

# Market Commentary

September 30, 2024



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INVESTMENT ADVISORS

## U.S. Equities Market

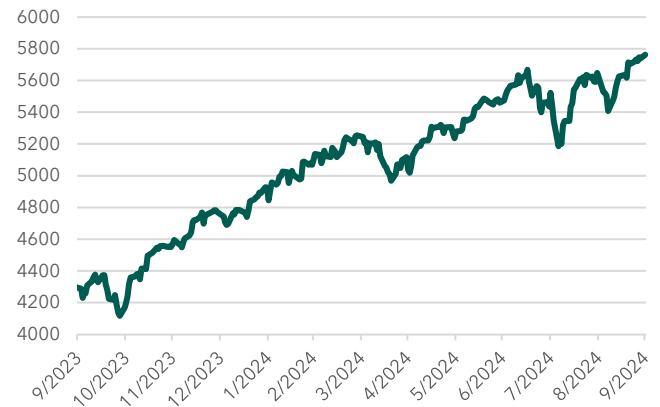
*In Like a Bear, Out Like a Bull*

Equity markets opened the third quarter on a severe losing streak but finished at, or near, all-time highs, with the S&P 500® Index posting a 5.9% gain. Unlike the second quarter, which was led by a handful of Technology stocks, the market broadened substantially. Interest-rate sensitive sectors such as Utilities, Real Estate and Financials led performance as anticipation, and realization, of lowered interest rates powered gains. Energy was the only sector to post negative returns as global industrial production remained weak and the Chinese economy - the world's largest energy consumer - continued to battle a real estate depression and slowing growth. From a factor perspective, with lowered rates, Value outperformed Growth for the first time in many quarters, though historical comparisons are still quite lopsided in Growth's favor. Similarly, small company stocks outperformed large company stocks, while both posted quite positive returns.

Aside from rates, equity markets seem to be fixated on two important issues: the health of the labor market and a possible recovery of the industrial economy. Since the COVID rebound, the U.S. consumer has led the global economic recovery. The U.S. economy was first buoyed by government stimulus, which led to an extremely strong labor market. Real wage gains - wage increases minus inflation - were very positive. However, as government stimulus and growth in money supply created the highest inflation in decades, the U.S. consumer market bifurcated, creating what we call a "K" shaped recovery. Upper-income consumers, particularly those who own real estate and financial assets, benefited from inflating property values, strong equity markets and higher interest income, while lower-income consumers began to suffer from inflated prices of everyday necessities such as rent, food, transportation, and energy. The effects of this are still to be seen, but we do have indications in sub-prime credit markets and dollar stores that low-income consumers are under pressure and spending more discriminately. As long as labor markets remain healthy, the economy can continue to grow; that said, if the labor market weakens, things can turn quickly, which is why many at the Federal Reserve (the "Fed") are now talking more about jobs than inflation.

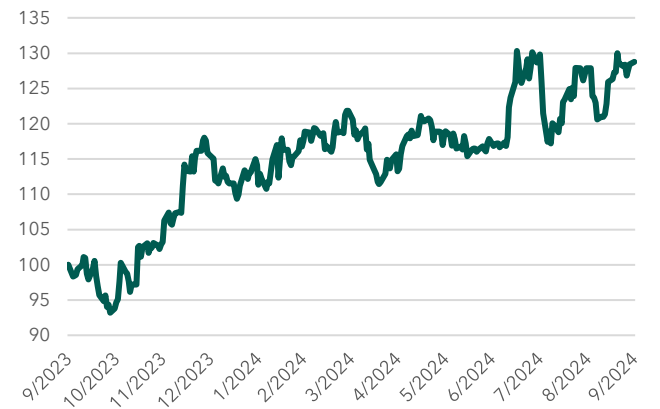
As to the second point, the industrial economy is doing poorly. Outside of specific areas like semiconductors, housing and aerospace, the lack of demand is acute. COVID caused large supply shortages which led to short-term industrial growth, but now that those shortages have been alleviated, end demand needs to recover. For the U.S., where the economy is more services-driven, it is less of an issue, but for Europe, China and most emerging markets, goods demand is far more important. The U.S. remains the best-positioned economy currently, but the rest of the world needs to stimulate demand, or things will start to look bleak.

S&P 500® Index



Source: Bloomberg

Russell 2000® Index



Source: Bloomberg

Russell 1000® Growth / Russell 1000® Value



Source: Bloomberg

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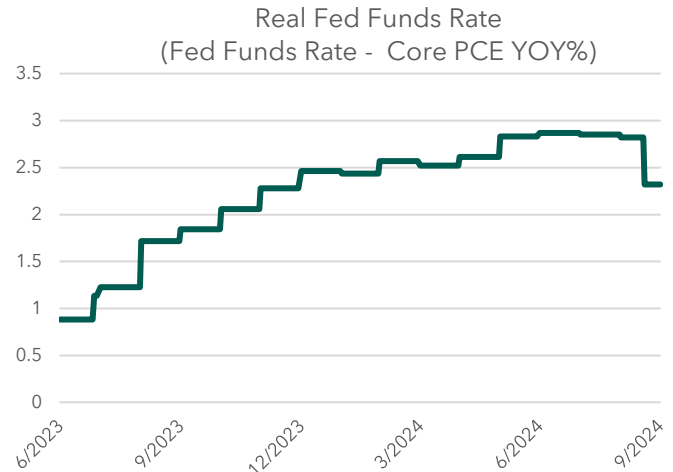
## U.S. Taxable Fixed Income Market

### *The Fed Labors Toward Neutral*

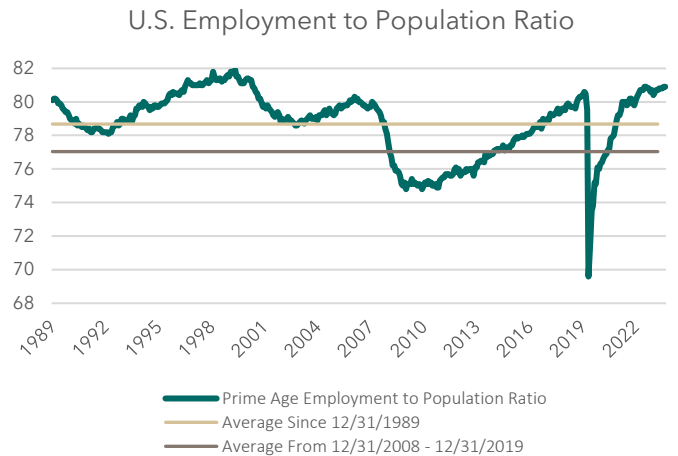
The Bloomberg Intermediate Government/Credit Index gained 4.2% in the third quarter, driving 2024's year-to-date performance up to 4.7%. Expectations for the beginning of a Fed cutting cycle drove the quarter's returns, especially as markets started to price in a 50 basis point cut to start the cycle. The forward guidance from the Fed made it clear that they are now more focused on the full employment portion of their dual mandate.

The last hike from the Fed came at the end of July 2023. This hike drove the *real* Fed Funds Rate, defined as nominal Fed Funds Rate minus inflation (core PCE on a year-over year basis), to about 1.3%. Since then, as inflation has fallen, the real Fed Funds Rate has gotten as high as 2.9%, where it roughly remained until the Fed cut rates for the first time since March 2020. Currently, the real Fed Funds Rate stands at 2.4%, but to get back to where it was after their last hike, the Fed would need to cut another 100 basis points. Moreover, it would take 140 basis points to get back to where they consider policy to be no longer restrictive. For context, the real Fed Funds Rate averaged -0.8% from the end of 2008 to the end of 2019. That negative rate was considered accommodative because firms were able to raise prices on a yearly basis at a faster clip than their borrowing costs. Now, corporations can no longer increase prices faster than their borrowing costs have risen, making it harder for them to pay back debt. The Fed has provided forward guidance relating to this phenomenon, highlighting that they would have to lower rates as inflation fell so as to not maintain overly restrictive policy. Additionally, they have more recently emphasized a weakening labor market as a concern and something they would not like to see deteriorate further. Through this lens, it should come as no surprise that they cut 50 basis points to start this interest rate easing cycle.

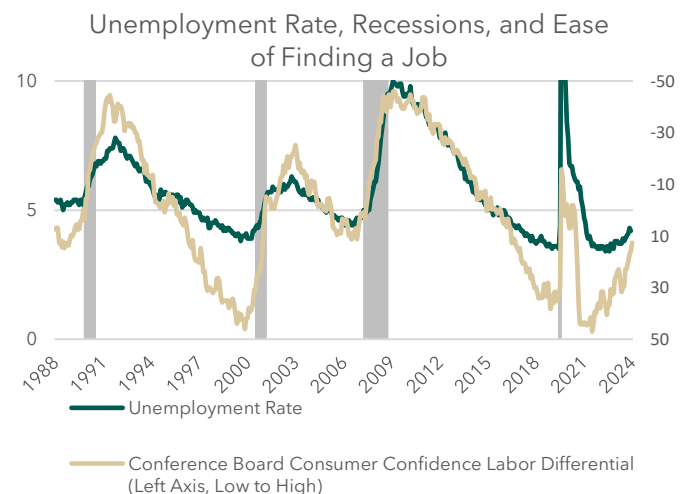
Time will tell if they are able to plug the recent leak we have seen in the labor market - especially as those working part-time for economic reasons have increased over the last year and consumer surveys indicate it has gotten harder to find a job. Offsetting those indicators are the highest employment-to-population ratio among people aged 25-54 since the late 1990s, high asset prices, and a robust lending environment. Additionally, residual seasonality in economic data could be exaggerating the reported weakness. Lower rates should help keep asset prices high, drive continued residential construction and higher demand for loans, and provide much needed relief for the commercial real estate sector. All of that would be supportive of employment and consumption and, were it all to happen quickly enough, stave off a hard landing.



Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

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## U.S. Municipal Fixed Income Market

*Bucking the Trend, Munis Post Best Q3 Returns in a Decade*

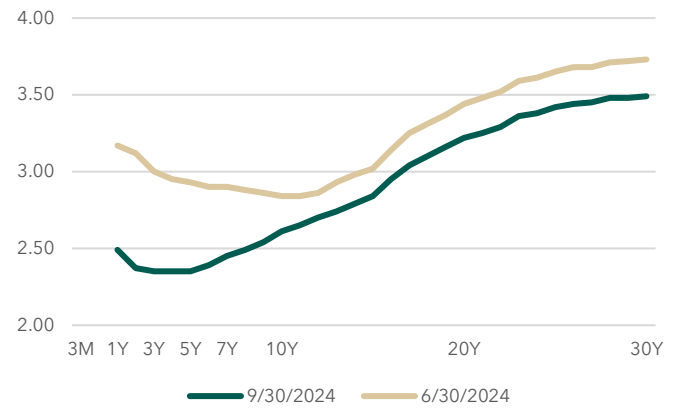
Entering the third quarter of 2024, the Treasury market was still pricing in a “higher-for-longer” rate environment. However, as Q3 progressed, inflation continued to moderate, and the labor market began to show signs of cooling. In late August, during a speech at Jackson Hole, Fed Chair Jerome Powell gave his strongest indication yet of impending rate adjustments, saying, “The time has come for policy to adjust.” Market participants’ attention then pivoted from the timing of rate cuts to the magnitude and pace at which they would occur. Treasury yields moved lower as investors speculated an interest rate cutting cycle had started and priced it into the market. Over the course of Q3, Treasury yields were lower by 111 basis points, 61 basis points, and 44 basis points in the 2-year, 10-year and 30-year portions of the yield curve. Municipal yields moved lower as well, but not in lockstep. Yields on 2-year, 10-year and 30-year AAA-rated munis were lower by 76 basis points, 23 basis points, and 24 basis points, respectively, over the course of the quarter.

September marked the ninth straight month of year-over-year issuance gains and the sixth consecutive monthly issuance figure above \$40 billion. Year-to-date primary market issuance is up 38% and could be in-line for one of the largest calendar years on record. The unexpected uptick in supply has been driven by a backlog of issuance that was cost-prohibitive when rates moved higher in 2022/2023, reduced federal stimulus funds administered to state and local governments, and issuers’ desire to front-run possible volatility surrounding the November presidential election, consistent with prior election years.

This elevated issuance, typically a headwind for the sector, was met with firm demand, driving positive total returns. Municipal fund inflows, as reported by Lipper, posted 12 consecutive weeks of inflows over the course of the quarter. As a result, munis posted gains in July, August, and September, bringing the total return on the Bloomberg 1-15 Year Municipal Index to 2.6%, the best performing third quarter since 2011.

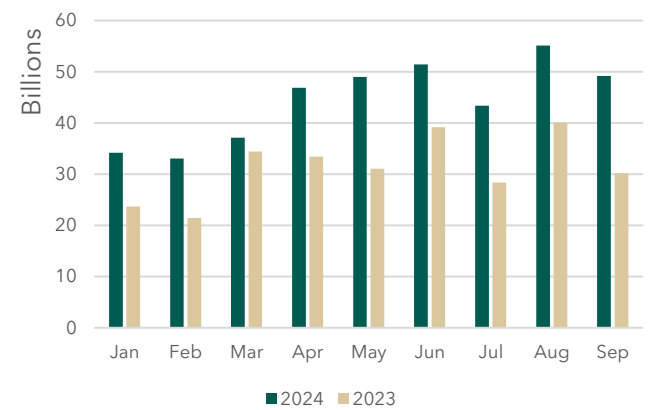
Muni-to-U.S. Treasury ratios remain attractive and are cheap relative to near-term averages. We expect issuance to remain elevated in October, with only a month left prior to the election, and believe an attractive entry point could present itself should ratios cheapen further. Regardless of who wins the presidential election and which party controls the House and Senate, taxes are likely to move higher as we face massive (and growing) federal government deficits. The value of the muni tax-exemption will likely increase, and we expect demand to remain strong, especially from individuals in the top tax brackets, providing a tailwind heading into Q4 and beyond.

BVAL AAA Callable Yield Curve



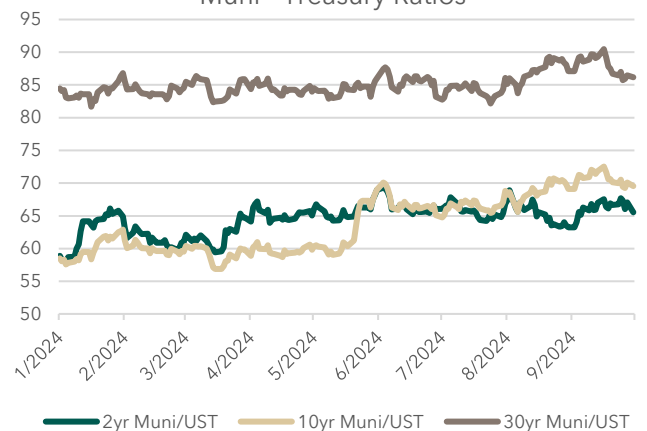
Source: Bloomberg

2024 vs. 2023 Issuance



Source: Bloomberg

Muni - Treasury Ratios



Source: Bloomberg

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## International Equities Market

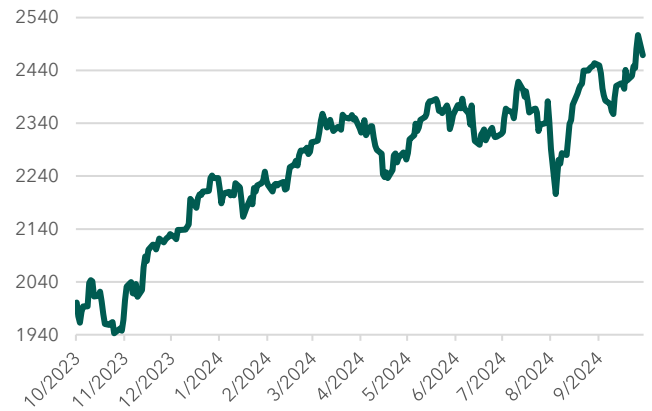
### *How Do You Say Bazooka in Mandarin?*

International equities outperformed domestic equities during the third quarter. Emerging market equities (represented by the MSCI Emerging Market Index) finished on top, returning 8.7%. This strong finish for emerging market equities is notable given the index trailed over much of the quarter until the final week. The MSCI EAFE Index (our proxy for developed international equities) came in second, returning 7.3%. In comparison, U.S. equities as represented by the Russell 3000® Index, finished the quarter up 6.2%. The U.S. dollar declined during the quarter, which was additive to international performance.

The biggest news of the quarter occurred during its last week, when the Chinese government announced several measures to strengthen the weakening economy and stock market. The package included both monetary and fiscal policy initiatives. The initial announcement was archetypal monetary policy with the central bank cutting interest rates and lowering banks' reserve requirements. The government also announced several new programs designed to support the declining property market, which many believe is China's biggest economic problem. Down payment requirements were reduced for both primary and secondary homes; however, the most significant were the changes made to mortgage refinancing. Consumers are now able to refinance their loans more quickly, which will hopefully boost consumer spending and restore consumer confidence. Finally, the government surprisingly announced two new programs to boost the stock market. The first targeted corporate share repurchase programs, while the second targeted financial services firms' balance sheets, enabling them to use more leverage for their investments.

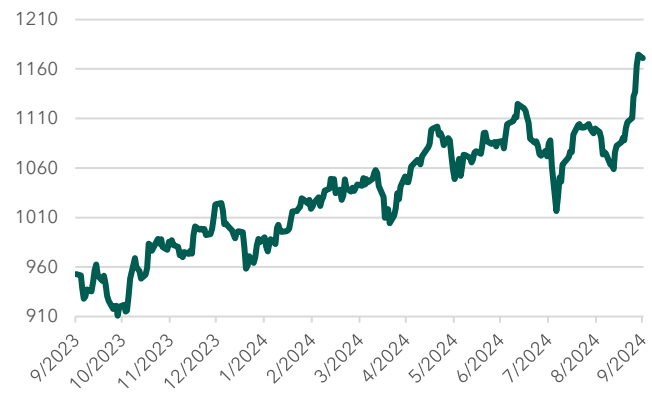
Do the announced fiscal and monetary programs measure up to the "bazooka" many have called for as sufficient? The initial street reaction was skeptical because the size of this program (estimated to be about 2 trillion yuan) is not as big as previous programs. However, market views changed once they learned China's Politburo dedicated its September meeting to the economy, which is a break from its traditional political calendar. China's ruler, Xi Jinping, has refrained from bold economic stimulus plans in the past, but it appears he is putting those reservations aside. Chinese stocks responded strongly to the news, finishing the quarter up over 25%. It will be important to monitor the progress of these programs, given China is the world's second largest economy and a significant driver of world GDP growth.

MSCI EAFE Index



Source: Bloomberg

MSCI Emerging Markets Index



Source: Bloomberg

Bloomberg Dollar Spot Index



Source: Bloomberg

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## Disclosures

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The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. Indices are not available for direct investment.

The S&P 500® Index is a gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

The Russell 2000® Index measures the performance of the small-cap to mid-cap segment of the U.S. equity universe. It includes the bottom two-thirds in terms of company size of the Russell 3000® Index.

The Russell 1000® Growth Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

The Russell 3000® Index measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market. The Russell 3000 Index is constructed to provide a comprehensive, unbiased and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are reflected.

The Federal Funds Rate is the interest rate that banks charge each other to borrow money overnight. It is a key tool used by the Federal Reserve to control the money supply and influence economic activity.

The Conference Board Consumer Confidence Labor Differential is an indicator that takes the percentage of consumers who say jobs are plentiful and subtracts the percent that say jobs are hard to find.

The BVAL AAA Callable Yield Curve is a standard market scale with non-call yields up to year 10 and callable yields thereafter. This curve assumes a normalized 5% coupon and is plotted as an offer side yield to worst.



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The MSCI EAFE Index is broadly recognized as the pre-eminent benchmark for U.S. investors to measure international equity performance. It comprises the MSCI country indexes capturing large and mid-cap equities across developed markets in Europe, Australasia and the Far East, excluding the U.S. and Canada. Numerous exchange-traded funds are based on the MSCI EAFE Index, and the Chicago Mercantile Exchange, NYSE Liffe U.S. and the Bclear platform of Liffe are licensed to list futures contracts on this index as well.

The MSCI Emerging Markets Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Market countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The Bloomberg Dollar Spot Index tracks the performance of a basket of 10 leading global currencies versus the U.S. Dollar. It has a dynamically updated composition and represents a diverse set of currencies that are important from trade and liquidity perspectives.