If you've been paying attention to the headlines, you know that September was a rough month for the markets. The S&P 500 finished down 4.9%, making it the worst month of the year.[1] For the quarter, the S&P dropped 3.6%, while the Dow lost 2.6%.[1]

What's behind this surge in volatility? While it's easy to see all these numbers and headlines and feel overwhelmed, it might be helpful to think of the markets as a knotted-up ball of string. By slowly tracing the string backward, we can gradually untangle it. By doing that, we can discover the markets' recent performance is based largely on a series of causes and effects, each leading into the next. So, in this message, let's unravel that string together and make sense of what's going on.

**Cause: Reduced oil production by Saudi Arabia, Russia, and others → Effect: Higher oil prices**

In June, Saudi Arabia – second only to the United States as the world's largest oil-producing country – announced it would cut its production by one million barrels per day.[2] Several other nations, including Russia, followed suit. All told, these cuts total around five million barrels a day. Prior to this, oil prices had slid by nearly 15% over the previous seven months.[2] These countries wanted to reduce supply to drive prices back up. Initially, the cuts were only supposed to last for one month, but they have since been extended. The law of supply and demand holds that when supply goes down and demand does not, prices go up. Due to these cuts, oil prices have risen to their highest level since November of 2022.[3] This, in turn, has driven up the cost of gasoline.

**Cause: Higher oil prices → Effect: Rising Inflation**

As you know, many goods and services depend on oil and gas. Higher prices make certain types of transportation and manufacturing more expensive for businesses. Anything that requires oil to be produced becomes more expensive. Anything that requires oil to be shipped from one place to another becomes more expensive. You get the idea. These costs are often passed to consumers in the form of more expensive airline tickets, food, electricity…it starts adding up.

We have a name for rising prices: Inflation. Now, inflation is still down significantly from where it was earlier in the year. (The inflation rate was 6.4% in January and dropped to as low as 3% in June.) But it has ticked up again during the summer, rising to 3.7% in August.[4]

**Cause: Persistent Inflation (plus resilient economy) → Effect: High Interest Rates**

To combat inflation, the Federal Reserve has hiked interest rates to their highest level in decades. Higher interest rates have helped bring prices down, but they also make things more costly for businesses. As a result, investors had hoped that lower inflation would prompt the Fed to slowly reduce interest rates.

Technically, rates have not risen in two months. But since inflation is still proving stubborn – and since the economy is still growing – investors are coming to terms with the likelihood that rates will remain high for the foreseeable future. Furthermore, if inflation continues to tick up, we may even see *another* rate hike before the year is out.

**Cause: High interest rates → Effect: Higher bond yields**

The realization that rates are likely to *remain* high has led to a spike in bond yields. In fact, the yield on 10-year Treasury bonds is currently at its highest level in 16 years![5] You see, when interest rates go up, the price of existing bonds usually falls. That's because investors can buy *newly* issued bonds that pay higher coupon rates than older bonds. As a result, if bond owners want to sell their older bonds, they must do so at a discount. When bond prices go down, bond *yields* – the return an investor expects to gain until the bond matures – go up.

**Cause: High bond yields → Effect: Less attractive stock market**

Rising yields tend to make bonds more attractive to some investors. Bonds, especially US Treasurys, are often seen as more stable and less volatile compared to stocks. So, when investors feel they can get a decent return with less volatility, that tends to cause money to flow *out* of the stock market and *into* the bond market. The end result: Stocks go down.

Whew! We did it, «Salutation». We traced the string and discovered some of the causes and effects currently driving the stock market.

**One more possible cause-and-effect to keep an eye on**

Now, to be clear, this string doesn't cover *every* factor beneath the current volatility. For example, higher gas prices and rising inflation tend to also decrease consumer spending, the lifeblood of our economy. Should spending go down, that would lead to lower quarterly earnings for many companies that trade on the stock market.

To-date, consumer spending has been steady enough to keep the labor market strong and our economy growing. (The economy grew by 2.2% in the first quarter of 2023, and 2.1% in the second quarter.[6]) Data for the third quarter won't be released until the end of October, but, as of this writing, the Federal Reserve projects even higher growth for Q3.[7] The fear that some investors have, however, is that higher prices *will* lead to a drop in consumer spending. This, of course, would lead to a more anemic economy.

Now, in some respects, this is actually what the Federal Reserve wants. A drop in consumer spending would force companies to lower prices on the goods they provide, thereby decreasing inflation. But it's a fine line the Fed has to hit, rather like a parachuter trying to land on a very small target. If the economy slows too *much*, that will cause a recession. If it doesn't slow *enough*, that would cause **stagflation** – a situation where the economy becomes stagnant even though inflation remains high.

Stagflation is rare, and currently, we're nowhere near it. In fact, we've only had one significant period of it in living memory, which occurred all the way back in the 1970s. But since the markets move largely on what *could* happen – not what is currently happening – the fear of stagflation may also be contributing to the recent volatility.

**So, that's where things stand**. As you can see, there is a lot to monitor right now. Over the coming months, investors will be poring over every bit of data that comes out of the government for hints of what might come down the road. Meanwhile, the markets may well remain volatile for some time.

The good news is that *you* don't have to spend your time scrutinizing reports and worrying about what they mean. That's what *we're* here for! Our team will continue to keep a close eye on the markets, the economy, and your portfolio. If we ever feel changes need to be made, we will make them. In the meantime, we hope you enjoy the upcoming holiday season! Get out there and experience the fall colors, the crisp air, and the taste of pumpkin in seemingly every drink

you order. And, if you ever have any questions or concerns, please let us know. We are always happy to address them.

Have a great autumn!

Sincerely,

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Chief Executive Officer
Founding Partner

Michael J. Hudock, Jr., CPM®
President and Founding Partner
Wealth Consultant

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[2] "Saudi Arabia Says It Will Cut Production to Stem a Slide in Oil Prices," *The NY Times,* June 4, 2023. https://www.nytimes.com/2023/06/04/business/oil-prices-opec-plus.html

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[4] "Consumer Price Index – August 2023," *Bureau of Labor Statistics,* https://www.bls.gov/news.release/pdf/cpi.pdf

[5] "In the Market: US bond market signals the end of an era," *Reuters,* October 2, 2023. https://www.reuters.com/markets/rates-bonds/market-us-bond-market-signals-end-an-era-2023-10-02/

[6] "Gross Domestic Product (Third Estimate)," *Bureau of Economic Analysis,* September 28, 2023. https://www.bea.gov/news/2023/gross-domestic-product-third-estimate-corporate-profits-revised-estimate-second-quarter

[7] "Estimate for 2023: Q3," *Federal Reserve Bank of Atlanta,* October 2, 2023. https://www.atlantafed.org/-/media/documents/cqer/researchcq/gdpnow/realgdptrackingslides.pdf

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