MARKETS ARE MOVING FROM A QUIET PERIOD TO A MORE VOLATILE PERIOD + PERSPECTIVE FROM RESPECTED EXPERTS

I would like to share with you my current outlook on the markets, and also provide useful perspective from respected market experts.

MOVING FROM A QUIET PERIOD TO A MORE VOLATILE PERIOD

So far, 2021 has been an excellent year for the stock market and a not-so-great year for the fixed income market. But the strength of the overall stock market has more than offset the slight decline in the overall fixed income market. Consequently, most well-diversified balanced portfolios have enjoyed very reasonable returns so far in 2021.

One interesting fact about 2021 is that as of August 31st, major indices such as the US S&P 500 Index and the Canadian TSX Composite Index had notched seven straight months of gains. What is also surprising is that history has shown that markets usually continue to do well over the next three-to-six months after such long stretches of consecutive monthly increases. That is the good news.

The bad news is that the month of September is the weakest month of the year on a historical basis. So my instinct tells me that September may be a poor month - especially compared to what has happened up to now in 2021 - but we are likely to witness a good end to the year. In fact, a number of equity strategists agree that the stock market should end the year higher than its current level (see ADDED PERSPECTIVE section below).

In looking out one year ahead from now, I see both positive and negative factors affecting the markets. I believe that the positives will more than offset the negatives, making me optimistic for 2022 – an opinion shared by RBC WM and numerous market experts.

<u>Factors that are positive tailwinds for the stock market</u>
- Many corporations have now started to buy back their own shares and increase their dividends.
- Corporate profits are increasing at much higher pace than their historical average, and analysts have had to increase their profit forecasts.
- The major central banks continue to implement accommodative/easy monetary policies - which are keeping real interest rates very low.
- Most major government have been backing strong fiscal stimulus packages.
- The average consumer is in relatively good shape, and has been able to save money and/or lower debt during COVID. This is not to gloss over the numerous social, health, and economic hardships felt by so many as a result of COVID.
- RBC does not foresee an economic recession in the next 12 months.
- I have also noticed that the high bullish (i.e. optimistic) sentiment we witnessed back in January has dissipated. Investors are more bearish (i.e. pessimistic), which is actually a positive contrarian indicator.

Factors that are negative headwinds for the stock market

- Taxes are bound to go up. It is more a question of when and by how much. An increase in corporate taxes would hurt net-after-tax profits of corporations - which typically is a negative for stock prices. An increase in personal taxes would lower the amount of money individuals have to spend and/or to invest - which are also negatives for stock prices. And changes to the taxation of investment income (e.g. capital gains and dividends) could lower the incentive to invest.
- Inflation is a concern for many investors. We are certainly witnessing some price/cost increases in various pockets of our economy. Mild inflation can be a good thing - even for the stock market, but strong inflation is typically not. High inflation will (1) push companies and individuals to curtail their spending, (2) eat into net savings, and (3) can result in big increases in interest rates. These are all net negatives for the markets. That being said, certain sectors of the stock market can actually benefit from high inflation (e.g. possibly the resource and real estate sectors, and companies that have strong pricing power).
- What is happening in China is certainly catching our attention. China makes a lot of the goods we buy (think clothes/ running shoes/ electronic items, etc.) and has also become a major consumer. Recent political and regulatory actions from the Chinese government, important and significant on their own, are causing greater scrutiny from market analysts.
- Interest rates are likely to increase over the next five years. This would be a negative if it happened quickly and/or earlier than analysts are currently predicting. I also believe that 10 year government bond rates moving above four percent would be a negative for the markets.
- The threat of a possible shutdown of the US federal government.

As previously mentioned, we believe the positives will outweigh the negatives over the next 12 months. Strong corporate earnings will , in my opinion, ultimately prevail over the other factors and be instrumental in driving stock prices higher over the next 12 months - even while we are likely to experience more volatility.

ADDED PERSPECTIVE

In this section, as I often do, I would now like to offer a few very recent quotes/insights/observations (starting from the most recent) from respected market experts and financial institutions that hopefully provide useful perspective during these special times.

" Despite concerns about the recent downshift in economic and business cycle momentum, we remain confident that strong growth lies ahead and activity is bound to re-accelerate….for these reasons, we remain positive on the equity outlook, and expect the S&P 500 to reach 4,700 by end of this year and surpass 5,000 next year on better than expected earnings"
Source: US Equity Strategy, JP Morgan, authors include Marko Kolanovic PhD and Dubravko Lakos-Bujas, September 15

"The bottom line is that we are bullish for now, but fully recognize that we have been in a pristine environment for stocks. A slowdown in GDP will likely slow profit growth, while rising inflation will eventually lift long term interest rates. Tax hikes are still a threat, as are tougher COVID-related restrictions that limit a service-sector recovery. However, with the Fed as easy as it is, the tailwinds from easy money remain strong. The market is not overvalued, but it is not as undervalued as it once was.
Source: Stocks versus the Economy, Brian S. Wesbury, Chief Economist, First Trust, September 13

"Looking ahead, we expect positive, but more modest pace of gains for equities driven primarily by earnings growth"
Source: September Asset Allocation Guide, RBC Wealth Management, September 9

"The prospects for a greater degree of market volatility than investors became accustomed to over the past 17 months notwithstanding, we think most major equity markets would be able to deliver worthwhile total returns including dividends over the coming 12 months."
Source: Global Equity – Adjusting to the Adjustment Period, Global Insight Monthly, RBC Wealth Management, September 1 // WOULD YOU LIKE A COPY?

"*Last Tuesday, Harvey increased his S&P 500 year-end price target to 4,825 from 3,850, a Wall Street high. Despite his bullishness for the final four months of the year, he gave a less optimistic outlook for 2022 — delivering a 4,715 target. Harvey believes a record year will be followed by a hangover of sorts. But for now, he's firmly in the risk-on camp. 'We want more cyclical exposure,' Harvey said. 'We want more exposure to what we consider high Covid-beta plays because we do think the economy is going to move forward'."*
Source: CNBC, quoting Chris Harvey, Head of Equity Strategy,Wells Fargo, August 29

"We believe that the trend toward reopening and recovery remains intact. We expect strong economic and corporate fundamentals to support a continued rally in US stocks…We recently revised higher our 2021 and 2022 S&P 500 earnings per share estimate…
We expect this to help lift the index from 4,441 at present to around 4,600 by the end of the year, and 5,000 by the end of 2022."
Source: CNBC, quoting Mark Haefele, Global Chief Investment Officer, UBS Wealth Management, August 24

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As always, we will remain vigilant in regards to the markets, events and trends that might impact the investments of our clients, and we greatly appreciate your support.

Should you have any questions or concerns, please feel free to reach out.

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September 16, 2021