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Quarterly Insights – October 2021

Market Volatility Spikes as We Enter Fourth Quarter

The S&P 500 hit new all-time highs again in the third quarter as investors looked past a resurgence of COVID-19 cases in the U.S. and instead focused on the positive combination of a resilient economic recovery, ongoing historic support from the Federal Reserve, and strong corporate earnings.

However, market volatility did notably pick up during the final few weeks of September. Reminding investors that the transition to a post-pandemic “new normal” isn’t always going to be smooth. Many of the positive factors that supported stocks earlier in the quarter began to fade. First, corporate commentary turned more cautious last month. Profit warnings that cited supply chain constraints and margin compression came from multiple industries, and that caused investors to become more concerned about the outlook for corporate earnings. Then, economic data from August showed that the rise in COVID-19 cases had weighed slightly on the economic recovery. Finally, after investors ignored the looming policy battle in August, politics once again became an influence on markets as Democrats unveiled new details on a $3.5 trillion spending and tax plan that included increases to the corporate tax, personal income taxes for high earners, and changes to capital gains and inheritance taxes. Those factors weighed on markets initially in September, but the volatility was compounded by the news that the second-largest property developer in China, Evergrande, was likely going to default on debt payments. Fear of potential financial market contagion hit stocks in late September and the S&P 500 suffered its first 5% pullback in nearly a year.

Markets remained volatile into the end of the quarter as the Federal Reserve confirmed market expectations that it will begin to reduce Quantitative Easing before year-end, while Washington approached the looming deadline of a government shutdown with no extension in sight, although that was avoided in the last few days of the quarter.

The S&P 500 finished September with moderate losses, although the index still logged a positive return for the third quarter. Other US equity indexes had mixed Q3 returns.

US Equity Indexes	Q3 Return
S&P 500	0.58%
DJ Industrial Average	-1.46%
NASDAQ 100	1.09%
S&P MidCap 400	-1.85%
Russell 2000	-4.36%

Source: YCharts

Internationally, foreign markets declined in the third quarter. Emerging markets dropped sharply, initially on concerns that rising COVID-19 cases would derail the global recovery, but late in the quarter, emerging markets fell even further on Chinese growth worries that stemmed from the Evergrande debt issues. Foreign developed markets, meanwhile, declined modestly during the final few weeks of the quarter on general global growth concerns combined with potentially higher global interest rates.

International Equity Indexes	Q3 Return
MSCI EAFE TR USD (Foreign Developed)	-0.35%
MSCI EM TR USD (Emerging Markets)	-7.97%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	-2.88%

Source: YCharts

Switching to fixed income markets, most bond classes were little changed in the third quarter. Most bond indices were solidly higher through mid-September as investors rotated to safety following the rise in COVID-19 cases in July and August. But in late September, the Federal Reserve confirmed tapering of Quantitative Easing will begin this year. That, combined with still-high inflation statistics, weighed on fixed income markets during the final few days of the third quarter which erased most of the quarter-to-date returns for many bond indices.

US Bond Indexes	Q3 Return
BBgBarc US Agg Bond	0.05%
ICE US T-Bond 7-10 Year	-0.21%
BBgBarc US MBS (Mortgage-backed)	0.10%
BBgBarc Municipal	-0.27%
BBgBarc US Corporate Invest Grade	0.00%
BBgBarc US Corporate High Yield	0.89%

Source: YCharts

In sum, the market remained resilient in the third quarter, but the final few weeks of September served as a reminder to investors that markets will face the resolution of numerous macroeconomic unknowns in the fourth quarter, and while fundamentals remain decidedly positive, an increase in market volatility should be expected.

Fourth Quarter Market Outlook

Market performance in the third quarter reflected continued improvement in the macroeconomic outlook. The economy showed resilience in the face of another wave of COVID-19, while corporate earnings were better than expected. However, that resilient performance should not be taken as a signal that risks no longer remain. In fact, the next three months will bring important clarity on several unknowns including future Federal Reserve policy, taxes, the pandemic, and inflation.

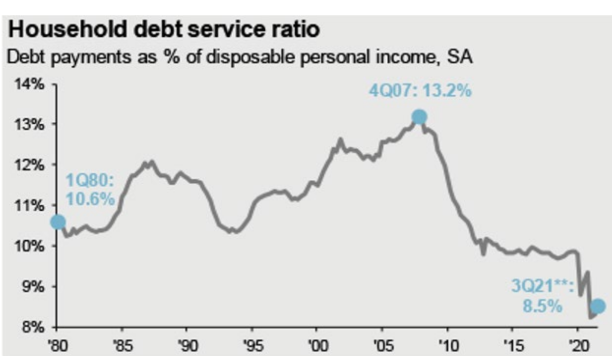
- **The Fed:** The Federal Reserve has communicated that it will begin to taper Quantitative Easing in the fourth quarter (likely in November), but markets do not yet know when exactly the Fed will start to scale back those asset purchases or the pace at which they will be reduced. If the Fed starts to taper QE sooner than expected, or the pace of reductions is faster than the market has currently priced in, it will cause additional volatility.

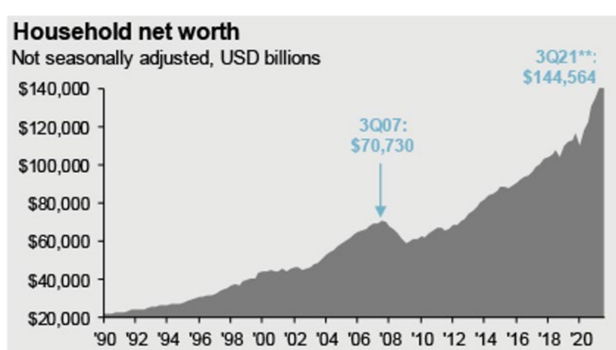
- **Politics:** Congress recently passed an increase in the debt ceiling, but it's estimated to only carry the government through early December. Additionally, they are continuing to debate the passing of the Infrastructure Bill and the $3.5 trillion Budget Reconciliation Bill while trying to avoid a government shutdown in December. If policies from Washington are viewed as negative for corporate earnings or consumer spending, they will cause a rise in market volatility.

- **Pandemic:** Regarding the still ongoing pandemic, COVID-19 remains a risk for the economy and the markets. Positively, effective vaccines have allowed policymakers to avoid re-implementing economic lockdowns that could hurt corporate earnings and the economy. But the risk remains that a new COVID-19 variant renders the vaccines less effective and that would put the economic recovery in jeopardy.

- **Inflation:** Finally, inflation remains elevated and at multi-decade highs, and that combined with continued supply chain disruptions is starting to impact corporate margins and profitability. If an increasing number of companies warn about future profitability due to these factors during the third-quarter earnings season, it will negatively impact markets.

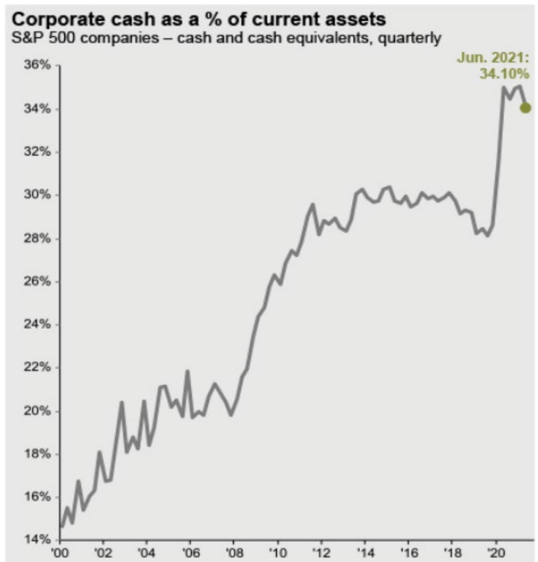
Yet while risks remain, as they always do, macroeconomic fundamentals are still decidedly positive. The balance sheets of U.S households, whose spending on goods and services accounts for over two-thirds of our economic growth, have held up remarkably well through the pandemic. Household debt payments, as a percentage of disposable income, sit near a four-decade low, while household net worth is near all-time highs.





Source: JP Morgan Asset Management Guide to the Markets – U.S. data as of 6/30/2021

Meanwhile, corporate balance sheets remain strong with cash balances near record levels. As the economic backdrop has continued to stabilize, we expect companies to deploy some of this cash through M&A, dividends, and share buybacks. These activities could provide a positive tailwind to equity markets.



Source: JP Morgan Asset Management Guide to the Markets – U.S. data as of 6/30/2021

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Sincerely,

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