

# 10 things for investors to watch in the fourth quarter

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The third quarter was a rather momentous one for economies and markets as disinflation continued in most developed economies, major Western developed central banks broadly embraced easing, and stocks had a strong quarter in many regions.<sup>1</sup> As we head into the fourth quarter, what could happen next? Here are 10 things to watch:

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## 1. The price of oil

With the US longshoremen's strike behind us (at least until January but likely to be fully resolved then), the other big macro concern is an escalation in Middle East tensions and its impact on the price of oil.

The good news is that this is not the late 1970s. Today, the United States is the world's single largest producer of crude oil, producing 12.9% of total crude oil in the world.<sup>2</sup> And the US has been the single largest producer for the past six years; prior to that, it hadn't topped the list since the mid-1970s.<sup>3</sup> In addition, OPEC+ has had more difficulty reaching agreement on production controls that help keep prices higher. As a result, oil prices have been relatively low despite the conflict in the Middle East.

Having said that, we have seen a significant increase in oil prices in the last week on concerns that Israel may bomb Iran's oil industry. In fact, the price of Brent crude oil was below \$72 per barrel on Sept. 26 but has risen to \$80 per barrel since then.<sup>4</sup> I am hopeful that this will be a short-term spike, and recent history is on my side. In both October 2023 and again in April 2024, we saw the price of oil spike above \$90 per barrel on jitters over an escalation in Middle East conflict, only to come back down quickly.<sup>4</sup>

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## 2. US stock market volatility

Since Sept. 26, as the price of oil has risen, the VIX volatility index has also risen from the 15 level to nearly 20.<sup>5</sup> With an upcoming US presidential election as well as the potential for oil prices to rise further, I would expect the VIX to rise even more in the near term. But we have to keep in mind that increases in volatility and market swings can be very emotional and represent mispricing opportunities.

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## 3. Gold prices

Gold prices continued to rise in the third quarter. I view gold as a hedge against geopolitical risks. Many investors seem to be feeling comfortable moving out on the risk spectrum so long as they have hedges in their portfolio such as gold. I have noticed that over the last decade, gold seems to have replaced US Treasuries as the "safe haven" asset class of choice for many investors. I expect this trend to continue, given uncertainty around the US election and rising tensions in the Middle East. Gold could also prove more attractive to some investors because the opportunity cost of owning gold decreases as rates come down. It is important that we recognize that in this environment, a rising gold price does not necessarily indicate a "risk off" environment.

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#### 4. Eurozone economy

The eurozone economy has been very resilient, but it's coming under increased pressure. Eurozone Purchasing Managers' Index (PMI) readings for September show the manufacturing sector is deep into contraction territory (Germany in particular is facing very strong headwinds), and services activity, while still in expansion, is at a seven-month low.<sup>6</sup>

The good news is that the flash estimate for eurozone inflation in September was 1.8%, down from 2.2% in August, which is notable because this was the first time inflation fell below the European Central Bank's (ECB) target of 2% since June 2021.<sup>7</sup> This increases the odds of another rate cut when the ECB meets next week. However, it is not a "fait accompli" since services inflation remains elevated despite some disinflationary progress. Because of the pressure the eurozone economy is under, I'm hopeful the ECB continues to ease, which should help provide a much-needed boost to the economy.

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#### 5. US inflation

After last week's extremely strong jobs report for September, there are renewed concerns about the US economy running too hot. Not only was jobs creation much higher than expected, but now wage growth is up 4.0% year over year, well above the 3.6% year over year growth rate in July.<sup>8</sup> In fact, this fear of overheating actually started earlier in the week with the ISM Services Purchasing Managers' Index reading for September, which was 54.9, well above August's reading of 51.5.<sup>9</sup> What's more, the new orders sub-index rose to a whopping 59.4 in September, more than 6 points above August's reading of 53.9. This spooked markets, especially coming on the heels of the Federal Reserve's supersized rate cut in September.

We will want to watch data closely since Federal Reserve (Fed) Chair Jay Powell's speech last Monday made it clear the Fed is still data dependent, and that includes inflation data: "As I mentioned, our decision to reduce our policy rate by 50 basis points reflects our growing confidence that, with an appropriate recalibration of our policy stance, strength in the labor market can be maintained in a context of moderate economic growth and inflation moving sustainably down to 2 percent. Looking forward, if the economy evolves broadly as expected, policy will move over time toward a more neutral stance. But we are not on any preset course. The risks are two-sided, and we will continue to make our decisions meeting by meeting. As we consider additional policy adjustments, we will carefully assess incoming data, the evolving outlook, and the balance of risks."<sup>10</sup>

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#### 6. The path of monetary policy

In general, I expect a number of major central banks to progress on their monetary policy paths more slowly than previously expected. For example, I wouldn't be surprised to see the Fed alter course and only enact one more rate hike this year. And now that Japan has a new prime minister, an already-cautious Bank of Japan, cognizant of the market reaction to its last rate hike, may move more slowly in its normalization process. In general, I think central banks will continue on their respective policy paths but will be more cautious in the near term.

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## **7. UK equities**

I can't help but be excited about UK equities. I know there are short-term headwinds related to the Autumn Budget, which is scheduled to be released Oct. 30, but valuations on the MSCI UK Index are attractive relative to developed country peers.<sup>11</sup> The UK economy has held up well thus far and UK household balance sheets are strong, although sentiment has recently been hurt by fears about the budget. The catalysts for UK stocks to move higher could simply be the removal of uncertainty once the budget is released as well as continued monetary policy easing. In addition, the UK index's dividend yield was a robust 3.64% -- well above the MSCI ACWI yield of 1.87%.<sup>12</sup>

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## **8. The 10-year US Treasury yield**

The 10-year US Treasury yield has moved back up above 4% as markets re-think the Fed's path.<sup>13</sup> This is no surprise given the recent strong economic data coming out of the US. However, I think there will be significant volatility in coming weeks, and I expect the yield to move around substantially, reflecting economic data, "Fedspeak," and even concerns around the election.

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## **9. Stimulus in China**

As I have said before, the recently announced stimulus package has the potential to have a very significant impact on the Chinese economy -- and could also give a lift to industries in the European economy such as luxury goods manufacturers given their dependence on Chinese consumers. Of course, I anticipate Chinese equities will be a strong beneficiary. We have already seen a positive reaction to what has been announced thus far, and I expect more upside potential as we get more details on the stimulus. Thus far, I am very encouraged, but we will want to pay close attention to the details around fiscal stimulus, which is a necessary companion to monetary stimulus.

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## **10. Earnings season**

US equity valuations have been high<sup>14</sup>, and so US earnings season takes on even more importance in my book. FactSet estimates year-over-year earnings growth for the S&P 500 of 4.2% for the third quarter.<sup>15</sup> And we have already seen 60 companies in the S&P 500 issue negative earnings guidance while only 50 have issued positive guidance.<sup>15</sup> The fact is that analysts have lowered earnings estimates by a wider margin than is typical between the start of the quarter and now. However, I'm encouraged that we are likely to see a broader array of companies beat those reduced expectations, and that it looks to me like only a small percentage of total companies will report negative earnings growth.

As always, I will pay close attention to the comments and guidance given during the earnings calls; this will be critical in giving us a sense of the state of the economy and next quarter's earnings.

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## Notes

<sup>1</sup>Source: MSCI. For the quarter ending Sept. 30, 2024, the MSCI Europe Index returned 6.63%, the MSCI UK Index returned 7.94%, the MSCI US Index returned 5.93%, the MSCI Japan Index returned 5.88%, the MSCI China Index returned 23.64%, and the MSCI Emerging Markets Index returned 8.88%.

<sup>2</sup>Source: US Energy Information Administration, March 11, 2024

<sup>3</sup>Source: American Enterprise Institute, June 11, 2019

<sup>4</sup>Source: Bloomberg, as of Oct. 7, 2024

<sup>5</sup>Source: Bloomberg, as of Oct. 7, 2024

<sup>6</sup>Source: S&P Global/HCOB, October 2024

<sup>7</sup>Source: Eurostat, October 2024

<sup>8</sup>Source: US Employment Situation Report, Oct. 4, 2024

<sup>9</sup>Source: Institute for Supply Management, October 2024

<sup>10</sup>Source: Federal Reserve speech transcript, Sept. 30, 2024

<sup>11</sup>Source: MSCI as of Sept. 30, 2024. The MSCI UK Index had a price-to-earnings ratio of 12.86 compared to 21.76 for the MSCI All Country World Index (ACWI)

<sup>12</sup>Source: MSCI, as of Sept. 30, 2024

<sup>13</sup>Source: Bloomberg, L.P., as of Oct. 7, 2024

<sup>14</sup>Source: MSCI as of Sept. 30, 2024. The MSCI US Index had a price-to-earnings ratio of 27.33 compared to 21.76 for the MSCI All Country World Index (ACWI)

<sup>15</sup>Source: FactSet Earnings Insight, Oct. 4, 2024

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## Important information

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

Dividend yield is the amount of dividends paid over the past year divided by a company's share price.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The Employment Situation Report is released by the US Bureau of Labor Statistics to monitor labor market data on a monthly basis.

A flash estimate is an early estimate for an economic data point.

Fluctuations in the price of gold and precious metals may affect the profitability of companies in the gold and precious metals sector. Changes in the political or economic conditions of countries where companies in the gold and precious metals sector are located may have a direct effect on the price of gold and precious metals.

Inflation is the rate at which the general price level for goods and services is increasing.

The MSCI All Country World Index is an unmanaged index considered representative of large- and mid-cap stocks across developed and emerging markets.

The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips, and foreign listings (e.g., ADRs).

The MSCI Emerging Markets Index captures large- and mid-cap representation in emerging market (EM) countries.

The MSCI Europe Index captures large- and mid-cap representation across a universe of developed market countries in Europe.

The MSCI Japan Index measures the performance of the large- and mid-cap segments of the Japanese market.

The MSCI United Kingdom (UK) Index is designed to measure the performance of the large- and mid-cap segments of the UK market.

OPEC+ refers to the members of the Organization of Petroleum Exporting Countries (OPEC) and other oil-exporting non-OPEC members.

A policy rate is the rate used by central banks to implement or signal their monetary policy stance.

Purchasing Managers' Indexes (PMI) are based on monthly surveys of companies worldwide and gauge business conditions within the manufacturing and services sectors.

The ISM Services PMI is published by the Institute for Supply Management to assess the US services sector, and the new orders sub-index is a component of the PMI that tracks the path of new orders made in the services sector.

Risk-off refers to price behavior driven by changes in investor risk tolerance; investors tend toward lower risk investments when they perceive risk as high.

A basis point is one-hundredth of a percentage point.

The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 Index option prices. VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

Brent crude oil comes from the North Sea and is a global benchmark for oil prices.

The price-to-earnings ratio measures a stock's valuation by dividing its share price by its earnings per share.

The opinions referenced above are those of the author as of **Oct. 7, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.