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In our summer newsletter we quoted the old Wall Street axiom "…sell in May and go away…". Perhaps that would have been good advice if one stayed away until the end of the third quarter as stocks pulled back from annual highs in August and September. It was certainly not a rout in the market as the S&P 500 regained some of the lost ground late in September and ended the third quarter down 2.1% (total return) for the three months since June 30th. For the year to date through September 30th, the S&P 500 advanced by 13.1%.

The disparity in returns across the U.S stock market remains glaring as the NASDAQ, bolstered by tech giants and other perceived fast-growing companies, has gained 28% so far this year. The Dow Jones Industrial Average (DJIA) is ahead by only 1.6%. While the DJIA (30 stock index) includes some of the year's best performers like Apple and Microsoft (both up about 36% and both in the NASDAQ Composite and S&P 500) the DJIA also has industrial companies like 3M, down 25.5%, consumer staples such as Coca Cola, down 15.1% and health care, Johnson & Johnson, down 12.0%. The DJIA also has energy, communications and financial services stocks which have had a mixed year at best. So, while the broad stock market as measured by the S&P 500 has had a reasonably good year so far, the gains have certainly not been shared across all market sectors.

The modest decline in stocks during the third quarter was due in part to continuing concerns over inflation, interest rates and the uncertainty about future rate hikes by the Federal Reserve. Inflation remains above Fed targets, but there has been progress slowing the inflation in many consumer products. Higher interest and mortgage rates have cooled off the housing market. While the Fed may continue to raise rates, they must be mindful of the potential danger to the economy of an overly restrictive policy.

Interest rates have reached levels not seen in decades and many believe fixed income investments (bonds, Treasury Notes, etc.) are now offering a reasonable short-term alternative to stocks. There is still inversion in the bond market as, for example, the 2-year note yields more (5.2%) than the 10 (4.8%) and 30 (4.8%) year notes, but not by much. For the first time in many years, investors have been able to build a fixed income portfolio with meaningful returns.

A current challenge in building a fixed income portfolio involves timing and duration. If the Fed is close to ending the rate hike cycle, it may make sense to extend maturities out a bit in anticipation of an eventual rate reduction cycle if the economy slows down in the next year or two. However, there is certainly no guarantee that rates will not go higher from current levels.

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Any investment in longer-term bonds should consider market conditions as well as individual guidelines of each investor's long-term plan.

For those of us who have been around for a while, a 10-year U.S. Treasury Note yielding less than 5% may not seem too exciting but in terms of where interest rates have been, the yield has risen dramatically. According to data from Macrotrends[1], the last time the 10-year Treasury yielded this much was in 2008. The yield on the 10- year at the beginning of 2021 was 0.93% so the magnitude of the advance has been remarkable. Some analysts are concerned that we really do not know the effects of such a change, and they are worried about the possible negative effects on credit and the economy. These are valid concerns, and we would recommend moving carefully when increasing exposure to fixed income investments.

There do seem to be opportunities, however, in stocks and bonds for the long term as the economy continues to do well. There seems to be some consensus developing for either a soft landing for the economy or a modest slowdown next year. Valuations in certain stocks are reasonable and the opportunity to add balance to portfolios with additional bond exposure is another positive.

We look forward to discussing our thoughts with you and we encourage you to contact us with any questions. All the best,

John C. Knox, CFA John C. Downing, CFA

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A bond is a fixed-income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental). A bond could be thought of as an I.O.U. between the lender and borrower that includes the details of the loan and its payments. Bonds are used by companies, municipalities, states, and sovereign governments to finance projects and operations. Owners of bonds are debtholders, or creditors, of the issuer.

***Standard & Poor's 500 (S&P 500)** is an unmanaged group of securities considered to be representative of the stock market in general. Indexes are unmanaged and do not incur management fees, costs, or expenses. It is not possible to invest directly in an index.*

***Dow Jones Industrial Average (DJIA)** is a price-weighted index of 30 actively traded blue chip stocks. Indexes are unmanaged and do not incur management fees, costs or expenses. It is not possible to invest directly in an index.*

***Nasdaq** is a global electronic marketplace for buying and selling securities. Originally an acronym for "National Association of Securities Dealers Automated Quotations"—it was a subsidiary of the National Association of Securities Dealers (NASD), now known as the Financial Industry Regulatory Authority (FINRA). Indexes are unmanaged and do not incur management fees, costs, or expenses. It is not possible to invest directly in an index.*

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[1] MacroTrends 10/13/2023