

# After an awful month for stocks, what's in store for October?



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For those who don't know me well, I must confess that I am a movie buff — and I enjoy bad movies almost as much as good movies because of their comedic value. One thing I learned long ago is that if you are looking for a bad movie, typically one need not look any further than a sequel. (As my 15-year-old daughter would say, "Facts.") While there are always exceptions, movie studios tend to fast-track sequels because they know there is a built-in fan base, but sometimes that leads to rushed scripts and rushed production — and lots of unintended laughs. Cases in point include "Son of the Mask," "The Next Karate Kid," "Jaws 3," and "Jaws 4" as well as "Friday the 13th Part VIII: Jason Takes Manhattan." As the mother of a 19-year-old who is convinced he wants to be a screenwriter, I take comfort in knowing that, if nothing else, he will probably always be able to find work writing scripts for sequels.

The reason I bring up sequels is because September was an awful month for stocks — the S&P 500 Index experienced its worst performance since March 2020. And it's not just US stocks — global equities also suffered. That begs the question: where do we go from here? Will October be an ugly sequel to September? Or will it be the start of a new chapter for the market?

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### Four reasons why I'm positive on the stock market

Some strategists are pointing to technical models that suggest October could be a worse month for stocks than September. We all know that some terrible stock market sell-offs have occurred in Octobers past, so there is legitimate concern that this October might follow that script. But whether or not this month proves to be difficult for stocks, I feel strongly about the importance of staying invested in the stock market — and, for those with cash on the sidelines, looking for buying opportunities if there are sell-offs.

Following are some compelling reasons to be positive on the stock market, in my view:

- 1. Progress in the fight against COVID-19.** COVID-19 cases have fallen more than 30% since late August, while new daily cases in the US have fallen 35% since Sept. 1.<sup>1</sup> And Merck just announced that studies have shown molnupiravir, its experimental COVID-19 therapy, reduced hospitalizations and deaths by approximately 50%.<sup>2</sup> This is very positive news, especially given the difficulty many countries have faced in fully vaccinating their populations. What makes the development of this therapy important is that other treatments for COVID-19 come in IV form or through injection, so it's far more difficult to distribute them quickly and broadly (one must go to a hospital or medical clinic). This pill is being likened to Tamiflu, which has been very effective in lessening the impact of influenza.
- 2. Attractive valuations.** While still not modest, valuations are more attractive than they were just a few weeks ago thanks to the sell-off. It feels as though much of the bad news is priced in, but arguably not all the good news.

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3. **Robust capital market activity.** Global mergers and acquisitions (M&A) activity is up significantly. In fact, global M&A activity for the first nine months of 2021 exceeded \$4.3 trillion, which is already more than the largest year of M&A activity on record.<sup>3</sup> Initial public offering activity in the US is also significantly higher. This suggests business confidence and a lack of risk aversion.
  4. **Very accommodative monetary policy.** The Federal Reserve remains quite dovish, resisting announcing the start of tapering in September. And even when it begins tapering, which will likely occur later this fall, the monetary policy environment should be extremely accommodative as the Fed has massive assets on its balance sheet. In fact, many major developed market central banks have bloated balance sheets — and that is not going to change any time soon. This should provide an environment that is supportive of risk assets. In addition, and importantly, Fed Chair Jay Powell has decoupled rate hikes from tapering, setting a higher bar for the former.

Again, this doesn't mean we won't see sell-offs in October, but I still believe stocks will finish the year higher than where they are now.

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### Five issues to watch this month

Here are just a few things to watch in October:

1. **The US employment situation report.** Initial jobless claims have been creeping up in recent weeks, which is causing some concern about the job market. I am eager to see what the September jobs report tells us when it's released on Oct. 8. I have long said that this report could be the first to reflect some return to normalcy for American workers — enhanced unemployment claims for remaining states ended in early September and kids went back to school, easing child care pressures on parents trying to return to the workforce. A very disappointing jobs report could rattle markets, but I think it would only be a temporary setback for employment, given improvement in the fight against COVID-19. I am focused on wage growth, as that tends to create stickier inflation. However, even if we see significant wage growth, we will need to look carefully at which sectors it is coming from; as I have said before, I would not be as concerned if the wage inflation is coming from the service sector as I believe there is more flexibility to adjust wages downward in the future, given there is so much employee turnover in this space.
2. **More drama on China Evergrande.** The Chinese property developer faced another debt deadline today, with a \$260 million dollar bond payment due Oct. 3.<sup>4</sup> And today it requested a halt to the trading of its shares in Hong Kong, as it appears a deal to sell a majority stake in its property management business is in the offing. This suggests the company is attempting to restructure and meet its obligations, while Chinese regulators are focused on ring-fencing Evergrande, ensuring that there is no contagion; both are welcome news. I expect more developments on this front in coming weeks. The Evergrande saga is far from over.
3. **Debt ceiling drama.** If Congress is unable to raise the debt ceiling, it could certainly negatively impact stocks and bonds — especially if US debt is downgraded by one or more of the ratings agencies. And that's what credit rating agencies have been warning could happen. Ratings agency Fitch warned that if the debt ceiling isn't raised or suspended "in a timely manner, political brinkmanship and reduced financing flexibility could increase the risk of a US sovereign default."<sup>5</sup> I suspect there will be more scary headlines

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on this topic, but I ultimately expect the debt ceiling to be raised — it may be a situation where Democrats must singlehandedly raise it through reconciliation, but I believe it will get done, and a default and downgrade will be averted. Hopefully it will occur in the “timely manner” that credit rating firms are looking for.

4. **US-China trade tensions.** Early last week I had heard rumors that the US would be slowly and quietly rolling back tariffs imposed during the Trump administration — something I had expected to happen much earlier. But the US Trade Representative struck a more aggressive tone today, saying China is not meeting its obligations under Phase One of the trade deal. This could just be diplomatic theater; she also argued that the US needs to forge a “new course” in trade relations with China, so perhaps that still means a rollback of tariffs. We will want to follow this situation closely in the coming weeks. A rollback of tariffs could be a positive for both US and Chinese stocks.
5. **Fed re-appointment questions.** The odds that Powell will be re-appointed to his position as Fed Chair have decreased in the last several weeks. Betting site PredictIt indicated a 90% chance of reappointment for Powell as recently as Sept. 12; that is now down to 63% as of Oct. 3.<sup>6</sup> Still not bad odds, but it’s worth contemplating what would happen if he is not re-appointed. To put it simply, the Fed would likely tilt more dovish. The upside risk is that investors could become more bullish because of increased confidence that the Fed won’t act aggressively and choke off the economic expansion underway. However, I think the biggest downside risk in this scenario is that markets lose confidence that the Fed will be able to control inflation. Now it’s important to note that this could play out for multiple months, since his term does not end until early next year.

And so while October inspires fear in investors because of its track record of a few high-profile crashes, we must remember that most Octobers are fairly sanguine. Having said that, October 2021 could be an ugly sequel. I certainly wouldn’t be surprised to see heightened volatility and nervous investors. But while I see bad movie sequels for their comedic value, I would view an ugly market sequel as a buying opportunity.

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#### Notes

<sup>1</sup>New York Times, Oct. 4, 2021

<sup>2</sup>Merck, Oct. 1, 2021

<sup>3</sup>Refinitiv

<sup>4</sup>Business Insider, “Trading in Evergrande shares has been suspended pending a ‘major transaction’ - and as another debt test looms,” Oct. 4, 2021

<sup>5</sup>Fitch Ratings, “Debt Limit Brinkmanship Could Put Pressure on US ‘AAA’ Rating,” Oct. 1, 2021

<sup>6</sup>PredictIt, as of Oct. 3, 2021

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#### Important information

Past performance does not guarantee future results.

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.

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.

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