Looking for signs of what's to come for the markets

Kristina Hooper
Chief Global Market Strategist

Weekly Market Compass | September 19, 2022

It's human nature to look for signs of what the future holds. I recall my mom had a friend who would pay for tarot card readings, looking for hints about who her daughter would marry one day. And as I've mentioned in past blogs. I remember when people carefully watched then-Federal Reserve Chair Alan Greenspan's briefcase for signs of what would happen at the next Fed meeting.

Today, market watchers are looking for signs of what might happen in the economy and markets. Indicators can come in many forms — from technical to economic to fundamental. So what are some of these indicators telling us now?

Bellwether stocks

One good source of information is earnings guidance from companies perceived to be "bellwether stocks." These companies are viewed as helpful in predicting the performance of the economy or market or a particular sector, and so their earnings guidance (or earnings results, or even stock price performance) can carry more weight in terms of market sentiment.

Interestingly, the word origin of "bellwether" comes from the world of shepherding. Shepherds took one male sheep — often referred to as a "wether" — and placed a bell around its neck, using it to lead the flock. The bellwether was a trendsetter, leading its flock, and so we look to bellwethers for clues of trends to come.

Because of its global reach and the nature of its business — transportation of goods — FedEx is viewed as a bellwether stock, one that can provide insight on the health of the global economy. Late last week, FedEx shook markets with the warning it provided: "First quarter results were adversely impacted by global volume softness that accelerated in the final weeks of the quarter. FedEx Express results were particularly impacted by macroeconomic weakness in Asia and service challenges in Europe…"[1] FedEx added that "…macroeconomic trends significantly worsened later in the quarter, both internationally and in the US"[1] This cast a pall over the stock market, as expectations of a serious global economic downturn grew.

The culprit? This is largely about central bank tightening in response to inflation.

Rising rates

As the World Bank explained last week in releasing a study on the policies being used to combat inflation: "Central banks around the world have been raising interest rates this year with a degree of synchronicity not seen over the past five decades…"[2] David Malpass, president of the World Bank, not only sounded the alarm about global growth slowing sharply, but used the study to advocate for a shift in the policy response to high inflation, "To achieve low inflation rates, currency stability and faster growth, policymakers could shift their focus from reducing consumption to boosting production.

Looking for signs

Today, market watchers are looking for signs of what might happen in the economy and markets, especially when we might expect a bottom for the stock market.

FedEx casts a pall

FedEx shook markets with its comments about macroeconomic weakness, and concerns about a serious global economic downturn grew.

All eyes on the Fed

To me, the actions of the Federal Reserve would be a far more significant signal about shorter-term stock market performance than an earnings warning or technical indicator.

Policies should seek to generate additional investment and improve productivity and capital allocation, which are critical for growth and poverty reduction."[2]

The World Bank study's recommendations will most likely fall on deaf ears, but there is hope that in its upcoming meeting this week, the Fed will not just think about the most recent US Consumer Price Index report, which triggered the start of the market sell-off last week, but perhaps might think — even just a little bit — about warnings from the World Bank and FedEx, among others.

Technical indicators

Many are looking for signs that might indicate when the stock market sell-off has bottomed. One key indicator is the VIX; piercing the 40 level has traditionally been considered a reliable indicator of a market bottom. However, the VIX is hovering around 26 right now — far from where market watchers would like to see it.[3] And the S&P 500 fell below 3900 — viewed as a key technical support level — on Friday; this is viewed as another sign the market has yet to bottom.[3]

So is there hope of a stock market turnaround in the near term? Given how much markets have been driven this year by central bank actions — especially Fed tightening — the answer in my opinion is yes. I still believe the Fed can be the catalyst for a turnaround in US and global markets if it pivots to a less hawkish stance. While that may seem unlikely to happen this week, given another 75 basis point hike seems to be a fait accompli (or perhaps it might be more appropriate to call it a "Fed accompli") — I believe a slight pivot could still come. Keep in mind we will be receiving a "trifecta" of messages from the Fed on Wednesday: the rate hike decision, the "dot plot" and the press conference. The actual decision could be the least important, because markets will be looking ahead to what is to come, and that's where the dot plot and the press conference come in. We could get a less hawkish dot plot than had been anticipated or, even more likely, some less hawkish language from Fed Chair Jay Powell at the press conference. That, to me, would be a far more significant signal about shorter-term stock market performance right now than bellwether earnings guidance or a technical indicator.

Conclusion

I think it's worth noting that the tarot card reader never did accurately predict that my mom's friend's daughter would remain single. Shepherds will tell you that some sheep are better at herding than others, and technical indicators can be more accurate in certain market environments than in others. Most of all, the stock market is not very efficient in the shorter term, often acting more like a "voting machine" than a "weighing machine."

My hope is that, no matter what the "signs" tell us and regardless of whether the Fed makes a subtle pivot, asset owners with longer time horizons maintain portfolios that are well-diversified across and within the three major asset classes (stocks, bonds, and alternatives) — despite the noise and nervousness of the current market environment.

With contributions from Thomas Wu

Notes

[1]Source: FedEx earnings guidance, 9/15/22

[2]Source: World Bank, "Risk of Global Recession in 2023 Rises Amid Simultaneous Rate Hikes," 9/15/22

[3]Source: Bloomberg, L.P., as of 9/19/22

Important information

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.

All investing involves risk, including the risk of loss.

Diversification does not guarantee a profit or eliminate the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions. Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock 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.

Tightening is a monetary policy used by central banks to normalize balance sheets.

A basis point is one hundredth of a percentage point.

The US Consumer Price Index measures change in consumer prices as determined by the US Bureau of Labor Statistics.

The Federal Reserve's "dot plot" is a chart that the central bank uses to illustrate its outlook for the path of interest rates.

The opinions referenced above are those of the author as of Sept. 19, 2022. 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.