

CAPITAL MARKETS UPDATE

# Stocks Rebound in October as Fed and Inflation Take Center Stage

OCTOBER 31, 2021

## U.S. EQUITY MARKETS

After markets struggled during the month of September, most major asset classes rebounded strongly in October and left the S&P 500's first 5% pullback in 2021 a distant memory for many investors. In fact, the S&P 500 Index (SPX) rallied 7.0%, the S&P 400 Mid Cap Index (MID) gained 5.9% and the Russell 2000 Index moved higher by 4.3%. While international equities underperformed their domestic counterparts, the MSCI EAFE Developed International ex-US Index and MSCI EM Index still posted profits of +2.5% and +1.0% respectively.

Growth stocks outperformed value stocks by 2.1% over the month, with U.S. technology companies outperforming most. Coinciding with growth outperformance, long-term interest rates continued to climb higher for most of the month, weighing on global fixed income markets.

## THE FED IMPACT

The Fed has begun to slow its bond-buying program and it appears the first Fed rate hike will occur in mid-2022 due to stronger than expected inflation readings. On a monthly basis, the reduction will see \$10 billion less in Treasuries and \$5 billion less in mortgage-backed securities.

There has also been a slight change in the Fed's view on inflation. The post-meeting statement kept the word "transitory" to describe price increases that are running at a 30-year high, though it qualified the term somewhat by saying pressures are "expected" to be temporary. Chairman Powell also says that he expects conditions pushing inflation to last "well into next year."

While the U.S. fiscal and monetary tailwinds are expected to be reduced next year, U.S. household balance sheets remain stronger than pre-pandemic levels, corporations are holding a lot of cash, and there remain significant amounts of unspent federal monies in the U.S. economy.

## COVID-19 STILL LOOMS LARGE OVER THE U.S. ECONOMY

Despite COVID-19 cases continuing to decline globally throughout the month of October, the impact of the rise in cases in August and September has still affected many parts of the U.S. economy, including supply chain and labor shortages, along with weaker-than-expected consumer spending during the past few months.

Based on initial estimates, the U.S. economy expanded 2.0% over the third quarter of 2021, which was lower than the 2.6% expected. Specifically, vehicle purchases dropped 54% on the back of additional semi-conductor shortages. Global labor shortages continue to impact businesses and the prices of goods and services.

## STRONG EARNINGS SEASON

As the month of October came to an end, the U.S. earnings season was in full motion and reports were mostly positive. As of the end of October, a little over one-half of U.S. public companies had reported their earnings and over 80% had exceeded market expectations. That is one of the best starts to a U.S. earnings season in years and, overall, corporate earnings have been around 9.5% higher than forecasted.

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