Quarterly Market Outlook

October 2024

The Fed Eases

The economy expanded at a solid pace in Q3 as inflation continued to normalize, with real growth tracking 2%+ in the U.S. and core inflation approaching the Fed's 2% target. With inflation down and the labor market loosening, the Fed initiated its first interest rate cut in September, reducing the target Fed Funds Rate 50 bps to the 4.75-5.00% range.[1]

Markets Rally

The decline in interest rates across the yield curve was a tailwind for most asset classes in Q3, with global equities up 7% (now up 19% YTD), the Bloomberg U.S. Aggregate Bond Index up 5% (4% YTD), and gold surging 13% (28% YTD). While the AI rally finally began to cool, value sectors like financials, industrials and utilities carried the indices higher. Meanwhile, oil declined 17% on weaker expected demand, particularly from China.[2]

Growth Outlook Positive Overall

Consumer spending remains healthy, supported by strong wage growth, low debt levels and rising wealth. Corporate spending also looks supportive, as companies increase capital expenditures on AI, onshoring and energy infrastructure, and government outlays are expected to rise slightly next year. In addition, falling interest rates should allow households and businesses to borrow and spend more and should ease financing costs for more indebted companies. On the other hand, economic growth is expected to slow, credit-card and auto-loan delinquencies are rising, manufacturing has hit new lows, consumer surveys are negative, and the labor market continues to cool. We are monitoring these indicators as potential early warning signs of a slowdown but, for now, with spending growth steady and rates falling, the economy looks to be on firm footing.[3]

Inflation Is Normalizing

Inflation continues to trend toward target, and with energy prices and rents down and the labor market easing, inflation for both goods and services seems likely to slow further. While lower interest rates could potentially cause an uptick in demand and pressure inflation higher, the economy may prove less sensitive to modest rate cuts than in the past, just as it was less sensitive to the aggressive tightening of 2022-23.[4]

Geopolitical and Election Risks

A Trump presidency could lead to tax cuts and deregulation on the one hand and aggressive tariffs on the other, while a Harris presidency could mean higher taxes and a stricter regulatory environment. Although a divided Congress could blunt either agenda, these differences could potentially increase market volatility as the election approaches and pose differing risks for growth and inflation. In addition, with the conflict in the Middle East rapidly intensifying and the Russia-Ukraine war ongoing, geopolitical uncertainty looks heightened. [5]

Risks to Markets

U.S. equity-market valuations remain elevated, particularly for large-caps, with the S&P 500 trading at a forward P/E of 21 compared to 16 each for the S&P 400 (mid-caps) and S&P 600 (small-caps). International and emerging equities, in contrast, are trading at forward P/Es of 14 and 12, respectively – low even relative to historical norms. Equity valuations reflect aggressive expectations across the board, as analysts project double-digit earnings growth for both U.S. and international stocks. On the fixed-income side, Treasuries are pricing 10-year inflation at 2.3%, leaving little cushion for an upside surprise, while real yields are back to 1.7%, and credit spreads remain tight. With valuations elevated and expectations high, we believe that even a modest negative earnings or inflation surprise could have a magnified impact.[6]

The Value of Diversification

With favorable outcomes largely priced in, we believe it makes sense to be balanced to economic surprises in the event growth and/or inflation unfold differently from what markets expect. We also believe that, especially when valuations look stretched, skilled active management can continue to generate returns and provide valuable diversification for portfolios – both in the public markets, where lowly correlated "alpha" can exploit market inefficiencies and dislocations regardless of how markets perform, and on the private side, where managers can leverage their differentiated sourcing funnels, networks and operational expertise to add value.

Notes

All data as of 9/30/24.

[1] Source: Bloomberg (CPI YOY Index, CPI XYOY Index, GDGCAFJP Index, DOTS); Fed meeting recap: Chair Powell defends central bank's decision to go big with first cut (cnbc.com).

[2] Source: Bloomberg (USGG2YR Index , USGG10YR Index, MXWD Index, LBUSTRUU Index, XAU Curncy; CL1 Comdty); Oil slumps 17% in Q3 as Middle East conflict offset by slowing demand | Reuters.

[3] Source: US consumer spending resilient; inflation continues to abate | Reuters; AI stocks aren't in a bubble | Goldman Sachs; The Resurgence Of U.S. Manufacturing: Onshoring And Nearshoring Trends (forbes.com); An Overview of the President's FY 2025 Budget-2024-03-11 (crfb.org); Economic Forecast for the US Economy (conference-board.org); Americans Are Falling Behind on Their Bills. Wall Street Is Alarmed. – WSJ; Manufacturing PMI® at 47.2%; August 2024 Manufacturing ISM® Report On Business® (prnewswire.com); Fewer openings, harder to get hired: U.S. labor market likely softer than it appears | Federal Reserve Bank of Minneapolis (minneapolisfed.org); US consumer confidence sours on labor market jitters | Reuters.

[4] Why We Expect Inflation to Fall in 2024 | Morningstar; Economic Outlook U.S. Q4 2024: Growth And Rates Start Shifting To Neutral | S&P Global Ratings (spglobal.com).

[5] Republican leader: Trump plans could be paid for with tax cuts, deregulation (cnbc.com).

[6] Source: Bloomberg (USGG10YR Index, USGGBE10 Index), Stock Market P/E Ratios - Yardeni Research, Forward P/Es - Yardeni Research; YRI Earnings Outlook - Yardeni Research; Moody's Seasoned Baa Corporate Bond Yield Relative to Yield on 10-Year Treasury Constant Maturity (BAA10Y) | FRED | St. Louis Fed (stlouisfed.org); ICE BofA US High Yield Index Option-Adjusted Spread (BAMLH0A0HYM2) | FRED | St. Louis Fed (stlouisfed.org).

IMPORTANT INFORMATION