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Market Newsletter Third Quarter 2024

EXECUTIVE SUMMARY

- Stocks and bonds performed well in the third quarter. In the stock market, there was a broadening of performance as previously underperforming stocks caught up.

- The Federal Reserve cut interest rates by 50 basis points and indicated that inflation is “much closer” to its 2% target and that the focus going forward would be in supporting the employment market. It also indicated that the economy is strong overall.

- S&P 500 earnings are forecasted to grow by a healthy 11.3% in calendar year 2024 and 14.4% in 2025.

- Going back to 1984, both stocks and bonds have usually done well after the first interest rate cut by the Federal Reserve.

- Historically, no matter which party got the reins to the White House, stocks have appreciated over time. While performance is better under certain administrations, missing out the gains earned when the White house and/or the Congress were controlled by a specific party led to lower overall gains. Don’t let politics influence your investment decisions.

Table 1: Market indices

(Returns include dividends reinvested)	**Quarter to date**	**Year to date**	**1 Year**	**3 Year Annualized**	**5 Year Annualized**
S&P 500	5.89%	22.08%	36.35%	11.91%	15.98%
S&P Mid Cap 400	6.94%	13.54%	26.79%	7.47%	11.78%
S&P Small Cap 600	10.13%	9.33%	25.86%	3.99%	10.21%
MSCI Emerging Markets	8.88%	17.24%	26.54%	0.82%	6.15%
MSCI EAFE	7.33%	13.50%	25.38%	6.02%	8.72%
Vanguard Total Bond Market Index	5.03%	4.31%	11.28%	-1.55%	0.20%
Investment Grade Credit	5.75%	5.76%	14.14%	-0.98%	1.17%
Non-Investment Grade Credit	5.32%	8.0%	15.66%	3.08%	4.55%
Bloomberg Commodity Index	0.68%	5.95%	0.96%	3.66%	7.79%
Dollar Index	-4.80%	-0.55%	-5.08%	2.27%	0.28%
10 Yr. Rate	3.80% 09/30/2024	3.87% 12/31/2023	4.57% 09/30/2023	1.53% 09/30/2021	1.60% 09/30/2019

Source: S&P Dow Jones, ml.com, MSCI.com, Morningstar, Bloomberg, Yahoo Finance

Table 2: Vanguard LifeStrategy (Asset Allocation) Funds

	Quarter to date	**Year to date**	**1 Year**	**3 Year Annualized**	**5 Year Annualized**
LifeStrategy Income	5.30%	6.85%	14.87%	0.59%	2.59%
LifeStrategy Conservative Growth	5.74%	9.58%	18.82%	2.39%	5.06%
LifeStrategy Moderate Growth	6.16%	12.27%	22.82%	4.14%	7.45%
LifeStrategy Growth	6.50%	14.97%	26.88%	5.87%	9.82%

Source: Vanguard

Table 3: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)

As of 10/04/2024			
	Latest Release	Recent Trend	Notes
Non-Farm Employment	254,000	Positive	The latest jobs report blew past expectations reflecting a strong employment situation. Unemployment rate ticked down to 4.1%. Previous two months numbers were revised up by 72,000- another indication of strength in the jobs market.
Weekly Claims for Unemployment Insurance	225,000	Positive	Initial claims for unemployment insurance shows that the jobs market is still strong and there are no major layoffs.
ISM Manufacturing Index (over 50 indicates growth)	47.2	Negative	Manufacturing activity contracted for the 6th straight month in September as companies were unwilling to invest in capital and inventory possibly because of interest rate uncertainty. Hopefully, the recent interest rate cut by the Federal Reserve will reverse that.

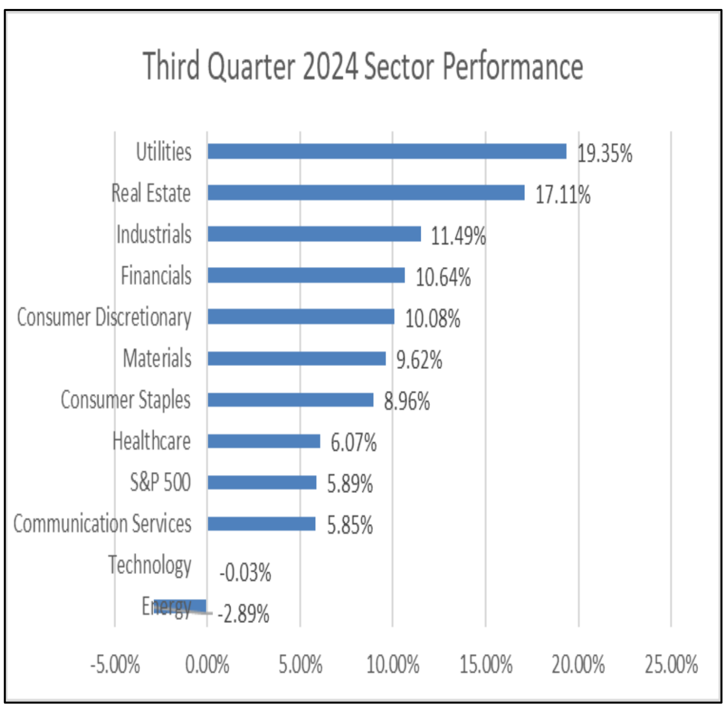
ISM Non Manufacturing Index (Over 50 indicates growth)	54.9	Positive	The services sector has recovered from the lows set in July and the ISM index recently expanded at the fastest rate since early 2023. This is in contrast to the manufacturing sector which is contracting.
Consumer Prices (Month over month change)	0.2%	Positive	Inflation continues to drop to manageable levels. The year over year inflation dropped to 2.5% the lowest level since 2001. Excluding food and energy, prices increased by 3.2% since last year.
Producer Prices (Month over month change)	0.2%	Positive	Wholesale prices have reached acceptable levels. The year over year price increase was 1.7%. Excluding food and energy the increase was a bit hotter 2.4%
Retail Sales (Month over month change)	0.1%	Positive	The consumer seems to be in good shape based on retail sales which surprised on the upside in August. Previous month's number was revised upwards as well.
Consumer Confidence (Conference Board)	98.7	Negative	Consumer confidence fell the most in three years. Despite a relatively strong labor market and falling inflation, consumers were weighed down by the elevated prices, smaller pay increases and fewer job openings.
Durable Goods Orders (Month over month change)	0	Negative	Durable goods orders were flat in August, which was better than the sharp drop that was expected. Core capital goods orders, which exclude volatile sectors like transportation and defense, rose 0.2% in August after a 0.2% drop in July. Despite some recent improvements, companies are still reluctant to invest in capital goods.
Industrial Production (Month over month change)	0.8%	Positive	Industrial production rebounded from a hurricane related slide in the previous month, signaling a pick up in manufacturing and mining output. High borrowing costs continue to restrain capital spending and limit consumer demand for big-ticket items but should improve with a drop in interest rates.
Capacity Utilization	78%	Positive	Capacity utilization rose closer to its long term average.
Housing Starts	1.356 Million	Negative	Housing starts bounced back in August after tumbling to a cycle low in July helped by gains in one-family home starts. Builders are saddled with large amount of inventory waiting for a pickup in demand with falling mortgage rates.
Home Prices (Case-Shiller Home Price Index- Year over Year)	5.92%	Positive	Home prices hit a record high in July based on the Case-Shiller home price index. The growth rate has decreased but is still healthy. New York posted the biggest year-over-year home-price gains
GDP (Real, Annualized)	3%	Positive	Second quarter GDP growth was as expected and shows that the US economy grew at a robust rate. This was a pickup from the slower first quarter rate of 1.6%. Both consumer and businesses spending grew at a healthy rate.

Source: Bloomberg, www.federalreserve.gov, www.bls.gov, www.ismword.org, www.nahb.org

Stocks rose in the third quarter adding to their gains for the year, leading to the US markets having their best performance in the first 3 quarters of the year since 1997. However, under the surface there was a significant transformation this quarter on how these gains were registered. In the first half of the year, investor's fascination with Artificial Intelligence (AI) propelled the market higher led by technology stocks, the immediate beneficiaries of AI. But that changed in the third quarter, when investors grew a bit skeptical of the benefit of AI to company earnings. Against a backdrop of favorable economic news and improving investor confidence, the market broadened out- previously underperforming areas of the markets such as utilities, industrials and financials, outperformed the technology sector (Fig 1). Value stocks (i.e stocks that are relatively cheaper) beat growth stocks (i.e stocks of companies growing their earnings faster but trading at a higher valuation). Stocks of the smallest companies in the market, shook off their lethargy and trounced stocks of larger companies. As seen in Fig 2, the 'Magnificent 7' (The 7 stocks, mostly in the technology sector, with the highest value in the market i.e the S&P 500 index) have been responsible for 45% of the rally this year as compared to 63% of the rally last year. All in all, it is a good sign that the 'market breadth' is improving and all sectors of the market are participating in the rally. Despite a broad appreciation in stocks, the gains came amidst a spike in volatility, especially in early August when fears of a recession whipsawed stocks.

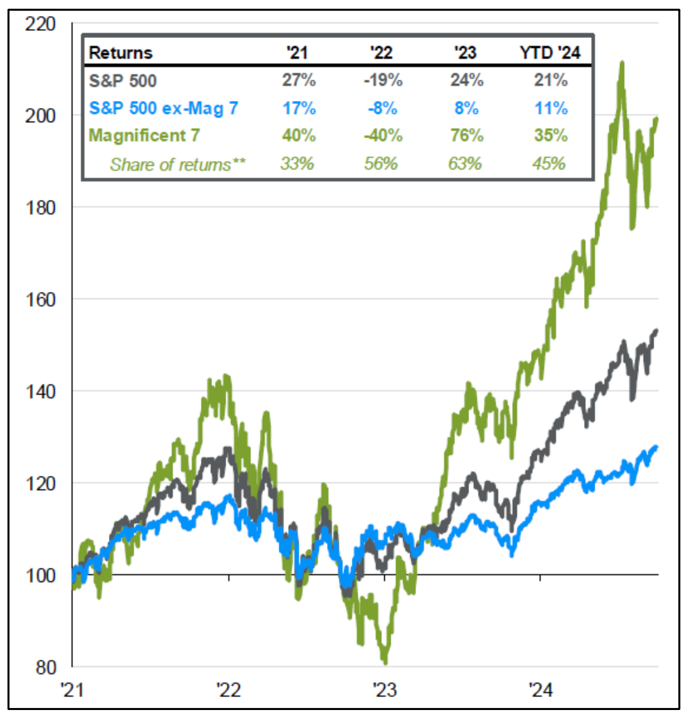
Interest rates fell in the quarter providing a strong tailwind to bonds (Bond prices are inversely related to interest rates). The 10-year US Treasury yield fell below 4%.

Fig 1: Sector leadership changed in the 3rd Quarter



Source: *Morningstar, Sarsi*

Fig 2: The Magnificent 7 vs the rest of the stocks



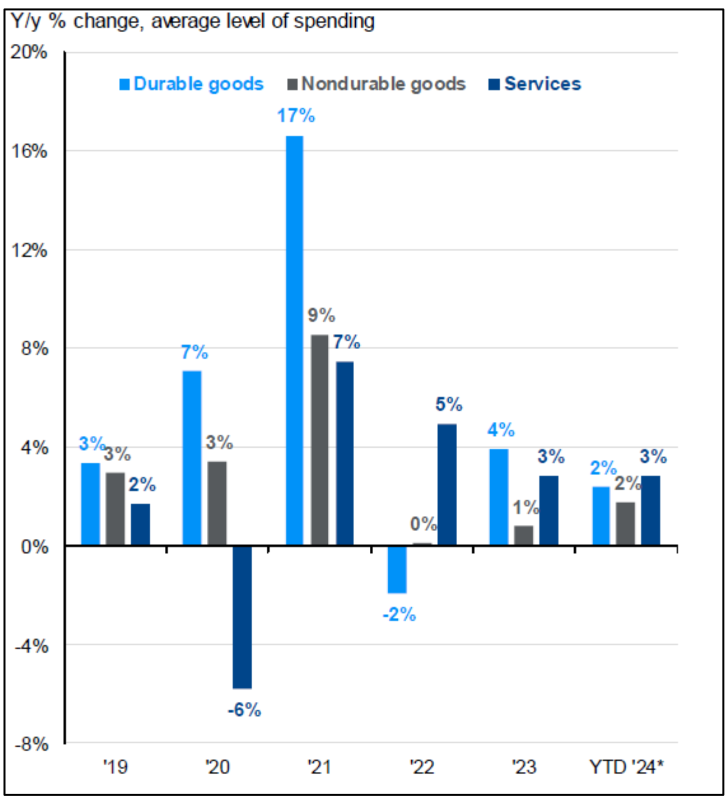
Source: JP Morgan

Following its September meeting, the U.S. Federal Reserve (Fed) announced its first interest rate cut since 2020, slashing interest rates by a larger than expected 50 basis points (100 basis points is equal to 1%). The Fed Chairman Jerome Powell emphasized that inflation is "much closer" to its 2% target and that the focus going forward would be in supporting the employment market. Historically, a first rate cut of 50 bps has typically coincided with recessionary conditions. However, the economy is quite strong at present. In a speech to a group of economists a few weeks after announcing the rate cut, the Fed Chairman said that "our economy is strong overall" but further rate cuts can be expected by the end of the year as the Fed attempts a "recalibration" of monetary policy. These rate cuts should support further U.S. economic growth and employment growth.

The US economy is indeed strong overall. In particular, the American consumers, who account for a large portion of the Gross Domestic Product (GDP) are in good shape. As can be seen in Fig 3, although consumer spending is below the highs set after the pandemic, it is still quite healthy. Consumers are also saving more- Fig 4 shows that personal savings as a % of disposable personal income is perking up.

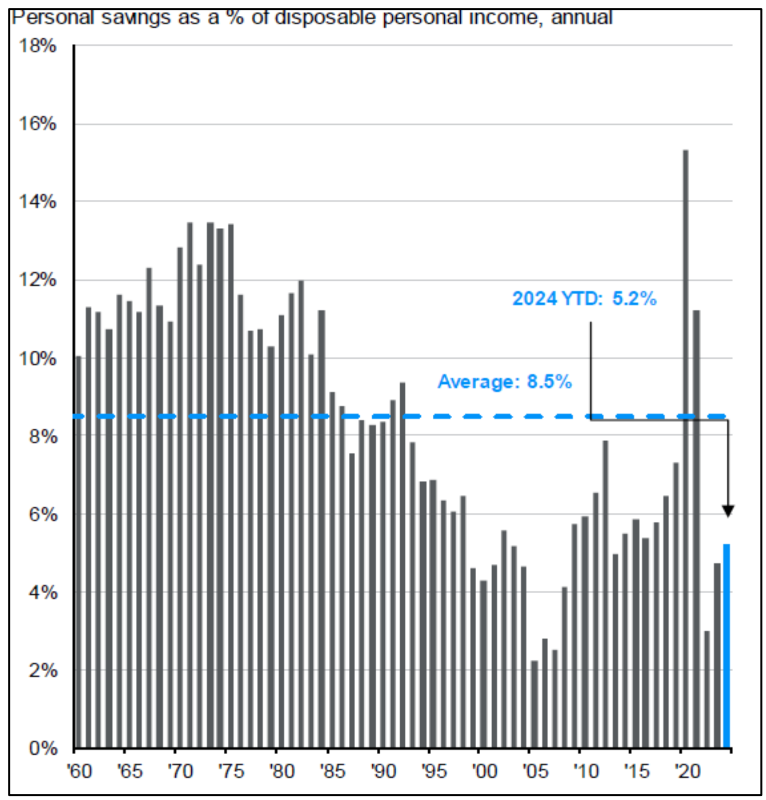
It also turns out that the economy was stronger than we earlier thought in the last few years. The Bureau of Economic Analysis recently revised upwards US GDP and savings figures for the years after the pandemic. These revisions suggest that productivity could be revised upwards and inflation lower- a good outcome for the economy. It seems all the earlier handwringing about whether we will have a 'hard landing' (Recession), or a soft landing (Slowing economy without a recession) were very misguided.

Fig 3: Real consumer spending by category



Source: JP Morgan

Fig 4: Personal Savings Rate



Source: JP Morgan

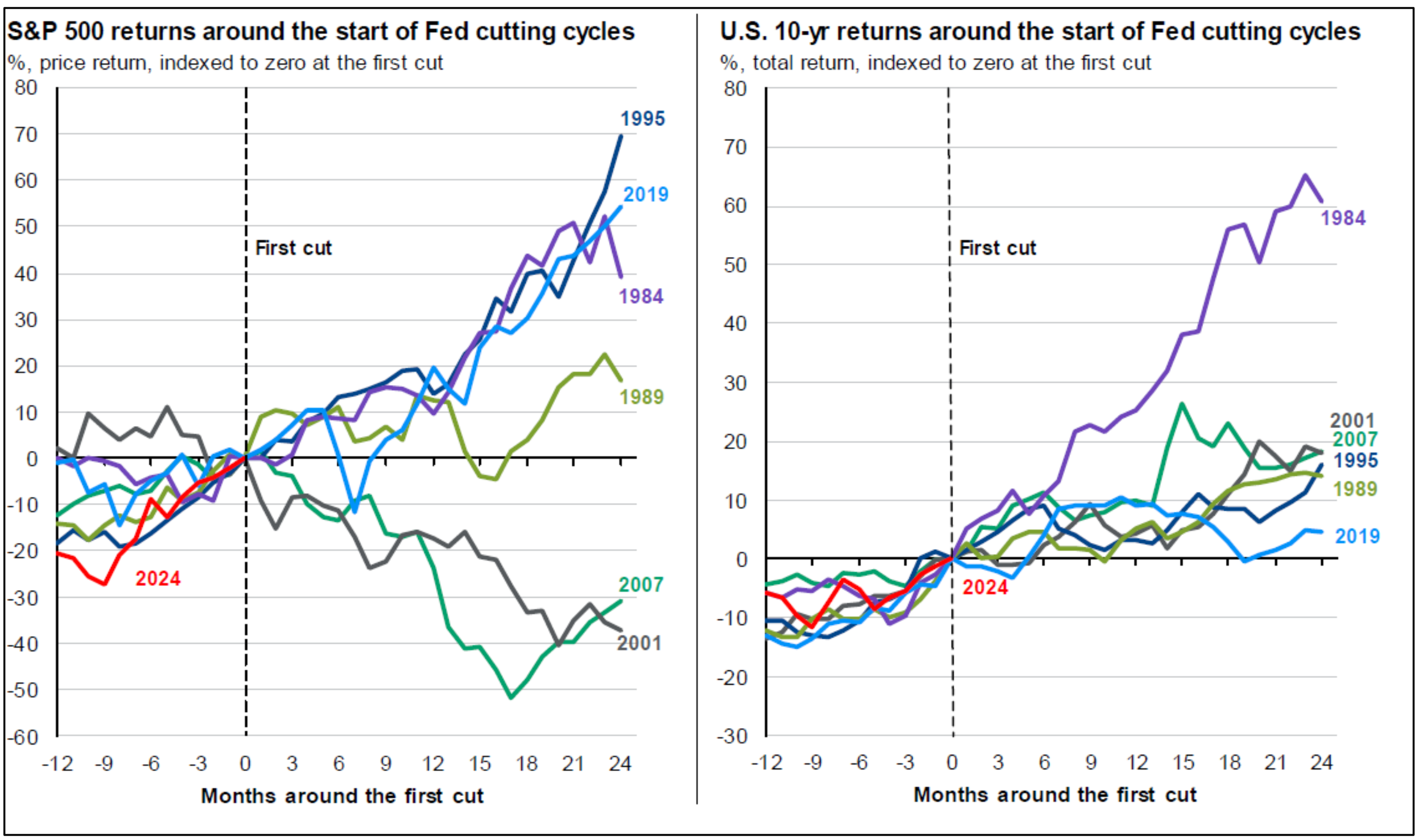
At the end of September, China announced a broad range of stimulus measures to jump start its flagging economy. This led to dramatic moves higher in the Chinese stock market, raising hopes that the end to a four-year bear market was imminent. If the Chinese authorities follow up on their promise and pass much needed reforms, asset prices in China could appreciate further supporting other emerging markets as well.

US Corporate earnings surprised to the upside in the second quarter of 2024 as 80% of the companies in the S&P 500 index beat estimates. This is higher than the beat percentage of 77% in the last 5 years and shows that there is good momentum for earnings growth to continue. Overall, earnings grew by 11.3% from last year, the highest growth rate since the fourth quarter of 2021. Soon, companies will start reporting earnings for the third quarter and according to FactSet, earnings growth is expected to slow to 4.3%. S&P 500 earnings are forecasted to grow by 11.3% in calendar year 2024 and 14.4% in 2025.

Market performance after the first rate cut

Going back to 1984, both stocks and bonds have done well after the first interest rate cut by the Fed, as seen in Fig 5. Bonds have never lost money 2 years after the first rate cut. Stocks have also performed well after the first rate cut except in 2001 and 2007 when a rate cut was followed by a recession. If history is any indication, it seems stocks and bonds should do well if we avoid a recession. (Disclaimer: *Past performance is no guarantee of future performance)*

Fig 5: Stocks and Bonds performance after the first Fed rate cut

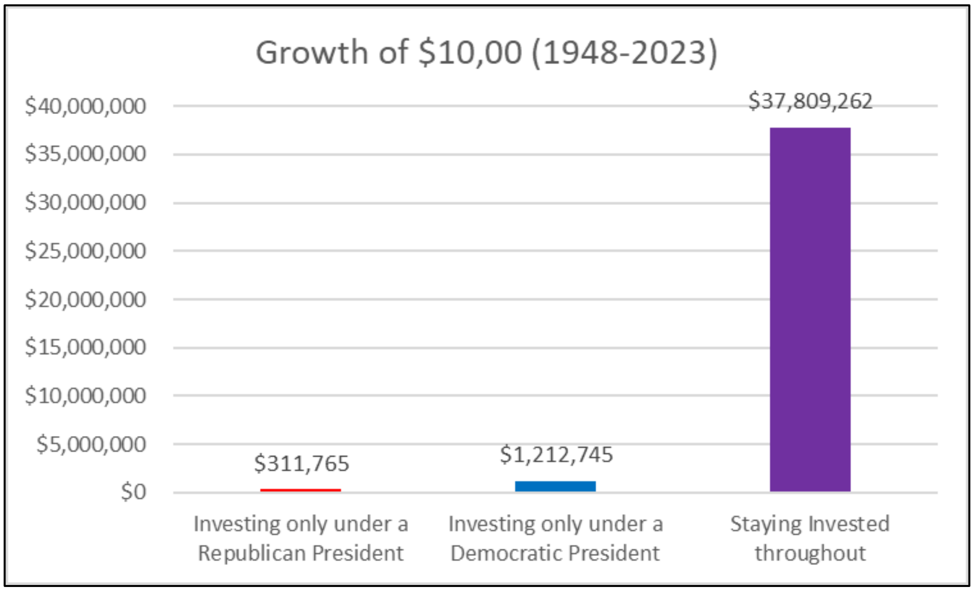


Source: JP Morgan

The Markets and the elections.

Amidst market and economic activities, the US elections in November is foremost on investor's minds. With the late shakeup in the Democratic line up, National polls indicate the election is a toss-up, with no clear front-runner. As we have discussed previously, (See HERE) historically, no matter which party got the reins to the White House, stocks have appreciated over time. If you are curious about how the economy and stocks have performed under every President since Calvin Coolidge, click HERE for an exhibit. What this shows is while the performance is better under certain administrations, missing out the gains earned when the White house and/or the Congress were controlled by a specific party led to lower overall gains.

Fig 6: US stock performance depending on who controls the White House



Source: Charles Schwab, Sarsi

Fig 5 drives home the point about staying invested throughout all administrations. An investor who put $10,000 in US stocks at the beginning of 1948 (After the end of World War II), and stayed invested only during Republican Presidency, would have seen that money grow to $312,000 by the end of 2023. On the other hand, if the investor stayed invested only during Democratic Presidency they would have seen the $10,000 grow to $1.2 Million. While this result may be misinterpreted to mean staying invested only during Democratic Presidency is better, that is not the case. The result would have been spectacularly higher if you stayed invested no matter which Party controlled the White House. The $10,000 invested at the beginning of 1948 would have grown to $38 million if you had stayed invested throughout! In conclusion, Don't let politics influence your investment decisions.