September 2024 Capital Markets Commentary

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"In three words, I can sum up everything I've learned about life: it goes on."

Robert Frost

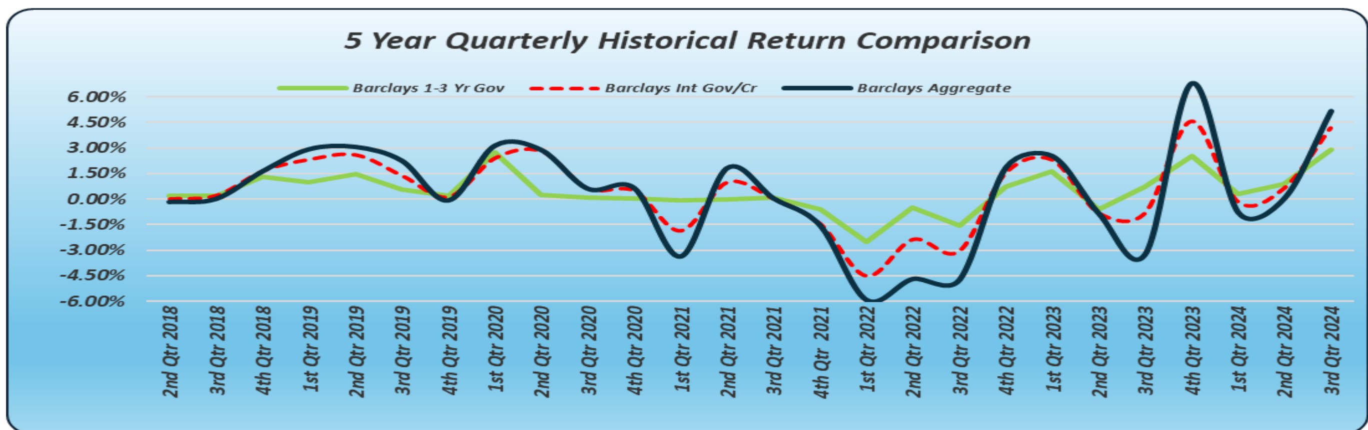
Fixed Income

The Fixed Income markets ended the 3rd quarter on a high note. After a relatively weak 1st and 2nd quarter, returns of +5.19% for the quarter and a 1-year return of +11.5% on the Bloomberg Aggregate Index, have brought the fixed income markets back into the news. The upward pressure on yields to start the year has given way to the probability that the FOMC will not only start to lower rates (as has happened) but are on a new policy path given recent data. This was reinforced by the FOMC's decision to lower Fed Funds by 50 basis points in September. However, no matter how much inflation numbers have improved, they are still a bit higher than the Fed's target.

In the 3rd quarter of 2024, spreads in high grade fixed income sectors have been tightening but yields remain relatively high and attractive. Riskier fixed-income categories, such as leveraged loans and emerging market debt, gained while US Treasuries and mortgage-backed securities also rose in value.

The FOMC met in September, and this time moved the target Fed Funds to a range of 4.75% to 5.00%. Inflation is still higher than the Fed's target, but most Fed governors are leaning towards lowering rates over the coming months.

As mentioned, returns were positive across all parts of the curve during the quarter. The Barclays U.S. Aggregate posted a +5.19% return for the quarter, and the Barclays Intermediate Index was at +4.17%. The short end of the yield curve also saw a positive return, with the 1-3 Year Government Index at +2.89%. And, at the truly short end of the curve, the 1 Year T-Bill returned +2.0% for the quarter. The 10-year Treasury yield ended the quarter at +3.81%. The 5-year Treasury yield ended at +3.58%, and the 2-year Treasury yield ended at +3.66%. (As of the end of September, yields are lower by approximately 50 to 60 basis Points from June)



Fixed Income Markets - Looking Ahead

At the September meeting, there was finally an adjustment in policy and the FOMC lowered rates by 50 basis points.

Inflation has slowed enough to levels that should allow the Federal Reserve to continue to cut interest rates, which improves the total-return prospects for bonds through the end of the year.

Although the fixed income markets are looking for continued downward rate cuts, which are priced into the market currently, we continue to believe that, although there will probably be an additional Fed cut in 2024, the easing may be muted. With the recent rise in yields, investors still should not miss the opportunity to lock in attractive yields and potentially benefit from the price appreciation that will occur when yields continue to decline in 2024 and 2025.

The Fed's top priority of inflation reduction and containment remains. Although market participants seem to be optimistic on the broad fixed income outlook, questions remain. 1) If we have peaked on rates, how low will they go? 2) With rates lower and the Fed on a different policy path, will recession fears grow? Stay Tuned.

Equity

The equity market, as measured by the S & P 500 Index, ended with another strong quarter as September ended. Hitting record highs, the quarter end signaled a continued strong equity market. Reinforced by the combination of a slowing but solid economy, better-than-expected corporate earnings, reduced inflation, and a policy shift by the Federal Reserve, stocks rallied almost +6% in 3rd quarter of 2024 and had YTD performance numbers of +22.1%.

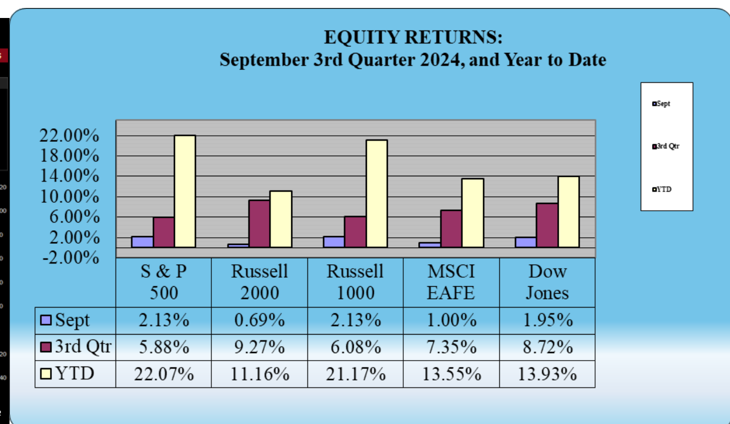
With inflation reducing faster than expected, below 3%, moving closer to the Fed's 2% target, the 3rd quarter of 2024 saw a 50-basis point rate cut in September. The equity market has now had positive returns in six of the last seven quarters.

U.S. markets experienced growth for the third quarter, but not without some chaos. Both small (Russell 2000 index) and large (S&P 500) company indices posted positive numbers, but the paths were quite different than prior quarters this year. The past few months produced much more volatility, highlighted by the events experienced in the first week of August, due to problems in the Tokyo Stock Market. It rectified itself rather quickly.

For much of the past couple of years, the markets have been through a very stubborn inflationary environment and investors have been cautious, the very largest of stocks being the primary beneficiaries. The largest stocks, which dominate the S&P 500, saw much less growth for the quarter and most were either flat or slightly down by the end of September. Even with the largest stocks flat, the index still returned almost +6.0% for the quarter, meaning the smaller companies that make up the remainder of the Index captured much more interest from investors.

While the stock market saw intermittent selloffs during the quarter, it continued marching higher as corporate earnings still hold out hopes that the economy can avoid a recession. As mentioned above, the S&P 500 index rose 22% during the first nine months of the year. The Nasdaq Composite also gained during the 3rd quarter, earning close to 3%.

All indexes were positive for the quarter. On the U.S. side, the S&P 500 ended with positive +5.9% return for the quarter, and the Russell 1000 index returned +6.08%. Other indices did equally well. The Russell 2000 index returned +9.3%, and the Dow returned +8.7%. The international markets also posted positive returns of +7.35% for the quarter.



	S & P 500	Russell 2000	Russell 1000	MSCI EAFE	Dow Jones
Sept	2.13%	0.69%	2.13%	1.00%	1.95%
3rd Qtr	5.88%	9.27%	6.08%	7.35%	8.72%
YTD	22.07%	11.16%	21.17%	13.55%	13.93%

Equity Markets - Looking Ahead

End of 2024 – 2025. How does it play out?

As we enter the 4th quarter of 2024, conditions remain good for U.S. equities. While the broad stock market goes into the final months of 2024 having resumed its rally, beneath the surface, the returns look somewhat different, thanks to a rotation out of the big tech names that had led much of this bull market. Instead, areas that had lagged—small company stocks, value stocks—are performing well.

As mentioned last quarter, stock markets have historically experienced volatility in the few months prior to U.S. Election Day.

However, markets typically recover in the weeks following the election. Nevertheless, political developments are likely to amplify stock volatility throughout the rest of the year, even if they don't fundamentally change the economic or business outlook. In this election cycle, expectations are that Congress remain divided, which means no regulation or legislation is likely regardless of which party wins.

Markets tend to prefer this environment of political gridlock, as it means a more transparent operating environment for companies to run their businesses.

As we move forward, there are risks for markets and investors. Inflation has fallen but remains above Fed targets. The timing and amount of future interest rate cuts by the U.S. Federal Reserve is positive for the markets. But we need to be wary. What goes up can come down.

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The Economy

The Economy

Change is in the air. For the first time since early 2022, there's a different economic story to tell other than mostly raised or steady interest rates by the Federal Reserve. Quite the reverse, following the FOMC's September meeting, Chairman Jerome Powell announced the Fed's first rate reduction in years, acknowledging that inflation is comfortably heading towards their target of 2.0 percent.

The FOMC reduced their overnight rate by 50 basis points or 0.5% at their September meeting, the first decrease since rates began to rise 2.5 years ago. While markets expected a cut, the debate was whether it would be 25 or 50 basis points. During the most recent press conference, Federal Reserve Chairman Jerome Powell indicated that data released since their prior meeting – including weak employment numbers – probably played a part in the higher rate cut.

When we analyze the rationale behind the recent decision, we must be cognizant that the Fed operates under a dual mandate: maximizing employment while maintaining price stability. A weaker labor market helped pave the way for the cuts as the unemployment rate rose to 4.3%, not an excessive number, but certainly moving higher. Many argue the rate cut was a preemptive move to prevent the job market from worsening further, while others suggest the Federal Reserve waited too long amid a cooling labor market. Throughout, the Fed maintained they are "strongly committed to supporting maximum employment."

For the most part, there wasn't much second-guessing from the markets and economists on the 50 basis point reduction because many were calling for the Fed to ease up on its inflationary policy for months. On the global stage, the U.S. monetary policy has been more reserved compared to what some other countries have done, particularly in Europe where many of the larger economies have reported inflation in the range of 2.2% and started cutting rates earlier in the year.

The Economy - Looking Ahead

Economic Growth? Jobs? Inflation? Recession? Global problems? Upcoming U.S. Election?

We all know that the Fed has kept interest rates unchanged for the past year or so while they tried to balance their mandate of maximum employment and stable prices. **It seems to have worked for now**.

After considering downward revisions to prior employment statistics, the FOMC opted for a "jumbo" cut of 50 basis points for its first move. In the press conference following the meeting, Fed Chairman Jerome Powell tried to stress that the jumbo cut did not come from a place of panic but rather was a positive step to avoid falling behind the curve, calling the move a "recalibration" and highlighting that the Fed does not see a recession on the horizon based on recent data. Mr. Powell also stressed that the Fed is not in a rush to get back to neutral.

The broad economic picture is a study in contrasts. While the manufacturing sector continues to show signs of weakness, other economic indicators show a more optimistic picture. Consumer spending remains robust even in the face of earlier economic headwinds. The labor market continues to add jobs too, though at a more calculated pace than in previous quarters. This strength in consumer behavior and employment has been a key in maintaining economic stability.

As we look to the future, the economic model is best described as cautiously optimistic. The Federal Reserve's sagacious(I just learned this word) approach to monetary policy, combined with robust corporate earnings and several positive economic indicators, provides a foundation for continued growth. However, this optimism is tempered by several factors that demand watchfulness. It should be noted that while the economy has shown remarkable resilience and adaptability in the face of numerous challenges, the path forward requires careful navigation.

While the markets have shown previous concerns about the Fed's "restrictive" monetary policy increasing the risks of a recession, it seems hard to claim the policy is restrictive when the economy is growing at or above its perceived long-term growth rate of about 2%. The Atlanta Federal Reserve's estimate of real gross domestic product growth in the third quarter is now at 3.1%.If those estimitates pan out, it seems more likely that the Federal Reserve will achieve its goal of a "soft landing."

The economy appears to be in good shape for now. However, election dynamics may influence day-to-day volatility in the 4th quarter, but financial market reactions to election results don't tend to be overly extreme (other than the short term) and eventually take a backseat to underlying economic conditions.

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