

# Eads & Heald Wealth Management Offers Stock Market Guidance and Analysis

*Eads & Heald Wealth Management's investment guidance suggests potential short-term volatility, but affirms long-term confidence in the stock market.*

**Eads & Heald Wealth Management**  
Financial Planning + Investment Management  
35 Years Serving Investors

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*Matt Eads, CFA*

Eads & Heald Wealth Management is in its 35th year of business. The firm's advisors have 135 years of combined investment experience.

Stocks reached a new record high in early September before pulling back to finish the quarter essentially unchanged. Tacking on dividends, the S&P 500 index was up less than 1% during the third quarter. Despite the meager returns during the most recent quarter, U.S. stocks, as measured by the S&P 500 index, have generated solid returns, up 15.9% year-to-date and 30% over the last 12 months.

Value stocks have continued to outperform growth stocks so far this year. The gap between growth and value is most pronounced in small-cap stocks where small-cap value is up 23% year-to-date compared to 3% for small-cap growth stocks.

Stocks in the energy sector declined during the third quarter, but remain the top-performing sector for the year, followed by the financial sector. The energy and financial sectors are up 43% and 29%, respectively. Meanwhile, the utilities and consumer staples sectors are lagging the other segments of the market with returns just over 4% year-to-date.

Ongoing inflation concerns, supply chain bottlenecks, labor shortages, and uncertainty around fiscal and monetary policy are risks facing the market as we move through the coming quarters. Inflation has been running above 5% for the last few months. It is the first time inflation has been this high since 2008, and the longest stretch of 5%+ inflation since the period spanning the

end of 1990 into 1991.

The average rate of inflation over the last 50 years is 3.9%. Keep in mind that the last 50 years included double-digit inflation in the 1970s as well as more recent decades where inflation was generally below 3% and frequently 2% or less. The bottom line is that recent inflation readings represent a significant uptick in inflation and, if sustained, could have ramifications for investors. As noted in our letter last quarter, there is a strong link between the trend in inflation and the performance of growth stocks versus value stocks. We have our finger on the pulse of inflation trends and know how to navigate your portfolio through different inflationary environments.

Government debt continues to climb and is currently above 100% of Gross Domestic Product (GDP). Annual budget deficits have been greater than 10% the last 2 years and there are additional spending proposals that could potentially add trillions of dollars to the debt load. So far, rising debt and large deficits have not spooked bonds investors. Nonetheless, if current spending trends continue and inflation remains elevated, it is likely that interest rates will rise.

The yield on 10-year treasury bonds remains low but has ticked up slightly to 1.5%, up from 0.9% at the end of last year and 0.5% in August 2020. The average yield on 10-year treasuries since 1958 is 5.4%. Similar to the low rates of inflation we experienced prior to the recent rise, we have been living through a period of historically low interest rates.

A major factor keeping interest rates low has been the actions taken by the Federal Reserve. They continue to hold the interest rate they control near zero. Furthermore, the most recent round of quantitative easing that started in March 2020, through which the Fed purchases bonds in an effort to keep interest rates low and stimulate the economy, has resulted in the purchase of an additional \$4 trillion of bonds. When the Fed purchases bonds, it holds them as an asset on its balance sheet. Assets on the Fed's balance sheet now exceed a whopping \$8 trillion. To put the current balance sheet into context, consider that prior to the first rounds of quantitative easing that were implemented in 2008 to aid the economy in the wake of the financial crisis, the Fed's balance sheet stood at \$870 billion.

Historically low interest rates have had a profound impact on many and have been a particular hardship on those seeking a safe investment alternative. As an illustration, consider the following example. The income earned on \$100,000 in a savings account is currently \$70 per year, while the income needed to beat core inflation is \$3,977. In other words, even though a savings account may not lose money on a nominal basis, the purchasing power of the dollars in the account will actually decline each year when you account for the effects of inflation.



Matt Eads, CFA

The downward trend in interest rates started in 2008 when the Fed started lowering interest rates to combat the financial crisis. In the 14 years between 1994 and 2007, income from a savings account exceeded the income needed to beat core inflation in all but 3 years. Since then, interest income has not exceeded the amount needed to outpace inflation.

Given the string of record closes, above-average market returns, and the myriad risk factors described above, a temporary correction would not be surprising. Considering the S&P 500 stock index's return of about 30% over the last 12 months through September 30, even a correction of 20% would put the index back near its historical long-term average annual return of 10%. The point is to view any potential future corrections in the context of the incredible returns the market has generated recently.

Corrections inevitably elicit the temptation to flee stocks for safer alternatives. As we have stated countless times, attempting to time the short-term swings in the market is never a wise investment strategy; selling when it seems like the sky is falling is almost always counterproductive. In our view, stocks remain the best investment option to outpace inflation and provide attractive long-term returns for investors with the appropriate risk tolerance and time horizon. History is on your side.

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