Quarterly Newsletter

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Market Overview

All three major averages experience third quarter gains. However, it was the Russell 2000 that outperformed The Nasdaq[1], S&P 500[2], and the Dow Jones Industrial Average[3] indices as yields moved lower, earnings grew, economic growth was positive, and rate cuts were anticipated. The Russel 2000 led the second quarter stock gains finishing up 9.27%, with the Dow Jones Industrial Average Index, the S&P 500 Index, and The Nasdaq trailing at 8.72%, 5.89%, and 2.76%, respectively.

During the third quarter of 2024, utilities were the best performing sector, gaining 19.35%, followed by real estate at 17.29%, and industrials by 11.49%. As we predicted earlier, we continued to see a broadening in this bull market. Rate sensitive sectors began to outperform throughout the quarter with long end interest rates falling. The utility sector is now the best performing sector year to date, up 30.50% followed by communication services, which is up 25.45%. Another interesting dynamic during the quarter was seen with the risk off trade unwinding with technology finishing the quarter at -0.03% and gold continuing to push 13.05% higher during the quarter. Gold is now outperforming the S&P 500 year to date.

The Federal Reserve (the "Fed") decided to cut the federal funds rate by 50 basis points during their September meeting. Goods inflation continued to fall throughout the quarter while services inflation remained sticky. The yield curve, which had been inverted for over two years, has now returned to its typical upward slope. This shift occurred after the 2-year interest rate fell more rapidly than the 10-year rate, a phenomenon known as bull steepening. The Federal Reserve's recent decision to lower interest rates by half a percentage point further contributed to this change, though the impact was not as pronounced as expected. While an inverted yield curve is frequently seen as a warning sign of a recession, it's actually the reversal of this inversion that has historically been more closely linked to economic downturns. In the past, the yield curve has typically returned to its normal upward slope before the onset of recessions. However, this correlation might be coincidental rather than a reliable predictor. Based on current economic conditions, we don't anticipate a U.S. recession in the near future. During the third quarter of 2024, the 10-year Treasury yield reached a high of 4.49% on 07/01/2024 and a low of 3.59% on 09/16/2024. The sudden downturn in yields allowed cash on the sidelines to come into the equity markets.

Turning to international markets, emerging market equities outperformed developed market stocks during the quarter.[5] Chinese policymakers decided to inject trillions of yuan into the system and lower borrowing costs at the end of the quarter in an attempt to bolster their economic growth to a target of around 5%. The declining dollar also helped emerging and international market returns as well.

Mark L. Blom, CFP® — Brent Miller, CFA® — Kirk Masci

U.S. Equity Returns Table Source: Tamarac			**U.S. Treasury Yield Table** Source: Treasury				**Other Indices Table** Source: Morningstar		
Index	**Q3 2024 Returns**	**2024 Returns**		**09/2024**	**09/2023**	**09/2022**		**Q3 2024 Returns**	**2024 Returns**
Dow Jones	8.72%	13.93%	3 month	4.73%	5.55%	3.33%	Gold (GLD)	13.05%	27.14%
S&P 500	5.89%	22.08%	2 year	3.66%	5.03%	4.22%	Brent Oil (BNO)	-11.94%	3.66%
NASDAQ	2.76%	21.84%	5 year	3.58%	4.60%	4.06%	U.S. Dollar Index (UUP)	-3.26%	4.02%
Russell 2000	9.27%	11.17%	10 year	3.81%	4.59%	3.83%	Int'l Equity Markets (EFA)	6.77%	12.95%
MSCI World	8.17%	14.70%	30 year	4.14%	4.73%	3.79%	Emerging Equity Markets (EEM)	7.68%	14.84%

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Will the Market Close Out 2024 on a High Note?

The long-awaited market broadening finally manifested in Q3 2024, with a more diverse basket of stocks leading the S&P 500 Equal Weight Index higher by 9.6% compared to the 5.9% return of the market-cap weighted version of the index. Easing inflation concerns and the expectation of falling interest rates roused small cap stocks from their first half doldrums, leading the Russell 2000 Index to outperform the S&P 500 Index for the first time since Q4 2023. These recent trends inevitably lead to some pointed questions about the market's near-term future. More specifically, will the broader market rally persist in Q4 2024, or will we see a return to the mega-cap driven market of the first half of the year? Or alternatively, are we looking at a heightened risk of a market correction to close out 2024? For the answer to these questions, we must once again turn to a discussion of recent macroeconomic trends.

Those of you who follow Chairman of the Federal Reserve (the "Fed") Jerome Powell know that he is fond of discussing the Fed's "dual mandate" of promoting maximum employment and stable prices. After much speculation, the Fed opted to cut the federal funds rate by 50 basis points on 9/18/24, marking the first rate cut since the Fed begin its tightening cycle in March 2022. The Fed's decision to cut by 50 rather than 25 basis points was primarily driven by the following considerations: 1) moderating inflation concerns resulting from further progress towards the Fed's 2.0% inflation target, and 2) potentially concerning labor market conditions due to slowing job gains and a slight uptick in the unemployment rate.

On the inflation front, the July Personal Consumption Expenditures (PCE) Price Index reading, the last PCE data point prior to the Federal Open Market Committee (FOMC) meeting in mid-September, increased by 0.2% in July and 2.5% from the year ago period, moving closer to the Fed's 2.0% target. On 9/27/24, the U.S. Bureau of Economic Analysis released the August PCE report, which showed that PCE price index increased by 0.1% in August and 2.2% on a 12-month basis, providing further evidence that inflation continues to moderate and providing ex-post support for the Fed's larger rate cut earlier in the month.

With regard to employment, the U.S. Bureau of Labor Statistics released its August employment report on 9/7/24. The report was mixed, with the unemployment rate coming in at 4.2% as expected but nonfarm payrolls increased by 142,000, below the consensus 161,000 forecast. It was against this mixed labor market backdrop that the FOMC met later that month and opted to proceed with the 50-basis point cut. The most recent employment report (September), released on 10/4/24, represented a promising development. The unemployment rate came in at 4.1%, lower than the consensus estimate of 4.2% and the August figure of 4.2%. In addition, nonfarm payrolls increased by 254,000, well above the 140,000 consensus estimate.

Turning to economic growth, Q2 2024 GDP growth was recently revised to a final estimate of 3.0%, representing a marked acceleration from Q1 2024 growth of 1.6%. The accelerating growth rate was primarily attributable to higher private inventory investment and an acceleration in consumer spending, both of which represent positive developments for the persistence of domestic economic growth. While the initial estimate for Q3 2024 GDP will not be released until October 30th, the Federal Reserve Bank of Atlanta's GDPNow forecasting model is currently calling for Q3 2024 GDP growth of 2.5%, which is consistent with a robust economy.

Putting all of these data points together, the economy appears to be on solid footing. Inflation is slowly continuing to moderate, with shelter costs and rising prices in the services sector proving to be the most resilient components of the aggregate inflation picture. We expect services inflation to eventually catch up with the progress on the goods side of the economy. Regarding rising housing costs, we believe that falling interest rates will eventually lead to increased supply of both existing and new homes, providing a much-needed check on rising shelter costs.

The FOMC will meet two more times in 2024, once in November (11/6-11/7) and once in December (12/17-12/18). Given current economic conditions, we would expect no more than two 25 bps rate cuts between now and the end of the year. While we expect short-term rates to continue to gradually decline in step with expectations of incremental cuts to the federal funds rate, we believe there is a heightened probability of the 10-year Treasury yield rising back to 4.0% from its quarter-end level of 3.78%. This assessment is based on our expectation of robust and resilient economic growth and an improving and stabilizing labor market outlook.

Circling back to our initial queries about the stock market, what does all of this mean for equities? If the Fed is able to engage in two additional 25 basis point rate cuts by year end, without reigniting inflation and before the economy slips into a recession, i.e. the “soft landing” scenario, we believe there is more room for the market to run. This does not mean that the ride will be a smooth one and we expect a slight uptick in volatility as we move closer to what is expected to be a close and highly contested presidential election.

We are forecasting a continuation of the Q3 2024 trend of periodic oscillation between “risk on” and “risk off” trading environments where large cap growth and small cap stocks may lead the market on one day and defensive, value-oriented equities and safe haven commodities such as gold serving as the market leaders the next. While we expect the market broadening to persist for much of Q4 2024, we would not be surprised to see mega cap technology and technology adjacent stocks (i.e. the “Magnificent Seven”) catch fire at some point and end the quarter on a high note. We remain firm believers in the promise of generative AI and companies that are able to successfully leverage this technology to the benefit of their customer base will continue to enjoy outsized market returns in our view.

In sum, while we believe Q4 2024 will be a bit choppy from a performance perspective, we continue to forecast that a modest rate cutting environment in the absence of recessionary economic signals and/or resurgent inflation should propel the market higher by year end. We believe our diversified stock portfolios provide protection against the potential downside of periodic bouts of rotation from growth to value sectors.[6] In addition, while the market in aggregate appears to be priced at a premium, we believe it there are pockets of the market that still appear attractive from a valuation perspective, and within these undervalued market segments, it is possible to find stocks that trade at a material discount relative to their near and long-term earnings power.

Brent J. Miller, CFA® – Senior Portfolio Manager

1.The S&P 500 Equal Weight Index (EWI) is the equal-weight version of the S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight of 0.2% of the index total at each quarterly rebalance.
2.The market cap weighted S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
3.The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell Index. The index is commonly used as proxy for U.S. small cap stock market performance.
4.The GDPNow model forecasts GDP growth by aggregating 13 subcomponents that make up GDP with the chain-weighting methodology used by the U.S. Bureau of Economic Analysis
5.https://www.atlantafed.org/cqer/research/gdpnow
6.Diversification does not ensure a profit or guarantee against a loss.

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