Commerce Trust Company
Wealth | Investments | Planning

Five Minutes with Commerce Trust's Chief Economist – Scott Colbert
11/29/21

Scott Colbert:

Good morning. It's Monday, about 11:00 AM. The markets are open, and the markets are up on this Cyber Monday. Of course, the big news today and over the last few days has been this, the 15th variant of the coronavirus, the so-called Omicron variant that suppressed markets last week, in fact, pushed them down. The S&P 500 fell more than 2% last week, and global markets fell even more. The average international stock down about 3.5%. Small cap stocks getting beat up here domestically too, down around 4%. It certainly put a damper on the Thanksgiving weekend. It maybe even put a damper somewhat on online shopping. And clearly, the stock market fell. But we're getting a rebound today, mostly because the first take on this is that the Omicron variant is likely to be more transmittable, but perhaps a lot less virulent than the Delta variant.

What did happen when we had the Delta variant surge? Of course, we had growth slow in the third quarter. Growth was only 2% in the third quarter. We saw the stock market was flat, and we saw interest rates come down a little bit. We're optimistic that this won't be as troubling as the Delta variant, but I think it's still much too early to know. Clearly though, the markets weren't really priced for another problem with the coronavirus because we had a huge risk-off trade. In fact, we saw the VIX (Chicago Board Options Exchange Volatility Index), the implied volatility in the market, jump by 10%. That's only happened 18 times in the last 30 years. So, it was a rather complacent market. Is there anything good to come from this variant? Perhaps a healthier pricing in the stock market in terms of better valuations. A recognition that we still need to take caution… perhaps will increase vaccines or vaccinations on a going forward basis.

But I don't think there's any doubt that it's going to cool the markets down a bit and perhaps maybe from a positive perspective, take a bit out of the inflationary surge that we've been seeing. Other than that, we've had a very strong quarter. October was exceptionally strong, and November was coming in on the heels of October with a similar pace. There are a lot of tracking that shows what GDP is likely doing for the quarter. And the GDP Now forecast1, which is sponsored by the Atlanta Fed, is up 8.4% so far, predicting growth in the quarter. Now, 8.4% is an annualized number. That really means that growth is likely to be 2% on a nominal basis in a fourth quarter, but that's on a real basis. If we have growth in the fourth quarter anywhere, 7% or 8%, add inflation to that, that's a nominal growth rate nearly into double digits.

Jobs are exceptionally strong. We had over a half a million jobs created in the month of October. We'll get the November jobs report this Friday. And the market consensus is for another add-on of about a half a million jobs. Incomes are surging because of two things, wages and salaries and benefits are up about 5% on a year over year basis, and worked hours and employment is up about 5%. That's adding to about 10% extra income for the average household on a year over year basis. And of course, that's translating into gains in retail sales. And of course, corporate profitability is at all-time highs. It sure looks like the third quarter total profits are going to be above second quarter profits by about 4.5%, which means that the S&P 500 earnings are approximately $215 to $217 per share.

They're likely to increase in the fourth quarter as well. It's just a chip shot right now to get to $220 of S&P 500 earnings. The S&P 500 is exactly at 4,650 as we're speaking, which tells you the PE is a little bit higher than 21, but lower than 22 as we end the year. We're in the process right now of writing our "Outlook" for the 2022. I thought perhaps I'd try and summarize it here quickly and give you a little heads up about what it's going to be. And then two weeks from now, we'll talk about what's in print. Clearly, the easiest and most conviction-trade that we have is that interest rates are likely to continue to increase. With inflation still high, interest rates exceptionally low, and the Fed likely to take some of the punch bowl away, we think interest rates are going to rise.

Stock prices, that's a tougher call. We're still optimistic on the stock market in that valuations, while expensive, earnings are still likely to grow faster, allowing the market to grow into its valuations. So we're optimistic on stocks. We think global GDP is likely to increase at a faster pace than U.S. GDP as they begin to catch up. And of course, the outlook for jobs is still exceptionally strong. There are still these 11 million job openings. We're slowly pulling people back into the workforce. And the outlook for the U.S. economy is exceptionally positive. The worry, of course, is, will there be another variant, a 16th, a 17th, and 18th variant of the coronavirus? And when can we really put this back and put it behind us? So we'll be back in a couple weeks to talk about what we've put in print. And hopefully two weeks from now, you'll see it in your inboxes, our Outlook for 2022. But it's a rather optimistic one. And we'll be able to talk to you about it soon.

1 https://www.atlantafed.org/cqer/research/gdpnow#:~:text=Latest%20estimate%3A%208.6%20percent%20%E2%80%94%20November,8.2%20percent%20on%20November%2017.