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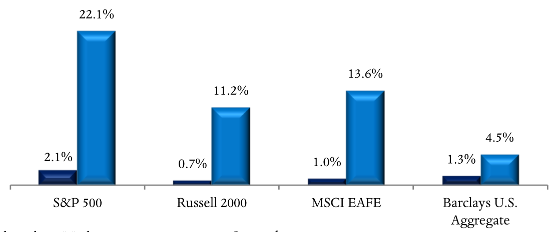
Markets

The third quarter of 2024 featured several periods of market volatility, but concluded with positive returns across most major asset classes. Early August witnessed a sharp decline in stocks, triggered by softer US economic indicators, and the Bank of Japan's coincidental decision to raise interest rates. Investor sentiment improved significantly toward quarter's-end, driven by the Federal Reserve's long-awaited first interest rate cut, a more dovish stance from Japanese monetary authorities, and the introduction of economic stimulus measures in China. After all, the S&P 500 advanced +2.1% in September and +5.9% in Q3 (+22.1% ytd). Encouragingly for equity investors, there were signs of a long-anticipated "broadening out" of returns, with value stocks outperforming their growthier counterparts. Further, interest rate sensitive sectors such as US small caps delivered quarterly returns of +9.3% while global REITs rose an impressive +16.2% during the same period. In Asia, Chinese stocks rallied strongly last month after Chinese policymakers announced a raft of new stimulus measures, which led the Shanghai composite higher by +17.6% in September, +14.3% in Q3 and +15.3% ytd.

Fixed income markets were buoyed by a 50 basis point Fed interest rate cut and the decline in medium to long term bond yields. The Barclays US Aggregate benchmark returned +1.3% in September and +5.2% in Q3 (+4.5% ytd). Third quarter returns were broad-based across sovereign and corporate bonds, with emerging market debt now atop the sector's performance in 2024.

Commodity performance has been relatively muted thus far in 2024, returning a modest +0.7% in Q3 and +5.9% ytd. However, these figures mask considerable divergence among constituents. Amid increasing concerns of a slowing global economy, WTI Crude oil prices fell by -7.3% in September (to $68.17/barrel), -16.4% last quarter and -4.9% ytd. Conversely, gold has been rallying to new all-time highs throughout the year (+5.3% in September; +13.3% in Q3; +27.7% ytd), ending the period at $2,364/oz.



Source: Bloomberg Markets

Geopolitics

The US presidential election campaign entered its critical final phase in September, featuring the presidential debate between former President Donald Trump and Vice President Kamala Harris. The televised event garnered significant public interest, with viewership exceeding 67 million. The debate marked a pivotal moment in the electoral process, potentially influencing voter sentiment and campaign strategies in the run-up to Election Day on November 5th. Concurrent with the presidential race, electoral campaigns are intensifying for 34 of the 100 US Senate seats and all 435 seats in the House of Representatives. Current polling data indicates a highly competitive presidential contest, while control of Congress hinges on the outcomes of multiple closely contested races. This simultaneous campaigning for executive and legislative branches underscores the comprehensive nature of this election cycle and its potential to significantly shape US governance and law in the coming years. Voter decision-making, especially among those still undecided, is expected to be shaped by key policy issues and trends, including immigration, reproductive rights, geopolitical conflicts, and economic perceptions.

United States

Fourteen months after its last interest rate hike, the Federal Reserve lowered the Fed Funds rate by 50 basis points, to a range of 4.75% - 5.00%. Post the decision, Fed Chair Powell commented that he and the committee believe that while inflation (CPI 2.5% and 1.2% ex-shelter; PCE 2.2%) remains above the central bankers' 2.0% target, it is on a swiftly decelerating trajectory. Moreover, the Fed appeared fearful of a weakening economy, pointing to the recent increase in the unemployment rate, and likely acted pre-emptively. The consensus Fed Funds rate outlook now calls for levels to reach 3.2% by the middle of 2025. While the Fed is painting a picture that inflation and employment are slowing, pundits rebut that the Atlanta Fed's GDPNow estimates healthy Q3 economic growth of 2.5%.

Perhaps vindicating the Federal Reserve's monetary policy stance, September's reading of US consumer confidence fell steeply to the lowest level in three years. Consumers' assessments of current business conditions turned negative while views of the current labor market situation, including less hours worked, slower payroll increases, and fewer job openings, softened further. This sentiment is, however, perplexing given that reported labor market statistics remain quite healthy, with employers adding 254,000 jobs last month, across a wide swath of industries, lifting the three-month average to 186,000 and leading the unemployment rate down fractionally to 4.1%. In addition, average hourly earnings grew a robust 0.4% sequentially, and 4.0% over the past 12 months. With inflation slowing and companies hiring, the present situation should be welcome news for households that have been frustrated by years of price increases.

Europe

Eurozone economic data has painted a picture of fragility, with Germany's reliance on manufacturing acting as a particular drag amid both weak demand from China and rising competition from less expensive Asian imports. This can be confirmed from the eurozone manufacturing purchasing managers' index (PMI) for September which came in at 45.0%, an eight-month low, with the overall composite falling into contractionary territory, at 49.6%. With European inflation cooling, to 1.8% from 2.2%, and economic activity relatively muted, the European Central Bank delivered its second interest rate cut in September taking overnight rates to 3.5%, with additional cuts expected.

UK data has generally been more upbeat so far in 2024, although consumer confidence did fall in September in advance of October's budget announcement.

Asia

In the clearest signal yet that Beijing stands ready to support the Chinese economy and financial markets, the People's Bank of China (PBOC) announced coordinated monetary stimulus and property support measures. Actions included a 50 bp cut to the Reserve Ratio Requirement for banks (with potentially more to follow). In addition, the PBOC cut various short and medium-term central bank lending rates by 20-30 bps. To support the property market, the central bank also called for a 50 bp cut to interest rates on existing mortgages, and a reduction of the minimum downpayment requirement to 15%. These actions came on the heels of the latest readings of Chinese Producer Prices declining 1.8% and core-CPI up a mere 0.3%. Chinese central planners' are clearly fearful of the prospect of deflation (namely a downward wage-price spiral) and willing to combat the possibility, which should be beneficial for the global growth outlook.

September 2024 Economic Statistics

	Sep-24	Dec-23	Dec-22
Federal Funds Target Rate	*4.75 - 5.00%*	*5.25 - 5.50%*	*4.25 - 4.50%*
Consumer Confidence Index	*98.7*	*110.7*	*108.3*
Manufacturing PMI Index	*47.2%*	*47.4%*	*48.4%*
Unemployment Rate	*4.1%*	*3.7%*	*3.5%*
JPY/USD	*143.62*	*141.06*	*131.11*
USD/EUR	*1.1134*	*1.1036*	*1.0702*
Gold/oz.	*$2,634.49*	*$2,062.59*	*$1,824.40*
Oil (WTI)/bbl	*$68.17*	*$71.65*	*$80.26*

Sources: see disclosure *

In Japan, newly elected Prime Minister Shigeru Ishiba emphasized that his top economic priority is to defeat deflation and put the nation on a stable growth track. To accomplish this, he plans to promote higher wages, boost productivity, support the revival of rural areas and turn Japan into an "investment powerhouse" by continuing to encourage a shift of private savings into investments. Ishiba also instructed his cabinet to compile a fresh economic package to cushion the blow to households from rising living costs.

Outlook

The US economy continues to defy expectations of a slowdown. Employment remains robust, with above-inflation wage growth, thanks to increasing job openings, especially in the services sector. This has come to pass despite headwinds from higher inflation and interest rates. Our analysis is that the economy has been less sensitive to a tightening monetary policy in part due to consumers and corporations having previously locked-in low levels of interest rates, as well as the unprecedented fiscal stimulus since the pandemic. It is also important to put the chain of monetary policy events into perspective. Interest rates were rapidly raised, from the zero bound, by 5.25%, between March of 2022 and July of 2023. Then, last month, investors cheered a sizeable 50 basis point cut and expect significant further reductions over the coming year. Such rapidity has not allowed sufficient time to pass in order for the lags of tighter monetary policy to bite.

The economy continues to be supported by fiscal stimulus. The US federal government has run a $1.9 trillion deficit through the end of August, $302 billion higher year-over-year, driven largely by increases in net interest payments (circa +40%) and mandatory expenditures for Social Security, Medicare, and Medicaid (circa +7%). As a result of years of profligate spending, the US national debt has reached $35.7 trillion, a record level as a percentage of GDP. This raises the question did the Fed cut interest rates prematurely, and what is their true motivation? Further, will the associated liquidity boost lead to a reacceleration of economic growth and inflation? Should such a scenario come to pass, investors can expect elevated levels of interest rates and financial market volatility.

Equity markets are discounting a firm economy, decelerating inflation and a looser job market. Corporate earnings for the third quarter are set to report, with consensus growth expectation of 4% for the average S&P 500 company. Thereafter, analysis are calling for robust earnings growth of 12% in the fourth quarter and 15% for the whole of 2025, which should be supportive of valuations and allow for a healthy broadening of participation. More than 60% of S&P 500 components outperformed the index in Q3, compared to approximately 25% in the first half of the year. As a result, the equal-weight version of the S&P 500 gained +9% last quarter, versus +6% for the benchmark, which is influenced by the heavily weighted shares of megacaps.

Perhaps an acknowledgement of our aforementioned conundrum, Fed Chairman Jerome Powell recently tempered expectations of future interest rate cuts. We maintain that there is enough strength in the economy that it's unclear whether more rate cuts would be beneficial, if central planners wish to avoid a potential overheating. For sovereign bond investors, this likely means interest rates will stay higher for longer, conversely, a strong economy bodes well for risker credit. Perhaps most salient, the defensive qualities of fixed income can once again help offset equity losses during periods of volatility.

Financial markets are at an interesting macroeconomic juncture, given what we would describe as a foggy monetary policy and geopolitical outlook. To augment performance and reduce the volatility of traditional portfolios, we continue to recommend select hedge funds and non-market correlated investments that are nimble and opportunistic. Further, our research indicates that precious metals, namely gold, and associated miner investments can be additive to risk-adjusted returns. For capital appreciation oriented investors, select software equities, with an activist element, appear to be timely investments. We have also identified innovative private equity funds attempting to disrupt the education and healthcare industries.

*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.