SlateStone WEALTH

Markets Are Resilient in the Face of Global Unrest

Third Quarter 2024 Review

During the third quarter, market volatility increased as investors faced political turmoil and added uncertainty about future economic growth. However, the return of Fed rate cuts and solid corporate earnings helped to offset those political and economic anxieties. The S&P 500 hit another all-time high and finished the third quarter with strong gains.

Markets began the third quarter with a continuation of the first half rally thanks to good second quarter earnings and generally solid economic data. The S&P 500 finished up 1.1% in July, well off the mid-month highs. Volatility persisted in early August as a weaker jobs report added to domestic economic concerns. The unemployment rate rose to the highest level since November 2021. Investors' fear of an economic hard landing triggered a sharp decline that saw the S&P 500 fall 3% on August 5th - the worst one-day selloff in nearly two years. However, that decline proved brief as economic data over the next few weeks remained positive. Then, on August 23rd, the Fed Chair announced at the Kansas City Fed's Jackson Hole Economic Symposium that the "time had come" for the Fed to begin to cut rates. That message further fueled the rebound in stocks and the S&P 500 finished August with a 2.3% gain. September saw another disappointing employment report, stoking investor concerns about an economic slowdown. Following that report, financial journalists and ex-Fed officials made public calls for the Fed to cut interest rates by 0.50% at their September meeting. That call came to fruition on September 18th when the Fed lowered short term rates for the first time in four years. In addition, they also promised additional rate cuts before year-end. As a result, the stock market surged to a new high and finished the third quarter with more solid gains, adding to what was already a strong year-to-date return.

Politics and the looming presidential election did little to 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 Trump. However, those expectations changed rapidly following Biden's withdrawal from the race and the nomination of Vice President Kamala Harris. As the third quarter ended, national polls ever-so-slightly favored Harris, while the outlook for control of Congress remained uncertain.

Third Quarter Performance Review

Investor expectations for falling interest rates and bond yields were the major influences on the index, sector, and factor performance during the third quarter. Markets were broadly positive with some notable changes in leadership. Starting with market capitalization, small caps outperformed large caps for the first time in 2024. Investors rotated out of large-cap stocks into more interest-rate-sensitive small caps. Smaller companies historically receive the most benefit when borrowing costs decrease.

Foreign markets outperformed the S&P 500 in the third quarter as the relative underperformance of the U.S. 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, specifically Chinese stocks, outperformed both the S&P 500 and foreign developed markets as the Chinese government announced numerous stimulus measures late in September.

US Equity Indexes	Q3 2024	YTD
S&P 500	5.89%	22.08%
NASDAQ Composite	2.76%	21.84%
DJ Industrial Average	8.72%	13.93%
S&P 500 Equal Weighted	9.59%	15.16%
Russell 2000 (Small Cap. Stocks)	9.27%	11.16%
MSCI EAFE (International Developed)	7.35%	13.55%
MSCI Emerging Markets (International EM)	8.82%	17.13%

Source: Bloomberg Professional (9/30/2024)

The performance was broad-based with ten of the eleven S&P 500 sectors finishing the third quarter with a positive return, continuing the year-to-date rally we have all enjoyed. The influence of lower yields was evident in the sector outperformers. Utilities and real estate, two sectors that provide large dividends and therefore tend to benefit when bond yields fall, handily outperformed the remaining nine S&P 500 sectors. Regarding sector laggards, the communication services, technology, and energy sectors were the only sectors to finish the third quarter below the broad market. Investors rotated out of tech and towards higher dividend and more cyclically sensitive sectors. Energy was the worst performing sector in the quarter as concerns about global growth, especially in China, weighed on oil demand expectations **(see sector breakdown below)**.

Source: Bloomberg Professional (9/30/2024)

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg US Aggregate Bond Index) posted a very strong quarterly return thanks to a combination of falling inflation, mixed U.S. economic data, and an anticipated Fed rate cutting cycle. Delving deeper in the fixed income sector, longer duration bonds significantly outperformed those with shorter durations as investors reached to lock in higher yields amidst falling inflation and underwhelming labor market data. Shorter maturity bonds also saw a positive return however, their lower duration limited the price appreciation.

Turning to the corporate bond market, investment grade fixed income outperformed lower quality junk bonds, although both saw strong quarterly gains. For the first time in 2024, investors favored investment-grade bonds amid increased economic uncertainty, as investors sought the safety of higher-rated bonds over the greater return potential of junk (high-yield) bonds.

US Bond Indexes	Q3 2024	YTD
Bloomberg US Aggregate Bond	5.20%	4.45%
Bloomberg US T-Bill 1-3 Month	1.36%	4.08%
ICE US T-Bond 10-20 Year	7.63%	4.01%

Source: Bloomberg Professional (9/30/2024)

Near-term Outlook

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

Regarding economic growth, expectations for projected Fed rate cuts helped market participants look past some soft economic reports, especially in the labor market. But, with those initial rate cuts now behind us, we should expect markets to be more sensitive to any disappointing economic data. Bottom line, with the S&P 500 just off record highs, the market has priced in a soft economic landing.

Politics, meanwhile, will become a more direct market influence as we approach November 5th. Depending on the expected and actual outcome, we could see an increase in both macro and microeconomic uncertainty that could impact the broader markets as well as specific industries and sectors (e.g., oil and gas, renewables, and financials). The macro uncertainty stems from possible policy changes on immigration, the expiring Trump tax cuts, global trade and tariffs, and the long-term fiscal health of the United States. Additionally, geopolitical risks remain elevated and so far, the Russia/Ukraine war and the ongoing conflict between Israel, Hamas, and now Hezbollah have not negatively impacted global markets this year. There is always a possibility this could change, and these unfortunate situations must be consistently monitored as the escalation of these conflicts would impact markets, regardless of any Fed rate cut or election outcomes.

As we start the fourth quarter, the stock market's momentum remains decidedly positive, and has proven quite resilient. Additionally, current economic data is still pointing to a soft economic landing. So, while there is elevated uncertainty between now and yearend, the fundamental underpinnings of this market remain broadly positive.

At Slatestone, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this investment environment. Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

SlateStone Wealth Investment Committee