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Investment and Financial Consultants

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THIRD QUARTER 2024 ECONOMIC AND FINANCIAL MARKETS REVIEW

Stock market volatility increased during the third quarter as investors grew concerned that the economy was slowing too rapidly. Deteriorating economic conditions typically lead to slower corporate earnings growth, which results in lower stock prices. However, investors were pleased that the Federal Reserve Board lowered interest rates in September for the first time in many years by 0.50% to help counter the slowing economic growth. As a result, the S&P 500 Index ended the third quarter up 20.81% year-to-date, while the Dow Jones Industrial Average gained 12.31%. As for the bond market, the Bloomberg Intermediate U.S. Government/Credit Bond Index increased 4.68% year-to-date as of September 30, 2024.

This year, the Fed has been challenged because they must walk a tightrope regarding their monetary policy. On the one hand, the Fed must be careful not to lower interest rates too much or too fast, or else inflation could accelerate again. This is because lower rates make it cheaper for corporations and individuals to borrow, leading to an increase in spending, which can lead to a rise in prices. However, they also need to ensure interest rates are not too high, which could stifle economic growth and lead to higher unemployment, lower corporate earnings, and possibly even a recession. When interest rates are too high for too long, the economy weakens as corporations and individuals typically borrow and spend less. This balancing act will likely be the focus of investors and traders going into next year.

The Federal Reserve Board will likely choose to continue lowering interest rates into the future to support the economy as the inflation rate is expected to continue to decline. Further declines in interest rates would be positive for stocks because they make stocks more attractive than fixed-income investments, which now pay lower yields. Lower interest rates also help support the labor market and the economy in general. However, one disadvantage of the Fed lowering interest rates is that it will reduce the yield investors can earn on fixed-income investments such as bonds, CDs, and money market funds.

Many investors have been concerned lately that the economy is slowing too much, which could ultimately result in a recession. They fear that the reason the Fed has already reduced interest rates by one-half percent is that the economy is already slowing and in danger of falling into recession. We do not believe the economy is in a recession or that there is an immediate threat of entering a deep recession despite a recent slowdown in manufacturing, employment, and other leading economic indicators. In fact, we believe that economic activity will increase again after the Fed lowers interest rates a few more times. As long as the economy remains out of recession and corporate earnings do not deteriorate significantly, the bull market in stocks should continue.

Typically, the fall is not a positive time for the stock market. This is especially true in election years when the election is expected to be contentious and the outcome is very uncertain. Investors and traders do not like uncertainty, and close elections create unpredictability regarding economic policies, potential future tax increases, government spending, etc. However, once an election is over, the financial markets typically breathe a sigh of relief and begin to rally again.

This year, we have generally kept our investment philosophy simple by overweighting large-company U.S. stocks and high-quality bonds while investing very little in small-company stocks, foreign stocks, emerging market stocks, and other volatile asset classes. Investing in more volatile parts of the financial markets has not made much sense when the performance of large-company U.S. stocks has generally been more profitable. However, in the future, we may look to expand into additional asset classes if the Fed continues to lower interest rates and we see good value opportunities.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your portfolio or the financial markets in general.

** Index returns were obtained from the Wall St. Journal and Bloomberg on October 1, 2024.*