

Three Market Surprises in 2021

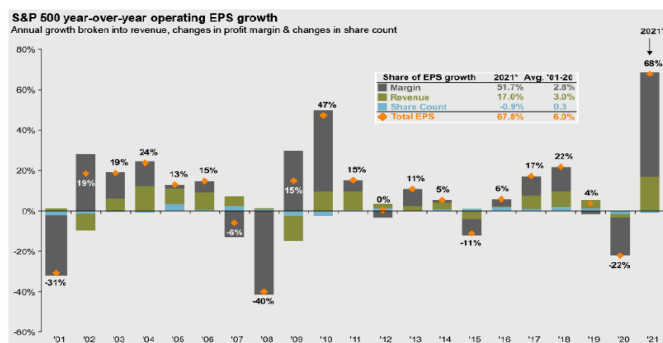
December 17, 2021

Each year the markets bring new surprises and 2021 was no different. Despite a slew of concerns including new COVID variants, inflation and supply chain disruptions, here are three surprisingly positive events that have shaped the markets in 2021.

#1: Corporate earnings at record profits

Investors began 2021 on an optimistic note given the arrival of the vaccines and low interest rates, which created a backdrop for strong economic recovery. It was underestimated just how profitable companies would be. Despite challenges of supply chain disruptions, as well as shortages in material and labor, companies have simply blown away expectations and delivered some of the biggest profits ever recorded¹.

In 2021, S&P 500 companies are on track to grow their operating earnings profit per share by 68% year over year². Part of the surge in year over year growth originated from a low starting point in 2020, but nonetheless growth remains impressive. Even more surprising is the increase in earnings from margins growth. Companies can increase their margins by either increasing revenues through selling more goods, increasing prices or through reducing costs by finding cheaper sources of raw materials. Given the challenges of 2021, it's surprising to see companies were not only able to adapt but performed remarkably well.

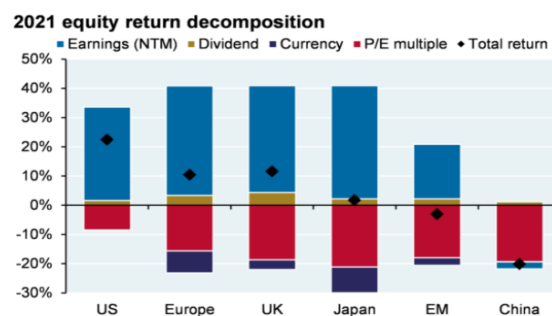


Source: JPMorgan Guide to the Markets. November 30, 2021.

Looking forward, at the risk of stating the obvious, investors should anticipate earnings profits to slow after stellar growth in 2021. Slower earnings growth from historic peaks does not change the positive outlook for stocks but likely dampens the return potential looking ahead.

#2: Stock valuations fall despite rising stock prices

In 2021, as stock prices have continued to soar, many investors have begun to worry that the stock market may be overvalued. The price/earnings ratio or P/E ratio is a common measure to assess the fairness of stock price. In general, a lower P/E ratio would mean the price is undervalued relative to future earnings and higher P/E means that that prices are overvalued. While this is an overly simplistic way of evaluating things, it does provide a reasonable gauge to assessing stock market valuations. In 2021, investors, worried that the stock market was becoming expensive as prices continued to soar, can take some solace. The spectacular corporate earnings growth in 2021 has accounted for all of the market gains causing P/E multiples to fall markedly, giving the markets a little breather³.



Source: JPMorgan. 2021 Holiday Eye on the Market: The Middle Ages

Nonetheless, relative to longer-term historical averages, US stock valuations are high based on a P/E ratio basis. Despite being rich in valuations, it's important to note that P/E ratios have little ability to predict near-term returns

over one-to-three years, but do have greater predictive power over the longer-term, looking out 10 years or more.

#3: Strong returns from stocks

As the economic recovery took stronghold, expectations for stock returns were also optimistic in 2021, but the sheer pace has been surprising. US stocks are up 22% for the year through the end of November, as measured by the S&P 500. These returns are compounded on top of 16% returns for 2020 and 29% for 2019. Perhaps what's even more surprising is how smooth the overall ride has been. Historically, the second year of the bull market can often be unpredictable with more choppiness. In fact, the

S&P 500 has only experienced a drop of 5% year-to-date from its peak in early September, while historically since 1980, the market has experienced a decline of 14.3% on average,⁴ according to JPMorgan. While the markets still have time to close out the remainder of the year, these returns to-date are surprisingly remarkable.

Looking forward to 2022, we will likely continue to be surprised by the markets. For investors, it's not about predicting the next set of surprises, but maintaining the discipline of staying invested and diversified along the way.

¹ JPMorgan Guide to the Market. Data as of November 2021.

² JPMorgan Guide to the Market. Data as of November 2021.

³ JPMorgan: 2021 Holiday Eye on the Market: The Middle Ages

⁴ JPMorgan: Guide to the Market (Slide: Annual returns and intra year declines) Data as of November 2021.

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