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3Q 2024 Commentary

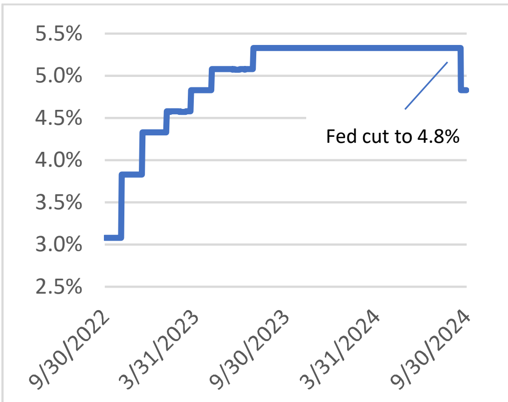
October 10, 2024

Most investable asset classes delivered positive returns in the quarter – stocks, bonds, gold.

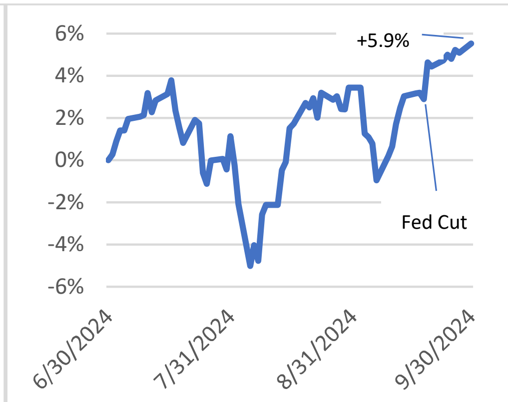
THE BIG THINGS: Fed Cut Rates; Bonds Rallied; Stock Diversification Paid Off

- The Federal Reserve made first rate cut since 2020.
- Bonds rallied as inflation continued to decelerate and the Fed cut interest rates.
- All equity indices moved higher; large cap growth lagged.

Fed Funds Rate, 9/30/22 - 9/30/24



S&P 500 Return, 3Q 2024



EQUITIES

Quarterly Returns: Stocks Up, Value Led, Large Cap Growth In The Back Seat

Value stocks outperformed growth in the quarter, with 4 of the "Mag 7" stocks down.

- Best: Small Value +10.2%, Mid Value +10.1%, Large Value +9.4%[1]
- Worst: Large Growth +3.2%, Large Core +5.9%, Mid Growth +6.5%
- The S&P 500 returned +5.9%, NASDAQ +2.8%.
    - 4 of Magnificent 7 stocks were down (Google, Amazon, Microsoft, NVIDIA).
- International: developed markets +7.3% and emerging markets +7.8%.
- Gold +14% and hit another all-time high; the dollar fell vs Euro, Yen and Pound.
- Bitcoin returned +4%.
- Hedge fund and other alternative asset returns were mostly positive.

[1] Large cap growth = Russell 1000 Growth Index; Large cap core = S&P 500; Large cap value = Russell 1000 Value Index; Mid cap growth = Russell Mid Cap Growth Index; Mid Cap Core = Russell Mid Cap Index; Mid cap value = Russell Mid Cap Value Index; Small cap growth = Russell 2000 Growth Index; Small cap core = Russell 2000 Index; Small cap growth = Russell 2000 Value Index; Developed international = MSCI EAFE Index; Emerging markets = MSCI Emerging Market Index. These terms will be used throughout the commentary. Source: FactSet & PSG.

Equities rallied with Fed cut and are having a great year.

2024 YTD Returns: Most Indices Up Double Digits; Large Leading Small/Mid

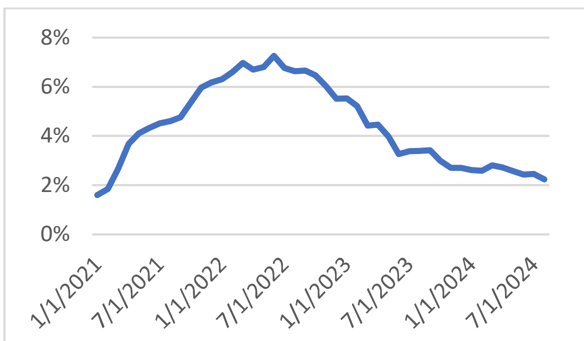
- Best: Large Growth +24.5%, Large Core +22.1%, Large Value +16.7%
- Worst: Small Value +9.2%, Small Core +11.2%, Mid Growth +12.9%
- The S&P 500 returned +22.1%, NASDAQ +21.8%.
    - All Mag 7 stocks have had positive returns: NVIDIA, Meta and Amazon outperforming
- International: developed markets +13.5% and emerging markets +14.4%.
- Gold +28%; Pound and Euro up vs the US dollar, Yen down.
- Bitcoin +50%.
- Most hedge fund and other alternative assets have had a solid year for their relative levels of risk.

FIXED INCOME

Quarterly and YTD Returns: Big Rally with Inflation Cooling Down, Fed Cut 0.5%

- Municipal and corporate bond prices rose in the 3rd quarter as interest rates fell.
- There was little change in the price of corporate or municipal bonds relative to Treasuries in the quarter.
- The strong rally flipped YTD bond returns from negative to positive.

Inflation – PCE 2021 through 2024[2]



Falling inflation readings and market expectations of inflation remaining contained gave room for Federal Reserve to cut rates.

Rally Fueled By Falling Inflation, Interest Rate Cuts

- Inflation resumed the downtrend of the last two years (see chart above).
- The Federal Reserve cut interest rates expecting inflation to remain at lower levels.
- The bond market is pricing in 10-year inflation expectations of 2.1%, down from 2.5% just a few months ago.
    - This is close to the Federal Reserve's long term inflation target of 2%.
- The Fed's rate cut coupled with lower inflation expectations sparked a rally across the Treasury interest rate curve. (***Table 1*** below, overleaf)
    - Yields fell more for short term yields than long term yields.
    - The changes caused the yield curve to become normal (upward) sloping in September (10-year yields rose above 2-year yields).
        - The yield curve had been inverted since July 2022.

[2] Personal Consumption Expenditures (PCE) Price Index; Federal Reserve officials have expressed this is their preferred inflation measure

Table 1

US Treasury Yields *(source- FactSet)*

Maturity	12/31/23	6/30/24	9/30/24	3Q24 Yield Change	2024 YTD Change
3 Month	5.4%	5.4%	3.8%	**(0.7%)**	**(0.7%)**
2 Year	4.3%	4.7%	3.6%	**(1.1%)**	**(0.6%)**
5 Year	3.8%	4.3%	3.6%	**(0.8%)**	**(0.3%)**
10 Year	3.9%	4.4%	3.8%	**(0.6%)**	**(0.1%)**
30 Year	4.0%	4.5%	4.1%	**(0.4%)**	**+0.1%**

We believe the best way to play growth outside the US is through US multinationals.

ECONOMIC AND MARKET ENVIRONMENTS

Growth Continues Unabated In US; Languishes In EU

- The US economy grew at a 3% clip in the second quarter.[3]
- Economic growth in Europe was 0.6%,[5] marking the 5th straight quarter of <1% growth.
    - This continues the long-term trend of the US growing more quickly than the EU.
    - The European economy has grown 20% from 2009-2023, while the US economy grew 89% over the same period.
    - Going back to 1990, the US economy has grown 459%, while Europe's has grown 263%[6]
- The US continues to lead in many technological sectors, particularly in Artificial Intelligence.
- We continue to believe the best way to play growth outside the United States is through US multinational companies.
- Loss of faith in the stability of the US dollar and/or US government debt could cause us to alter our views.

Loss of Iranian oil alone would be disruptive but not catastrophic to economic growth.

Widening War In Middle East

- The human tragedy of the conflict cannot be fully expressed here.
- One year on from the October 7th massacres in Israel, the war has widened from Gaza to direct conflict between Israel and Hezbollah/Iran.
- Concerns that Iran's oil infrastructure will be a target of future strikes should not be dismissed.
- Loss of Iranian oil alone would likely be cushioned by excess supply capacity in Saudi Arabia and relatively weak demand from China.
- If Iran attacked Saudi Arabia and closed the Strait of Hormuz, the disruption would be much more significant.
    - If just Iran oil production is knocked out or if a wider war is quickly resolved, we expect the impacts to be muted.
    - A protracted full-scale war between Iran and Israel/Saudi Arabia would almost certainly lead to a disruptive rise in oil prices.

[3] Source- Bureau of Economic Analysis, growth is at a Seasonally Adjusted Annual Rate (SAAR)
[4] Data is seasonally adjusted; Source: Bureau of Labor Statistics
[5] Real GDP in Euro area (19 countries), in Euros
[6] World Bank, FRED (Federal Reserve Economic Data), PSG, growth is in nominal US dollars.

        - Likely impacts include slower growth or economic contraction, higher inflation, and higher interest rates.

Perspectives On Politics and Markets

- We respect our clients' passion about the outcome of the election.
- The outcomes of the US presidential and congressional elections are unknown.
- Historically markets have performed well with Congress and the presidency under Democratic control, Republican control, and split governments. (Table 2 below.)
    - Companies and markets adjust quickly to changes.
    - We believe both higher tariffs and higher taxes are negative for risk assets.
        - That said, we are not convinced the outcome will change our strategic preference for equities over bonds and cash for long term investors.
- We do not believe either presidential candidate has put forth meaningful proposals to shrink the historically wide budget deficit, which we believe is unsustainable. (See 1Q Commentary here).
- All potential measures to reduce the budget deficit negatively affect at least some portion of the electorate.
- We continue to believe politicians will ignore the budget deficit until markets force change; the bond rally seems to have pushed off any reckoning.

The outcome of the election does not impact our strategic preference for equities over bonds and cash for long-term investors.

Table 2

Democratic, Republican, and Split Gov't Growth & Returns (since 1947)*

	GDP Growth	S&P 500 Returns
Democrat	4.0%	9.3%
Split	2.7%	8.6%
Republican	2.8%	12.9%

* Compound annualized growth and returns; Source: JPMorgan, BEA, Standard & Poor's, FactSet.

CONCLUSIONS

Bonds:

- Inflation continues to trend toward the Fed's 2% target, increasing the likelihood of lower short-term rates.
- A wider war in the Middle East, or markets reframing the current US fiscal situation, would likely lead to higher long-term interest rates.
- Bond market volatility may increase.
- Short to medium term bonds offer more relative stability than long term bonds.
- Corporate bond spreads (difference in yields between quality corporate bonds and Treasuries) are currently low and would likely widen if volatility increases.
- Short term municipal bonds continue to be expensive relative to Treasuries, but intermediate and longer-term municipal bonds will likely earn more than inflation over time assuming the Federal Reserve can reach their inflation targets.

Short to medium term bonds offer protection and stability should volatility increase.

Stocks:

- Value should offer relative stability in a more volatile geopolitical environment.

- Small Cap, Mid Cap, and Value stocks continue to trade at attractive valuations given the strong economy and consumer.
    - Lower interest rates could help sustain the rally.
- Should oil prices spike, value-oriented managers, which tend to tend to have higher allocations to energy than growth-oriented managers, should be somewhat insulated if the war in the Middle East escalates.
- We continue to believe Artificial Intelligence (AI) may transform many businesses and having an allocation to the leading AI stocks, even at these price levels, is warranted.

Private Investments / Alternatives:

- We continue to believe gold will act as an effective store of value in times of fiscal, monetary, or geopolitical stress.
- Most allocations to private investments have done well this year.
    - They have not kept up with equities, but most are not designed to outperform equities in what has been an exceptional year thus far.
    - Private investments continue to offer respectable long-term returns with lower volatility than the equity market.
- We continue to favor distressed credit.
- We continue to search for interesting alternative investments that offer attractive risk adjusted returns uncorrelated with equities and bonds.

DISCLOSURE