Outlook for November 2021

Key Market Drivers

Supply chain disruptions caused by clogged ports, labor shortages, and the delta variant of Covid-19 should begin to dissipate as the global economy adjusts within a still strong demand environment. Government policymakers will also look to intervene in trying to help relieve obvious pain points.

Economic growth in the U.S. is beginning to recover from the disappointing third quarter as production keeps up with demand generated by the financially (and more physically) healthy American consumer. Holiday spending is poised to increase close to 10% year over year. Sporadic shortages and pent-up demand will keep inflation rates high, but inflation should recede into 2022. European economies have been restrained to a greater extent by inconsistent supply chains and higher infection rates over the summer. As such, these economies may be even bigger beneficiaries of loosening supply chains and sharply declining hospitalization rates although consumers on the continent did not receive the same level of governmental income support as was delivered in the U.S.

The inevitable slowdown in Chinese economic growth, which was happening prior to the pandemic, has been accelerated by the re-engineering of global supply chains and the growing assertiveness of the government in attempting to address income inequality issues. Market forces in correcting imbalances will likely be constrained until the economy slows enough to convince the government to relent and allow supply to more adequately meet demand.

Our Perspective

Equity Markets

- Strong demand and increased pricing power have so far allowed U.S. companies to maintain profit margins despite the jump in labor and materials costs. As equity markets have been driven to record highs primarily by earnings growth in a rising rate environment, continued cost pressures and tougher year-over-year comparisons in fourth quarter earnings results may lead to some price consolidation and the development of a tight trading range for the remainder of the year.
- Developed international equity markets should benefit from the sharp decline in infection rates and continued monetary ease, but supply chain blockages need to subside for these markets to catch up to the performance of the technology driven U.S. markets.
- Emerging market equities have been restrained somewhat this year by the rising dollar although the most prominent headwind has been uncertainty around the progression of the Chinese economy given the prospect of greater government interference. The increase in commodities prices should be helpful for the Latin America markets and those more exposed to the energy sector, but these markets are also more vulnerable to earlier central bank intervention in fighting higher inflation rates and protecting their currencies.

Bond Markets

- Intermediate and longer-term government bond yields have drifted higher in a controlled way as the Fed has so far effectively managed the tapering message. The yield curve has flattened somewhat, reflecting growing concern of a policy mistake with the Fed reacting too early to what may indeed be transitory inflation. Rates should continue to rise in this rather strong economic growth environment. However, bond market participants will be reluctant to aggressively challenge the Fed's resolve in gradually pulling back monetary ease.
- Continued economic expansion and low expected default rates have kept the yield spread of below investment grade securities at historical lows in relation to treasuries. As investors push for better returns in a yield starved environment, the high yield asset class has become expensive and particularly vulnerable to any economic disappointments that may occur.
- Emerging market debt normally struggles in a rising dollar environment. However, poor year-to-date performance has been compounded by country specific credit issues, the most recent of which is the sharp increase in default risk on the debt of certain Chinese property companies. Investors should exert caution as these countries recover from the pandemic induced recessions at a painfully slow rate.

Outlook for November 2021

Our Perspective (Continued)

Monetary Policies/ Currencies

- Although the Fed continues to deem current inflation rates as temporary and caused primarily by shorter term disruptions in the supply of goods and labor, they will react to the current inflationary and economic growth environment by beginning the process of reducing monthly asset purchases this month. The program is expected to end by next summer. The slower improvement in the jobs recovery, and the stubborn income equality gap, should both keep the fed funds rate at zero until the end of next year.
- Most other developed market central banks are further away from implementing any meaningful tightening policies as their economies have been slower to recover and inflationary pressures are largely driven by external supply issues over which these central bankers have little ability to impact.
- While monetary policy usually entails the utilization of blunt force tools, The Peoples Bank of China is looking to focus more on trying to address growing asset price bubbles in the real estate sector while being careful to avoid inadvertently choking off already slowing demand in other areas of the economy.
- Despite the Fed pledging to keep rates near zero for the foreseeable future, relative economic growth rates and higher intermediate and longer-term interest rates should continue to favor the dollar over most other currencies at least through year end.

Commodities

- Supply constraints, both strategic and systemic, have driven energy prices sharply higher over the past few months. Demand should remain strong through year-end, given global economic growth forecasts. However, supply should begin to catch up as the economics for producers should motivate the OPEC cartel and U.S. shale producers to increase production of oil and natural gas.
- Gold has either lost its luster (pun intended) as a preferred inflation hedge to the cryptocurrency alternatives or it is an indication that inflation rates should slowly recede as the global economy moves into 2022.

What This Means for Investors

In strong markets such as the one we are experiencing in 2021, equity markets tend to carry the positive momentum into year-end. Looking beyond this year, global equities will be facing tougher year-over-year earnings comparisons, profit margin challenges, and incrementally tighter monetary policies. Improved productivity will be key to maintaining economic growth as policy support wanes. Capital spending on technology should be monitored closely as it will be necessary to help offset what may be a more permanent shortage of labor in certain sectors of the economy.

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