



Market Commentary

Weekly perspective on current market sentiment

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Last week's S&P 500 Index: -0.31%

Don't panic, it's just politics (again)

Key takeaways

- Historical precedents suggest that a government shutdown will likely have a negligible long-term impact on the economy and markets.
- If the government shuts down, economic data will be delayed and could lead to the Federal Reserve not having a complete picture of the economy as it considers additional rate cuts.

A government shutdown looms as stalled congressional negotiations increase the probability that nonessential government services cease on October 1. A deal to keep the government open could be reached at any time. In the event the government does shut down, historical precedents suggest that such events typically exert modest, short-term pressure on financial markets, often manifesting as heightened volatility rather than systemic disruptions.

The biggest impact on financial markets could be the economic reports that may not be released during a shutdown. This is particularly problematic as labor markets may be softening and the Federal Reserve (Fed) will be looking for data to support additional rate cuts at upcoming meetings. The September jobs report is set to be released on Friday and could be one of the first major economic releases impacted by a shutdown. Should a government shutdown drag on, other major data releases such as weekly jobless claims, Consumer Price Index (CPI), retail sales, and Producer Price Index (PPI) could be impacted. Chair Powell's recent comments emphasize a data-dependent approach to rate cuts, implying that persistent weak labor signals could prompt the Fed to accelerate rate cuts to avoid falling behind the curve while strong labor data could lead to a slower pace of rate cuts. Without government data, it may be more difficult for the Fed to lean on a data-dependent approach to rate policy. We don't think a delay in data would necessarily preclude a rate cut at the October 29 Federal Open Market Committee meeting, but it clouds the picture the Fed has on the economy and may lead the Fed to lean more on private data like ISM services and manufacturing, ADP jobs, and Challenger layoff reports.

The initial reaction in capital markets to a shutdown would likely be to send equities lower and bonds higher (as bonds move higher in price bond yields move lower). We think such a move, if it were to occur, would be brief, but it could offer an opportunity for investors looking to reposition. For bond investors, lower yields could offer investors an opportunity to reduce exposure in long-term bonds where we have an unfavorable view. We currently favor prioritizing the intermediate portion of the yield curve with maturities ranging from three to seven years. Any equity-market pullback, even if short-lived, can be used as an opportunity to incrementally add exposure to our favored cyclical and growth sectors: Financials, Information Technology (IT), and Industrials. We also rate the more traditionally defensive Utilities sector as favorable, in part as a backdoor way of gaining exposure to the secular data-center buildout tied to artificial intelligence.

It is also worth highlighting that the government will continue to pay its debts during any shutdown. The debt ceiling was lifted in July and is not affected by the current negotiations on Capitol Hill. The government will continue to pay Social Security and Medicare. While a shutdown fog may obscure economic data for a time, investors would be wise to look past the current political impasse and focus on what we view as a constructive economic outlook going forward.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Definitions

An index is unmanaged and not available for direct investment.

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

Producer Price Index (PPI) is a family of indexes that measures the average change in selling prices received by domestic producers of goods and services over time.

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