Ameriprise Financial

Weekly Markets Commentary

Oct. 11, 2021

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Are Company Valuations Justified?

Investors Will Soon Learn More as Q3 Earnings Season Approaches

A second straight soft employment report has perhaps clouded the Fed's tapering outlook. In September, the economy created just 194,000 new non-farm jobs, the lowest monthly total this year. Not only was the total well below the Bloomberg consensus forecast of 500,000 jobs, but it also followed the surprisingly weak August total, which was revised somewhat higher to a more respectable 366,000 from the original report of 235,000. It no doubt raises questions and adds to the frustration surrounding the persistency of friction in the labor market that is leaving large numbers of job openings unfilled. The labor force participation rate fell as well.

There were some bright spots in the report. The length of the average work week rose, as did average hourly earnings, and for the first time in this recovery the unemployment rate fell below 5.0 percent. Whether the last two months of data alters the view that enough substantial further progress towards full employment has been achieved to justify a taper announcement by the Fed in November remains to be seen. In all likelihood, the answer is probably not, but it does make the Fed's decision more difficult, especially against a backdrop of rising inflationary pressures. The release of the minutes from the Fed's September meeting on Wednesday may shed some additional light on its current thinking.

Inflation and Earnings Will Be in the Spotlight This Week

Inflation will be in the spotlight this week with Wednesday's release of the CPI for September. The year-over-year headline rate is forecast to be unchanged at 5.3 percent. Not helping is the price of oil. WTI crude is higher again early this week, trading above $80 a barrel for the first time since 2014. Since the start of the year, crude is higher by 68 percent, and higher by almost 20 percent just since the start of September. The CPI core rate is expected to edge higher to 4.1 percent.

Third quarter earnings season begins this week, and the topic of inflation will be front of mind. The extent to which margin pressures from rising input costs can be offset by pricing power will be scrutinized closely. The big banks begin the process this week, just as they are experiencing a series of analyst downgrades on the basis of valuations. The KBW bank index is higher by 39 percent year-to-date, more than double the 17 percent gain in the S&P 500 index.

Overall, stocks managed to grind out a 0.8 percent gain last week. Much of the move higher came after a deal was announced to extend the debt ceiling until early December, avoiding an embarrassing and disruptive impasse at the end of this week. The gain pulled the index above its 100-day moving average where it has found some support. But it remains below its 50-day moving average and is down 3.2 percent from its September 2nd peak.

Bond Yields Surged Higher; Retail Sales, Consumer Sentiment and Inflation Reports Out This Week

The bond market is closed for the holiday on Monday. But yields surged higher last week. The ten-year note yield climbed 15 basis points to 1.61 percent. Three weeks ago, prior to the Fed's September meeting, it was yielding 1.30 percent. The yield on the two-year note rose from 0.26 to 0.32 percent last week, after sitting at 0.22 percent prior to the Fed meeting. Yields on below- investment- grade bonds have been rising as well. The ICE Bank of America High Yield index yield rose 11 basis points to 4.20 percent last week and has risen 33 basis points since the Fed's September meeting. And in that time its spread over Treasuries has widened by 17 basis points to 320. Notably, BBB spreads are unchanged since the Fed meeting.

This week's economic calendar includes a look at September retail sales, which are expected to be slowed in part by low inventories of motor vehicles. Consumer sentiment is expected to show modest improvement along with firm inflation expectations. And, of course, both the September CPI and PPI reports are scheduled. But with the brinksmanship in Washington having been resolved, at least temporarily, the focus will be clearly on earnings, and whether they remain robust enough to continue to support high stock valuations.

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Investing involves risk including the risk of loss of principal.

A **10-year Treasury note** is a debt obligation issued by the United States government that matures in 10 years. The 10-year yield is typically used as a proxy for mortgage rates, and other measures.

A 2**-year Treasury note** is a debt obligation issued by the United States government that matures in 2 years.

The **KBW Bank Index** is a benchmark stock index of the banking sector. It includes a weighting of 24 banking stocks selected as indicators of this industry group. The stocks represent large U.S. national money center banks, regional banks, and thrift institutions.

Stock investments involve risk, including loss of principal. High-quality stocks may be appropriate for some investment strategies. Ensure that your investment objectives, time horizon and risk tolerance are aligned with investing in stocks, as they can lose value.

There are risks associated with **fixed-income** investments, including credit risk, interest rate risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer term securities

Non-investment-grade (high-yield or junk) securities present greater price volatility and more risk to principal and income than higher rated securities.

Past performance is not a guarantee of future results.

An index is a statistical composite that is not managed. It is not possible to invest directly in an index.

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