Webinar Introduction

- Hi everyone and thank you for joining us today.
- Welcome to the 4Q 2024 Quarterly Client Webinar.

10 Market Themes for 4Q 2024

This collection of market insights highlights 10 themes we believe are most likely to shape the investment environment this quarter.

1. Market Recap – Timeline of Key Events in 2024
2. Stock Market – An Increasing Number of Stocks are Participating in the Rally
3. Interest Rates – Federal Reserve Cuts Rates by -0.50%
4. Path Forward – How Much Could Rates be Cut by?
5. Economic Trends – Watching Interest Rate Sensitive Industries
6. Historical Perspective – How Does the S&P 500 Perform During Rate Cuts?
7. Labor Markets – Weakening, but Not Weak by Historical Standards
8. What We're Monitoring – Number of Companies Mentioning "Recession"
9. Presidential Election – Staying Invested vs. Choosing Sides
10. New Opportunities – Stock / Bond Correlation Returning to Normal

Team Member Name
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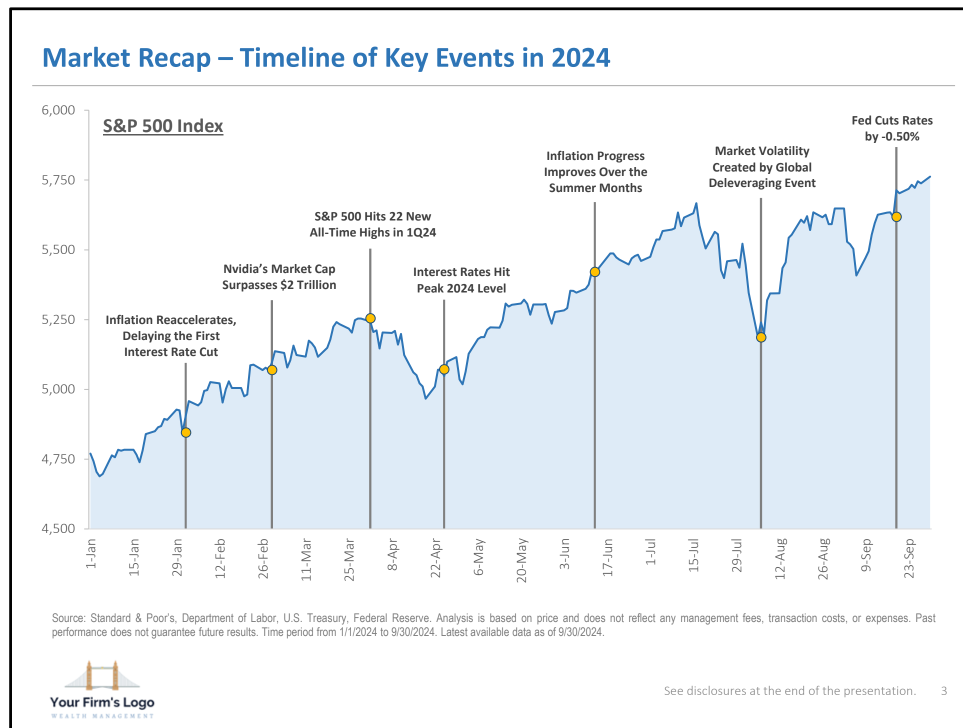
Key Talking Points

- Today, we will be discussing several market moving topics and how they might impact your portfolio in the coming months.



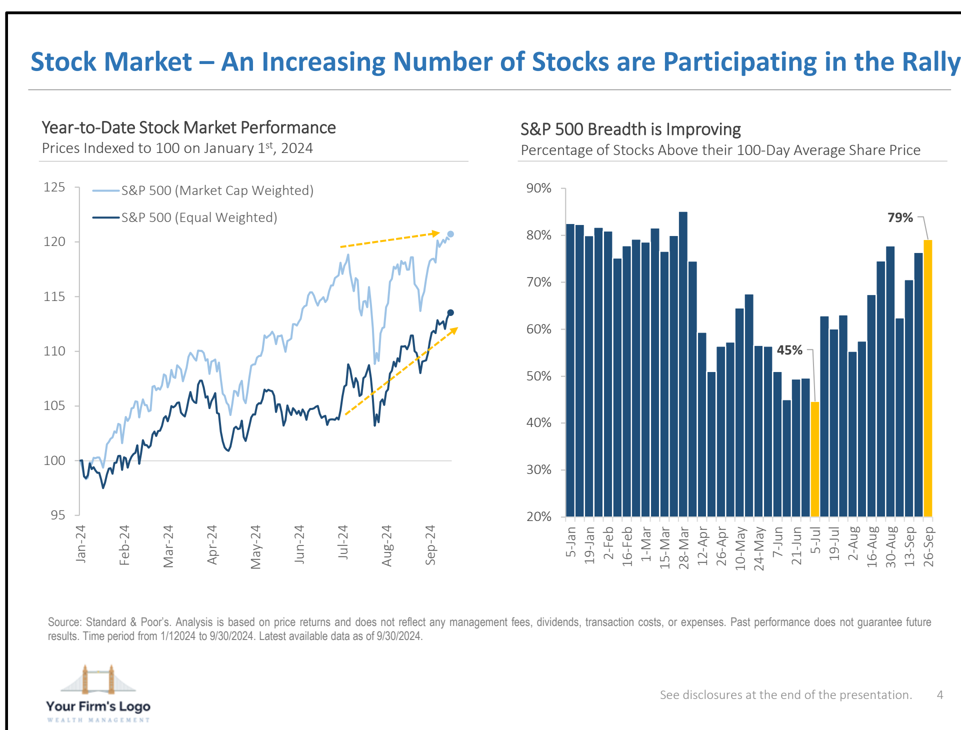
Key Talking Points

- This slide graphs the S&P 500's movement this year and marks key events on the calendar. Despite multiple sell-offs and increased volatility recently, YTD the S&P 500 has gained +20% through Q3 and trades near an all-time high. This year started with expectations for significant interest rate cuts, with investors forecasting nearly -1.5% of cuts before year-end. The first cut was anticipated to occur in March, but by late January, those expectations were being questioned as inflation reaccelerated. Bonds traded lower in Q1 as Treasury yields rose to reflect the prospect of fewer interest rate cuts.

- Notably, the bond market's Q1 troubles had little impact on the equity market. Investor enthusiasm for artificial intelligence (AI) stocks drove the S&P 500 higher, with the index setting 22 new all-time highs in Q1. Nvidia, a leading semiconductor company in the AI industry, returned over +80%. By the end of February, its market cap had surpassed $2 trillion, a dramatic rise from under $1 trillion less than a year earlier. While stocks posted strong Q1 returns, inflation concerns eventually caught up to the stock market in April. The 10-year Treasury yield rose by nearly +0.58% to start Q2, while the S&P 500 declined nearly -5%.

- Inflation progress improved over the coming months. April ultimately marked the peak in inflation fears, with Treasury yields peaking in late April and the stock market resuming its upward trajectory throughout the remainder of Q2. Bonds posted four months of consecutive gains from May to August, as investors bet that a combination of falling inflation and rising unemployment would lead to significant rate cuts. The S&P 500 approached 5,700 in mid-July, but the renewed optimism gave way to concerns about AI stocks. During Q2 earnings season in July, investors raised concerns about the high costs of developing AI and whether the future revenues would justify today's high investments.

- In early August, the stock and bond markets experienced significant volatility. Investors were spooked by a rise in unemployment from 4.1% to 4.3%. This sudden surge of market volatility caused investors to sell stocks and buy bonds, leading to a significant deleveraging event across global financial markets. The S&P 500 traded down nearly -8% from mid-July through the first week of August. However, the volatility was short-lived, and the S&P 500 rebounded to end August with a modest gain. There was some residual volatility in early September as investors returned from summer break, but the S&P 500 again recovered quickly and set a new all-time high later in the month. The rise in market volatility marks a significant shift from the past 12 months of steady S&P 500 gains, but so far, investors have brushed it aside.



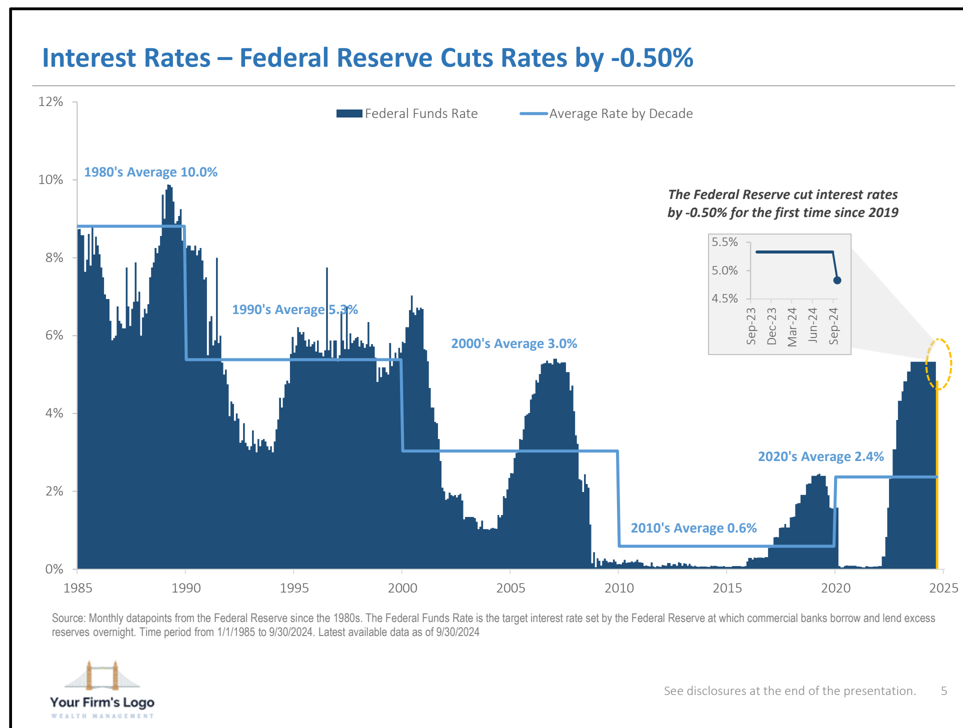
Key Talking Points

- This slide offers a deeper look into the S&P 500's performance this year. The line chart compares the index's return using two methods: market cap-weighted (light blue) and equal-weighted (dark blue), both indexed to 100 starting January 1, 2024. Overall, the market cap-weighted index has outperformed the equal-weighted index year-to-date. The divergence between the two indices was especially pronounced in the first half of 2024, indicating that a small number of large companies (those with the biggest market caps) propelled the stock market higher earlier this year.

- However, the gap between the two indices peaked in early Q3 and narrowed by the end of September, with equal-weighted outperforming market-cap weighted by +4%. The equal-weighted index's outperformance indicates that smaller and mid-sized companies, which have less influence on the market cap-weighted index, performed better in Q3 after trailing in Q1 and Q2.

- The bar chart on the right further highlights this broadening Q3 rally, as it tracks the percentage of S&P 500 stocks trading above their 100-day moving averages. A higher reading indicates more stocks are experiencing upward momentum, as they are trading above their average price over the past 100 days. Early in the year, market breadth was relatively strong, with over 75% of S&P 500 companies trading above their 100-day moving averages. There was a notable decline in April due to inflation and economic growth concerns, but since mid-June, market breadth has improved, indicating that more stocks are participating in the equity market rally.

- Earlier this year, the market cap-weighted index's outperformance indicated that larger companies were leading the market gains. Investors worried about the narrow leadership and were concerned that it masked underlying weakness in the broader market. The Q3 improvement in market breadth is a positive sign, signaling a more broad-based and healthier rally. One of the catalysts that helped to improve market breadth was the start of the interest-rate cutting cycle, which we discuss on the next slide.

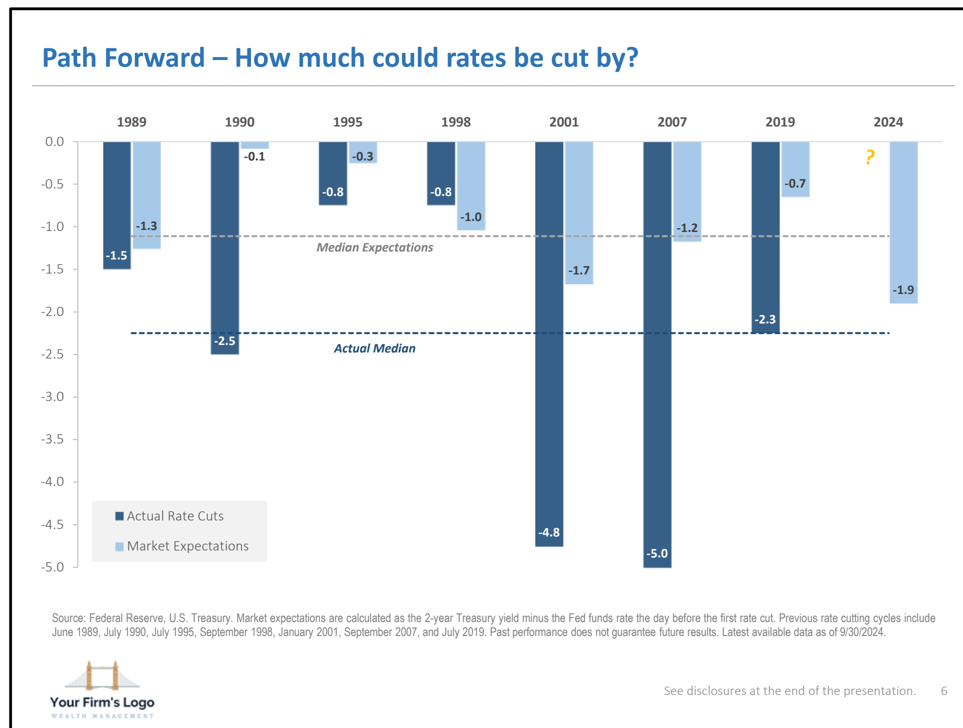


Key Talking Points

- This slide graphs the Federal funds rate, which is the interest rate that the Fed raises and lowers to set monetary policy. It shows the rate-hiking and rate-cutting cycles since 1985, along with the average Fed funds rate for each decade. The chart shows the trend of falling interest rates over the past few decades, with the average interest rate declining each decade from the 1980s through the 2010s. However, the far right of the chart shows the sharp rise in interest rates this decade.

- Over the past five years, the Fed cut interest rates to near-zero during the COVID pandemic to support the economy. It kept rates near 0% until March 2022, when it began raising interest rates in response to soaring inflation. From March 2022 to July 2023, the central bank raised rates by +5%, one of the largest and fastest rate-hiking cycles in recent history. Since the last rate hike in July 2023, the Fed has held rates steady as it waits for inflation to return to its 2% target.

- After 14 months, the Fed started the rate-cutting cycle with a -0.50% cut at its September meeting. The Fed's transition to cutting interest rates comes as its focus shifts from lowering inflation to supporting the labor market. Since the last rate hike in July 2023, inflation has dropped from 3.3% to 2.6%, while unemployment has risen from 3.5% to 4.2%. The Fed is more confident that inflation will return to its 2% target, but it's concerned about the overall health of the U.S. labor market. Investors expect the Fed to cut interest rates at its meetings later this year, with further reductions expected throughout 2025. The next slide frames the market's rate-cut expectations.

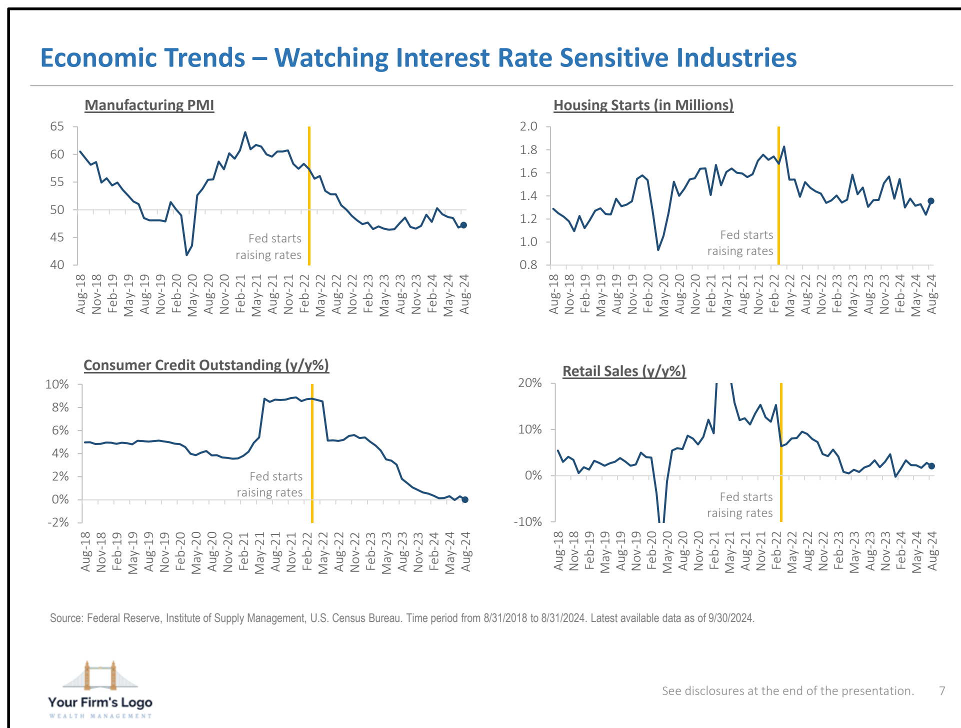


Key Talking Points

- This slide examines how the market's rate-cut expectations historically compare to the Fed's actual number of rate cuts. The dark blue bars show the Fed's actual rate cuts, while the light blue bars represent the market's expectation at the time of the first cut in each cycle. In all but one prior cycle, the Fed cut rates more than the market initially anticipated. In 1990, the market expected a total of -1.3% of rate cuts, but the Fed cut by -2.5%. Similarly, in the 2001 dot-com bubble, investors expected -1.7% of total cuts, but the Fed implemented a larger reduction of -4.8%.

- The chart shows that the market consistently underestimates the extent of rate cuts, but the gap between expectations and reality varies significantly over time. The difference was small in 1995 and 1998 (-0.5% and +0.2%, respectively), but it was much larger in 2007 and 2001 (-3.8% and -3.1%, respectively). These larger gaps occurred when the economy was weakening and entering recessions, leading to deeper rate cuts as the Fed tried to counter slowing growth. In contrast, economic growth increased as the Fed cut rates in 1995 and 1998, so fewer cuts were needed.

- Investors expect the Fed to cut rates by -1.9% this cycle. Compared to prior cycles, the light blue bars show the market's expectations for this cycle are high, even surpassing 2007 ahead of the 2008 financial crisis. Investors believe falling inflation and rising unemployment will cause the Fed to aggressively cut rates, but the data shows the market's poor forecasting track record. History indicates the timing and amount of actual rate cuts will depend on the economy's path. A weaker economy would justify more rate cuts, while a stronger economy could require fewer rate cuts. The next slide examines how the Fed's rate hikes have already impacted the economy.



Key Talking Points

- This slide presents four economic indicators that offer insight into the current state of the U.S. economy: Manufacturing PMI, Housing Starts, Consumer Credit Outstanding, and Retail Sales. Let's examine what they reveal about recent economic trends.

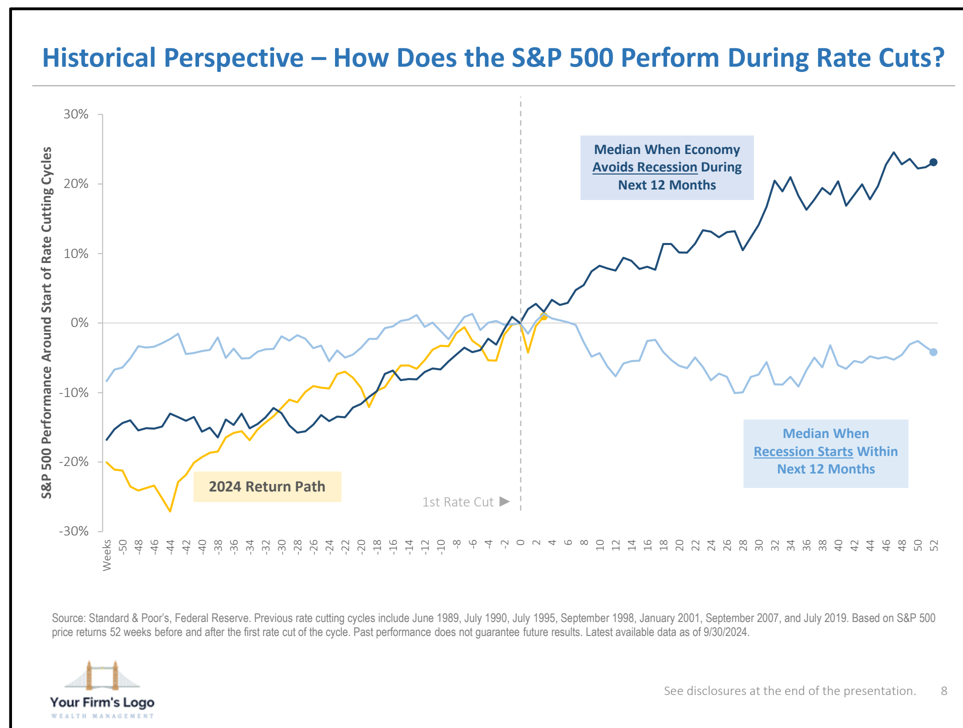
- The Manufacturing PMI, or Purchasing Managers' Index, is a key gauge of manufacturing activity. Values above 50 indicate expansion, while those below 50 signal contraction. The pandemic triggered a sharp decline in manufacturing, followed by a strong recovery in 2021. However, since the Fed began raising interest rates in March 2022, the PMI has steadily declined and remained below 50. This suggests the manufacturing sector is contracting, with higher interest rates likely putting downward pressure on the industry.

- Housing starts data tracks the number of new residential construction projects, an important leading indicator and a key measure of housing market health. After an initial drop early in the pandemic, housing starts recovered and climbed steadily through early 2022. However, as the Fed raised interest rates, the number of housing starts declined. This downward trend reflects the impact of higher mortgage rates, which have reduced affordability and dampened construction activity.

- Consumer credit outstanding represents the year-over-year change in consumer loans. This metric provides insight into the willingness of consumers to take on new debt, such as car and auto loans. Loan growth surged during the pandemic, fueled by fiscal stimulus, low interest rates, and rising wages. However, since the Fed began raising rates, loan growth has flatlined. Slowing loan growth can be a sign that consumers are less willing or able to borrow due to higher interest rates, which can curb purchases of interest-rate-sensitive goods like homes, autos, and boats.

- Retail sales provide insight into consumer spending, a key driver of economic growth since consumer spending makes up a large portion of GDP. Retail sales plummeted as the economy shut down early in the pandemic, but spending rebounded sharply in late 2020 and 2021. While retail sales growth has slowed with rising interest rates, it remains positive, indicating that consumer spending is holding up relatively well despite higher rates.

- Together, these data points reveal the impact of rate hikes on the economy. Higher interest rates appear to be impacting manufacturing, housing, and loan growth. However, the main engine of the economy, the consumer, continues to spend. The data suggest that the current level of interest rates is restrictive, and the Fed's goal in lowering rates is to stimulate interest-rate-sensitive sectors and prevent a deeper slowdown. Economists will monitor these data points in the coming months and quarters to gauge the impact of the Fed's rate cuts on the economy.

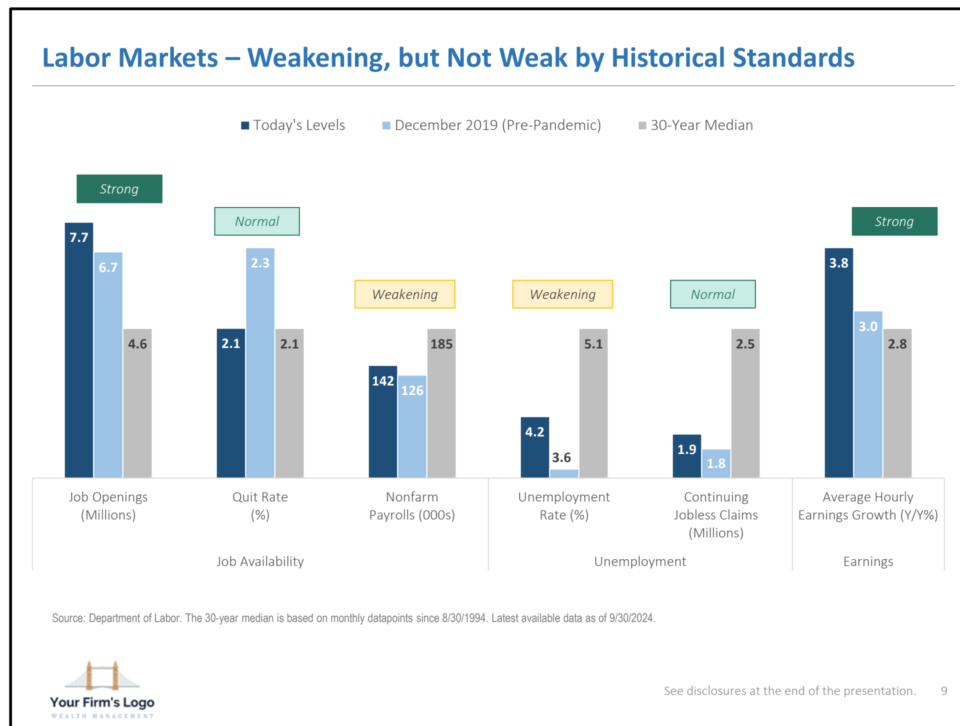


Key Talking Points

- The previous slide discussed the impact of interest rate hikes on the economy. This slide shows why investors will be focused on what happens to the economy as the Fed lowers interest rates. The chart tracks the S&P 500's performance in the 12 months before and after the first interest rate cut. It features two paths. The dark blue line represents the S&P 500's return path when the economy avoids a recession in the 12 months following the first rate cut. The light blue line represents the S&P 500's return path when the economy enters a recession within 12 months after the first rate cut. For comparison, the two lines are indexed to 100 the week of the Fed's first interest rate cut.

- Historically, the S&P 500 has performed very differently depending on whether the economy falls into a recession after the first rate cut. When rate cuts stimulate economic growth, the S&P 500 gains an average of +23% over the next 12 months. However, if a recession follows, the S&P 500 tends to trade sideways or slightly lower, with an average return of -4%.

- A prior slide discussed how the economy's trajectory can impact the depth of the Fed's rate-cutting cycle. This slide highlights how the broader economic environment can also impact the stock market's performance. Our team will monitor the economy in the coming months to see if interest rate cuts boost economic activity. One key data point we'll monitor is the labor market, which we'll discuss on the next slide.



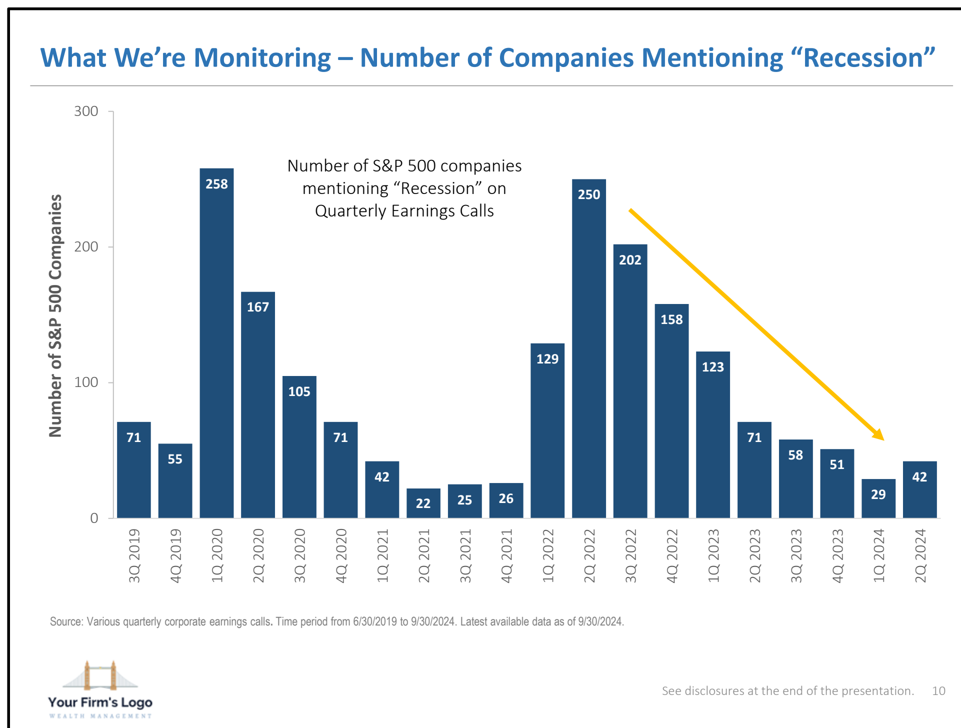
Key Talking Points

- Concerns about rising unemployment and a softening labor market contributed to the Fed's decision to cut interest rates. This slide examines those concerns by comparing labor market data from today against levels from December 2019 (baseline prior to the pandemic) and the 30-year median (historical standards). The variables include job openings, the quit rate, monthly job growth, unemployment, continuing jobless claims, and average hourly earnings.

- Starting with job openings, there are 7.7 million job openings today. This is down from the peak of 12.2 million in March 2022, but it's above the 6.7 million in December 2019. This suggests that while demand for workers has eased, it remains relatively strong by historical standards. The quit rate stands at 2.1% after reaching a peak of 3% in early 2022, as many employees seized opportunities for higher pay and better work-life balance amid a tight labor market. A lower quit rates suggests employees are less confident about their ability to find a new job. Monthly job growth totaled +142,000 in August; an increase compared to December 2019, but below the 30-year median. While job creation has slowed compared to recent years, it's only slightly below the 30-year median.

- One primary concern has been the unemployment rate, which rose to 4.3% in July. This is the highest level since October 2021 and a +0.8% increase from July 2023. Although unemployment is trending higher, today's 4.2% shows it remains low by historical standards. Continuing jobless claims, which represent the number of workers receiving unemployment benefits for an extended period, has risen with unemployment, but it too remains low by historical standards. The far-right set of columns show average hourly earnings growth has slowed since peaking above 5% in recent years, but wage growth remains stronger than both December 2019 and the historical median.

- The data show that while the labor market is softening compared to recent years, it remains solid by historical standards. The key question for the Fed and investors is what this softening over the past year represents. Is the labor market simply normalizing after experiencing significant disruption during the pandemic, or is it an early sign of weakening labor demand? This uncertainty is one reason the Fed moved to cut interest rates in September.

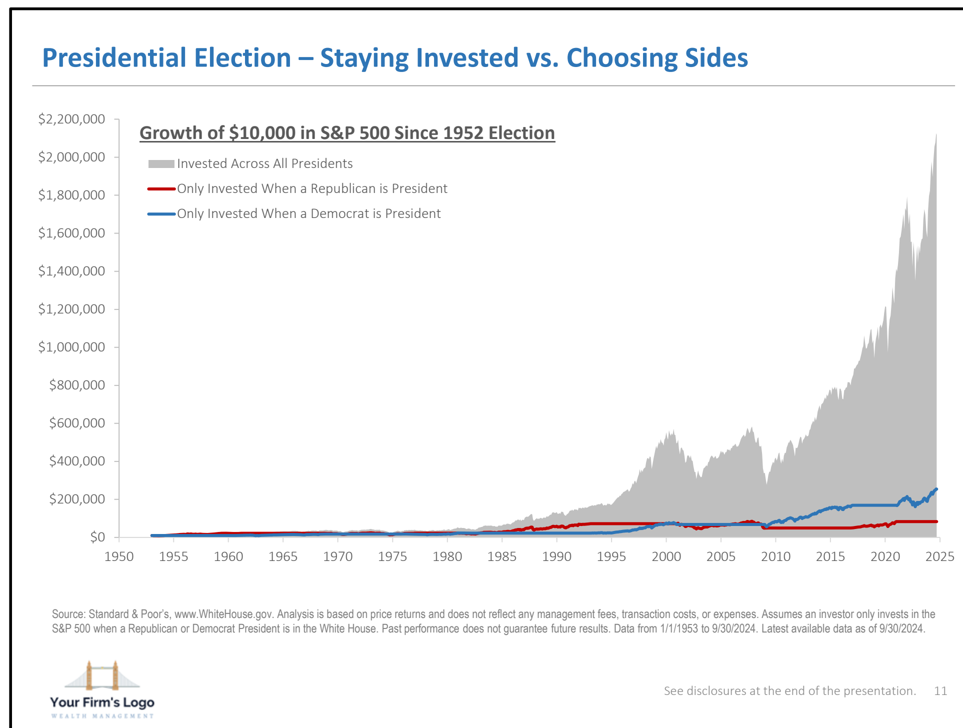


Key Talking Points

- This slide tracks how often S&P 500 companies mentioned the word "recession" on earnings calls from Q3 2019 to Q2 2024. Mentions spiked in Q1 2020, with 258 companies using the term, up from 55 in the previous quarter. This surge coincided with the onset of the COVID-19 pandemic and the resulting economic uncertainty created as the global economy shut down. As the economy reopened and growth rebounded, the number of mentions decreased significantly throughout 2020 and 2021, an indication that recession fears diminished after the initial shock.

- In early 2022, there was another surge in mentions, peaking at 250 in Q2. This second spike coincided with the start of the Fed's tightening cycle in March 2022, a period when inflation was running at multi-decade highs and the Fed was preparing to raise interest rates. Management teams were concerned that high inflation and rising interest rates would hurt demand, leading to a recession. However, since the peak in Q2 2022, there has been a clear and consistent downward trend in mentions. By Q2 2024, the number of companies mentioning "recession" had declined to just 42, an indication that recession concerns among S&P 500 companies have diminished considerably.

- The decline in companies mentioning "recession" aligns with improving stock market conditions and the U.S. economy's resilience despite higher interest rates. It signals a more optimistic outlook for the economy and suggests companies and management teams, who are closely involved in daily business operations, are becoming less worried about an imminent recession.

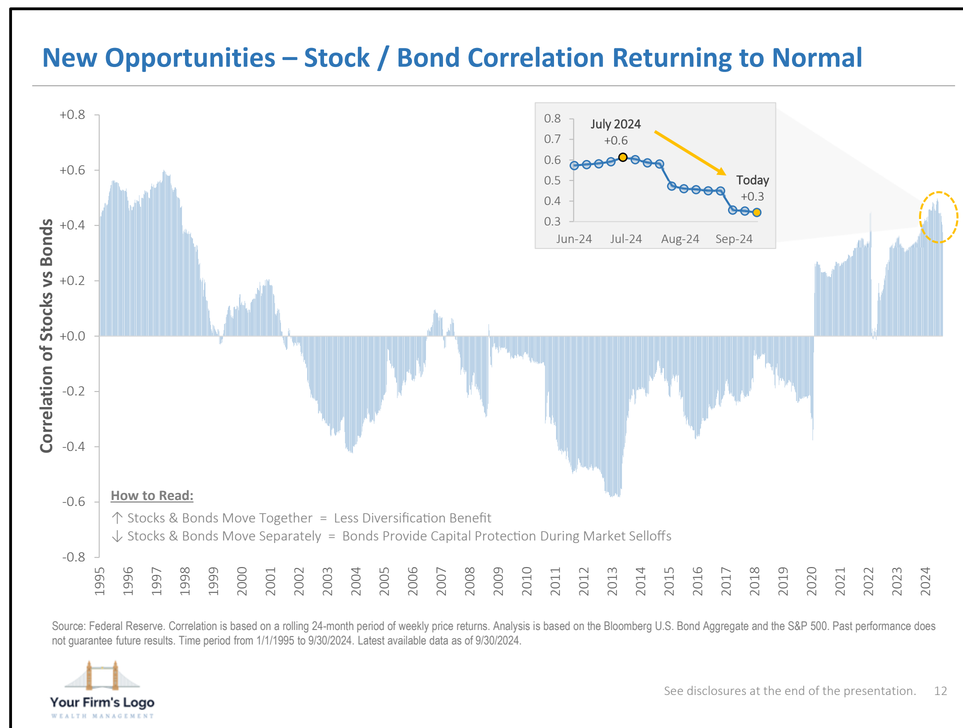


Key Talking Points

- As the 2024 presidential election approaches, Americans are preparing to vote in what polls forecast to be a tight race. Like many investors, you may wonder how the election outcome could affect financial markets and whether you should change your investment strategy. While elected leaders can influence economic growth by enacting laws and regulations, data suggests that who occupies the White House has little to no impact on investment performance. Fundamental factors like corporate earnings growth and valuations impact the stock market far more than political headlines. Politicians make many promises during election years, but these often go unfulfilled because of the government's system of checks and balances. Moreover, the economic outcomes of policies are less predictable than officials think, with the economy more influenced by factors like job growth, interest rates, and inflation.

- The slide shows the financial impact of allowing political beliefs to influence investment decisions. It tracks the growth of $10,000 invested in the S&P 500 index, comparing three different investment strategies based on political affiliation. If an investor only invested in the stock market when a Republican was President (red line), $10,000 would have grown into $83k today, excluding dividends. Investing only when a Democrat was President (blue line) would have returned $254k. While the gap may seem wide, if an investor ignored the president's political party and remained invested, the gray shaded area shows the $10,000 would have grown to over $2.1 million.

- Political views can stir strong emotions, but making investment choices based on those feelings can lead to poor portfolio decisions. Instead, it's better to focus on time-tested investment principles and avoid letting politics influence your long-term strategy. The U.S. economy's success, growth, and resiliency don't change with each new election, and neither should your investment strategy. It's best to express political opinions at the ballot box, not in your portfolio.



Key Talking Points

- Bonds haven't provided protection against stock market sell-offs in recent years, but that may about to change. The slide graphs the rolling 2-year correlation between stocks and bonds since 1995. Correlation measures how two assets, such as stocks and bonds, move relative to each other. A positive value indicates they move together, which reduces diversification benefits. A negative value indicates they move in opposite directions, with bonds acting as a hedge against stock declines. Bonds are often added to portfolios for their potential diversification benefit, or negative correlation. Stocks tend to perform well during periods of economic growth when corporate earnings are strong, while bonds are attractive during economic slowdowns and periods of uncertainty. Combining the two asset classes in a portfolio can reduce overall risk, as gains in one can offset losses in the other.

- The chart shows that the correlation between stocks and bonds has varied over time. During periods of negative correlation, such as the market downturns in 2000-2003 and 2008-2013, bonds provided strong diversification benefits against stock market selloffs. In contrast, during positive correlation phases, such as 1995-1999, stocks and bonds moved together, offering less diversification benefit. Since the COVID pandemic in March 2020, the correlation between stocks and bonds has increased sharply, even surpassing levels from the late 1990s. Stocks and bonds have moved together in recent years, reducing the diversification benefits of bonds.

- The pop-out chart shows the stock-bond correlation has declined in recent months. This suggests that bonds are providing slightly more diversification benefits as inflation approaches the Fed's target and it starts to lower interest rates. A return to negative correlation would be beneficial for investors, with bonds returning to their traditional role of protecting capital in the event of a stock market selloff.

Questions?

Get in Touch!

Phone (123) 456-7899 | Email info@yourfirm.com

Schedule Time with Our Team

Your Calendar Link (e.g. Calendly)

Closing Thoughts

- Thank you everyone for joining us today as we hope this webinar has been insightful into the market themes our team is following as we work hard to manage your family's wealth alongside ours.

Open your webinar to questions … OR End it with a call-to-action like below …

- For our current clients, you can always get in touch with the team by contacting _______ and we look forward to seeing you soon.
- For prospective clients that tuned in today, thank you for joining us. Please feel free to schedule time directly on our calendar to discuss your financial planning needs. We would love the opportunity to earn your business.

Definitions

2Y / 10Y / 30-Year Treasury Bonds: Treasuries are debt obligations issued and backed by the full faith and credit of the U.S. government.

Consumer Price Index (CPI): Measures the changes in the price level of a basket of consumer goods and services purchased by households.

Federal Fund's Rate: The target interest rate set by the Federal Reserve at which commercial banks borrow and lend excess reserves overnight.

Federal Reserve: The Federal Reserve System is the central bank of the United States. It was founded by Congress in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system.

Forward Price to Earnings Ratio: The forward P/E ratio (or forward price-to-earnings ratio) divides the current share price of a company by the estimated future ("forward") earnings per share (EPS) of that company.

Growth Stocks: Growth stocks are companies expected to grow sales and earnings at a faster rate than the market average.

Inflation: A general rise in price level relative to available goods and services.

ISM Purchasing Managers Index (PMI): The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms. It is considered to be a key indicator of the state of the U.S. economy.

Price Return: The rate of return on an investment portfolio, where the return measure takes into account only the capital appreciation of the portfolio, not including income generated in the form of interest or dividends.

Prime Interest Rate: A base rate used by banks to price short-term consumer and business loans.

Real Yield: The interest rate earned on a fixed income investment after factoring in the impact of inflation as measured by the Consumer Price Index (CPI).

Total Return: Return on a portfolio of investments including capital appreciation and income received on the portfolio.

Unemployment Rate: A lagging economic indicator which is calculated as the percent of the labor force that is jobless.

Value Stocks: Stocks that are inexpensive relative to the broad market based on measures of fundamental value (e.g., price to earnings or price to book).

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