Market Commentary

October 2024

Equity and Bond Market Update

(as of September 30, 2024)

Index	YTD	1-Year
Dow Jones Industrial Average TR	+13.9%	+28.9%
S&P 500 Total Return Index	+22.1%	+36.4%
Russell 2000 Total Return Index	+11.2%	+26.8%
MSCI EAFE Index (net)	+13.0%	+24.8%
MSCI Emerging Markets Index (net)	+16.9%	+26.1%
Bloomberg US Aggregate Bond TR	+4.5%	+11.6%

Recent Economic Indicators

	Statistic	Data as of
Unemployment Rate	4.2%	Aug 2024
Gross Domestic Product (GDP)	+3.0%	Q2 2024
Consumer Price Index (CPI) – Y/Y	+2.5%	Aug 2024
Consumer Confidence (1985=100)	98.7	Sep 2024
30-year fixed mortgage rate	6.21%	Wk of Sep 29
Housing Starts (single family)	992,000	Aug 2023
10-Year Treasury Yield	3.74%	9/1/2024

Major equity and bond markets advanced during September, with diversified emerging markets taking the lead, up almost +7% during the month, due dominantly to the performance of Chinese stock markets returning close to +22% in just the last week of the month. All other major indices, including the Bloomberg US Aggregate Bond Index, advanced from +1% to just over +2% during September.

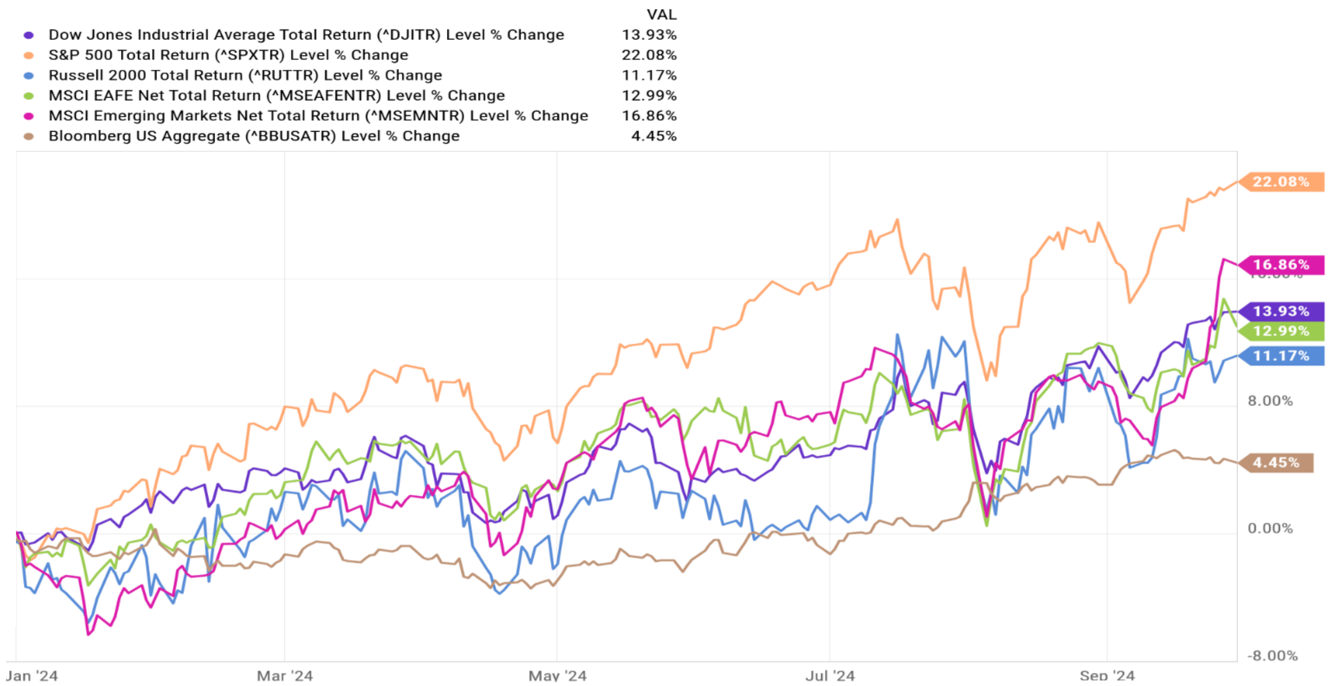
After pausing the fed funds rate at an effective level of 5.33% since mid-2023, the Fed cut rates by 50bps at their September meeting to an effective rate of 4.83%. All analysts were expecting at least a 25bp cut at the meeting, and a minority expected a 50bp cut, so it was a bit surprising the Fed opted for the first cut in the cycle to be at the higher level. At this time, the majority of the participating Fed governers forecast, according to the FOMC "Dot Plot" graph, that rates will be cut by another 25bps to 50bps by the end of this year, and will be at a level between 3.25% to 3.50% at the end of 2025, and around 3.0% at the end of 2026, which is very close to their longer run expected level for the fed funds rate.

The focus of this month's comments will be on corporate earnings. We have said before that more than anything else, company earnings drive the level of the stock market. Over the last four recessions, as well as the subsequent expansions, there was a high correlation between the level of growth in corporate earnings and the performance of the S&P 500 index. The thing to keep in mind regarding this is that the level of falling earnings and falling stock markets during recessions happens very fast and is very dramatic, but the level of earnings growth is much faster coming out of a recession than the recovery in the stock market. This can be explained by a "mean reversion" in the Price/earnings (P/E) ratio, where the P/E is historically high when we enter a recession (especially forward-looking), and then "corrects" (or even "overcorrects") as the level of the stock market bottoms out. Sometimes, as we saw in the 4th quarter of 2008 during the Great Financial Crisis (GFC), the P/E ratio actually goes negative since we saw the only quarter in a generation of actual aggregate earnings losses during that quarter.

Currently, we are trading above the historical average P/E levels over the last 25 years by about 15%-20% based on trailing earnings. We will need to see significant growth in corporate earnings over the next couple of years to justify current S&P 500 index levels, in the 15%-20% growth frame. This is not unattainble, but will require a "soft landing" in the economy (avoiding recession) to see this materialize. Higher than average P/E ratios do not necessarily dictate into an inevitable downturn in equity markets. We are currently about two years into market advances where current P/E ratios were higher than the historical average. We have seen some periods five years or longer where this has been the case.

With the Federal Reserve recently beginning the rate cutting cyle since inflation is taming, we will have to see the frequency and amount of coming rate cuts to get a better idea of what they are seeing over the horizon. If rate cuts come fast and furious, then most likely the labor market is deteriorating. If they come at a more measured pace, then we should be in good shape going into 2025 and 2026. Incoming data on the manufacturing and services sectors, inflation, the labor market, retail sales and consumer confidence, and the housing market will be major players in determining our path forward.

Major Market Indices Price Return (YTD through September 30, 2024)



Source: YCharts

Currently, the sectors of the U.S. economy forecasted to deliver the highest growth in earnings over the second half of this year include technology, health care and communications services. Those sectors expected to deliver the lowest growth in earnings (or even negative) include energy, industrials and real estate. Earnings growth in the Magnificent 7 stocks (tech-centric, high-profile companies that have lead the market over the last few years to new highs) are still expected to vastly outpace the remaining companies in the S&P 500 Index this year, as well as the trouncing in profit margins, with Mag 7 companies posting an average profit margin of over 23% versus the remaining S&P 500 constituent companies posting an average of 8.5%. It is quite apparent why so much attention has been placed on these mega-cap techology companies. Small-cap companies have lagged well behind large-caps when measuring earnings growth. On the aggregate, small-caps have actually lost earnings power over the last year, but are expected to make an earnings comeback in the coming years within a lower interest rate environment.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.

Please contact Lifestyle Asset Management, Inc. at (281) 612-2035 or by email at **pjackson@lsaminc.com** should you have any questions or comments.

Sources:
- S&P Dow Jones Indices website (us.spindices.com)
- MSCI Barra website (http://www.mscibarra.com)
- The Conference Board (www.conference-board.org)
- Bureau of Economic Analysis (www.bea.gov)
- JP Morgan Guide to the Markets
- FTSE Russell (www.ftserussell.com)
- Bankrate.com (www.bankrate.com)
- Bureau of Labor Statistics (www.bls.gov)
- United States Census Bureau website (www.census.gov)
- Federal Reserve Bank of Atlanta (https://www.atlantafed.org/cqer/research/gdpnow)

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities. The index is meant to reflect the risk/return characteristics of the large capitalization U.S. universe.

The S&P 500® Equal Weight Index is the equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

The Russell 2000 is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of the 3,000 largest stocks in the United States. The Russell 2000 serves as a benchmark for small-cap stocks in the U.S. and is meant to reflect the risk/return characteristics of the small capitalization U.S. universe.

The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada. It is maintained by MSCI Barra, a provider of investment decision support tools; the EAFE acronym stands for Europe, Australasia and Far East.

The MSCI Emerging Markets Index is an index created by Morgan Stanley Capital International (MSCI) designed to measure equity market performance in global emerging markets.

The Barclays US Aggregate Bond Index is a broad-based benchmark index that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS and CMBS.

The Dow Jones Equity All REIT Index is designed to measure all publicly traded real estate investment trusts in the Dow Jones U.S. stock universe classified as equity REITs according to the S&P Dow Jones Indices REIT Industry Classification Hierarchy. These companies are REITs that primarily own and operate income-producing real estate.

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