

Quarterly Market Outlook

October 2021

Vaccinations Accelerate Globally, Including in Emerging Markets

45% of the world's population has now received at least one vaccine dose, up from 24% just 3 months ago. Countries like Japan, Mexico, and India – which had low vaccine penetration going into the quarter – have now at least partially vaccinated 66%, 62% and 43% of their populations, respectively. The pace has slowed in the U.S., however, which has now fallen behind Canada, the UK and most of Europe in vaccinations per capita.¹

Delta Casts a Shadow

The highly contagious Delta variant now accounts for 99% of cases in the U.S., up from a negligible percentage just last May.² Although vaccines remain effective against severe disease, hospitalization and death from Delta, they are less effective against transmission, particularly as time passes and antibody levels drop.³ Additionally, with children ineligible for vaccines and many adults still opposed to them, new daily cases in the U.S. surged past 150,000 last quarter. Cases are now on the decline again, while daily deaths are hovering around 2,000.⁴

Growth Expected to Pick Up Again After Slowing

Economic growth moderated in Q3 amid Covid's resurgence, with higher costs, China's regulatory crackdown, and the prospect of Fed tapering adding cause for concern. While these factors may weigh on growth, policy remains stimulative, business investment is improving, and consumption has held up well outside of travel.⁵ Economists expect real growth to accelerate in Q4 to a ~5% annualized rate in both the U.S. and Europe as Delta recedes.⁶

Inflation Stays Elevated as Pressures Build

U.S. headline and core CPI are running at 5.3% and 4.0%, respectively, year over year – well above the Fed's long-term 2% target.⁷ While prices in pandemic-sensitive sectors like airlines and hotels retraced in August (after soaring earlier this summer), prices continue to increase more broadly. Supply-chain disruptions are pervasive, certain shipping costs have soared, and oil is now above \$80/barrel – a level not seen since 2014.⁸ Housing prices are also rising rapidly, as are rents, which will likely flow through to CPI with a lag.⁹

The labor market is also tight. Job openings are at their highest level ever, and with many older workers having retired during the pandemic, there are now more open positions than unemployed workers to fill them.¹⁰ This is putting upward pressure on wages, pushing company labor costs higher and reinforcing an already strong level of consumer demand.¹¹

Infrastructure and Spending Bills in Jeopardy

The \$1.2 trillion infrastructure bill that the Senate passed in August with bipartisan support now awaits a vote in the House. House Republicans have largely opposed the bill as expected, but progressives have also pushed back, seeking guarantees for the Party's \$3.5 trillion, 10-year social-welfare spending plan that now looks likely to be scaled back.¹² The original plan was set to include provisions for universal pre-K, childcare and higher-education tuition subsidies, expanded healthcare coverage and assistance, and provisions to incentivize the transition to clean energy.¹³ The passage of these two packages looks increasingly tenuous.

Tax Hikes in the Offing

The Democrats have unveiled substantial tax increases to pay for the bills, including raising the corporate tax rate from 21% to 26.5%, the top rate on dividends and long-term capital gains from 20% to 25%, the top marginal rate from 37% to 39.6%, and the minimum tax on U.S. companies' foreign income from 10.5% to 16.6%.¹⁴ These increases are a potential headwind to corporate earnings longer term.

Bond Yields Spike; Equities Down Slightly; Commodities Up

The U.S. 10-year yield surged past 1.5% at quarter end following the Fed's hawkish taper announcement.¹⁵ Stocks globally ended Q3 down about 1%, with China being a notable detractor. Meanwhile, commodities have rallied to multi-year highs as oil and gas prices continue to climb.¹⁶

Potential Risks to Stocks and Bonds

Going forward, the picture for equities looks mixed. On the one hand, consumers and corporates are flush with cash, which will likely support spending and buybacks. And returns year to date have been driven by earnings growth, rather than multiple expansion. On the other hand, valuations remain elevated, with the forward P/E on the S&P 500 at levels not seen since the tech bubble.¹⁷ Equities remain priced for strong earnings growth and look vulnerable to higher commodity prices, shipping costs, wages and taxes, which could all squeeze margins even if demand remains robust. As for bonds, while yields have risen they are still low relative to history – particularly in light of mounting inflationary pressures – and real yields remain negative. If inflation starts to undermine growth or forces central banks to tighten, returns to both stocks and bonds could disappoint.

Consider Inflation Hedges, Active Management and Private Assets

Most portfolios remain exposed to the risk that inflation stays higher for longer and could benefit from hedges like commodities and inflation-linked bonds. And with valuations high, we see a stronger case for skilled active managers who can add value regardless of how markets perform. Above all, we continue to find opportunities in the private markets that we believe are compelling – including in real estate, private equity and private credit strategies.

NOTES

¹ Source: <https://ourworldindata.org/covid-vaccinations>

² Source: <https://www.nytimes.com/2021/09/18/health/delta-covid-us-cases-cdc.html>

³ <https://www.cdc.gov/coronavirus/2019-ncov/variants/delta-variant.html>

⁴ Source: <https://coronavirus.jhu.edu/data/new-cases>

⁵ Source : <https://www.reuters.com/world/us/delta-darkens-us-q3-growth-views-fed-taper-announcement-expected-nov-2021-09-17/>;
<https://www.reuters.com/world/us/us-core-capital-goods-orders-rise-solidly-august-2021-09-27/>

⁶ Source: Bloomberg (ECGDUS Q421 Index, ECGDEU Q421 Index)

⁷ Source: Bloomberg (CPI YOY Index, CPI XYOY Index)

⁸ Source: Bloomberg (CL1 Comdty); <https://www.wsj.com/articles/supply-chain-issues-car-chip-shortage-covid-manufacturing-global-economy-11633713877>

⁹ Source: Bloomberg (NHSLAVS% Index, ETSLMP%Y Index)

¹⁰ Source: <https://www.dallasfed.org/research/economics/2021/0527>

¹¹ Source: Bloomberg (SBOIEMPL Index, CONCJOBP Index, USURTOT Index); BLS (<https://www.bls.gov/charts/job-openings-and-labor-turnover/unemp-per-job-opening.htm>); <https://www.wsj.com/articles/weekly-jobless-claims-09-30-2021-11632938796>

¹² Source: <https://www.reuters.com/world/us/democrats-will-be-disappointed-party-pares-agenda-white-house-2021-10-03/>

¹³ Source: <https://www.wsj.com/articles/what-is-in-the-3-5-trillion-reconciliation-bill-11632870621>

¹⁴ Source: <https://www.wsj.com/articles/democrats-release-details-of-tax-increase-11631539532>

¹⁵ Source: Bloomberg (USGG10YR Index)

¹⁶ Source: Bloomberg (BCOMTR Index; CL1 Comdty)

¹⁷ Source: Bloomberg (SPX Index - BE008)

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