Q4 2024 NEWSLETTER

IMPACT

FINANCIAL STRATEGIES

Super Bowl Rings. The Masters Green Jacket. The elusive Soft Landing.

October 4, 2024

The Steelers are 4-0, the S&P and Dow are at all-time highs, and I even managed three pars in my last golf game. The Fed is finally cutting… What could go wrong? Everything is lining up perfectly for a Super Bowl run, a scratch round, and a big sigh of relief that the Fed has saved the economy. We're all clear!

That's what I wrote just last week on Sept 27th in preparation for this quarterly newsletter. Remember that saying about "not counting your chickens before they hatch?" As luck would have it, the Steelers stumbled, the markets have retreated, and my golf game… Well, let's say I was lucky to find one par my last game. It's a reminder of how fleeting perfection can be—whether in football, golf, or most relevant here, in the markets.

I've been thinking a lot about this in relation to our current economic environment. It's becoming increasingly challenging to discern what constitutes "good data" versus "bad data," and what it all means for the rest of the year. It's not just the absolute numbers that matter but also the direction and rate of change. Borrowing a great analogy from our friends at The Sevens, picture this: your team (aka The Steelers 😊) are up by three touchdowns—feeling confident, you head to the concession stand. But when you return, they're only up by one. You're still ahead, but your confidence in the outcome begins to waver. How much time is left, who has the ball? Who are we playing? That's where we are right now. On paper, we're still in the lead—the economic scoreboard is largely positive—but many of the signals are only just barely in the green. And it wouldn't take much for them to shift into the red. You wouldn't be willing to "bet the farm" that everything will work out as you *hope* it will. There are a lot of things that could influence what happens next. We cannot afford to ignore the risks or become complacent as we emotionally want to chase these returns and guess at the final outcome.

I have an addition to this newsletter for you. At the end, I've added a standalone color-coded 2-page economic scorecard to help you see what we're monitoring as we move into the final quarter. I was waiting for today's job data to come out before sending this out. It reflects just a snippet of what might influence the direction of this economy and the markets through the end of the year. Unfortunately, there are other influences that are harder to monitor, including rising geopolitical tensions and increased rhetoric as we get closer to the election.

As always, I hope you enjoy this newsletter and find value in the insights. Please feel free to share it with anyone who might find it useful. I look forward to connecting with you as we move into the fall and the upcoming holiday season. Please be on the lookout for some exciting news as we are expanding your team and our resources to continue to better serve you.

By the way: I really didn't think a 3-0 Steelers team had a SB appearance locked up; I am a mediocre at best golfer, (three pars might be my best round ever), and I would love to see the market ONLY go up!

I hope you enjoy this newsletter, please reach out if you have any questions or comments,

Justin

Quarterly Insights – October 2024

Markets Are Once Again Resilient in the Face of Rising Economic Uncertainty

Markets were volatile in the third quarter as investors faced political turmoil and increased uncertainty about future economic growth, but the return of Fed rate cuts and solid corporate earnings helped to offset those political and economic anxieties, and the S&P 500 hit another new all-time high and finished the quarter with strong gains.

Markets started the third quarter with a continuation of the first-half rally thanks to good Q2 earnings results and generally solid economic data. However, while the S&P 500 hit a new all-time high in mid-July, the second half of the month proved more volatile. That volatility was driven by an intense rotation within the S&P 500 from the heavily weighted tech sector (more than 30% of the S&P 500) to other, smaller market sectors such as utilities, financials and industrials. The impetus for this dramatic rotation was a combination of profit taking following the substantial AI-driven tech stock rally and a larger-than-expected decline in inflation which caused Treasury bond yields to fall sharply as investors anticipated imminent rate cuts by the Fed. That expectation boosted the economic outlook and caused investors to rotate towards market sectors that benefit more directly from a strong economy. So, while investors didn't exit the market entirely, the decline in the tech sector weighed on the S&P 500 and was not fully offset by gains in other, smaller market sectors. The S&P 500 finished July well off the mid-month highs and with just a small gain, up 1.1%.

The late-July volatility continued in early August as a much-weaker-than-expected July jobs report, released on August 2nd, added to economic concerns. The unemployment rate rose to the highest level since November 2021 and investors' fear of an economic hard landing triggered a sharp, intense decline that saw the S&P 500 fall 3% on Monday, August 5th, the worst one-day selloff in nearly two years. However, that decline proved brief as economic data over the next few weeks was generally solid and that helped calm investors' anxieties. Then, on August 23rd, at the Kansas City Fed's Jackson Hole Economic Symposium, Fed Chair Powell told markets the "time had come" for the Fed to cut rates. That all but guaranteed a rate cut at the September meeting. That message further fueled the rebound in stocks and the S&P 500 finished August with a 2.3% gain, completing an impressive rebound from early-month weakness.

The rally continued in September thanks to growing expectations for a large Fed rate cut that offset lackluster economic data. The August jobs report, released in early September, was another disappointment and again increased concerns about an economic slowdown and stocks were modestly volatile to start the month. However, following that report, numerous financial journalists and ex-Fed officials made public calls for the Fed to cut interest rates by 50 basis points at the September meeting and expectations for a larger-than-expected rate cut helped offset underwhelming economic data and the S&P 500 hit a new all-time high ahead of the Fed decision. Then, on September 18th, the Fed met market expectations and cut rates for the first time in four years and promised additional rate cuts between now and year-end. Investors welcomed this news and the S&P 500 surged to a new high and finished the month and quarter with more solid gains, adding to the strong year-to-date return.

Finally, politics and the looming presidential election did impact markets during the third quarter. Investors started the quarter expecting a Trump victory and Republican control of Congress, based on polling following President Biden's struggles at the June debate and after the failed assassination attempt on the former president. However, those expectations changed rapidly following Biden's withdrawal from the race and nomination of Vice President Kamala Harris. As the third quarter ended, national polls slightly favored Harris while the outlook for the control of Congress remained uncertain.

Third Quarter Performance Review

Investor expectations for falling interest rates and bond yields were the major influences on index, sector and factor performance during the third quarter, as markets were broadly positive but with some notable changes in leadership.

Starting with market capitalization, small caps outperformed large caps for the first time in 2024 as investors rotated out of large-cap stocks and into more economically sensitive small caps, as they historically have received the most benefit from lower borrowing costs that come with falling interest rates.

From an investment style standpoint, value handily outperformed growth, although both investment styles posted positive returns for the third quarter. The outperformance of value was evidence of the significant rotation we saw from the tech sector (which dominates most growth funds) to lower P/E and more economically sensitive parts of the market such as financials, industrials, utilities and others.

On a sector level, nine of the 11 S&P 500 sectors finished the third quarter with a positive return and that continued the broad year-to-date rally we've all enjoyed. Evidence of the influence of lower yields on returns can be seen in the sector outperformers, as utilities and real estate, two sectors that have relatively large dividends and benefit when bond yields are falling, handily outperformed the remaining nine S&P 500 sectors.

Looking at sector laggards, the tech and energy sectors were the only sectors to finish the third quarter with negative returns, as investors rotated out of tech and towards those higher dividend and more cyclically sensitive sectors. Energy, meanwhile, was the worst performing sector in the quarter as concerns about global growth (especially in China) weighed on oil demand expectations.

US Equity Indexes	Q3 Return	YTD
S&P 500	5.89%	22.08%
DJ Industrial Average	8.72%	13.93%
NASDAQ 100	2.12%	19.97%
S&P MidCap 400	6.94%	13.54%
Russell 2000	9.27%	11.17%

Source: YCharts

Internationally, foreign markets outperformed the S&P 500 in the third quarter as the relative underperformance of the tech sector was a headwind on S&P 500 returns. Foreign developed markets saw a solid rally in the third quarter as investors anticipated additional rate cuts from the European Central Bank and other major global central banks. Emerging markets also outperformed the S&P 500 and foreign developed markets as the Chinese government announced numerous stimulus measures late in September and that boosted Chinese stocks and emerging market indices and ETFs.

International Equity Indexes	Q3 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	7.33%	13.50%
MSCI EM TR USD (Emerging Markets)	8.88%	17.24%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	8.17%	14.70%

Source: YCharts

Commodities were mixed, but in aggregate saw moderate losses in the third quarter thanks mostly to weakness in oil prices. Oil declined sharply in Q3 as global demand expectations were reduced courtesy of soft Chinese economic data early in the quarter and on generalized global growth concerns. Gold, however, staged a strong rally thanks to elevated geopolitical uncertainty and the weaker dollar, as gold hit a new all-time high in Q3.

Commodity Indexes	Q3 Return	YTD
S&P GSCI (Broad-Based Commodities)	-5.26%	5.23%
S&P GSCI Crude Oil	-16.44%	-4.74%
GLD Gold Price	13.26%	27.53%

Source: YCharts/Koyfin.com

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) saw a very strong quarterly return thanks to a combination of falling inflation, mixed U.S. economic data and as investor's anticipation of an aggressive rate cutting cycle from the Fed.

Looking deeper into the bond markets, longer duration bonds handily outperformed those with shorter durations as investors reached for longer-term yield amidst falling inflation and underwhelming labor market data. Shorter duration bonds also saw a positive return, however, as investors anticipated the start of an aggressive rate-cutting cycle by the Fed.

Turning to the corporate bond market, investment grade bonds outperformed lower quality "junk" bonds although both saw strong quarterly gains. For the first time in 2024, investors favored investment-grade bonds amidst increased economic uncertainty, as investors sought the safety of higher-rated bonds over increased yield.

US Bond Indexes	Q3 Return	YTD
BBgBarc US Agg Bond	5.20%	4.45%
BbgBarc US T-Bill 1-3 Mon	1.36%	4.08%
ICE US T-Bond 7-10 Year	5.74%	4.26%
BbgBarc US MBS (Mortgage-backed)	5.53%	4.50%
BbgBarc Municipal	2.71%	2.30%
BbgBarc US Corporate Invest Grade	5.84%	5.32%
BbgBarc US Corporate High Yield	5.28%	8.00%

Source: YCharts

Fourth Quarter Market Outlook

With the start of the Fed's rate cutting cycle now behind us and the general pace of future cuts now broadly known, focus for the final quarter of 2024 will turn towards economic growth and politics. Given the volatile nature of both, it's reasonable to expect periods of elevated volatility over the coming months (but, as we saw in the third quarter, markets can still move higher even amidst increased volatility).

Starting with economic growth, expectations for aggressive Fed rate cuts helped investors look past some soft economic reports in Q3, especially in the labor market. However, with those rate cuts now behind us, we should expect markets to be more sensitive to any disappointing economic data, especially in the labor market. Bottom line, with the S&P 500 just off record highs, the market has priced in a soft economic landing, so if the economic data in Q4 is weaker than expected and recession fears grow, that will increase market volatility between now and year-end.

Politics, meanwhile, will become a more direct market influence as we approach the November 5th election. Depending on the expected and actual outcome, we could see an increase in macro and microeconomic volatility that could impact the broader markets as well as specific industries and sectors (e.g. oil and gas, renewables, financials and others). That volatility will stem from the uncertainty surrounding potential future policy changes (or lack thereof) towards important financial and economic issues such as taxes, global trade and the long-term fiscal health of the United States.

Finally, geopolitical risks remain elevated and while the war between Russia and Ukraine and the ongoing conflict between Israel, Hamas and now Hezbollah hasn't negatively impacted global markets this year, that's always a possibility and these situations must be consistently monitored as the spread of these conflicts would impact markets, regardless of any Fed rate cuts or election outcomes.

In sum, as we start the fourth quarter the market does face economic, political and geopolitical uncertainties. But market performance has been very strong in 2024; momentum remains decidedly positive, and this market has proven resilient throughout the year. Additionally, current economic data is still pointing to a soft economic landing. Finally, while political headlines may cause short-term investor anxiety and volatility, market history is extremely clear: Over time, the S&P 500 has consistently advanced regardless of which party controls the government and the average annual performance of the S&P 500 is solidly positive in both Republican and Democratic administrations.

So, while there is elevated uncertainty between now and year-end and it's reasonable to expect an increase in short-term volatility, the fundamental underpinnings of this market remain broadly positive.

Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

Justin

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Soft Landing versus Hard Landing Scorecard Q4 2024

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With the volatility we've seen since the beginning of August, I felt compelled to provide a visual scorecard to help clarify the data. It's becoming increasingly challenging to discern what constitutes "good data" versus "bad data," and what it all means for the rest of the year. It's not just the absolute numbers that matter but also the direction and rate of change.

While some of the monthly numbers reported over the last two weeks are positive (and thus, suggest the possibility of a soft landing), it's important to remember that the Fed has only ever successfully managed one before in the mid 90's, and it during a period where the labor market was getting stronger. That is not the case currently when you look at the trends. Most importantly, we follow the data; although most of these data points are still in the green, they are showing signs of stress and could easily turn red. This analysis is inspired by our colleagues at The Sevens Report.

Hard Landing vs. Soft Landing Scoreboard (As of October 4th, 2024)

	Current	One Month Ago	Two Months Ago	Hard Landing/Soft Landing
ECONOMY	How to read: > 50 = Growing; < 50 = contracting			
ISM *Manufacturing* PMI	47.2	47.2	46.8	Hard Landing
ISM *Services* PMI	54.9	51.5	51.4	Soft Landing
SALES/SPENDING	The General Trend is important, are these #'s rising or falling?			
Retail Sales	$616.26B	$615.85B	$607.98B	Soft Landing
NDCGXA	$73.67B	$73.48B	$73.69B	Soft Landing
LABOR MARKET	The General Trend is important, are these #'s rising or falling?			
Job Adds (Non-Farm Payrolls)	254K	159K	144K	Soft Landing
New Jobless Claims	225K	227K	233K	Soft Landing
Unemployment Rate	4.10%	4.20%	4.30%	Soft Landing

Source: ISM, Department of Labor, Census Bureau, Bureau of Labor Statistics, St. Louis Fed

Detailed Analysis

ISM Reports:

- ISM Manufacturing PMI: This index has hovered relatively flat since July but remains below the critical level of 50, signaling the 6^{th} consecutive month of worsening manufacturing conditions and a slowdown in growth.
- ISM Services PMI: Ever since breaking above 50 in July, this index has continued to rise each month, signifying that the services sector is growing, even as the manufacturing sector shrinks.
- **Key Indicator for a Hard Landing**: If both the ISM Manufacturing and Services PMIs drop below 50, it would signal increased likelihood of a hard landing.

Spending Reports:

- Retail Sales: Retail sales, the most comprehensive measure of consumer spending, has increased each of the last three months after declines earlier in the year. While currently heading in a positive direction, the volatility warrants caution.
- NDCGXA (New Orders for Non-Defense Capital Goods Excluding Aircraft): This metric, which is the best indicator of national business spending and investment, has plateaued recently. While this stabilization is better than a contraction, it raises concerns about the lack of growth. Corporate anxiety about future economic conditions may be leading to caution, but it has not yet led to significant cuts in spending or investment.
- **Key Indicator for a Hard Landing:** A sharp decline in retail sales or NDCGXA, dropping to multi-month lows within the next three months, would be a significant red flag.

Employment:

- Labor Market: Employment data is showing some unexpected vitality, beating analyst projections. Unemployment has started to decrease from its high in July, job adds have increased, and new jobless claims has remained relatively steady. However, metrics such as the unemployment rate are still at some of the weakest levels since 2021 and while the job market has been improving over the last few months, its overall health cannot be described as outstanding.
- **Key Indicator for a Hard Landing:** Monthly job adds falling below 100,000 or jobless claims rising above 300,000 would indicate a significant downturn.

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The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal.

The NASDAQ Composite Index is an unmanaged index of securities traded on the NASDAQ system.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500, measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment.
Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

The S&P GSCI is a composite index of commodities that measures the performance of the commodity market. S&P GSCI Gold is an index tracking changes in the spot price for gold bullion. S&P GSCI Crude Oil is an index tracking changes in the spot price for crude oil. GLD is a gold index fund based on gold and holds gold and/or cash as its only assets, but shareholders are not guaranteed to receive physical gold in exchange for their shares.

The MSCI EAFE (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

The MSCI Emerging Markets is designed to measure equity market performance in 25 emerging market indices. The index's three largest industries are materials, energy, and banks.

The MSCI ACWI (All Country World Index) is a free floating-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixedrate taxable bond market.

The Barclays US T-Bill index measures the performance of public obligations of the U.S. Treasury that have a remaining maturity of greater than or equal to 1 month and less than 3 months.

The ICE U.S. Treasury 7-10 Year Bond Index is market value weighted and is designed to include U.S. dollar denominated, fixed rate securities with minimum term to maturity greater than or equal to seven years and less than ten years.
Barclays Capital U.S. MBS Index measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA, and FHLMC.

The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity.
The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility, and financial issuers.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index is composed of fixed rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility and Finance, which include both U.S. and non-U.S. corporations.

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