Markets look for a foothold to climb the 'wall of worry'

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For the most part, global stocks have had a disappointing run in recent days. There are a number of concerning factors at the moment, and stocks haven't been climbing the proverbial "wall of worry." At least not yet. In this week's commentary, I explain what's driving investors' worries, and what catalyst could possibly help boost stocks over the wall.

What's driving the 'wall of worry'?

The concerns include:

The Federal Reserve's taper talk. The hope that the August jobs report might delay the start of tapering was dashed last week by "Fedspeak." We heard from several Fed officials who shared the general view that tapering should be announced and should commence soon. St. Louis Fed President Jim Bullard said it best, arguing that he is not concerned about the August jobs report because there isn't a scarcity of jobs: "There is plenty of demand for workers and there are more job openings than there are unemployed workers."[1] In other words, this is not a typical weak jobs market — it is unique to the pandemic. Jobs are actually robust — people just aren't taking them. Bullard advocated for tapering to start this year and finish in the first half of 2022. This "Fedspeak" certainly didn't lift markets.

Europe's "temporary tapering." The European Central Bank (ECB) announced it is not tapering — but it will be "adjusting" asset purchases downward for the next few months. In other words, the recalibration will result in a decrease in asset purchases, although it is expected to be brief. While ECB President Christine Lagarde has forbidden use of the word "tapering," some investors are skeptical — they view it as temporary tapering that could become more permanent, and that added to negative sentiment last week.

Fear about earnings. There is a view that "the best is in the rearview mirror" for corporate earnings, and that they won't be as good going forward. Yes, I expect earnings growth to moderate — it has to, as it has been extremely high. But earnings growth estimates for the coming quarters remain strong, with analysts projecting earnings growth of more than 20% for the fourth quarter of 2021.[2] Yes, it should slow from there, with FactSet estimates at 9.4% for calendar year 2022, but that is nothing to sneeze at.

Concerns about COVID-19. COVID-19 infections continue to command headlines. As I have said, this hasn't had a big impact on mobility, but it certainly has weighed on investors' minds. And there is always the specter of a much worse variant emerging, although thus far the Mu variant does not appear to be as formidable as some have feared.

Inflation concerns. The August US Producer Price Index (PPI) was a bit unnerving, surging 0.7% (and 0.6% ex-food and energy).[2] Year-over-year, the PPI was up 8.3% overall and 6.7% on core.[3] And inflationary pressures aren't unique to the US. There is enough concern about inflation that a number of emerging markets central banks have been hiking rates. However, this print doesn't change my view that the big increase in inflation is largely temporary, but it did give investors pause, adding fuel to fears about a "stagflationary" environment.

Threats to the "political status quo." Markets like political stability, and there is some uncertainty right now, starting with the upcoming Canadian elections, which threaten to unseat Prime Minister Justin Trudeau. We also have the surprise resignation of Japan's prime minister, Suga Yoshihide, and uncertainty about who will replace him. And there are concerns about the direction Germany is moving in — and, therefore, the European Union as well — given recent polling on the national election that will occur later this month (Chancellor Angela Merkel's successor is not polling well).

Seasonal jitters. Finally, there is fear simply because we are in September, heading to October, given a few epic market drops that have occurred this time of year. But as my colleague Brian Levitt recently explained, a few rough Septembers have played an oversized role in spoiling the month's reputation, and more recent Septembers haven't followed the negative storyline. This is also true for October.

How can stocks climb the wall?

It's clear that there's a wall of assorted worries, and investors haven't climbed it yet. But that's OK. Last week, in a media interview, I was asked what catalyst was likely to move stocks higher. One very possible catalyst is a market pullback. In this environment, with an improving global economy, adequate fiscal stimulus, and very accommodative monetary policy, I expect the gravitational pull of stocks to be higher. Sometimes the catalyst for stocks to move higher can simply be a pullback that is perceived to be a buying opportunity. That could be in the offing; I for one would welcome it.

In the meantime, I will be watching a number of issues, including the following.

Six issues for investors to watch

The Fed. The next Fed meeting occurs next week, and there is growing consensus that the start of tapering will be announced after that meeting. But I must repeat that I don't think investors should be concerned. This has been well-telegraphed in advance, and despite some hiccups, US economic growth remains solid. So in my view, this Fed action is appropriate and shouldn't derail markets.

September and October US jobs reports. I can't disagree with Bullard — this is not a weak jobs market. And as I have said before, I expect people to start taking those jobs now that kids are back in school and enhanced unemployment benefits have ended. The September and October US jobs reports will be litmus tests for my thesis, but I don't think the Fed will wait that long to announce the start of tapering — and, again, that will be OK for markets, despite jitters right now.

US corporate tax increase. Congressional Democrats are proposing a corporate tax hike to 26.5%. If that's the case, I think that would be a best possible scenario under the circumstances — we all knew there had to be a corporate tax increase in the offing, and it could have been much worse. Now there are other taxes they are proposing as well – and there is certainly dissension on these proposals. We will want to follow this closely.

US debt ceiling. We also have this looming issue of the debt ceiling. US Treasury Secretary Janet Yellen warned in a letter to congressional leaders last week that the Treasury Department may not be able to keep paying the government's obligations by next month unless Congress raises or suspends the federal borrowing limit. This couldn't come at a worse time given the severe divisions in Congress right now. I do expect it to be resolved, but I suspect it will come down to the wire and give us all a few upset stomachs and gray hairs in the process.

Economic growth forecasts. There has been so much focus on recent economic growth downgrades, but there have been some upward revisions as well. The ECB upgraded its growth forecast for this year to 5% from 4.6% in its June forecast.[4] While the ECB raised inflation expectations, they still show a substantial drop from 2021 to 2022, supporting the view that inflation is largely temporary. Inflation is now projected to be 2.2% this year but is forecast to fall to 1.7% next year — materially below the ECB's 2% target.[4] I of course will be following mobility and economic data closely, but I also will be tracking forecasts.

US-China trade relations. There was some optimism around the conversation last week between Joe Biden and Xi Jinping, but I don't think that will change much. I expect relations to remain strained for the time being, but I will be following closely in hopes that US tariffs will be rolled back, which would be a real positive for all concerned.

Of note

I would be remiss if I didn't mention the 20th anniversary of 9/11, which occurred this past weekend. Many of my US colleagues worked in the World Trade Center and were directly impacted by the attacks. I cannot think of this day without a heavy heart, and I will continue to pray for all the victims of this horrible act of terrorism, including their families, friends, and all loved ones.

Notes

[1]Financial Times, "Top Fed official pushes for quick 'taper' despite weak US jobs growth," Sept. 7, 2021

[2]FactSet Earnings Insight, Sept. 10, 2021

[3]US Bureau of Labor Statistics, Sept. 10, 2021

[4]European Central Bank, Sept. 9, 2021