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ECONOMIC COMMENTARY
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YOUR WEEKLY ECONOMIC UPDATE

18 October 2022

YEAR-END RALLY? CHRISTMAS MAY COME TWICE THIS YEAR…

After having suffered through September, global markets, historically, tend to experience more positive performance during the last three months of the year. Even though the chance of this may look slim this year, when compared with previous years, a year-end rally may just be on the table.

On average, United States (US) markets gain 3.9% during the last quarter of the year. The reason for this is unknown but one explanation may be that investors flood back into the market after the historically dismal performance of September, where returns usually average around -0.6%. What is also interesting is that, historically, the performance during the last three months of a year in which mid-year elections are held, is even better than other years. Usually, when it is time for a mid-year election, markets jump 6.3% during the last quarter.

Even though the US will have a mid-year election this year, on 8 November, markets may buck their historic trend. This is, firstly, because inflation in the US and most other parts of the world is remaining stubbornly high. US inflation reached a new high in September with core inflation remaining very sticky. The US is in a very strong economic position, which could make inflation a little bit stickier than most people would expect. An example of their strong economy can be seen in the labour market, where there are nearly two jobs available for every unemployed person. This explains why wages are roughly up 7% compared with a year earlier, as employers fight for new talent and to retain existing staff. Workers who earn more use these higher wages alongside excess savings to fund purchases, which drive prices up even more in the process.

As a result of higher inflation, the US Federal Reserve has indicated that they are not willing to take their foot off the pedal just yet. The resulting higher interest rates mean that companies must contend with higher borrowing costs, which erode their margins. Higher interest rates also mean lower earnings in present value terms because of a higher discount rate. The latter has a direct impact on the price that buyers are willing to pay for a company. All of this means some more pain for equity markets.

Secondly, investors are still extremely concerned about the possibility of a real recession, not just the technical recession that we are currently experiencing in the US. Despite re-iterating that the economy is still strong, JPMorgan Chase's Chief Executive Officer, Jamie Dimon, a well-respected man on Wall Street, warned that a "very, very serious" mix of headwinds was likely to tip both the US and the global economy into a recession by the middle of next year. Europe is, most likely, already in a recession, despite the Head of the International Monetary Fund, Christine Lagarde's, call that this is not the case. With the possibility of a recession weighing on investor sentiment, it is very important to remember that equities have already gone some way in pricing in a recession, considering that US markets are down by almost 25% from their highs. Financial markets are thus looking forward and, therefore, price in events well in advance.

With a myriad of global uncertainties weighing on financial assets, history may just be on our side over the next few months (if there are not any new surprises, of course). What is certain is that investors will almost surely welcome a year-end rally and a possible second Christmas.

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