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Weekly Commentary

Issue **No. 41** | **OCTOBER 25, 2021**

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By Hubert Marleau

Inch by Inch Stocks Trek Higher as Money Managers Scoop Them Up

Submitted October 24, 2021

A Snapshot of the Market for the Week Ended October 22, 2021:

The S&P 500 hit a record high on the back of another strong week for earnings, reaching its 55th record close of the year. Of the 80 companies on the S&P 500 to have reported through Wednesday, 81% had topped analysts' earnings forecasts. Corporate profits in Q3 are expected to have jumped more than 35% from the prior year. The broad market eased off from an all-time high on Friday because big tech stocks were hit hard. Nevertheless it was up 74 points or 1.7 % to end at 4545.

We've been in a bull market since the beginning of 2009, and will not end until we have a profit recession or earning yields are too low vis-a-vis bond yields, neither of which is the case at this time. According to an October BofA survey of fund managers, money is flowing into inflation assets—Commodities, Banks, REITS, Energy, and Industrials—even though growth optimism has waned. Global equity funds took in $25 billion. More money will likely continue to head toward the equity market because institutional cash holding is presently 4.7% of their total portfolios, up from 4.3% in September-this highest cash holding in the past year. The last time cash was as high as this was September 2020, when the S&P 500 bottomed out from a pullback as it did in September 2021. It rose 20% in the following six months. When cash levels hit 5.0%, a clear buy signal usually emerges. Cash levels are some $1.0 trillion higher than they were pre-March 2020. BofA's Michael Hartnett in a note to investors wrote: "The good news for traders is that while high yield bonds are modestly struggling, classic canaries-in- the-equity-coal mine like tighter financial conditions are trading well above danger levels".

Macro View cont.

By Hubert Marleau

Overall, the market was relieved to see that the size of President Biden's social spending bill has reportedly dropped from $3.5 trillion to a bit less than $2.0 trillion including a back down from pledged corporate tax increases as Democrats try to wrap up negotiations. While the Fed is expected to dial down its bond buying program, it would be premature on the part of the investors and speculators alike to believe that the monetary authorities will hike rates in 2022. Recent economic prints show that the pace of the economy and of inflation is receding. For example, the Atlanta fed's NowCasting model is measuring only a 0.5% annual rate of increase in Q3. Although traders are pricing in more aggressive interest-rate hikes, the Fed is likely to use hawkish rhetoric to keep a lid on inflation expectation, while holding back on actual rate increases, which would slow the recovery. The monetary authorities are aware that the consumer expectations indexes from both the University of Michigan and the Conference Board have fallen over the summer months. According to David Blanchflower, an economics professor at Dartmouth College, these qualitative metrics can be predictive of economic slowdowns and downturns up to 18 months in advance.

Fortunately, it does not appear that the economic halt will last. The Markit Services Purchasing Managers Index showed a reading of 58.2 for October, indicating that business activity is increasing, and rising cost is being passed on to consumers. Record copper prices are discounting a resumption of economic growth in Q4 and 2022. The metal is trading at the widest backwardation since the middle of the 1990s suggesting that the outlook for global capital expenditures is solid. In fact, such spending has not only gone back to its pre-virus trend, Morgan Stanley expects the U.S. to lead the way with the strong outlays since the 1940s. Add it all up, the economists at Morgan Stanley reckon global investment will grow 8.1% in 2021, the most in 25 years, and 5.3% in 2022.

The legitimate concerns over supply constraints will likely be overcome because capex should increase productivity enough to partially correct them. Some relief on freight costs, dram prices and CRB Rind index is occurring. As a matter of fact, there are reports in several industries that many businesses are overcompensating with extra orders for materials because the media is making a bigger thing of the supply shortages than it actually is. The BofA survey shows that 58% of the institutional respondents still think inflation is transitory and 38% think it is not. Congestion is primarily the product of dramatically high volume of demand. Retail sales are 20% higher than they were in December 2019–should have been more like 7.0%.

In this later connection, businesses have been able to pass on higher input costs stemming from supply shortage because demand has been very strong. Wells Fargo observed that aggregate pre-tax margins for the 80 nonfinancial companies that have so far reported third quarter earnings rose to 13.2%, higher than the 12.8% seen in the second quarter and above the 12.4% seen in the third quarter of 2019.

Macro View cont.

By Hubert Marleau

Interestingly, only 51% of them believe that oil prices will top $100 a barrel. This is a blessing. Prices of crude oil, natural gas and coal have soared of late bringing the total energy bills to W-GDP to 10.0% last Wednesday. This ratio fell a bit in the last two days. Nevertheless it must be watched closely. If it were to rise more and stay above 10.0% for a few months, it would become problematic for economic growth.

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