2021 October Market Outlook

There was great hope for this year, especially after the health and financial crisis of last year. Covid remains a problem, and now inflation and supply bottlenecks and shortages have changed the Outlook. The Outlook at the beginning of the year was wrong, so this should remind us that no one can predict the future accurately and consistently. Because I can't predict the future, is why I focus on buying stocks/assets that are undervalued and pay dividends.

Most investors, including myself, remain bullish.

Bullish

- Last year a new economic and market cycle started. The long-term average of economic cycles is about six years.
- Thanks to central banks around the world, there is plenty of liquidity for the global economy
- Trillions are sitting on the sideline
- Consumers continue to spend despite lower consumer confidence (see Bearish section for reasons for lower confidence)
- TINA (There Is No Alternative). Currently, most investors consider bonds, gold, real estate, cash as having little upside
- FOMO (Fear of Missing Out)
- Share buybacks are coming back
- Some companies are increasing their dividends
- Financial Advisors and 401k investors are big buyers of index funds and rarely sell, helping the markets be less volatile than past cycles
- Most analysts are expecting economic and earnings growth for 2022.

The current consensus growth rate of over 60 economists from the WSJ survey for 2022 is 3.59%. According to the survey, the projected growth rate for 2022 is 2.53%

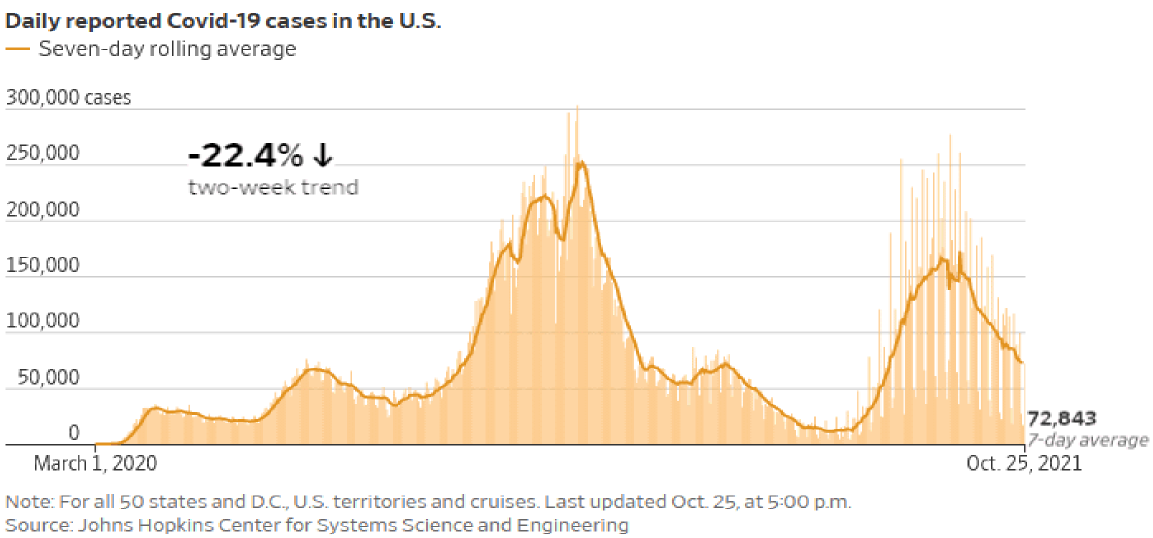
I will have my economic and market Outlook early next year.

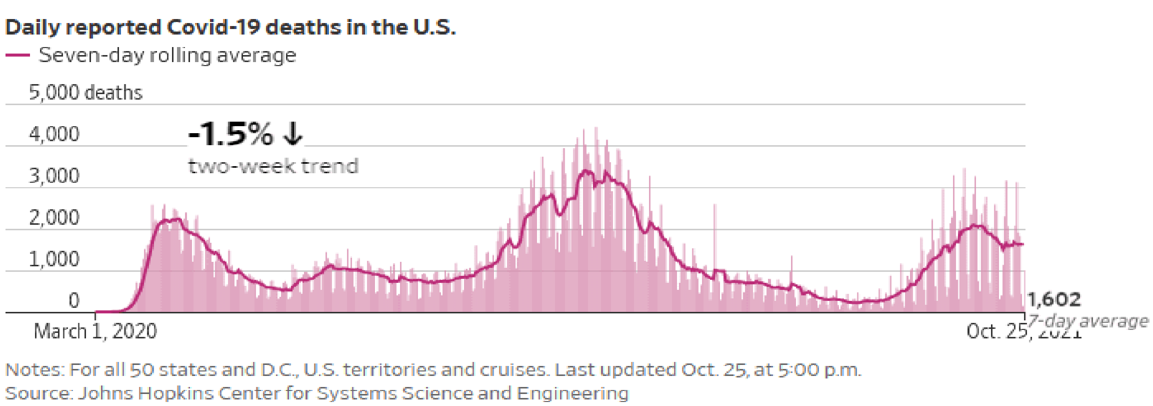
Bearish

- The covid health and financial crisis remain a concern. Some analysts, professional investors are looking past the pandemic (see last bullet point, Professional Portfolio Manager Concerns/Risks).

I consider covid a significant concern because it's a global problem where the virus can continue to mutate and wind up here/other critical global economies.

Covid infections and deaths are coming down, but they're still too high.





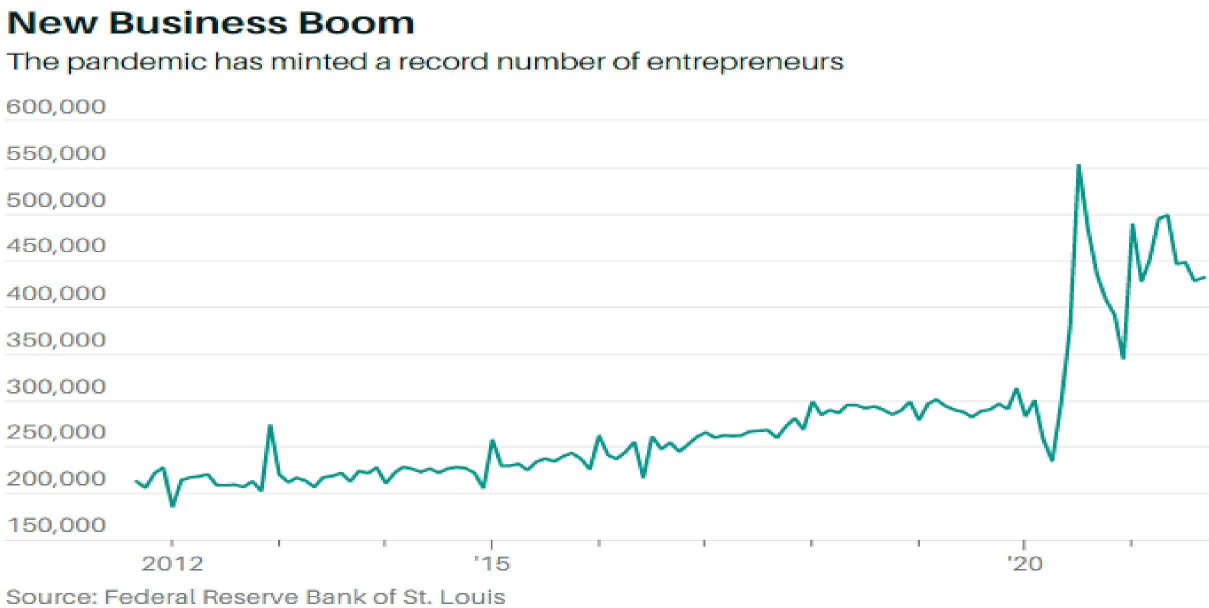
It's a shame so many people have died because of covid. People are getting tired of wearing a mask, social distancing, and a certain portion of the population will not get vaccinated. There are some valid reasons for the reluctance, but misinformation also plays a role. This means we will probably have to live with covid into 2022.

Even though it will take more time here in the U.S., we have probably seen the worst. The rest of the world is another story, especially poorer countries which is most of the world.

- Supply chain bottlenecks/disruptions are causing inflation and slower global growth

There are usually two types of inflation: cost-push (it costs more to produce/distribute) and demand-pull (demand outpaces supply), and we are experiencing both. Going from a closed economy to an open one has caused more global demand than supply, bottlenecks in the supply chain, and labor shortages. Most economists see inflation dropping after bottlenecks and labor shortages improve next year. It is critical to keep an eagle eye on inflation and interest rates.

- Labor shortages and high quit rates. Some economists have pointed out that about 3 million baby boomers have left the labor force since the start of the pandemic. Also, there has been an explosion of small business formations.



Retirees may not return to their jobs. Small businesses have a high failure rate, so some of these entrepreneurs may have to return to their previous careers/jobs.

Women have been returning to work less than men. The reasons given include child care costs and availability and the uncertainty of school closings and quarantines.

- China real estate and debt problems and slowing growth. China has borrowed too much money for real estate projects. Their economy is about 40% real estate. Many analysts and investors anticipated this would happen to China. This has happened many times to other countries, including the U.S. (the Great Recession circa 2008).

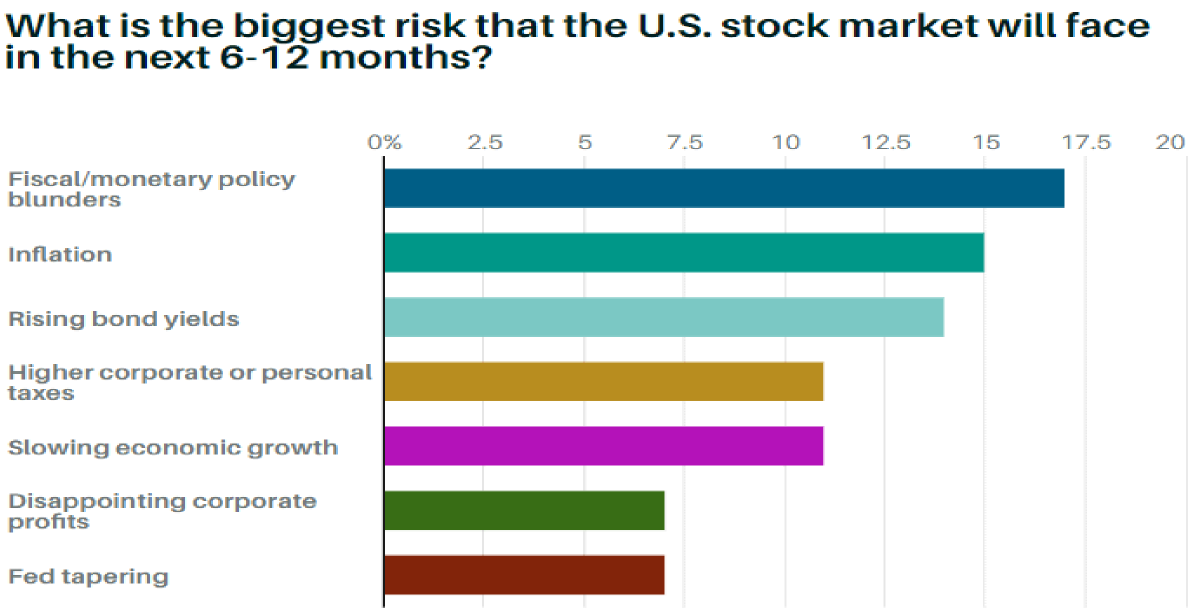
- Tax increases are on the table to pay for “human infrastructure investments.” Not clear if, when, or by how much.

- Fed tapering, there are inflationary pressures for the Fed to slow down its buying of treasuries and government agency paper. Long-term rates are starting to rise because of Fed tapering and higher inflation. When the Fed starts to buy less government paper, that could cause interest rates to increase further.

- Economic and earnings downward revisions. Economic and earnings growth are being revised downward because of the third spike in covid, supply chain bottlenecks, and rising inflation.

- Black (low probability high impact events) and gray swans (climate change-related weather events like floods, droughts, wildfires, cyber attacks)

- Below are the risks the market faces according to Barron's recent poll of professional money managers:



The biggest concerns are bad policies by the lawmakers (spending too much, raising taxes too high) and the Fed (not raising rates fast enough to head off inflation).

Inflation is the next major concern. Here is the WSJ survey of economists' forecasts for inflation: By the end of 2022, 2.54%, and 2.46% for 2023. Currently, inflation is about 5.4%.

Valuations

The markets fell about 5% in September, but prices rallied back, so the markets are overvalued again.

Below are several scenarios of where the S & P could gravitate to. Currently, the S & P is around 4,566.

Earnings for the S & P are expected to be about 220.

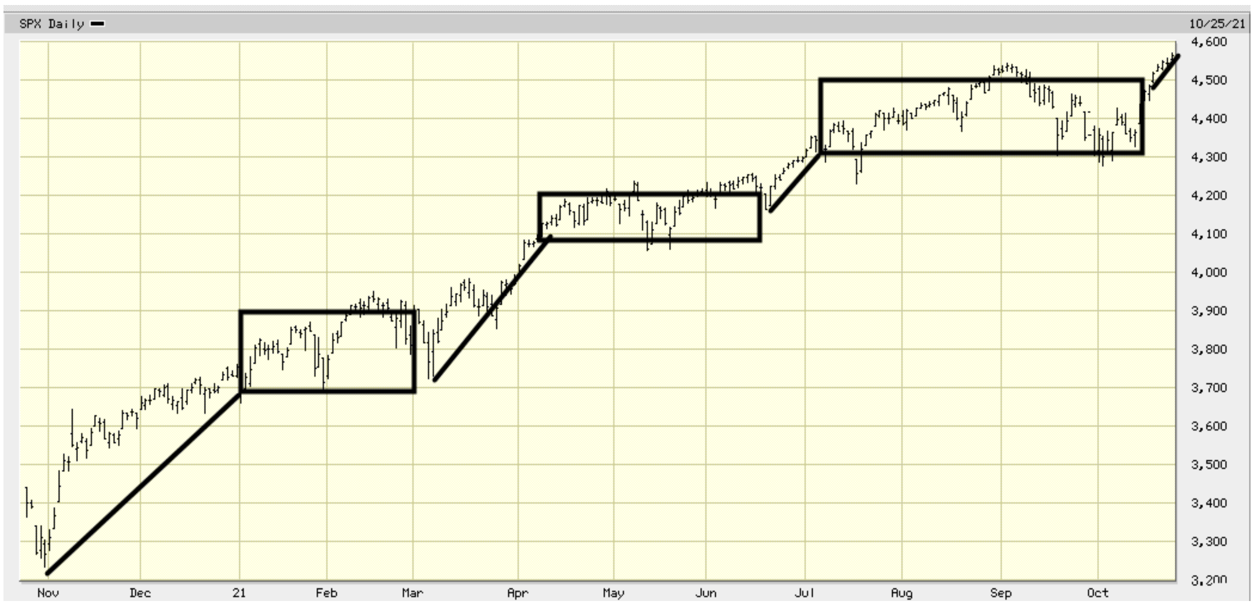
Using the current P/E for the S & P of 22, the market could rise to 4,840, about 6% above the current level.

If rates continue to rise and inflation stays at current levels into 2022, the P/E could contract to the historical high average of about 17. The price would fall to 3,740, about 18% lower than the current price.

Growth stocks with high P/Es would probably contract the most as interest rates rise to reflect inflation. Low P/E stocks with above-average dividends should perform better.

Technicals/Price Analysis

The market is following its seasonal script. The chart below exhibits its seasonality this year:



The chart above shows the usual price action of a bull market.

The market is anticipatory. This means the market normally starts to price in the prospects for the next year in October or November before the next year starts. We can see that after a pullback in 2020 October, the market bottomed and started focusing on the prospects for 2021 and rallied.

It's also normal that prices consolidate after a move. Prices consolidated for a few months and then rallied, followed by another consolidation that started in April. These consolidations typically occur around earnings season.

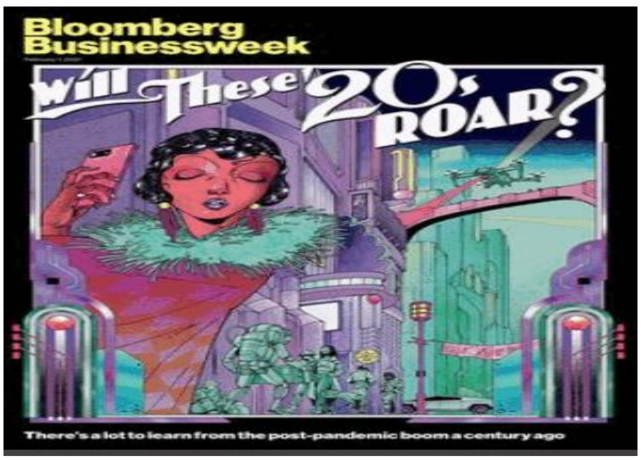
In my March Market Outlook, I wrote about the strategy "sell in May and go away." Most of the gains for the year are normally made by May. A summer rally typically occurs.

By September, October there is profit-taking from the summer rally and portfolio window dressing by professional money managers (buying popular performing stocks and selling weak performing stocks).

The market followed the seasonality script this year. We took some short-term profits towards the end of the first quarter and started deploying the profits in September and October. We are ready for 2022.

Psychology of the Markets

The psychology of the markets has changed from expecting the “roaring 20s” to the realities of dealing with the global pandemic. The comparison now is to the stagflation of the 1970s (conditions are very different today)



Current concerns include labor shortages, supply bottlenecks, and inflation.

Investors remain obsessed with overvalued growth stocks.

Many participants don’t seem to care or understand valuations and will pay any price for certain stocks.

Summary and Conclusion

- The market is facing several headwinds: labor shortages, supply bottlenecks, inflation.
- Most market participants, including myself, remain bullish
- The markets are overvalued
- The markets followed the typical seasonality of the markets, and participants could have followed the “sell in May and go away” strategy.
- Investors should be positioned by now for 2022.

I should have my economic and market Outlook by early next year.