MARKET COMMENTARY AND OUTLOOK | Q4 2021

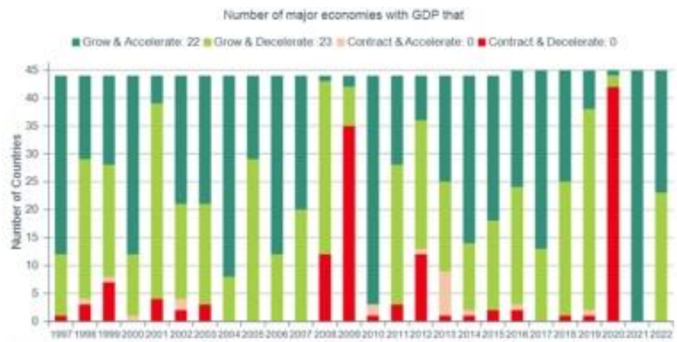
GLOBAL STOCKS AND THE ECONOMY

September and October come with a history of market volatility, and we saw a reminder of that on September 20th, when concerns about a potential default of Chinese property giant Evergrande Group helped drive stocks to their lowest drop since May. Despite a favorable economic environment forecast for 2022, markets may again opt to focus on near-term growth worries, including:

- Evergrande, the world's most indebted property developer and among the most highly leveraged companies in China, has recently been struggling to meet its debt obligations amidst regulatory changes, leaving investors worried about the potential fallout of default.
- While new global COVID-19 case counts have begun to recede after the delta variant surge this summer, ambiguity surrounding approval for booster vaccine doses could trigger investor concern over the potential for another rise in cases.
- The European Central Bank says it will marginally reduce the pace of its asset purchases. Although tapering is likely to make little difference to financing conditions, stock market volatility could arise from investors conditioned to react in response to changes in stimulus from central banks.
- Late-September elections in Germany and Japan (the world's third- and fourth-largest economies), may not lead to dramatic changes in policy. However, it may take months for Germany to form a new government, raising uncertainty around future policy direction.
- Shipping logjams are back and at the worst levels of the pandemic, raising risks to corporate sales, manufacturing production and inflation. As we near the third quarter earnings reporting season, the potential for sales or earnings disappointments may be rising.

Looking beyond the next few months, we believe that the 2022 global economic environment may be favorable for investors. Central banks are preparing to rein in the pace of stimulus, with particular focus on the expected pace of growth in the economy and inflation. The Organization for Economic Cooperation and Development (OECD) forecasts that every one of the 45 major economies in the world will be growing next year, with about half experiencing slower growth than in 2021.

Growth is expected to rise in all major countries in 2022.



Source: Charles Schwab, Macrobond and OECD data as of 9/17/2021.

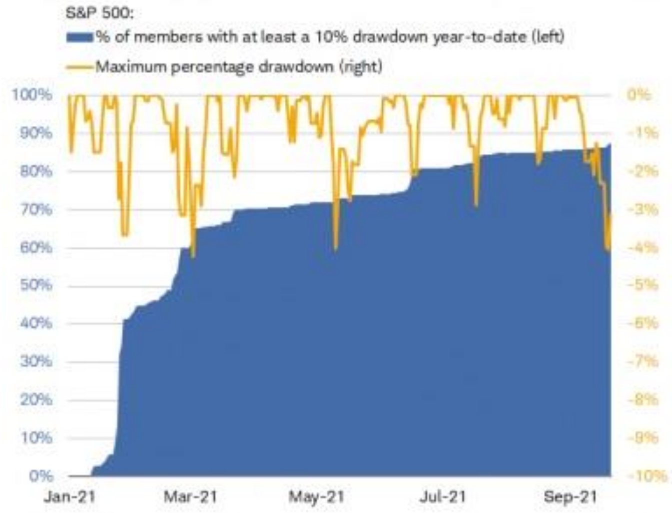
Global economic growth is expected to be 6% for 2021 and 4.9% for 2022, according to the International Monetary Fund (IMF). If realized, this would be the fastest growth in at least a generation, or probably closer to two or three. Not since 1973 has growth been 6% or higher. Although not a hard-and-fast rule, when world economic growth drops below 2% it is considered a global recession. Likewise, growth above 4% is understood to be an economic boom. It's exceedingly rare for global growth to exceed 4% for two years in row.

Stocks have tended to perform well with robust global growth. In particular, the MSCI EAFE Index has historically produced above-average returns when global growth was above 4%. A rising tide of rapid growth tends to lift stocks, despite waves of worry over near-term concerns.

U.S. STOCKS AND THE ECONOMY

While the crisis within China's property sector stemming from Evergrande's debt problems has contributed to recent volatility within the U.S. equity market, it isn't the sole reason for the weakness. The S&P 500 has maintained a steady climb this year, largely uninterrupted by the NASDAQ's correction in February/March, the collapse in several speculative market segments (e.g., meme stocks, special purpose acquisition companies, newer IPOs, etc.) since March, and sideways move in small-cap stocks since February.

Overall S&P 500 index performance suggests a relatively tame market, but there has been considerable churning underneath the surface. Not only have sector rotations remained swift and sizable, but many stocks within the S&P 500 have already reached correction territory this year. While the S&P 500 has yet to see even a 5% correction in 2021, nearly 90% of its members have already had at least a 10% correction at some point.



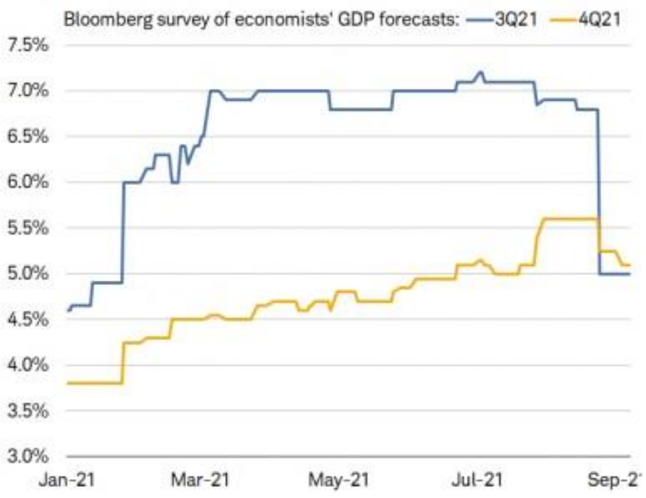
Source: Charles Schwab, Bloomberg, as of 9/22/2021. **Past performance is no guarantee of future results.**

The underlying weakness also suggests some fundamental challenges the economy is facing in the near term—not least being disagreements in Washington over the debt ceiling and the likelihood of slower economic growth in the latter half of the year.

Pressures from supply chain-related constraints and subsequent inflation concerns are still acting as headwinds for the economy. Depressed inventories—which caused second-quarter real gross domestic product (GDP) growth to be slower than expected—are taking longer to be rebuilt. Meanwhile, consumption (particularly within the services sector) is cooling, evidenced by the flat growth in restaurant retail sales in August. That has in turn caused economists to revise down their growth estimates for the latter half of the year. The consensus estimate for third-quarter growth has fallen from a peak of 7.2% in July to 5%, and fourth-quarter estimates have started to soften as well.

MARKET COMMENTARY AND OUTLOOK | Q4 2021

GROWTH EXPECTATIONS DIM

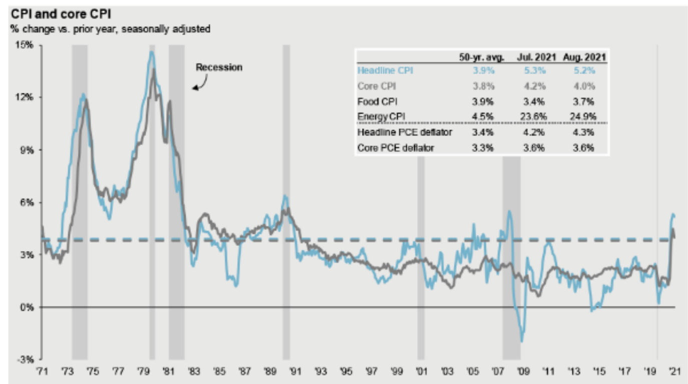


Source: Charles Schwab, Bloomberg, as of 9/21/2021. Growth rates expressed in annualized quarter/quarter terms, adjusted for inflation.

Many economic uncertainties remain, and given the ongoing sharp swings in sector leadership within the stock market, we continue to emphasize a factor-based approach—for example, focusing on fundamental factors such as high free-cash-flow yield, which suggests the company is generating enough cash to support itself and reinvest for growth. Maintaining a focus on high-quality segments of the market–e.g., companies with strong balance sheets, meaning strong sales and earnings relative to total assets—historically tends to work well in an environment that is still choppy, especially as the trajectory of the virus continues to influence market and economic results.

INFLATION

Inflation signals have heated up significantly as a surge in consumer spending continues to collide with supply shortages across major sectors of the economy. Some drivers of much higher inflation are beginning to abate and we expect inflation to moderate in 2022 as supply chain disruptions are ironed out and demand growth cools. However, strong wage growth, higher inflation expectations, a falling dollar and the lagged effect of higher home prices on rents should keep inflation more elevated than at the end of the last expansion.



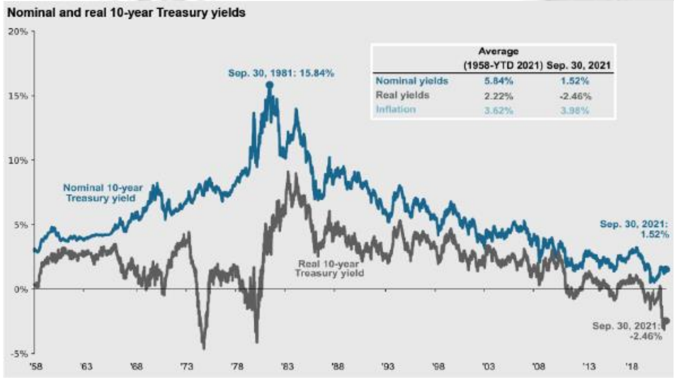
	50-yr. avg.	Jul. 2021	Aug. 2021
Headline CPI	3.9%	5.3%	5.2%
Core CPI	3.8%	4.2%	4.0%
Food CPI	3.9%	3.4%	3.7%
Energy CPI	4.5%	23.6%	24.9%
Headline PCE deflator	3.4%	4.2%	4.3%
Core PCE deflator	3.3%	3.6%	3.6%

Source: BLS, FactSet, J.P. Morgan Asset Management.
CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations.

INTEREST RATES

Interest rates likely to resume their ascent. The combination of very easy monetary policy and a recession has left 10-year treasury yields at very low levels. Interest rates will likely move higher into 2022, against the backdrop of rising inflation, faster growth, and a less accommodative Fed as they begin tapering. There continues to be a place in portfolios for fixed income to provide diversification and protection in the case of an equity market or economic relapse, but investors may want to focus on short duration bonds to be well-positioned if long term rates resume their ascent.

MARKET COMMENTARY AND OUTLOOK | Q4 2021



Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for September and August 2021 where real yields are calculated by subtracting out September 2021 year-over-year core inflation.

OUTLOOK

The U.S. economy has had a bumpier recovery than expected but is still on strong footing as we enter the fourth quarter, and further progress on the pandemic at home and abroad will continue to be a tailwind for the global economic recovery. We feel that earnings should start to slow from here and that even though companies have adapted very well during this crisis period, cost and supply pressures will arrive in the near future. We feel stronger than ever that investors would be wise to focus on fundamentals and maintain a diversified stance within their risk profile into 2022.

References:

"Economic & Market Update | J.P. Morgan Asset Management." Am.jpmorgan.com, 30 Sept. 2021, am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/economic-and-market-update/.

Jones, Liz Ann Sonders, Jeffrey Kleintop, Kathy. "Schwab Market Perspective: Choppy Waters." Schwab Brokerage, advisorservices.schwab.com/content/market-perspective. Accessed 14 Oct. 2021.