

## Quarterly Insights – October 2024

### Fed Rate Cuts and Solid Earnings Overcome Rising Economic Anxiety

Hello,

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 2<sup>nd</sup>, 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 5<sup>th</sup>, 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 23<sup>rd</sup>, 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 18<sup>th</sup>, 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.

### 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.

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.

### Fourth Quarter Market Outlook

With the start of the Fed's rate cutting cycle and the general pace of future cuts now broadly known, focus for the final quarter of 2024 will turn towards economic growth. The 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 5<sup>th</sup> election. Depending on the expected and actual outcome, we could see an increase in 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.

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.

At Debczak Wealth Management we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this investment environment. Successful investing is a marathon, not a sprint, and even bouts of intense volatility are unlikely to alter a diversified approach set up to meet your long-term investment goals.

We thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you accomplish your financial goals.

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

Sincerely,

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