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Dear Valued Investor,

With fall upon us and students back in classrooms, it seems like a good time to reflect on the various tests that the U.S. economy and stock market have passed recently. When the economy and markets are tested, the foundation for future growth and capital appreciation gets stronger.

The Federal Reserve (Fed) engineered one of its most aggressive rate-tightening campaigns ever in 2022 and 2023, providing a tough test for the U.S. economy. Amid widespread calls for recession, the economy chugged right along, powered by consumers who continued to spend, even as rates rose. How did consumers do it? Stimulus helped, though we probably got more than we needed. So did low fixed-rate mortgages. Regardless of how it happened, and despite the Fed's mixed track record, the economy passed this test.

The economy also seems to have passed its inflation test. The widely followed Consumer Price Index, which peaked at 9.1% year over year in June 2022, dipped below 3% last month. Same with the Fed's preferred inflation measure (core personal consumption expenditures excluding food and energy). In response, the 10-year Treasury yield is down nearly a full percentage point since its April 2024 high, and mortgage rates are down even more. Call that a passing grade, though one could still argue for an incomplete.

The stock market also passed a tough test recently. On August 5, the combination of a weaker-than-expected jobs report for July and too much borrowing from some overly complacent traders (much of it in Japanese yen currency) caused a sharp market sell-off. Stocks have since bounced back on subsequent evidence that the economy continues to grow steadily. In fact, U.S. gross domestic product grew at an impressive 3% annualized rate in the second quarter. Despite that bout of volatility, major stock market benchmarks from both Russell and S&P produced modest positive returns in August. Gains weren't just among the big tech companies, as performance has broadened out.

Perhaps the toughest tests for markets lie ahead. The upcoming election and related policy uncertainty could be a catalyst for a correction. A tougher geopolitical test could come from China, Russia, or Iran. Eventually, if the U.S. debt pile continues to grow, bond vigilantes will demand higher Treasury yields. Valuations are high despite even considering the double-digit earnings growth corporate America is generating. These are tough tests that may cause more volatility near-term, but markets and the economy have stellar long-term track records. Expect this bull market to continue to bring home excellent report cards.

Please contact your financial advisor with questions.

Sincerely,

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Chief Equity Strategist
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All index data from FactSet.

The Standard & Poor's 500 Index (S&P500) is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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