CAPITAL INVESTMENT COUNSEL

The Columns

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Jerome Powell's Federal Reserve press conference last week took me back to my childhood. Powell's message was that rates will be "higher for longer" and it made me think about the games we used to play when I was little. Just when you thought you'd won, the other person changed the rules, and you were right back to where you started from. Powell's handling of interest rates feels similar this year. Stocks had a good head of steam and went into August on a high. Since then, the spike in rates helped the S&P peel off 7% in August and September.

(Spoiler alert: this article ends positively)

It's hard to play a game, let alone invest, when the person in charge keeps changing the rules. Price stability is one of the Federal Reserve's mandates and, at least in my mind, they've failed miserably. As the economy came out of COVID in 2020, it took 33 weeks of salary to purchase a new car. At current prices, it takes 42 weeks to do the same. If you've filled up with gas lately, you know the pain. I paid $4.42 a gallon outside of Charlotte last week and wanted to cry. Not really, but it sure didn't feel good and don't get me started on home mortgages. A 30-year fixed mortgage was 2.7% in August 2021. The rate is 7.2% today. It feels like those high rates are starting to cool the economy, so maybe the Fed can sit tight and let the situation develop.

My Federal Reserve rant is out of the way, so let's look at the potential upside to the market selloff. My personal market GPS has been driven by declining CPI inflation. Inflation

peaked in July 2022 at 9.1% and sits at 3.7% currently. Stocks have done well in the past when extreme inflation has moderated. We only have five occurrences going back to 1916, but stocks were higher two years later in all five instances with an average gain of 31%. The market gained 20% since bottoming last October. If history stays on track, we could see markets tack on another 11% of gains over the next 13 months. I say that not just to be bullish but to also caution you against being too negative. In today's constant news barrage, it's difficult to step back and take the longer view. If inflation continues its downward path, the next year could be a positive surprise.

In my experience, the market hates surprises but is surprisingly adaptable once it gets used to the new normal. The fourth quarter of 2018 is a great example. Similar to now, Jerome Powell was the Federal Reserve Chair and he moved rates higher than the market indicated he should. Powell's strategy helped drive the S&P 14% lower during Q4 and the final act of the selloff was the Dow's infamous 600-point drop on Christmas Eve. After the market adjusted to higher rates, it bottomed in January 2019 and went on an upside tear. The S&P 500 gained 31% for 2019. I'm not forecasting a 31% rise for 2024 but simply want to point out the potential upside after we adjust to "higher for longer".

I have a calendar reminder that pops up the 2nd week of September each year. It tells me the 10 trading days following September 19th are the roughest on record for the market. (Source: S&P) We're right in the middle of that currently. I know late September may be rough and I brace for impact, but it still burns. You know me - I take the high road and use the selloff to add to my favorite holdings.

Which leads to a potentially positive future. The S&P dropped 1.4% in August and is on track for a 4% haircut in September. That sounds bleak, but it's been a solid setup in the past. When that's happened over the last 65 years, the market was higher in October 90% of the time and the last 3 occurrences showed an average gain of 95 for the month. (Ryan Detrick @ Carson) If

you have any comments, feel free to contact me at heddins@capital-invest.com or call me at 919-656-0836.

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