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Wealth Advisory Market Update

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Market Update

Earnings season is nearing its close with stellar marks. So far, 81% of companies reported a positive earnings per share (EPS) surprise and 75% printed better than expected revenue. Guidance, however, in many instances has been light as inflation and supply chain constraints are starting to put pressure on margins and product availability. On the back of strong earnings, equity markets surged in October with the S&P 500 returning 7% for the month. The rally was broad to begin the month; but in the last few weeks, only a handful of high-flying names actually moved the market. Currently, the forward P/E on the S&P 500 is at 21.4x which is well above the 10-year average of 16.5x. This gives us pause and points to vulnerability to a downside shock from multiple contraction. This has also increased our confidence in our quality/value stock overweight.

On the economic side, payrolls were better than expected for the month of October. We also saw higher revisions to both September and August. As the Delta variant began to fade towards the end of the 3rd quarter, it seems hiring once again picked up. On the downside, the higher-than-expected demand for goods along with a disruption in the supply chain, has led to inflation increasing at a faster pace than expected. The Consumer Price Index (CPI) print this morning was the highest since 1982. In our opinion, with supply chains in dire straits and an economy that seems to be improving – albeit at a slower pace than earlier this year – we foresee inflation persisting well into 2022. As mentioned in previous letters, we felt inflation would be stickier than what the Federal Reserve was predicting and that is exactly what we are seeing.

The open question is the Fed. Because of surging inflation, which is starting to hit middle- and lower-income groups at the pump and grocery store, will the Fed be forced to act faster than anticipated? By acting, we mean tapering Quantitative Easing (QE) at a faster pace than currently projected or by raising short-term interest rates sooner than what the market is predicting. These actions could possibly lead to a contraction or even a recession. This is why the Fed remains a key focal point to markets and is something we will be watching closely over the next several months.

We expect volatility to remain a key factor in markets heading into the end of the year. The current excess in non-profitable tech companies reminds us of 1999 all over again. Analysts on Wall Street have once again started basing Price Targets on a multiple of a future revenue, in some cases five years away. Valuations seem completely disconnected from fundamentals. Reversion to the mean is a powerful force, and we believe the time for the reversion is nearing.

We still favor quality/value over growth in the equity markets and remain short in duration with our fixed income investments. Even with the recent selloff, valuations remain extremely elevated in pockets of the market which we are avoiding. We will be watching and keeping you updated on our thoughts as more data comes out. At this point, we would welcome some corrective activity. Corrections are important in an efficiently functioning healthy market; however, we are currently not experiencing any. The fear of missing out (FOMO) has pushed the market to the irrational exuberance phase in some areas and we are positioned in our portfolios to take advantage of that.

We will continue to navigate this difficult environment to the best of our ability. As always, we at AMB thank you for your support and for allowing us to partner with you in reaching your financial goals.

Matthew J. Roach, CFA
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