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THIRD QUARTER 2023 ECONOMIC AND FINANCIAL MARKETS REVIEW

After a solid first half of the year, the stock market ran into some turbulence during the late summer. Many economic indicators have been improving lately, which is typically good news for stocks. However, the relatively strong economy has led to worries that the Federal Reserve Board will need to raise interest rates further to slow the economy and reduce persistent inflation. If the Fed raises interest rates too much to fight inflation, it could reverse the strong economic fundamentals and lead to a recession down the road. A recession would harm corporate profits, upon which stock prices are based. Despite these inflation and recession concerns, excitement over advances in Artificial Intelligence has been positive for a small group of very large technology companies, which has led to positive returns for the major stock market indexes so far this year. For example, the S&P 500 Index ended the third quarter up 11.68% year-to-date, while the Dow Jones Industrial Average gained 1.09%. As for the bond market, the Bloomberg Barclays U.S. Intermediate Government/Credit Bond Index increased 0.65% year-to-date as of September 30, 2023.

The Federal Reserve Board's goal is to raise interest rates just enough to reduce inflation without creating a recession. This is what is known as a "soft landing." Raising interest rates should slow economic growth and the pace of inflation by making it more expensive for businesses, individuals, and governments to borrow. However, so far this year, despite labor issues and rising oil prices, consumers and businesses continue to spend money at a rapid pace. This makes investors concerned that the Fed will need to raise interest rates even further than initially anticipated and leave them at these elevated levels for longer to bring down inflation. Investors had hoped that the Fed would be able to stop raising interest rates and potentially begin lowering them this year. However, that no longer appears to be likely, particularly after recent comments by the Fed chairman signaled that the Fed continues to worry about inflation.

For most of this year, interest rates on short-term fixed-income investments such as bonds, CDs, and money market funds have been climbing due to the Fed rate increases. This will be a positive for conservative investors going forward since interest rates on these securities are now higher than they have been in many years. Higher interest rates on fixed-income investments are also creating competition for stocks. Since the financial crisis of 2008, interest rates have been so low that the stock market was the only place to potentially earn a decent return. However, investors can now earn a reasonable yield in the fixed-income markets, including money market funds, which means that stocks are no longer the only way to make money investing.

Excitement over Artificial Intelligence has sent stocks of companies involved in this industry soaring during the first three quarters of this year. However, for the stock market indexes to continue to advance, more stocks across more sectors must also begin to appreciate. For example, stocks in industries such as financials, health care, consumer staples, utilities, and real estate have generally not performed well this year. In addition, small-company and mid-size company stocks continue to lag. It will be important for the stock market gains to broaden over the coming months for the bull market in stocks to continue.

Finally, so far this year, most corporations have been meeting or beating their quarterly earnings expectations. This means that companies are reporting earnings that are as good or better than Wall Street's estimates. In fact, many companies are raising their earnings estimates for the remainder of this year and early next year. If this trend continues, many stocks will likely rise because stock prices are typically based on a corporation's ability to generate positive earnings.

We continue to favor large-company stocks that can generate profits globally. We also expect that large company value stocks will start to perform as well as large company growth stocks once the infatuation with Artificial Intelligence stocks has subsided. We have become more optimistic about certain developed foreign stock markets than we have been in many years. Still, we are shying away from emerging market stocks due to weakness in the Chinese economy. Finally, we continue to recommend short-term bonds rather than long-term bonds because short-term bonds are less sensitive to rising interest rates.

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 Barclays on September 30, 2023.*