

Our Three-Legged Stool Economy

Economic Perspective

The LaFleur & Godfrey investment team has been patiently waiting for some time now for the Fed to cut interest rates. With growth good (not great) economic growth, and with employment slowing, we are encouraged that Fed Chair Jerome Powell finally pivoted & lowered the federal funds rate during its most recent Federal Open Market Committee meeting. It was an important step to transition monetary policy from restrictive to accommodative. We view this pro-growth policy change as an important economic development and one that stabilizes the third leg of an economic foundation that is likely to deliver better growth in the days ahead.

The other two economic stool legs, fiscal and trade policy, have thankfully experienced less policy uncertainty of late. According to Strategas, the recently-passed One Big Beautiful Bill is likely to benefit both consumers and businesses. They forecast that consumer tax refunds will increase by 44% next year to \$517 billion. In addition, they believe consumption will increase due to zero taxes on overtime, tips and car loan interest. Corporations should also benefit from stimulative fiscal policy.

In particular, we have seen business sentiment dramatically improve on a sequential basis. The sizable incentives for capital goods investment & R&D expensing are expected to benefit companies by \$87 billion and \$99 billion, respectively, for fiscal years 2025 and 2026! Lastly, in just six months, trade policy and sentiment have gone from bad to much improved. Tariff revenue has ballooned to \$113 billion at quarter-end, more than offsetting lower corporate income tax revenue for the year.

Net-net, the three legs of the economic stool have stabilized our economy's foundation compared to the highly uncertain environment around Liberation Day in April. While our current government shutdown situation (hopefully temporary) is less than ideal, our investment team believes the above-mentioned economic drivers are likely to mitigate most of the short-term negative impact.

Market Perspective

It seems like day in and day out we continue to see the stock market climb the proverbial 'wall of worry'. The month of September, typically the worst performing month of the year, just posted its strongest return since 2010 – with the S&P 500 Index advancing +3.5% during the month and +7.7% during the third quarter. With anticipated Fed rate cuts becoming reality, the saying “Don't Fight the Fed!” could not be more true! The market is currently pricing in a 100% probability of another quarter-point rate cut late-October and an over 80% probability of another rate cut during December. With interest rate cuts, and productivity gains from AI investment flowing throughout our economy, we see the outlook for corporate profits remaining strong.

Third quarter earnings are likely to rise by +9% - followed by increasingly stronger year-over-year gains (low double digit expected) through the first half of 2026. With the Standard & Poor's 500 Index's operating profit margin percentage at all-time highs, our investment team is confident that the market's fundamental backdrop will remain favorable. The better-than-feared profit growth reported last quarter (double the expectations) could not have come at a more perfect time as stock market valuations are still stretched. The S&P 500 Index currently trades at a 22.5 times forward price-to-earnings (P/E) multiple. According to FactSet, the 5-year average valuation is 19.9 times and the 10-year average valuation is 18.6 times. It is important to keep in mind that, after stripping out the significant Magnificent 7 tech-heavy influence, the rest of the broader market trades at a much more reasonable valuation level. In fact, our team sees abundant opportunities outside of the current market leadership.

Looking Ahead

In the spirit of the current Major League Baseball playoffs, we are reminded of the famous New York Yankee catcher Yogi Berra's quote “It's déjà vu all over again!” Our investment team, while constructive on the stock market over the near-term, is often reminded that equity returns during the second year of a presidential term are typically the worst of the four years. Will this year be different? We shall see, Yogi! With that said, we are always comfortable forecasting that investing flows historically gravitate towards high-quality assets over the long run. As many of you very well know, our firm does not believe in timing the market as we believe it to be a fool's game. Instead, regardless of what year we are in of a presidential cycle, we preach patience time and time again & that economic and investing curve balls will inevitably come and go over time. You can be rest assured that the LaFleur & Godfrey investment team will remain vigilant and disciplined as we navigate the changing economic and market landscape.