



Markets are Again Resilient in the Face of Rising Economic Uncertainty

Quarterly Insights by Peter G. Carolan

Markets were volatile in the third quarter as investors faced political turmoil and increased uncertainty about future economic growth, but the return of Fed rate cuts and solid corporate earnings helped to offset those political and economic anxieties, and the S&P 500 hit another new all-time high and finished the quarter with strong gains.

Markets started the third quarter with a continuation of the first-half rally thanks to good Q2 earnings results and generally solid economic data. However, while the S&P 500 hit a new all-time high in mid-July, the second half of the month proved more volatile. That volatility was driven by an intense rotation within the S&P 500 from the heavily weighted tech sector (more than 30% of the S&P 500) to other, smaller market sectors such as utilities, financials and industrials. The impetus for this dramatic rotation was a combination of profit taking following the substantial AI-driven tech stock rally and a larger-than-expected decline in inflation which caused Treasury bond yields to fall sharply as investors anticipated imminent rate cuts by the Fed. That expectation boosted the economic outlook and caused investors to rotate towards market sectors that benefit more directly from a strong economy. So, while investors didn't exit the market entirely, the decline in the tech sector weighed on the S&P 500 and was not fully offset by gains in other, smaller market sectors. The S&P 500 finished July well off the mid-month highs and with just a small gain, up 1.1%.

The late-July volatility continued in early August as a much-weaker-than-expected July jobs report, released on August 2nd, added to economic concerns. The unemployment rate rose to the highest level since November 2021 and investors' fear of an economic hard landing triggered a sharp, intense decline that saw the S&P 500 fall 3% on Monday, August 5th, the worst one-day selloff in nearly two years. However, that decline proved brief as economic data over the next few weeks was generally solid and that helped calm investors' anxieties. Then, on August 23rd, at the Kansas City Fed's Jackson Hole Economic Symposium, Fed Chair Powell told markets the "time had come" for the Fed to cut rates. That all but guaranteed a rate cut at the September meeting. That message further fueled the rebound in stocks and the S&P 500 finished August with a 2.3% gain, completing an impressive rebound from early-month weakness.

The rally continued in September thanks to growing expectations for a large Fed rate cut that offset lackluster economic data. The August jobs report, released in early September, was another disappointment and again increased concerns about an economic slowdown and stocks were modestly volatile to start the month. However, following that report, numerous financial journalists and ex-Fed officials made public calls for the Fed to cut interest rates by 50 basis points at the September meeting and expectations for a larger-than-expected rate cut helped offset underwhelming economic data and the S&P 500 hit a new all-time high ahead of the Fed decision. Then, on September 18th, the Fed met market expectations and cut rates for the first time in four years and promised additional rate cuts between now and year-end. Investors welcomed this news and the S&P 500 surged to a new high and finished the month and quarter with more solid gains, adding to the strong year-to-date return.



Finally, politics and the looming presidential election did impact markets during the third quarter. Investors started the quarter expecting a Trump victory and Republican control of Congress, based on polling following President Biden’s struggles at the June debate and after the failed assassination attempt on the former president. However, those expectations changed rapidly following Biden’s withdrawal from the race and nomination of Vice President Kamala Harris. As the third quarter ended, national polls slightly favored Harris while the outlook for the control of Congress remained uncertain.

Third Quarter Performance Review

Investor expectations for falling interest rates and bond yields were the major influences on index, sector and factor performance during the third quarter, as markets were broadly positive but with some notable changes in leadership.

Starting with market capitalization, small caps outperformed large caps for the first time in 2024 as investors rotated out of large-cap stocks and into more economically sensitive small caps, as they historically have received the most benefit from lower borrowing costs that come with falling interest rates.

From an investment style standpoint, value handily outperformed growth, although both investment styles posted positive returns for the third quarter. The outperformance of value was evidence of the significant rotation we saw from the tech sector (which dominates most growth funds) to lower P/E and more economically sensitive parts of the market such as financials, industrials, utilities and others.

On a sector level, nine of the 11 S&P 500 sectors finished the third quarter with a positive return and that continued the broad year-to-date rally we’ve all enjoyed. Evidence of the influence of lower yields on returns can be seen in the sector outperformers, as utilities and real estate, two sectors that have relatively large dividends and benefit when bond yields are falling, handily outperformed the remaining nine S&P 500 sectors.

Looking at sector laggards, the tech and energy sectors were the only sectors to finish the third quarter with negative returns, as investors rotated out of tech and towards those higher dividend and more cyclically sensitive sectors. Energy, meanwhile, was the worst performing sector in the quarter as concerns about global growth (especially in China) weighed on oil demand expectations.

US Equity Indexes	Q3 Return	YTD
S&P 500	5.89%	22.08%
DJ Industrial Average	8.72%	13.93%
NASDAQ 100	2.12%	19.97%
S&P MidCap 400	6.94%	13.54%
Russell 2000	9.27%	11.17%

Source: YCharts

Internationally, foreign markets outperformed the S&P 500 in the third quarter as the relative underperformance of the tech sector was a headwind on S&P 500 returns. Foreign developed markets saw a solid rally in the third quarter as investors anticipated additional rate cuts from the European Central Bank and other major global central banks. Emerging markets also outperformed the S&P 500 and foreign developed markets as the Chinese government announced numerous stimulus measures late in September and that boosted Chinese stocks and emerging market indices and ETFs.

International Equity Indexes	Q3 Return	YTD
MSCI EAFE TR USD (Foreign Developed)	7.33%	13.50%
MSCI EM TR USD (Emerging Markets)	8.88%	17.24%
MSCI ACWI Ex USA TR USD (Foreign Dev & EM)	8.17%	14.70%

Source: YCharts

Commodities were mixed, but in aggregate saw moderate losses in the third quarter thanks mostly to weakness in oil prices. Oil declined sharply in Q3 as global demand expectations were reduced courtesy of soft Chinese economic data early in the quarter and on generalized global growth concerns. Gold, however, staged a strong rally thanks to elevated geopolitical uncertainty and the weaker dollar, as gold hit a new all-time high in Q3.

Commodity Indexes	Q3 Return	YTD
S&P GSCI (Broad-Based Commodities)	-5.26%	5.23%
S&P GSCI Crude Oil	-16.44%	-4.74%
GLD Gold Price	13.26%	27.53%

Source: YCharts/Koyfin.com

Switching to fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) saw a very strong quarterly return thanks to a combination of falling inflation, mixed U.S. economic data and as investor's anticipation of an aggressive rate cutting cycle from the Fed.

Looking deeper into the bond markets, longer duration bonds handily outperformed those with shorter durations as investors reached for longer-term yield amidst falling inflation and underwhelming labor market data. Shorter duration bonds also saw a positive return, however, as investors anticipated the start of an aggressive rate-cutting cycle by the Fed.

Turning to the corporate bond market, investment grade bonds outperformed lower quality "junk" bonds although both saw strong quarterly gains. For the first time in 2024, investors favored investment-grade bonds amidst increased economic uncertainty, as investors sought the safety of higher-rated bonds over increased yield.

US Bond Indexes	Q3 Return	YTD
BBgBarc US Agg Bond	5.20%	4.45%
BbgBarc US T-Bill 1-3 Mon	1.36%	4.08%
ICE US T-Bond 7-10 Year	5.74%	4.26%
BbgBarc US MBS (Mortgage-backed)	5.53%	4.50%
BbgBarc Municipal	2.71%	2.30%
BbgBarc US Corporate Invest Grade	5.84%	5.32%
BbgBarc US Corporate High Yield	5.28%	8.00%

Source: YCharts

Fourth Quarter Market Outlook

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 and politics. Given the volatile nature of both, it's reasonable to expect periods of elevated volatility over the coming months (but, as we saw in the third quarter, markets can still move higher even amidst increased volatility).

Starting with economic growth, expectations for aggressive Fed rate cuts helped investors look past some soft economic reports in Q3, especially in the labor market. However, with those rate cuts now behind us, we should 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, that will increase market volatility between now and year-end.

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 (e.g. oil and gas, renewables, financials and others). That volatility will stem from the uncertainty surrounding potential future policy changes (or lack thereof) 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 and while the war between Russia and Ukraine and the ongoing conflict between Israel, Hamas and now Hezbollah hasn't negatively impacted global markets this year, that's always a possibility and these situations must be consistently monitored as the spread of these conflicts would impact markets, regardless of any Fed rate cuts or election outcomes.

In sum, as we start the fourth quarter the market does face economic, political and geopolitical uncertainties. But market performance has been very strong in 2024; momentum remains decidedly positive, and this market has proven resilient throughout the year. Additionally, current economic data is still pointing to a soft economic landing. Finally, while political headlines may cause short-term investor anxiety and volatility, market history is extremely clear: Over time, the S&P 500 has consistently advanced regardless of which party controls the government and the average annual performance of the S&P 500 is solidly positive in both Republican and Democratic administrations.



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.

To that point, at Stelvio Wealth Partners, we understand the risks facing both the markets and the economy, and we are committed to helping you effectively navigate this challenging investment environment. Successful investing is a marathon, not a sprint, and even intense volatility is unlikely to alter a diversified approach set up to meet your long-term investment goals.

Therefore, it's critical for you to stay invested, remain patient, and stick to the plan, as we've worked with you to establish a unique, personal allocation target based on your financial position, risk tolerance, and investment timeline.

We remain focused on both opportunities and risks in the markets, and we thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

A handwritten signature in black ink, appearing to read "P. Carolan", is positioned above the printed name.

Peter G. Carolan
Managing Partner

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The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.

The NASDAQ 100 Index is an unmanaged group of the 100 biggest companies listed on the NASDAQ Composite Index. The list is updated quarterly and companies on this Index are typically representative of technology-related industries, such as computer hardware and software products, telecommunications, biotechnology and retail/wholesale trade.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P SmallCap 600 Index in size: between \$1-4 billion.

The MSCI All Country World ex USA Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the USA. The Index consists of 45 country indices comprising 22 developed and 23 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The emerging market country indices included are: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

The MSCI Emerging Markets Index is designed to represent the performance of large- and mid-cap securities in 24 Emerging Markets.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The Bloomberg U.S. 1-3 Year Government Bond Index is composed of all publicly issued, non-convertible domestic debt of the U.S. government and its agencies. The Index also includes corporate debt guaranteed by the U.S. government. Only notes and bonds with a minimum maturity of one year up to a maximum maturity of 2.9 years are included.

The Bloomberg Mortgage Backed Securities Index is an unmanaged index of mortgage pools of the Government National Mortgage Association, Federal Home Loan Mortgage Corporation and Federal National Mortgage Association.

The Bloomberg Corporate High Yield Municipal Bond Index covers the universe of fixed rate, non-investment grade debt.

The Bloomberg Municipal Bond Index is an unmanaged index of a broad range of investment-grade municipal bonds that measures the performance of the general municipal bond market.

The Bloomberg Corporate Bond Index is an unmanaged market value-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more.