a problem going forward…

3Q Review: Headlines and headwinds left stocks barely ahead.

Stocks had a resilient start to the quarter with investors buying the mid-month dips in July and August to produce consecutive monthly returns well above 2.0%. However, the fatigue of digesting headlines on Congressional conflicts, pandemic-related supply chain issues, and Fed policy ruminations ultimately wore down market optimism in September leading to a 4.7% fall. Despite the late quarter pull back, stocks managed to eke out a modest gain of 0.6% and extend its streak of positive-returning quarters to six. Overall earnings growth for the quarter came in at an eye-popping 90% year-over-year with roughly 87% of companies reporting EPS beats. Unfortunately, this bright spot of growth was overshadowed by persistent headlines on the unsightly Afghanistan withdrawal, Hurricane Ida, global regulatory crackdowns, and the potential default of Evergrande, one of China's largest property developers.

Profit warnings rose as supply-chain issues persisted.

Although the number of companies increasing guidance in the third quarter was well above average, the amount of profit warnings also increased. An early September spike in reported COVID cases was largely ignored by the market as vaccinations continue to increase and serious hospitalizations declined. The market did take notice of the lingering effects on the supply-chain caused by the pandemic. At one point during the quarter, 73 cargo ships were waiting off the southern coast of California, America's busiest port complex. Even while reporting beats, multiple companies warned that profits going forward will be impacted by delays in the supply-chain as well as rising input costs that may not be easily passed on to consumers. The analyst community postulated on whether these warnings signaled that the market had achieved peak earnings growth.

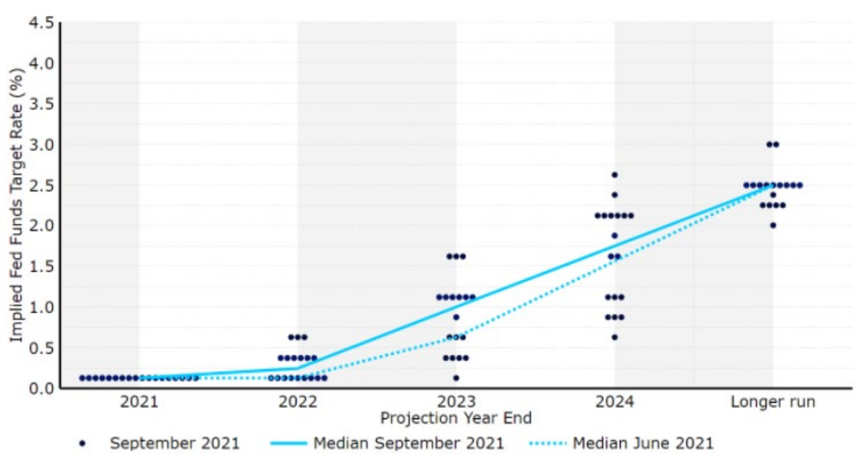
Market Performance

Index Returns (%)	**1M**	**3M**	**12M**
S&P 500	-4.65	0.58	30.00
S&P MidCap 400	-3.97	-1.76	43.68
S&P SmallCap 600	-2.43	-2.84	57.64
Factor Returns (%)			
S&P 500 Momentum	-4.80	1.93	21.90
S&P 500 Growth	-5.79	1.87	28.90
S&P 500 Value	-3.29	-0.85	32.00
S&P 500 High Beta	-1.86	-2.94	78.80
Top 3 Sector (%) QTD			
Financials	-1.85	2.74	69.13
Utilities	-6.18	1.78	11.01
Communication Services	-6.58	1.60	38.39
Bottom 3 Sector (%) QTD			
Industrials	-6.15	-4.23	28.96
Materials	-7.21	-3.51	26.48
Energy	9.44	-1.66	82.99

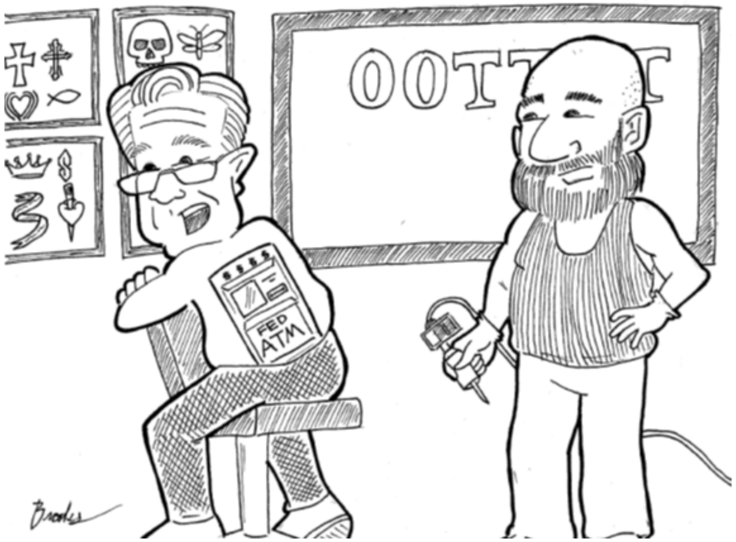
Fed finally indicated willingness to taper but not yet tamper.

After ~~months~~ ~~quarters~~ years of speculation, the Fed gave investors more concrete thoughts about its plan to start tapering its $120 billion monthly bond buying program. Fed Chair Powell indicated that the tapering process could potentially begin in November as he believed the economy had achieved the "substantial further progress" needed and expected the process to be completed in mid-2022. Powell and other regional Fed members reiterated that economic growth was not yet strong enough to justify immediate rate hikes. Even so, the dot plot from the September FOMC showed participants forecast a potential rate hike in 2022 and multiple hikes in 2023 and 2024. Market reaction to these announcements were rather muted as they were all largely in line with consensus thoughts on prospective Fed actions.

Figure 1: FOMC 'Dot Plot' [September 2021]



Source: Refinitiv Datastream Date: 23/09/2021



I've had this for a while but I'd like to change it up. Maybe you can make it a hawk or something…

The Real House Reps of Washington brought the drama.

The Senate's approval of a $1 trillion bipartisan infrastructure bill mid-quarter may have seemed like a positive milestone but ensuing disagreement among House members derailed efforts to move the legislation forward. Progressive democrats threatened to block the bill unless meaningful progress was made on a budget reconciliation bill that included Democratic priorities that have much less bipartisan support. Meanwhile, both Senate and House Republicans are encouraging Democrats to use budget reconciliation to raise the debt ceiling as they will refuse to vote on any measure that raises debt limits. While House Democrats managed to pass a bill that temporarily suspends the borrowing limit, the damage to market psyche has already begun with rumblings emerging about the potential for ratings agencies to downgrade the credit rating of US debt.

There is no alternative.....to volatility.

The prospect for a move lower in stocks is certainly possible as investors grapple to understand the ramifications of transitioning monetary policies, fiscal politics, a tightening labor market, and input cost pressures. The late quarter spike in bond yields could portend a dramatic sell off in the type of growth stocks that have been driving most of the increasingly concentrated market's gains for the past few years. However, recent economic reports (initial jobless claims, consumer confidence, manufacturing surveys) suggest that growth has yet to achieve a level that would force a sustained rapid rise in yields. In that lower rate environment, stocks continue to be the only game in town for investors looking to earn more than inflation. The only confident assumption available is that any further rise in the currently up trending market will be accompanied with volatility.