Hutchinson Financial Advisors, Inc.
5243 Hickory Park Drive, Suite C
Glen Allen, VA 23059

Main: 804.729.6420
Fax: 804.729.6425

HutchinsonAdvisors.com

3rd Quarter Market and Economic Update

September 28, 2023

"At the end of the day, it's not a normal condition to have interest rates at zero." – Lloyd Blankfein
"How many are worried about a government shutdown? How many are more worried about it starting back up?" -Jay Leno

Happy beginning of fall! Is it just me or did the summer seem to fly by this year? Nevertheless, the summer brought us a late July peak in the stock market and the continued decline in bond prices/rise in rates. Since the July 31st peak, the S&P 500 is down about 7.8%, as I type this a couple of days before the quarter ends. That equals the 7.8% drop in the S&P 500 in February and March during the banking problems. The weakness we've seen in August and September isn't unusual, as historically it is the weakest two-month period of the year for equities, according to our friends at Ned Davis Research (NDR). While the spring correction was mainly caused by the banking issues, what has caused this recent weakness, other than seasonality? Simply put, it is interest rates. Coincidentally, I have received several questions about interest rates from clients over the last few months, so I thought I'd answer those here.

The questions I get most regarding interest rates go something like this: When will rates get back near zero? When will mortgage rates get back to 3%? My answer to both questions is the same: Likely not anytime soon! As the quote above from former Goldman Sachs Chairman and CEO, Lloyd Blankfein, suggests, interest rates like we've had for the last 14-15 years is not a normal condition. Rather, the rates we've had since the Great Financial Crisis (circa 2008-2009) were abnormal. Those rates were the result of extraordinary policy measures taken by the Federal Reserve (Fed), as well as central banks around the globe. The Fed's zero interest rate policy allowed them to keep short-term rates at essentially zero, and their quantitative-easing policy of buying both Treasury bonds and Mortgage-backed securities kept a lid on market-based long-term rates. This produced a wide array of consequences, both intended and unintended. The federal government could finance its ever-expanding deficits, individuals could afford more expensive homes, and the price of almost all assets rose.

However, there were unintended consequences, too. Chief among them was that cheap money eventually leads to inflationary pressures. While inflation has come down a lot since the summer of 2022, it is still well above the Fed's stated goal of 2%. Another consequence was corporations and households leveraging their balance sheets. Corporations used the cheap money to buy back stock, which isn't necessarily a bad use of funds, but it means they have replaced equity with debt, and at some point, that debt will need to be refinanced at what is likely a higher rate. That increases interest costs and reduces profits, all other things being equal. For individuals, the allure of cheap money led many to borrow more than necessary to buy more expensive things. One saving grace for individual

Securities offered through World Equity Group, Member FINRA/SIPC. Hutchinson Financial Advisors, Inc. and World Equity Group, Inc. are independently owned & operated.

homeowners is that they are most likely locked into fixed mortgage rates on their homes for the next 15-30 years, so refinancing that debt isn't a consideration.

Well, the era of cheap and free money is over, for now anyway. The Fed has raised short-term rates to a range of 5.25% to 5.5%, while also signaling the possibility of one more rate hike this year; they meet on November 1 and December 13. That is the highest Fed Funds rate since March 2001. Further, 10-year Treasury yields stand at 4.62% as I type, which is the highest since November 2007. These are normal rates.

Interest rates are nothing more than the cost of money. When rates rise, the cost of doing business rises as well. Thus, the rates we are now experiencing can post a headwind to corporations (higher costs, lower profits) and, in turn, equity prices. On the other hand, those companies with substantial cash on hand can now generate a lot of additional non-operating income by getting a better rate on their cash. It's really no different than individuals getting more interest on our own cash reserves/savings. A potential ramification of higher interest rates on equities is that for the first time in 14-15 years, bonds now pose competition to stocks for investor capital. There will be lots of people who choose a bond over a stock given where rates are now. Thus, it may be a positive for all savers and income seekers, who now can get a decent real return (inflation-adjusted) without having to look at the stock market with as much capital as they did previously.

As I mentioned on the previous page, I don't think short-term rates are going back to zero any time soon, nor do I expect mortgage rates to get near 4%, let alone 3%, unless we have a severe recession. Currently, every indicator we look at suggests that a severe recession is not imminent. We have had 14 recessions in the U.S over the last 93 years, according to the National Bureau of Economic Research (NBER); about 1 every 7 years. Thus, I expect we'll get a recession sometime within the next year or two, but I am absolutely not certain precisely when or how severe it may or may not be.

As mentioned above, the Fed has signaled its intention to raise rates one more time this year because inflation is still well above their target. Unfortunately, the Fed's job is being made much tougher by things out of their control. The massive fiscal deficits add excess liquidity to the system, which offsets some of what they are trying to do by raising interest rates. Another issue has been the increased labor activism. Things like the UAW strike and the Actors and Writers strikes in Hollywood have historically led to higher labor costs and increased inflation. All of this adds up to interest rates staying higher for longer than many assume.

One last item I'll touch on since it is front and center in the news: a potential government shutdown. Barring an agreement in Congress, the U.S. Government will shut down "non-essential" operations at the end of their fiscal year, which is September 30. Since I've gotten a few questions about it, I wanted to give a brief reply on the history of government shutdowns. There have been 21 federal government shutdowns since 1976! Frankly, I had no idea it had been that many until I read a piece by the good folks at NDR. According to their research, the consequences of a government shutdown depend in part on the length of time it lasts. Of the 21 prior occurrences, the length of the shutdown ranged from 1 to 35 days, with the average lasting 9 days. The impact on equities has been muted, with an average drop of less than 1% until the end of the shutdown. The impact on the broader economy was also relatively muted and short-lived, with a slightly negative impact on GDP (Gross Domestic Product) in the immediate aftermath, but a quick rebound once the shutdown ended. Bottom line: I wouldn't worry too much about a shutdown, as Jay Leno joked in the quote on page 1.

In case you are wondering, I have absolutely no idea how the rest of this year will go for any asset class or the economy. As mentioned, inflation has come down, but not as much as the Fed would like. Interest rates, particularly market-based long-term rates, have been rising and now pose an impediment to the cyclical bull market in equities. By all indications, a recession is still not imminent, which is one reason I was more sanguine as we started 2023. I am less sanguine now compared to the beginning of the year, as signs that the global economy is slowing continue to show up. As I said in my 2nd quarter letter, "…the back half of this year could be more challenging". That has proven to be the case so far, but that doesn't mean the cyclical bull market is over. As of now, it is intact and we are going through a normal correction, as we did in the early part of spring. Regardless, we will let our objective models and indicators guide our investment decisions.

I hope you and yours are healthy and enjoying a wonderful start to the fall. Please let us know if there is anything we can do for you. We're always here to help. Thank you very much for the incredible number of referrals you've given to us this year. Not only do we appreciate the trust a referral shows in us, but we also truly love to meet and help new people. It's part of what makes this such a wonderful career, and I am so thankful and fortunate to have such a wide array of clients from such a diverse background. From all of us at HFA, thank you for your continued trust, confidence, and loyalty. It is a joy and a privilege to work with you and your family.

Best wishes,

Harvey E. Hutchinson IV
Harvey E. Hutchinson IV
President

Securities offered through World Equity Group, Inc ("WEG"); member FINRA and SIPC, a Registered Investment Adviser.
Hutchinson Financial Advisors, Inc. ("HFA") is a Virginia registered investment advisory firm.
Hutchinson Financial Advisors, Inc. ("HFA") is not affiliated with or owned or controlled by World Equity Group, Inc. ("WEG").
Disclosure: HFA holds long positions in the securities of JP Morgan for its clients.

The opinions in this letter are those of the author as of September 28, 2023, and do not necessarily represent the opinions of World Equity Group (WEG) or its officers and employees. All opinions expressed are subject to change without notice. There is no guarantee that the current market will yield the same results as in the past. This material has been prepared or distributed solely for informational purposes and is not a solicitation or an offer to buy or sell any security or instrument or to participate in any trading or investment strategy. The Standard & Poor's 500, NASDAQ, Dow Jones Averages, Russell Indices, Philly Banking Index, Goldman Sachs Commodity Index, MSCI World Stock Index and the Lehman Brothers Aggregate Bond Index are unmanaged indices and are not available for direct investment. Sources of information used in preparing this letter may include the following: Ned Davis Research, Barron's, the Wall Street Journal, CNBC, Doug Kass (Seabreeze Capital), RealMoney.com, Morningstar, and Howard Marks (Oaktree Capital). The data and analysis contained herein are provided "as is" and without warranty of any kind, either expressed or implied. Any securities mentioned in this letter may not be suitable for all investors; the value and income they produce may fluctuate due to many factors.