A Commerce Trust Market Brief with Scott Colbert

Economic Resilience Amid Market Volatility

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Scott Colbert: Good morning. It's Friday, November 6th, and the markets are trending positively after having had two volatile days. One, a very strong update post the midterm elections. And then secondly, just about the worst day for the S&P 500 (Index) in the past five or six years on Thursday.

Looking at the big picture we can see that the S&P 500 is still up 8.4% year-to-date, but it's down about 6.8% from its peaks last October. And of course, across the markets in almost every index we've also seen moves down. The S&P 400 Midcap (Index) stocks are down about 10% from their highs. The Russell 2000 (Index), a measure of small caps, are down about 13% from their highs. International markets are also down. In general, most stock indexes are up somewhere around now 10% on a year-to-date basis.

One bit of positive news offsetting some of the declines in the stock market is that interest rates have fallen a bit from their highs towards the end of last quarter, and we've seen positive results recently. The bond market (as measured by the Bloomberg Aggregate Index) now on a year-to-date basis is about flat after having been down almost 2 or 3% at its worst. And the muni (municipal bond) market (as measured by the Bloomberg Municipal Index) which really had a tough quarter in the third quarter of 2026, has rebounded strongly and is now in positive territory.

While the S&P 500 is down 6 or 7% from its highs in October, that masks the rather huge rotation that's going on underneath the markets. We can see this when we take a look at sector returns. Information Technology and Communication Services have fallen 22 and 15% (respectively). Think Magnificent Seven and all of the chip stocks there. Offsetting the downturn in the technological sector of course, has been a rotation to more defensive sectors like Health Care and Consumer Staples which have improved 11 and 13% respectively. And while rather obviously the stock market is volatile on a day-to-day and month-to-date basis, it's still positive on a year-to-date basis, and we don't want to lose track of the bigger picture which includes where is the economy headed and how has employment growth been behaving?

Since we've last talked, third quarter GDP (gross domestic product) statistics have come out and economic growth this year has been very positive. On a nominal basis it's still 5.9% on a year-over-year basis, about 30% faster than we typically move on a year-over-year basis. And real growth is exactly where it's been historically since the turn of the century, real positive growth of 2.1%.

Despite the fact that economic growth has been very solid and the financial markets have been positive on a year-to-date basis, that didn't mean we didn't see a rather dramatic shift politically on election night. Driving of course this shift in political sentiment is affordability or lack thereof, and we think from the biggest picture the simplest chart tells the best story.

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Simply put, inflation is up about 30-plus % pre-COVID to today, and wages and salaries have increased almost an identical amount, but there's been no real growth in wages. Thus the average consumer feels no better off today than they did six and a half years ago.

And while the stock market has been volatile, so too has the interest rate market. As the stock market peaked in October, we saw a rather dramatic increase in interest rates across the curve, driving bond prices down and returns into negative territory. Note the chart that shows that the 10-year Treasury was up over 1% on a year-to-date basis. This increase in interest rates of course pushed back on affordability. It drove mortgage rates up and it's bound to slow economic activity with some lag. Fortunately, interest rates seem to have peaked about a month ago and have fallen now about 30 to 50 basis points across the curve. This is the key reason we recommend a balanced portfolio, because as the stock market has fallen back the bond market has provided a positive 2 or 3% return since these interest rates peaked in October.

And while interest rates are volatile on a day-to-day basis, in the long run they tend to track inflation and we just haven't made much improvement in the inflationary outlook over the last several years. Two years ago the average core inflation rate was about 3.05%, perhaps a bit better a year later 2.9%, and (in 2026) it's 2.85%. But this hasn't been enough progress for the Federal Reserve, and this is why they began to tap on the interest rate brake in September as they pushed rates up 25 basis points. And while they paused in October, this lack of progress is still likely to lead them to push one more time and move interest rates up another 25 basis points in December.

And despite all the noise in the financial markets and the headline grabbing news from the elections, the key driver to economic activity is job growth. Just today we got the most recent employment report and the employment growth was relatively broad based, stable, and strong. Year-to-date so far, we've created 86,000 jobs on average per month, materially better than last year. Importantly, the unemployment rate has come down from its peak a year ago of 4.5% down to 4.1% today. More people are participating in the employment markets and the diffusion index, meaning the breadth of job growth, has improved, particularly as we've seen a growth in manufacturing, professional services, and healthcare so far this year.

And so to conclude, we'd suggest don't look at the day-to-day volatility of the market or even the political headlines from the election, but keep track of what's really going on.

Number one, economic growth remains exceptionally strong. The bigger picture is the economy continues to expand and is likely to grow next year, although probably at a slightly slower pace given the higher interest rate environment than it did this year.

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Secondly, job growth is not only positive but it's broadened. The unemployment rate is down and we're seeing a pickup in manufacturing and higher paying jobs.

Number three, while the stock market has been very volatile and of course we've rotated towards a defensive position, it's generally much better off post the midterm elections. You've probably even read that 19 out of the last 19 midterm elections the stock market is higher by June of the next year, that would be June of 2027.

And while the data center buildout is likely to slow down a bit given the change in the political landscape, we view this as a positive from an inflationary point of view, not pushing up so much on inflation, and even positive from an economic point of view as it slows down what was amounting towards perhaps a more boom-bust cycle.

Finally, we think that inflation rates have likely peaked and will begin to fall, and this also ought to be very supportive of financial conditions going forward.

So while it's been a very busy couple of weeks in terms of the financial market news as well as election headlines, we'll be back in a few weeks before the end of the year to keep you up to speed on all the news that's impacting the financial markets.

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