October 2021

Q3 2021 Commentary: Good, just not as good…

The stock market's steady march higher continued through August much as it had for more than a year. By mid-September, the S&P 500 had gone more than 200 days without closing below its 50-day moving average, the second longest such streak since 1990. Slow and steady has been winning the race. However, the streak came to an end in September and stocks drifted lower until the end of the quarter leaving only a modest 0.58% quarterly advance for the S&P 500. The economy appeared to pause over the summer due to supply chain and delta variant Covid-19 concerns. Longer term interest rates drifted modestly higher during the quarter resulting in a small 0.11% gain for bonds in the period. As we move forward, economies and financial markets will normalize as we emerge from the pandemic shock. The summertime pause will be a small bump on the road to full recovery

Stock market returns in 2021 have been driven by a surge in earnings expectations. At the start of the year, the S&P 500 companies' earnings, in aggregate, were estimated to be $165. Today, the estimate is $201. Earnings expectations have risen enough to lower the market earnings valuation despite the index's impressive move higher. Stimulus funds and return-to-normal activities have juiced the economy. We are now in the middle of the third quarter earnings reporting season, but early results point toward more of the same strong results. By and large, companies are beating expectations and it looks like estimates for the fourth quarter and next year will ratchet higher. Earnings ultimately drive stock prices and further earnings growth is strong support for current stock levels.

There are many niggling issues that will cause concern among investors, but we do not expect any to derail the stock market. Supply chain issues will persist, but they are probably at their worst right now and will improve as all parties work (literally around the clock in west coast ports) to resolve bottlenecks. With so much attention being paid to this issue, these problems will become yesterday's news in 2022. The Federal Reserve will begin to taper its purchases of bonds, but its actions have been so well communicated in advance that the stock market is already adjusting to that eventuality. It is broadly recognized that the economy has stabilized and there is less need for stimulus so scaling it back should not be a problem. Finally, inflation has proven to be less transitory than expected and if it persists it would be a significant negative for the stock market. However, the current inflation spike is predominately a function of supply chain scarcities which will pass. We agree with former Fed chairman Ben Bernanke that inflation will slow in 2022 as supply chain issues wane.

What is evident from the way the stock market traded this year is that none of these concerns have reflected negatively in the stock market. Only the late summer economic sputtering attributable to a rise in the covid delta variant had real impact. Purely from an investment standpoint, the positives swamp the negatives. Leading economic indicators remain positive and signal continued economic growth. Consumers are flush with cash to spend, and fiscal and monetary stimulus continues. These factors will keep the economy and corporate earnings on the right track. The normalization process is moving forward, and our daily activities are returning to pre-pandemic routines. The process will be uneven and that will lead to more stock market volatility, but some volatility is perfectly acceptable given overall positive trends.

436 14th Street, Suite 805 Oakland, CA 94612 / P: 510.835.0960 / F: 510.722.2266
www.sasserinvestments.com