From the Curb

Letter to Clients
Quarter Ending September 30, 2024

Markets were volatile in the third quarter as investors faced political turmoil and increased uncertainty about future economic growth, but the Fed's pivot to begin to reduce interest rates and solid corporate earnings helped overcome political and economic anxieties. By the time the quarter came to an end, the S&P500 hit another all-time high and finished the quarter with strong gains.

There was a lot for markets to digest in the third quarter. Good Q2 earnings and solid economic data led off the quarter. The real possibility that the Fed would begin to lower interest rates later in the quarter boosted the economic outlook and spurred investors to rotate away from AI-driven tech stocks and into other less favored large cap sectors. A larger-than-expected decline in inflation caused treasury yields to fall sharply encouraging investors to increase their exposure to risk assets by adding to small and mid-cap holdings.

Good news and bad news are currently being absorbed by markets on their face value. So, when a weaker than expected July jobs report was released in early August and the unemployment rate rose, fear of a hard landing returned and markets sold off. Subsequent data and fundamentals proved to be in line thus calming investors' concerns.

At a well-timed Jackson Hole Economic Symposium, markets got the news they had been waiting for when Fed Chair Powell uttered the words, "the time has come". The Chair shared its strategy to recalibrate monetary policy and begin the process of moving forward toward a more neutral stance. True to its words, the Fed cut interest rates by 50 basis points (one-half of one percent) with a promise for additional cuts to follow.

With the start of the Fed's rate cutting cycle now behind us and the general pace of future cuts now broadly known, focus for the final quarter of 2024 will turn towards economic growth, corporate fundamentals and politics. Given the volatile nature of all three, it's reasonable to expect periods of elevated volatility over the coming months.

Politics, meanwhile, will become a more direct market influence as we approach the November 5th election. Depending on the expected and actual outcome, we could see an increase in macro and microeconomic volatility that could impact the broader markets as well as specific industries and sectors. That volatility will stem from the uncertainty surrounding potential future policy changes 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. The war between Russia and Ukraine and the ongoing conflict between Israel, Hamas and now Hezbollah hasn't negatively impacted global markets this year. There is always a possibility that this could change and these situations must be constantly monitored.

We 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, we would expect that investors will reduce their exposure to risk assets. In sum, as we start the fourth quarter the market does face economic, political and geopolitical uncertainties. 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.

As you review your enclosed reports, you will note strong returns for both stocks and bonds. There continues to be a significant difference in returns between the S&P500 market-cap weighted index and the S&P500 equal weighted index. The cap-weighted index return is driven by the performance of the largest companies which have primarily been the AI-tech driven names. The equal weighted index is comprised of the same 500 names; however, they are held in equal amounts. Over the long-term the returns of the two indices have, more or less, matched. Over the last several years, performance has been concentrated in a handful of very large tech companies causing the market-cap weighted index to become highly concentrated. The impact of this excess exposure has shown up in the returns. For example, the S&P500 market-cap weighted index has had a nine-month return of 22.08% versus 15.16% for the equal weighted index. The portfolios that we construct for you avoid high concentrations which create additional risk. Therefore, your equity returns will lag the market-cap weighted index. Remember, your portfolios are more broadly diversified and include exposure to small and mid-cap and international holdings and also reflect your return and risk parameters.

Staying true to our investment approach, we don't expect to make any fundamental changes to your asset allocation. We will, however, continue to look for ways to reduce risks, increase the potential for capital appreciation and improve the income stream based on your specific investment objective and needs.

741 Chestnut Street | Manchester, NH 03104 | voice 603.624.8462 | fax 603.624.8274 | curbstonefinancial.com