Market Commentary

The third quarter of 2023 brought the end to a three-quarter positive performance streak in the S&P 500. It was a volatile quarter across most asset classes as rising interest rates were once again a cause for concern for investors. Absolute returns for the quarter don't fully convey the market environment we saw over the past three months as much of the downside occurred in the latter half of the quarter. The S&P 500 fell just over 3% and the Nasdaq, coming off its best 6 month start to a year, fell just under 3%. Fixed income returns for the quarter were disappointing again with the Bloomberg Aggregate Bond Index down just above 3% - bringing the year-to-date returns into negative territory. While headline risks are still present, the consumer has remained resilient in the face of rising prices and generationally high interest rates, which has kept (and could continue to keep) the economy from moving into a recession.

The third quarter brought continued focus on interest rates with many investors questioning, “How long will rates remain this high?” When the Fed rapidly increased interest rates in 2022 to combat inflation, many economists and market participants expected swift economic ramifications resulting in a recession in 2023. That outlook led to a steeply inverted yield curve where short-term yields were significantly higher than longer-term yields - an indication that the Fed would lower interest rates in the coming quarters to simulate an economy in a recession. However, with the strength of the consumer and residuals from government stimulus still taking effect, the economy continued to grow in the first half of the year and forecasts for a recession were pushed back (or taken completely off the table in some cases). While inflation has moderated from the historical levels we saw last year, we are still hovering well above the Fed's target level for inflation and certain components have proven to be stickier than expected.

The Fed has continued with its restrictive monetary policy to continue to try to bring inflation down, with hopes of avoiding a significant downturn in the economy. Market participants have responded by delaying their expected time frame for an interest rate reversal – now, not until the second half of 2024—which has resulted in a rise in longer-term interest rates as investors come to grips with a higher-for-longer interest rate regime. The upward pressure on interest rates led to a painful quarter for bond prices, but also applied pressure to the stock market as higher rates can reduce future profit growth.

While the near-term future for asset prices will likely be largely dependent on the path of interest rates, we do take comfort in the continued strength of the consumer allowing the economy to navigate the potential choppy waters through the end of the year. Looking further out, we could see the start of a new market cycle with the economy building off the momentum we are already seeing.

100 N. Pitt St. #400, Alexandria, VA 22314

(703) 214-6646 | www.fordwealthassociates.com

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