Making Sense of Finance

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Third Quarter 2024 Review

STOCK MARKET

Stock market gains in the US persisted in the third quarter as the S&P 500 rose over 5% and hit another record high. The economy and stock market proved to be more resilient than many had expected. Although experiencing a pullback in early August, bulls prevailed and drove the broader market higher, in part fueled by the Federal Reserve cutting the Fed Fund target rate by 50 basis points in September to a 4.75%-5.00% range. The first rate cut in four years. Similar to earlier in the year, gains were not just in mega cap tech stocks but across the board. An equal weighted measure of S&P 500 companies increased 9% last quarter, significantly outpacing the market cap-weighted S&P 500 index mentioned above. 400 out of the 500 stocks in the index were higher in the third quarter. The tech loaded Nasdaq Composite rose only 2.5% last quarter but on a year-to-date basis still matched the S&P 500 gain. The Dow Jones Industrial Index, while lagging the other large cap indexes this year, forged an increase of 8% in the third quarter. Even with the large rate cut and anticipation of more to come, corporate earnings can arguably be considered the principal driver of stock prices. S&P 500 companies in the aggregate reported second quarter earnings growth of 11% year over year; third quarter earnings growth is estimated at 4%. Overall earnings are forecasted to grow 11% in 2024 and 14% in 2025.

Most stock sectors increased in the third quarter, except for energy stocks, which showed a decline along with the price of oil. The rotation out of tech stocks was evident last quarter in that the leading sectors were utilities and real estate (businesses that are typically interest rate sensitive), also industrials and financials, all posting double digit percentage gains. Lagging yet still positive last quarter were the technology and communication stocks. However, tech stocks along with utility stocks are still leaders year to date. At long last midcap and small cap stocks also led with their outperformance of their large cap counterparts.

Unlike earlier this year, foreign stock markets recorded higher returns in the third quarter than their US counterpart. The MSCI EAFE index, which includes large cap developed country stocks

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Everyone and their neighbor has an opinion. At Karagosian Financial Services, we have a combined 40 plus years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is geared toward making sensible and prudent choices based on logic and experience, and not based on emotion.

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gained over 6% in US dollar terms. This superior return was partially due to the weakness in the US dollar last quarter. European stock markets provided better returns, since many are not as tech weighted in their respective stock indexes as US markets. Financial companies also have a more significant weighting in international markets. Emerging markets, as measured by the MSCI Emerging Market index in US dollar terms rose almost 9% in the third quarter. Chinese stocks did well much in part due to the announcement of a huge stimulus plan by the Chinese government.

BOND MARKET

Bonds in general performed as well as stocks did last quarter as measured by the Bloomberg Barclays US Aggregate Bond Index, which had a total return of 5.5%, to overcome losses from the first half of the year. The long anticipated Fed Fund rate cut arrived in September. The yield curve finally normalized as short term rates became lower than longer term rates, ending 26 months of a "not normal" inverted yield curve. The yield on a Two Year Treasury declined from 4.7% to begin the quarter to 3.6% at the quarter's end, while the Ten Year Treasury also declined but not in such a dramatic fashion from 4.36% to 3.81%. The Federal Reserve has indicated that it has confidence that inflation is heading back toward its target rate (September CPI inflation rate was reported at 2.4% year over year, smallest increase since February 2021) and is now focusing on the slowing labor market. With both long and short term interest rates falling in the third quarter, longer duration bonds performed the best as they are more interest rate sensitive. Still positive but lagging other bond sectors were short term bonds and municipals.

The US is not alone in lowering its central bank target rates. The European Central Bank, the Bank of England, and Canada all lowered rates in response to ebbing inflation and slowing economies. Japan's central bank was an outlier in that it hiked rates last quarter, strengthening the yen in return which was part of its goal. Japanese interest rates had been around zero for almost a decade.

OUTLOOK

The Fed surprised most investors with a 50 point rate cut with the idea of getting ahead of any future softness in the economy. Since the cut, the general consensus seems to be that there will be no further cuts in 2024. In general, we support the actions of the Federal Reserve and think that the larger-than-expected rate cut is more impactful to the US economy that has had a murky near term future.

Surprisingly, our outlook from last quarter's newsletter nearly all came true. There was sector rotation in stocks to the non tech. Utilities did well, and bonds had similar returns to stocks. No doubt, the presidential election will likely cause some short-term volatility, but as we stated in previous newsletters, a change in parties for President usually yields little difference in market performance over history.

Despite the second quarter GDP coming in at a very respectable 3%, with estimates for similar in the third quarter, and unemployment at 4.2%, consumer confidence continues to decline. The Consumer Confidence index in September came in at 98.7, down from 105.6 in August, while the index usually hovers around 80 during full-on recessions. Perhaps, the uncertainty due to the Presidential election is to blame.

Our job as value investors has been more difficult, of late. The markets have been strong for nearly two years, making valuations less enticing. Remember, that valuation does not determine the direction of markets, just the amount of potential volatility when the tide turns. Many years of continued increases in value could continue in the stock market, but it's futile to try to predict. We think the bond markets have some upside, as well, but much less with a fairly flat yield curve. Though much of the froth has been taken out of the real estate market, valuations remain on the higher side, in our opinion, limiting the upside. In addition, we don't expect a mortgage environment with sub 4% 30-year mortgages again soon. One sector that has softened lately is in traditional energy. Oil prices have hovered over the $70 range, down from a 2022 high of $119 per barrel in that year. We do not have an opinion of which direction it will go, but any economic shock could greatly influence this commodity. Consider that oil futures experienced a 700% swing in price from the height of the pandemic to mid 2022.

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