Zacks
INVESTMENT MANAGEMENT

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Mitch on the Markets

Portfolio Manager Investing Insights

Three Factors That Could Impact Fourth Quarter Returns

U.S. stocks have delivered a banner year, with solidly positive returns registered across the size and style spectrum. The question is, *what will the final two months of the year bring?*

Short-term returns are unpredictable. But I do have three factors I think could impact markets in this final stretch. Readers will note that the Federal Reserve is not one of them. In my view, the monetary policy factor is largely baked into stock prices, as there is no expectation that rates will move higher at the next two meetings.[1]

Setting the Fed and monetary policy aside for a moment, here are three year-end factors to keep in mind.

1. **U.S. Elections**

The stock market does not like uncertainty, which makes U.S. presidential election years more vulnerable to volatility flare-ups. History shows a fairly consistent pattern. Stocks have been choppy in the weeks leading up to election day, then settle—and often rally—once the result is known. Indeed, the CBOE Volatility Index—also known as the VIX—tends to be higher (on average) in late October and early November in election years, versus non-election years.[2]

Given the tightness of the race and an overall process that could be more drawn-out than previous cycles, we might reasonably expect historical volatility trends to apply to November. But I do not think this alone should alter an investor's positioning or outlook, which based on earnings and economic fundamentals remains constructive.

Investors may also be preparing for a specific outcome, as it is common in presidential election years for investors to assume their political party is better for the stock market. But history says the stock market goes up regardless of how power is divided.

ABOUT MITCH ZACKS

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Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

Political allegiance should not determine your investment strategy. Case-in-point, here's the growth of $10,000 from 1943 to 2023:

- $311,766 – If invested only during Republican presidencies
- $1,212,746 – If invested only during Democratic presidencies
- **$37,809,262** – Stayed invested regardless of which party controlled the White House

Since 1950, there have been 18 presidential elections, and over that time U.S. GDP has grown at an average annualized pace of 3.2% with the S&P 500 annualized 9.4% per year.

My advice for this final election stretch: recommit to being dispassionate, disciplined, patient, and focused on the long term. Even though it often feels like everything is riding on the outcome of the election, history reminds us that election results have not driven market results over the long term. The economy and corporate earnings do.

2. **China Policy Stimulus**

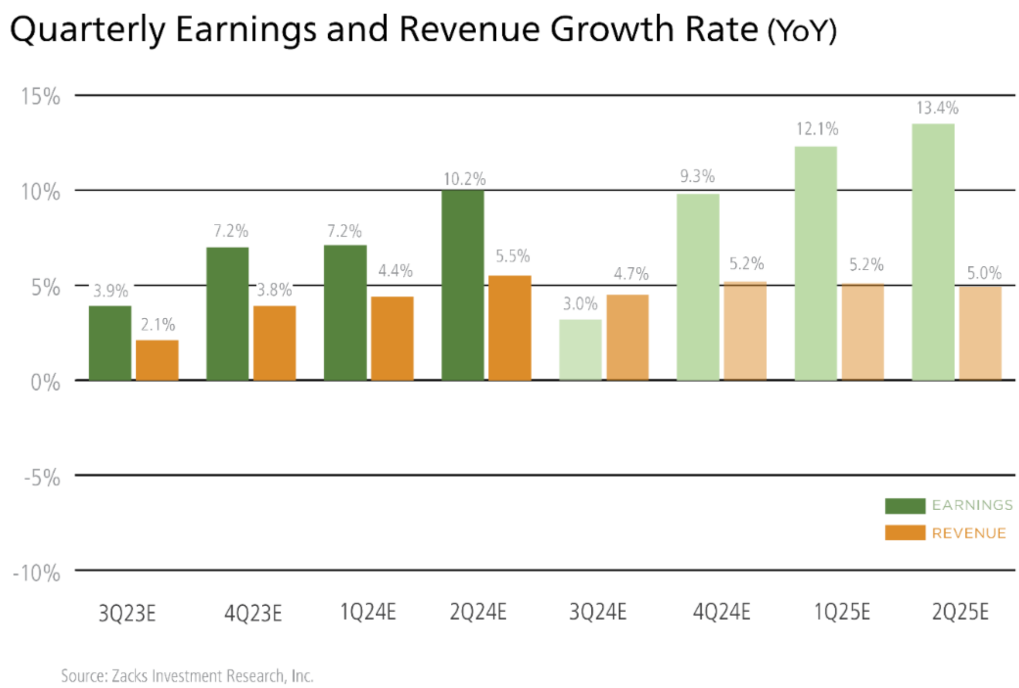
Investors have long been eyeing China for signs that the world's second-largest economy is finally pivoting to more accommodative monetary and fiscal policy. Announcements in recent weeks have largely fallen short of expectations, but the magnitude of the stimulus may matter less than the direction.

In September, the People's Bank of China (PBOC) announced it would cut its benchmark interest rate and allow banks to hold less cash in reserves relative to deposit levels, which was designed to free up more capital for lending. Mortgage rates were also cut by 50 basis points, and $70 billion in loans were made available for funds, brokers, and insurers to buy Chinese stocks. Last week, commercial lenders cut their benchmark lending rates as well.

Chinese shares have rallied in the wake of these decisions, but it may be that investors are feeling hopeful for a big policy decision that could arrive following the gathering of the National People's Congress in the coming weeks. That's where we could see a sizable fiscal stimulus plan that could tally in the hundreds of billions of dollars and would involve new debt issuance. Stay tuned.

3. **U.S. Corporate Earnings**

It's early in the Q3 earnings season, but the reports we've seen so far suggest that corporations are doing just fine. If we combine already-reported results with estimates for companies that are due in the coming weeks, total earnings for the S&P 500 index are expected to be up +3% from the same period last year on +4.7% higher revenues. The chart below shows the Q3 earnings and revenue growth pace in the context of where growth has been in the preceding four quarters and what is expected in the coming three quarters. Not too hot, not too cold.



Notwithstanding the modest growth pace in the third quarter, the aggregate earnings total for the period is expected to be a new all-time quarterly record, as the chart below shows.

Perhaps the most important feature of Q3 earnings season so far, however, is how estimates for the final quarter are holding up. Unlike the unusually high magnitude of estimate cuts that we had seen ahead of the start of the Q3 earnings season, estimates appear to be far steadier for Q4, as seen below. Total S&P 500 earnings are expected to be up +9.3% from the same period last year on +5.2% higher revenues.

In the final two months, it will be essential to watch how the remaining corporations report for Q3, and what they say about expectations for Q4 and next year.

BOTTOM LINE FOR INVESTORS

Historically speaking, strong starts to the year for stocks tend to result in strong finishes. Fundamentals support equity markets in this particular year as well. Arguably the most bullish factor in today's market is improving liquidity conditions, with nearly all major central banks all cutting rates and excess liquidity in the G10 at historic levels. If China takes bold action in the next few weeks, the case would become even more compelling.

The U.S. presidential election is likely the factor that unsettles investors the most, which is understandable. But just remember that over time, the stock market responds more to long-term earnings trends and broad-based economic growth, not to changes in political leadership. Politicians come and go, but the desire to grow, innovate, and pursue profit remains a constant.

1 J. P. Morgan. October 11, 2024. https://www.jpmorgan.com/insights/markets/top-market-takeaways/tmt-fourth-quarter-forecast-three-things-that-could-affect-markets

2 Zacks.com. October 18, 2024. https://www.zacks.com/commentary/2353509/what-do-q3-earnings-results-show?

STEADY INVESTOR WEEK

- **The I.M.F.'s current inflation take**
- **Gold prices set new records**
- **The decline in home sales**

The International Monetary Fund Thinks the World's Inflation Problem is Over

The IMF released new economic forecasts this week, and the message was clear: the global economy has managed to escape the surge in inflation—and the higher interest rates that accompanied it—without experiencing a recession. Without using the phrase, the IMF laid out the case for a "soft landing," projecting that global GDP would hold steady at 3.2% in 2024 and 2025, while inflation declines to 3.5% by the end of next year—down from 5.3% this year and a peak of 9.4% in 2022. A GDP growth rate of 3% is healthy for the global economy, and the 3.2% inflation rate, if achieved, would be lower than average inflation from 2000 to 2019. However, the IMF cited several risks to the forecast that could play out in the new year. Among them, are escalating wars in Ukraine and the Middle East and a sharp pivot to protectionism via tariffs and trade wars, which could disrupt supply chains and raise costs. The overall picture being painted of the global economy is one of "goldilocks" economic fundamentals with widely known risks, which we overall view as positive for equity markets.[1]

Gold Prices Set New Records, But Still Aren't Sound Long-Term Investments

The precious metal has been in rally mode recently, hitting new record highs and rising in 10 of the last 12 weeks. There's much speculation about the root causes of gold's ascent—the possibility of rising deficits and higher inflation due to the policies of either the U.S. presidential candidate, or the inverse, where rate cuts could weaken the dollar and therefore boost commodities. For close readers, it seems like the case is being made that gold will rise no matter what the economic future holds, which underscores a key issue with the precious metal—its price is largely driven by sentiment. Consider that fundamental analysis largely does not apply to gold because it can't—gold does not generate earnings, it does not pay dividends, and it does not create new products and services that add value to the economy. It follows that since becoming freely traded in 1974, gold has been highly volatile and also a poor performer relative to stocks and bonds. U.S. stocks' outperformance of gold over that time is nowhere near a close race, and bonds have doubled the performance of gold since 1975. For investors seeking to generate solid positive returns from investment in gold, it's been all about precision, often short-term timing, the opposite of the long-term approach we think most investors need.[2]

Home Sales Decline, Again

The National Association of Realtors reported that existing home sales fell in September, which puts 2024 on track to be the worst year for existing home sales since 1995. September sales fell 1% from August and 3.5% from September 2024, which was approximately twice as weak as economists were expecting. Elevated mortgage rates continue to be the thorn in the housing market's side—even though the Federal Reserve cut rates by 50 basis points and the 30-year fixed mortgage rate fell to approximately 6% last month, it came too late in the home buying season to make a big impact. Many families tend to want to move between school years, which means buying in the spring. Mortgage rates may see a bit more reprieve in the next year, if inflation continues to trend lower and the Federal Reserve continues on a path of monetary easing.[3]

[1] NY Times. 2024. https://www.nytimes.com/2024/10/22/business/economy/imf-inflation-trade-war.html

[2] MSN. 2024. https://www.msn.com/en-us/money/markets/gold-ends-08-higher-at-271370/ar-AA1sta2I

[3] Wall Street Journal. October 23, 2024. https://www.wsj.com/economy/housing/home-sales-on-track-for-worst-year-since-1995-9a2029ae?mod=hp_lead_pos1

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