October 2024

THE CAPSTONE QUARTERLY

With back-to-school season behind us, we now look towards the 4th quarter and all it has in store for us. After a fairly volatile August, the markets continue to do well and hang on to their gains so far this year. In this newsletter, Bryce discusses the long-expected rate cut from the federal reserve and Casey gives some insight into the markets during election years.

BRYCE'S POINT OF VIEW

Bryce Pease, CFP®

Rate Cut

Over the last two years, the Federal Reserve (the "Fed") has been trying to do the seemingly impossible: cool down consumer prices without starting a recession. To do that, the Fed turned to the only tool available to them: Interest rate hikes. The Federal Funds interest rate began gradually rising in early 2022 and had been at about 5.33% since August of last year.[1] That was the highest they'd been in 23 years.[1]

Higher interest rates serve as a kind of flame retardant on the overall economy because they make it more expensive for consumers and businesses to borrow money. This, in turn, reduces how much money people spend. Since consumer spending is a corporation's income, lower spending forces companies to lower their prices to attract new business. When this happens across the board, inflation will cool to a more manageable level.

This approach definitely works, but the problem is that it's applying a blunt instrument to a delicate situation. Since 1955, virtually every period of major rate hikes has led to a downturn.[1] If prices cool down too much, too fast, businesses stop hiring. Next, they start laying off workers to make up for the decrease in revenue. The economy contracts, and we have a recession. Some of these recessions were very short, but every downturn is painful in its own way. So, can you bring down inflation without bringing down the economy? History suggests it can't be done.

But the data we're seeing now suggests that this time, the Fed may have just done it.

Since the rate hikes began, inflation has fallen from a high of 9.1% in 2022 to 2.5% this past August.[2] That's extremely close to the Fed's stated goal of a 2% rate of inflation. Meanwhile, the economy has so far avoided a recession. Our nation's GDP grew by approximately 1.4% in the first quarter of this year, and 3% in the second.[3]

The Fed can't celebrate yet. You see, while inflation has been going down this year, something else has been going up: unemployment. After falling to a near-historic low of 3.4% in April 2023, the jobless rate has been slowly but consistently climbing. (The most recent jobs report, in August, showed unemployment was at 4.2%.)[4] Now, this isn't a large number; in historical context, it's actually quite low. But what matters is the trend, and the trend has undoubtedly been going up.

Because of these twin factors – declining inflation, rising unemployment — we've known for a while that the Fed must begin cutting interest rates. The question was when, and by how much. Well, now we know the answer: September 18, and 0.50%.[5] It's the first cut in over four years, and it brings rates down to a range of 4.75-5%. Which is larger than what many analysts expected.

As investors, one of the issues we face is that there's no reliable way to know exactly what will happen. Right now, the economy appears to contain more positive signs than negative, and this new rate cut is a very welcome development. However, it's worth remembering that rises in unemployment often precede a recession. Furthermore, many past recessions actually began just after the Fed began cutting rates, not while they were hiking them. When the Fed announced the rate cut on

September 18, they also suggested that further, smaller cuts are in store this year. While the markets have embraced the news, and may well continue to rise, we must be mentally prepared for bouts of volatility as investors parse every bit of data for signs of either rebounding inflation or runaway unemployment.

We continue to monitor and watch the markets, planning and preparing for the "what-if's".

CASEY'S CORNER

Casey Morris, CFP®

The Elections and the Markets

Since we are now in the home stretch of the election season, I'd like to spend my article once again discussing the elections and the markets.

So how do the elections affect the markets? My answer, not much. Since 1944, the S&P 500 has gained an average of roughly 10.7 % every presidential election year.[6] Of course, there can be some massive exceptions. For example, in 1980 when Ronald Reagan was elected President, the S&P rose over 25% and in 2008 when Barack Obama won the presidential election it fell over 38%.[6]

There is a danger in using the averages to try and predict what will happen. Take the "presidential election cycle theory" for example. Often, people believe that the US stock market is the weakest in the year following a presidential election. This was the case for Franklin Roosevelt. It also held true for Truman and Eisenhower. But in George H.W. Bush's first year, the S&P 500 rose 27%. In Bill Clinton's first year, it rose 7%, Barack Obama's first year saw the markets climb 23% and in Donald Trump's first year in office the S&P rose 19%.[7]

It's clear the presidential election cycle theory doesn't hold water. And that's true for election years as well. An average merely shows you what has already happened, not what's going to happen. If a hypothetical investor had followed this theory, they would have missed out on some of the biggest gains in market history. The same is true if that hypothetical investor had made decisions based on politics. Convinced Democrats are terrible for the country? Fine, but have fun missing out on the first year of Clinton's second term. Can't stand Republicans? Okay, but too bad you didn't catch the train between Reagan and the first Bush.

The fact of the matter is that, while the President might be the most powerful individual in the US, their power to drive the markets is distinctly limited. The Founding Fathers created a system of government where no branch (executive, legislative, or judicial) was supposed to dominate the other. The fact that neither the presidency nor any one political party has that much influence on the markets shows that our system of checks and balances extends to investing, too.

The markets are also driven by far more than just one person or event. They're controlled by the ebb and tide of trade, by the law of supply and demand, by innovation and invention, by international conflict and consumer confidence. The markets are like life. The course our lives take, most often, isn't determined by one gigantic decision, but by the millions of small decisions we make every day.

When it comes to planning for your financial future, we can't afford to let our political preferences drive our decisions. We have to factor in all of the data that is relevant to your personal goals. That's how we make educated decisions as opposed to emotional decisions. To put it bluntly, making financial decisions based off biased or overly narrow information is

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dangerous to your long-term goals. I'd recommend that you don't make important decisions based on which candidates you think will win or should win. Base them on sound financial planning and actual financial facts. The way to reach your financial goals is by having a sound investment strategy, making informed decisions, and taking emotion out of investing.

FINALLY…

On a more personal note, we want to celebrate and recognize a significant milestone for Bryce this year. In August, he and his wife celebrated 50 years of marriage. Their partnership and commitment to each other exemplify the values that we cherish. If you happen to catch him on the phone, be sure to send your congratulations his way.

Sincerely,

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P.S. If you ever run across anyone who could use our services or is unhappy with their current adviser, we always appreciate it when you pass on our name.

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