Digestion: Market is Working its Way through the Covid Recovery!

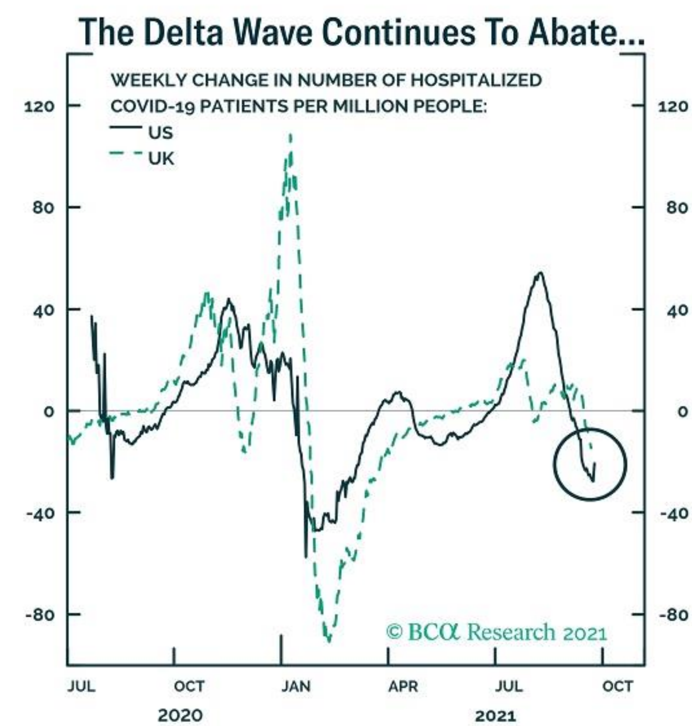
The stock market ascent paused in the third quarter with the S&P 500 clocking in a gain a little over ½%. The average stock declined, and leadership once again was provided by the growth factor. Interest rates roughly ended where they began masking a lot of volatility.

Interest rates accelerated at the end of the quarter which spooked the stock market. There is a heated debate over whether current high inflation readings are transitory or permanent. While that argument won't be settled for a long time, several bottlenecks in the global supply chain affecting many industries will keep prices higher for longer than was expected earlier in the year.

Despite a few economic hiccups the Federal Reserve (Fed) will probably announce in November a reduction of its massive stimulus program. At the onset of the Covid-19 outbreak, the Fed pledged to buy $120 billion of Treasuries and agency mortgage-backed securities each month until it had seen "substantial further progress" towards average inflation of 2% and maximum employment. Moreover, a growing number of Fed officials expect an interest rate increase next year. These expectations added to the financial market angst in September but are a necessary step in the normalization process.

The other drag on market psychology is the broad crackdown on business in China that started about a year ago. In addition, China has tightened credit conditions slowing growth. Over-leveraged property development companies have suffered the most highlighted by the collapse of Evergrande. Markets were worried about a possible contagion from this event but ultimately nothing developed.

Credit conditions in the US remain robust. Hundreds of billions of dollars of US corporate debt ratings have been upgraded, reflecting the strong rebound in profitability across much of corporate America. Credit spreads are near all-time lows, and interest rates are still historically very low.



Congress passed a sweeping $1 trillion infrastructure bill that will provide hundreds of billions of dollars to upgrade America's crumbling transport systems in a rare display of bipartisanship in a fiercely divided Washington. President Biden's more expansive spending agenda is facing resistance from the moderate side of the Democratic party which should ultimately please the financial markets.

Stock markets tend to pause and consolidate after making the type of advance we've experienced since the bottom of the Covid sell-off. The path forward for stocks will be rockier, but they still are the most attractive asset class for long-term investors. The Value factor has historically done well in a recovering economy, is not overpriced and could reassert leadership in the stock market.

"As John Templeton said: Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria."

Jim Tillar, CFA and Steve Wenstrup