Looking Back at the Markets in Q3 and Ahead to Q4 2021

After a great start to the quarter in July and August, the storms hit in September. Here in the U.S., markets pulled back significantly. The Dow declined by 4.2 percent for the month and 1.46 percent for the quarter. The S&P went down by even more for the month, at a 4.65 percent decline, although it gained 0.58 percent for the quarter. Finally, the Nasdaq trailed by even more, at a 5.27 percent monthly drop and a 0.23 percent loss for the quarter. Abroad, international markets were also hit, with developed markets down for both the month and quarter, at 2.9 percent and 0.45 percent, respectively. Emerging markets dropped 3.94 percent for the month and 7.97 percent for the quarter.

Let's look back at what drove these declines, as well as what we might expect ahead.

Looking Back

A perfect storm of market concerns. What drove the September declines was a reversal of both the medical and economic improvements seen in July and August. On the medical front, the Delta wave brought medical risks back to the forefront, generating a slowdown in hiring and consumer spending that raised economic risks. On top of that, at month-end, the Fed indicated that it would start tightening policy, leading to a rise in interest rates. In many respects, it was a perfect storm of market concerns all in one month, and it generated a sharp reaction.

Economic stats take a hit. We saw a sharp decline in hiring. From hiring more than 1 million in July to less than a quarter-million in August, layoffs started to rise again during the month, after declining earlier in the quarter, and ended the month where they started. Even as the job market weakened, the expiration around supportive federal programs, including supplemental unemployment insurance and eviction and foreclosure moratoria, raised worker worries and drove consumer confidence down. This was a significant change during the month. Weaker confidence is already showing up in weaker spending, and this could slow things going forward. The market reaction makes sense given these rising risks.

Looking Ahead

Improving medical news. Even as September ended the third quarter with a substantial increase in risk, there are reasons to believe the fourth quarter will be better. The medical news, which drove much of the economic damage, is starting to improve. New case growth, on a seven-day-average basis, was down by one-third during the month of September. The positive test rate was down by a similar amount, and hospitalizations were down by almost as much. The improvement has been sharp, and it may continue.

Economic risks starting to recede. The economic damage also stopped getting worse as the medical news improved. Layoffs rose but stayed at July levels, and consumer confidence appears to have stabilized. Strong business confidence and investment should provide a tailwind, and even the consumer economy still has substantial momentum. Many of the most significant risk factors, such as the expiration of federal programs, are starting to recede. As we move further into the fourth quarter, we will likely see more improvement as consumers respond to better medical news by going out and spending more.

Solid fundamentals. Supporting the idea that the fourth quarter will be better are the fundamentals. Earnings are expected to continue to come in strong. With margins up and sales holding, corporate earnings are expected to rise by 30 percent or more in the third and fourth quarters. Companies continue to sell more and to keep more of the sales as profits. From a business perspective, confidence remains high, and the results are justifying it. A recovery in the medical news and consumer confidence should help keep those positive trends on track.

Outlook Remains Positive

While the fourth quarter will face challenges, the outlook remains positive. The risks we saw in September are real. But there are also signs those risks may be fading—and that the very real positive trends from July and August will reassert themselves. September was the month when the markets started to take the risks seriously. October will be the month when we find out if that continues or if the improving trends turn it back around.

Sincerely,

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