Cetera® Investment Management

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Commentary

Government Shutdown Begins: What it Means for Markets and Investors

- The federal government enters its first shutdown in nearly seven years.
- While shutdowns cause disruptions, the impact is typically reversed once funding is restored.
- Historically, the long-term effect on markets and the economy has been muted.

For the first time in nearly seven years, the federal government has entered a shutdown. While technically partial, the ramifications are far-reaching, affecting federal operations, public services, and the release of key economic data, including the September payroll report scheduled for Friday. The key considerations are how long the shutdown will last, what it means for the economy and markets, and how it impacts investors.

There are no clear indications of how long the shutdown will last. Top Democratic and Republican leaders failed to reach a last-minute funding deal ahead of the new federal fiscal year, which began on October 1. Republicans pushed for a “clean” short-term funding bill, while Democrats sought to restore billions in healthcare spending, including rolling back Medicaid cuts and permanently extending Affordable Care Act (ACA) subsidies set to expire.

Government shutdowns are disruptive and neither party wants to take the blame, as is often the case. In the meantime, hundreds of thousands of federal workers face furloughs or will be required to work without pay until the shutdown ends and funding is restored. This is a real hardship for those relying on their paychecks.

The broader economic and market impact depends largely on how long the shutdown lasts. According to Bespoke Investment Group, GDP growth falls by 0.1% for every week the government remains closed.

Market volatility could rise in the near term if negotiations drag on. The long-term impact, on the other hand, is usually limited. Markets are forward-looking and tend to look past temporary disruptions. In fact, during the last shutdown, which was the longest on record at 35 days, the stock market rose.

Any negative impact on the economy is typically reversed when the shutdown ends. This is the 21st shutdown since 1976, and most have only lasted a few days, which is one reason why markets didn’t panic ahead of this one.

Another consideration is how the Federal Reserve (Fed) responds. The Fed’s next FOMC Meeting concludes in late October, and a prolonged shutdown could delay the release of key inflation and labor market data, leaving policymakers with less information on the health of the economy. While a rate cut later this month is currently anticipated by futures markets, the Fed could take a more cautious approach and pause rate cuts if uncertainty persists. The final FOMC meeting of the year is scheduled for mid-December.

Investors have become immune to the threat and act of government shutdowns. The broader impact is usually short-lived, and markets don’t skip a beat once they end. Staying diversified and maintaining a long-term perspective is the best strategy.

There are a few cracks in the foundation that could lead to another market pullback. Valuations are elevated again, market breadth is weakening, and investor sentiment is waning. Disciplined investors could benefit if short-term volatility creates opportunities. The broader economy continues to grow, consumers remain resilient, and there are solid earnings growth expectations for next year. It’s important to work with your Cetera financial professional for guidance and perspective to navigate any potential short-term market dislocation.

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