Principled Solutions

Sound Advice. Worthy Portfolios.

Dear Clients and Friends:

One constant in life is change. During the past year and a half, we have experienced more change than any of us bargained for. Change is disruptive—but also brings opportunities. For investors, those changes could set the stage for continued growth of this powerful and relatively young bull market.

The trajectory of the U.S. economy has changed recently because of the Delta variant of COVID-19 and related disruptions to companies' supply chains. According to the Federal Reserve Bank of Atlanta's estimate, the growth rate of gross domestic product (GDP) for the third quarter is tracking to just 1%, down from 6% two months ago. Rather than the start of a new downtrend, however, we expect growth to pick up through year-end as further progress is made beating COVID-19.

The stock market changed paths last month (consistent with historical seasonal patterns) as the S&P 500 Index experienced its first 5% pullback since October 2020. The good news, however, is that the fourth quarter has historically been the best for stocks with an average gain of 4%. As we look to next year, if the U.S. economy produces above-average growth as we expect, double-digit gains for stocks would be a reasonable expectation.

The Federal Reserve (Fed) may experience a big change early next year. Fed Chair Jerome Powell's term is up in February and his reappointment by President Biden is not assured. Mr. Powell's progressive critics don't believe he is tough enough on banks. The Fed is also about to start tapering its massive $120 billion per month bond-buying program before embarking on an interest rate–hiking campaign. That's a lot of change.

One thing we hope doesn't change is that the U.S. government keeps paying its bills. The debt ceiling, which has been raised 78 times since 1960, will need to be raised by October 18, according to Treasury Secretary Janet Yellen—or the country could (inconceivably) default on its debt. Congress will figure out a way to get this done but the political game of chicken could cause some jitters for markets if not resolved quickly.

Democratic policymakers are trying to effect a lot of change with the nearly $5 trillion in proposed spending on infrastructure and social programs. The two proposals will likely be scaled back closer to a combined $3 trillion to secure support from moderate Democrats (the $1.2 trillion hard infrastructure package has bipartisan support). This spending will come with tax increases to help pay for it, but that won't stop the federal debt from piling up. Thankfully that debt is cheap to service with interest rates still low.

That’s a lot of change. These changes create uncertainty, but markets may have already priced them in. The outlook for the U.S. economy still looks bright. Corporate profits are growing strongly. Low interest rates are supportive, and while inflation is still elevated, the worst of it may be behind us.

Please contact me if you have any questions.

Rachel