Market Monitor 3Q 2014

It was "good news/bad news" in the economy during the 3rd Quarter, but nothing specific swayed the markets in any particular direction. Instead, investors seemed content to ride the ongoing bull market wave through the summer, even as worry about stock market overvaluation began to simmer. Stocks ended the quarter up slightly, at least among large-cap indices. Higher-quality bond yields ended the period near where they had started, while rates for lower-quality junk bonds had risen by quarter-end.

Among the good news, U.S. economic growth rebounded from the poor showing at the start of the year to a robust 4.6% for the 2nd Quarter. That was the fastest pace of growth in two years. Meanwhile, the unemployment rate continued to improve, falling to 6.1% for August, then to 5.9% for September. But looking beneath the surface in the job market revealed a murkier picture. For example, the August report showed only 142,000 jobs were added during the month, the lowest number so far in 2014. Plus, the labor participation rate, which measures the percentage of working-age Americans who are employed or actively looking for employment, has fallen to its lowest level since the late 1970s.

None of this news—either good or bad—seemed to affect stock investors during the 3rd Quarter. The large-cap S&P 500 and Dow Jones Industrial Index dipped in August, but regained ground to reach new all-time highs in mid-September. Both indexes peaked just after the Federal Reserve announced they would maintain its near-zero interest rate policy for "a considerable time", while also ending its "quantitative easing" program of buying fixed-income securities. Both policies have aided the economic recovery since they were launched after the 2008 financial crisis. Following the final quantitative easing purchase of bonds in October, the Fed will rely on its primary monetary policy tool to help keep the economy on a steady pace going forward.

Not all boats were lifted in the rising stock market tide, as small-cap stocks suffered for nearly the entire quarter. Small-cap performance had been choppy all year, but a 7.6% slide in the 3rd Quarter brought the small-cap Russell 2000 Index into negative territory for the year-to-date. Going into the 4th Quarter, talk among market watchers is about divergence—with bigger and higher-quality investments heading in a different direction from the rest of the market. Such a split in fortunes could underscore the market's weakness, and may lead to heightened concern and volatility for investors as 2014 draws to a close.

S&P 500 Index is an index of 500 of the largest exchange-traded stocks in the US from a broad range of industries whose collective performance mirrors the overall stock market. Investors cannot invest directly in an index. The Dow Jones Industrial Average is a widely watched index of 30 American stocks thought to represent the pulse of the American economy and markets. Small cap stocks may be subject to a higher degree of risk than larger, more established companies' securities, including higher risk of failure and higher volatility. The illiquidity of the small-cap market may adversely affect the value of these investments so those shares, when redeemed, may be worth more or less than their original cost. The Russell 2000 Index is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index. Past performance is no guarantee of future results.

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