



# Peak or turning point?

Market Comment, October 2021



**As the fourth quarter gets under way, are we at the turning point for both the economy and the markets? Have we already passed the peak in terms of the economy? The question of quite where we are in the economic cycle will by definition only be possible with hindsight. The extremely strong earnings growth of companies in the first half of the year suggests that a peak has been reached. On the other hand, it may well be premature to call an end to the stock market rally. Nonetheless, expectations should be scaled back given the huge increases we have seen in equity prices and corporate earnings.**

The extremely strong growth in European and US corporate earnings reported over the summer suggests that a peak in growth development has been reached. This is understandable given that the comparative base in 2020 was very low as a result of lockdowns, hence year-on-year growth in the first half of 2021 proved particularly high. So high, indeed, that growth rates over the next few quarters must inevitably decrease again compared with last year. But that does not mean that we are on the brink of recession.

It should come as no surprise if a number of leading economies were to unveil rather less impressive economic growth going forward. A distinction should be made between the supply side of the economy, which can be quantified by levels of manufacturing production, and the demand side of the economy as reflected in the growth of consumer spending, for example. A decline in the growth rate of production should surprise no one. Quite aside from the base effect referred to above, the manufacturing sector is also struggling with a number of shortages in certain subcomponents which are required for the delivery of end products. Both of these factors are reducing production growth in the fourth quarter. Meanwhile, growth in consumer spending could fall back too. This may well be explained by rises in consumer prices – as inflation gathers pace, including in the area of energy prices, a certain amount of consumer purchasing power is eroded.

Another factor that should be carefully monitored and not underestimated is the likelihood of new coronavirus variants. As we have often stressed, developments in connection with the pandemic cannot be predicted. As the colder days of winter draw in, we may therefore see increasing levels of uncertainty, including where the development of the economy is concerned.

**“With equities having recorded well above-average rises, investor expectations should now be scaled back.”**

Gérard Piasko, Chief Investment Officer

As an additional factor, there is a lack of clarity over the strength of the US labour market and the impact of wages and inflation until the third – and quite possibly the fourth – quarter of 2022. The repercussions of the expiry of unemployment support from the autumn of 2021 will therefore be significant here. China’s economic development has also become more unstable, with recently published data clearly pointing to a growth slowdown. At the same time, the Chinese government has intensified the regulation of leading internet companies, which can be expected to weigh on the Chinese (and therefore also the global) economy, at least in the short term. After all, China remains the world’s second-largest economy. Last but not least, the change in the US central bank’s (Fed’s) monetary policy, which will initially involve the tapering of bond purchases, is another more uncertain variable for future macroeconomic and market developments.

Against this uncertain backdrop, greater market volatility in all asset classes – and not just equities – would not surprise us at all.

**Conclusion:** Due to the changing and now gradually rising prior-year base, global economic growth could slow. Furthermore, various special effects are likely to lead to greater volatility over the next few months. These include

supply problems in connection with subcomponents, which are having an impact on manufacturing growth, the regulation of key parts of the Chinese economy, including the real estate sector, and the unpredictability of coronavirus.

While it would probably be exaggerated to suggest we are seeing a definitive trend reversal across the board, the zenith of economic and earnings growth in the current cycle may well have been reached. This does not mean recession is knocking at the door, as both the economy and corporate earnings are still growing. But it may well be the case that all asset classes will now find themselves exposed to greater volatility. Bearing all this in mind,

investors are likely to be more moderate in their expectations of a straightforward bull market and uninterrupted economic growth, particularly after the (well above-average) rises recorded by equities in recent quarters.

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