Zacks
INVESTMENT MANAGEMENT

Market Strategy Report

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Zacks Investment Management

Born from Research, Built for Performance

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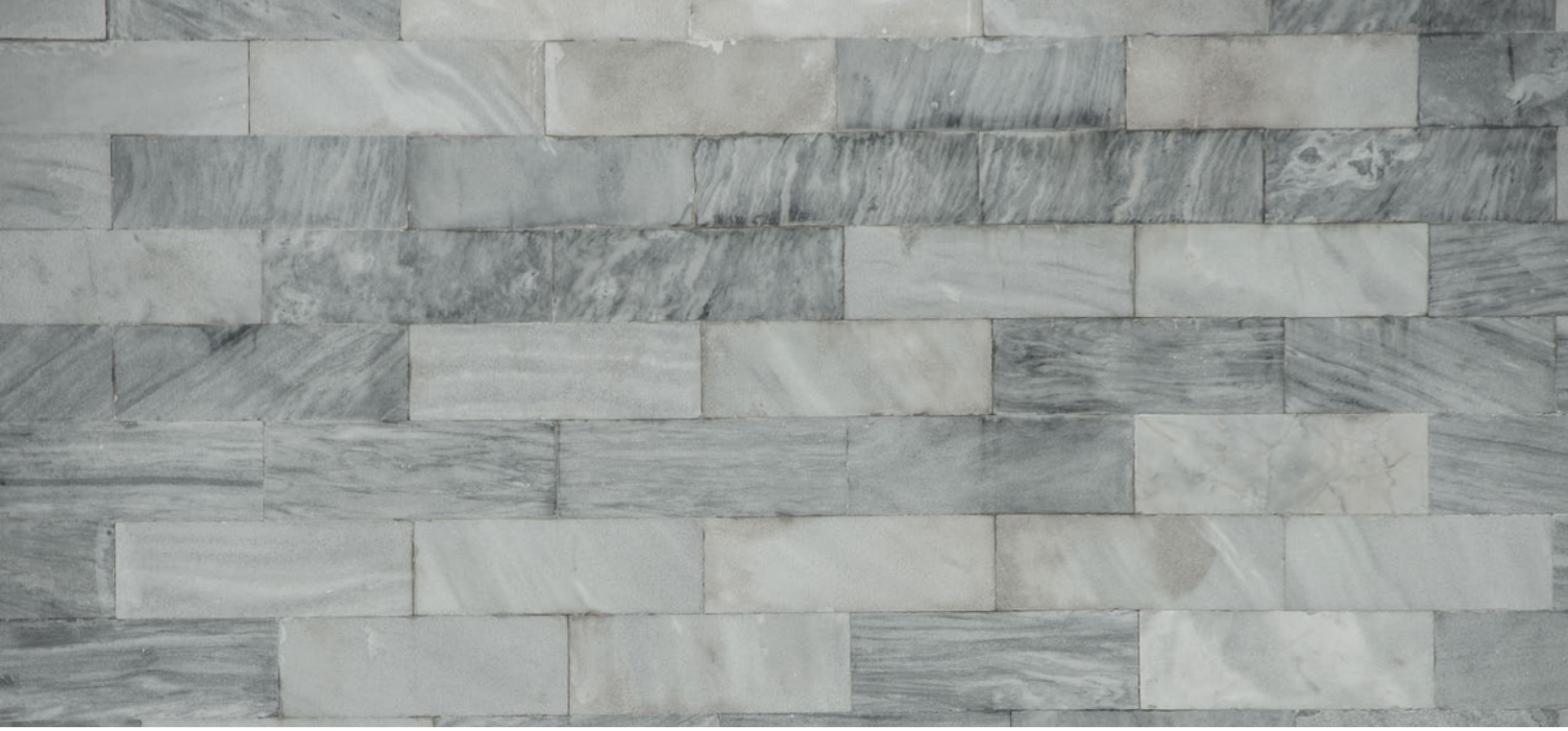
What to Expect from This Report

Forecasters often try to predict exactly where the stock market is headed, but a much better forecast is simply to look at where corporate earnings are likely headed. After all, interest rates and corporate earnings are the biggest drivers of stock market returns, in our view, so a stock market outlook is an earnings (and interest rate) outlook.

The U.S. jobs market has been a bit of a head-scratcher of late – there are more job openings than unemployed Americans, and workers are quitting at a staggering rate. The unemployment rate has fallen to just above 5%, yet there is a shortage of workers in the U.S. economy to meet demand. In this month's report, we dig into the numbers a bit more and try to make sense of the U.S. labor market.

This report will also take a brief look at what's happening in the oil markets, with some insight as to where oil prices may head from here.



A Stock Market Outlook is Really an Earnings Outlook

According to research and analysis from Zacks Investment Research, major U.S. publicly-listed firms should keep building up earnings-per-share (EPS) and revenue growth in the final quarter of 2021 and throughout 2022.

The Q4 2021 earnings growth rate for S&P 500 companies should be +20.2%, and in Q1 2022, we think the earnings growth rate for the S&P 500 should be approximately +6.9%. For Q2 2022, the EPS growth rate should be +5.0%. The estimated (year on year) EPS growth rate for the S&P 500 for 2021 is +42.7%. This is over four times the 10-year average (annual) EPS growth rate of +10.0%. If +42.7% is the actual growth rate for 2021, it will mark the largest annual EPS growth rate for the index since 2010 (+39.6%). That is impressive.

Why unusually large S&P 500 earnings growth rates?

First, analysts were too aggressive in their downward revisions to EPS estimates during the first half of 2020 at the height of the COVID-19 lockdowns. Second, the outlook for overall nominal U.S. macro growth showed up in double digits. Third, strong commodity prices and oil prices have driven up value stock EPS revisions. Finally, companies in the S&P 500 have become more optimistic about their EPS guidance.

What does this mean for the stock market's outlook? Pegging a level on the S&P 500, in our view, is less valuable than considering how earnings and earnings outlooks are expected to change over time. If earnings and revisions keep getting better and companies perform better than expected, that almost always shows up as support for higher stock prices.

For a detailed analysis of how expectations are changing in the earnings world, we turn to the Director of Research for Zacks Investment Research, Sheraz Mian. Sheraz thinks earnings have improved in meaningful – and often underappreciated – ways recently. He sees this improvement, and likely upward revisions, in the months and quarters ahead. There are four main reasons Sheraz makes this case[1]:

1. The revisions trend is positive and represents a notable improvement over historical periods. Earnings estimates for the fourth quarter of 2021 have been steadily going up, with the current +21.1% earnings growth rate up from +20% on September 1st and +17.4% at the end of June. Granted, the positive revisions to 2021 Q4 estimates aren't the first instance of such favorable revisions, as this trend has been in place since last summer. But this revisions trend is nevertheless in contrast to comparable periods over the last many years when estimates would be going down at this stage.

2. The favorable revisions trend is broad-based and not concentrated in one or just a few sectors. Looking at full-year 2022 earnings estimates, estimates have gone up by more than +25% since the start of the year and more than +14% since June 30th. Estimates have gone up for 16 Zacks sectors, with the biggest gains in the Energy, Basic Materials, Construction, and Finance sectors. The next point will make the case for the revisions trend to accelerate meaningfully in the coming months as the vaccines help us put the pandemic behind us, even as the pathogen continues to circulate among us. The fact is that there is no fundamental reason for the rally to lose ground as long as interest rates remain stable and earnings estimates maintain their current uptrend.

3. Current 2022 consensus earnings growth expectation for the S&P 500 index of +8.5% on top of the +44.4% gain expected this year reflect a macroeconomic view that has lately come under pressure as a result of the Delta outbreak and supply chain disruptions. The Q3 GDP growth deceleration notwithstanding, full-year 2021 GDP growth is expected to be around the +6% level and around +4% next year. These economic growth estimates largely reflect how the U.S. economy has historically behaved in coming out of economic downturns. Traditional economic downturns that originate in the financial markets tend to weigh on business and household sentiment for much longer than can reasonably be expected to be the case this time around given its medical/health origins. While full-year earnings estimates have gone up, they have yet to reflect the full extent of the post-Covid economic rebound.

The bottom line is that there is significant upside to current consensus earnings estimates. And an environment of rising earnings estimates and stable interest rates should keep stocks on an upward trajectory.

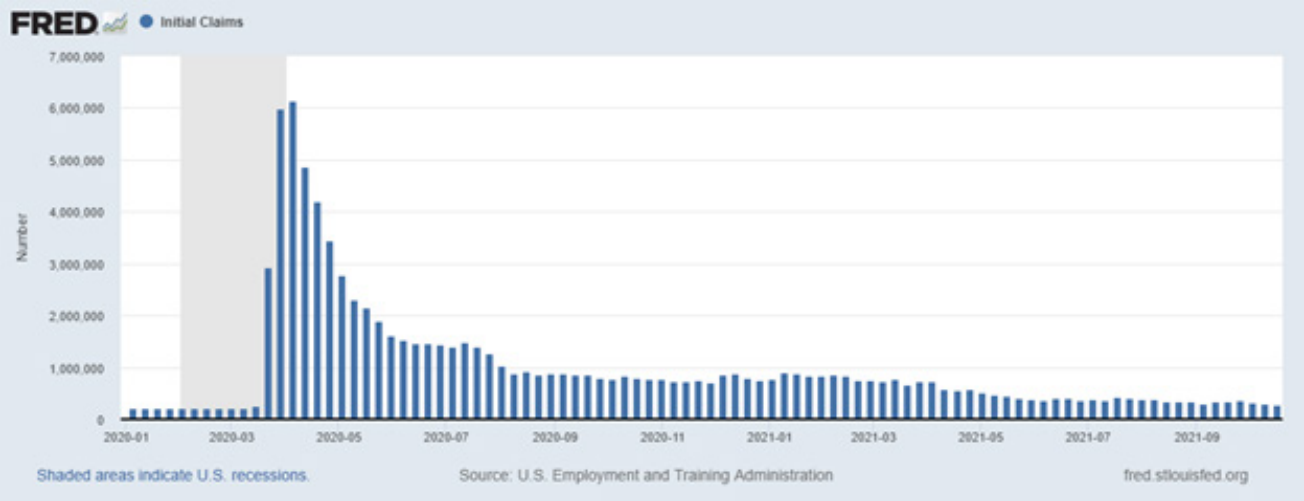
Making Sense of the U.S. Labor Market

According to the San Francisco Federal Reserve, "Despite the slowing growth in hiring, the unemployment rate in August fell to 5.2%. This measure however sends an incomplete signal about the extent of the labor market recovery. A number of key groups—including parents who have temporarily left the labor market due to childcare concerns—are not officially counted as unemployed. The employment-population ratio still sits 2.6 percentage points below its pre-pandemic high."

Jobless claims in the U.S. dropped to 290,000 at the end of October, which marks a new low within this pandemic-influenced economy. Jobless claims are perhaps a

better metric than the unemployment rate to consider when determining the health of the labor market, as claims serve as a proxy for layoffs. In 2019, a year when the U.S. economy was considered quite strong and before the pandemic struck, the weekly average for jobless claims was 218,000, meaning the U.S. economy is approaching a level of health in-line with the previous expansion. Continuing claims, which measure how many people are still unemployed and receiving benefits, also fell to a pandemic low.

As unemployment benefits eventually expire for those who are in the continuing claims category, a labor market with ample jobs awaits. In our view, we should continue to see improvement in the jobs market as a result.



Source: Federal Reserve Bank of St. Louis[2]

Even still, the number of Americans who have quit a job recently has soared. Child care issues, boomer retirements, and the desire to leave low-paying jobs for higher-paying ones are all factors. But there has also been a dramatic change to the way many people live and work in the wake of the pandemic, from the rapid acceleration of remote work to the desire to spend more time with family. Taken together, these factors have contributed to a rising number of people quitting their jobs.

The Number of Americans Quitting Jobs Has Soared

Source: Federal Reserve Bank of St. Louis[3]

The USA working population is responding rationally to a major loss of USA life. People are making a mass adjustment -- to live and work better, with more balance and meaning.

What's Going on in the Oil Markets?

On September 27, 2021, Goldman Sachs raised its forecast for year-end Brent crude oil prices to $90 per barrel from $80. They cited a faster fuel demand recovery from the Delta variant and supply constraints from Hurricane Ida. Soon thereafter, Brent futures hit a near three-year high as global output disruptions have forced energy companies to pull large amounts of crude out of inventories.

"While we have long held a bullish oil view, the current global supply-demand deficit is larger than we expected, with the recovery in global demand from the Delta impact even faster than our above-consensus forecast and with global supply remaining short of our below consensus forecasts," Goldman said in a note dated September 26, 2021.

Following up on that, OPEC+ said in early October that it would stick to an existing pact for a gradual increase in oil output, sending crude prices to three-year highs and adding to inflationary pressures that consuming nations fear will derail an economic recovery from the pandemic.

OPEC+ "reconfirmed the production adjustment plan", the group said in a statement issued after online ministerial talks, referring to a previously agreed deal under which 400,000 barrels per day (BPD) would be added in November, Brent crude then roared above $81 a barrel on news that the group would stay with its plan for gradual additional production, rather than offering more supply to the market. Prices seem likely to remain firm in the coming months, as demand shows little sign of letting up and supply is slow to come online.

Bottom Line for Investors

Financial media attention has been very focused on supply chain issues, higher energy prices, and labor market shortages – all combining to drive inflation and possibly crimp growth. While these forces do indeed all act as headwinds in the short- to medium-term, what really matters, in our view, is whether corporations can absorb some of the higher costs (and potentially pass them along to consumers) and continue to see strong and increasing earnings growth. If corporations can continue to deliver strong EPS results while interest rates remain relatively low – both outcomes we think are possible in the next year – then the stock market should be able to weather all the other issues.

(Continued)

How Can Zacks Investment Management Help?

Retirement Planning

To achieve your financial goals for retirement, we believe it is essential to create a clearly-defined strategy. Count on Zacks Investment Management to help you develop a strategy that reflects your individual needs, goals, and risk tolerance. Once you have your strategy, we'll help you stick to it—because, especially in volatile markets, what feels like "the right thing to do" may actually be what you don't want to do.

Portfolio Management

Since 1992, Zacks Investment Management has helped investors meet their financial goals, with billions in assets currently under management. Our overall investing is managed by our Investment Committee, with decades of industry experience. Based on this overall approach, we create customized portfolios for each client using our proprietary strategies, many of which are top-ranked by Morningstar.

Personalized Investment Counseling

When you're a Zacks Investment Management client, you can count on individual attention and prompt, responsive service. We're here to answer your questions, work with you to identify and reach your goals, and to make sure you're comfortable with the portfolio management you receive. Investing is an emotional process, and we will work with you to ensure disciplined investing, both in bull and bear markets.

Your Wealth Management Advisor is always available to meet your needs, including:

- Helping you understand what's going on in your portfolio—and why
- Reviewing your investment goals, objectives and strategies on a regular basis
- Addressing any day-to-day needs you may have in a prompt, responsive manner

Two ways to learn more and speak to one of our retirement professionals:
Call **1-800-701-9830** or click below to schedule an appointment

Schedule Your Advisor Consultation

The S&P 500 Index is a well-known, unmanaged index of the prices of 500 large-company common stocks, mainly blue-chip stocks, selected by Standard & Poor's. The S&P 500 Index assumes reinvestment of dividends but does not reflect advisory fees. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor. An investor cannot invest directly in an index.

The Russell 1000 Growth Index is a well-known, unmanaged index of the prices of 1000 large-company growth common stocks selected by Russell. The Russell 1000 Growth Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

Nasdaq Composite Index is the market capitalization-weighted index of over 3,300 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests. The index includes all Nasdaq-listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds (ETFs) or debenture securities. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The Dow Jones Industrial Average measures the daily stock market movements of 30 U.S. publicly-traded companies listed on the NASDAQ or the New York Stock Exchange (NYSE). The 30 publicly-owned companies are considered leaders in the United States economy. An investor cannot directly invest in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

The S&P Mid Cap 400 Index comprises 400 companies selected as broadly representative of companies with midrange market capitalization (market valuation of between 200 million and 5 billion). An investor cannot invest directly in an index. The volatility of the above benchmarks may be materially different from the individual performance obtained by a specific investor

The S&P Small Cap 600 Index is a market-value weighted index considered representative of small-cap US stocks. An investor cannot invest directly in an index. The volatility of the above benchmarks may be materially different from the individual performance obtained by a specific investor

The Russell 2000 Index is a well-known, unmanaged index of the prices of 2000 small-cap company common stocks, selected by Russell. The Russell 2000 Index assumes reinvestment of dividends but does not reflect advisory fees. An investor cannot invest directly in an index. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor.

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[1] Zacks. October 29, 2021. https://www.zacks.com/stock/news/1820183/can-the-rally-continue?-

[2] Fred Economic Data. October 28, 2021. https://fred.stlouisfed.org/series/ICSA#0

[3] Fred Economic Data. October 28, 2021. https://fred.stlouisfed.org/series/JTSQUR