

“Investing isn’t about beating others at their game. It’s about controlling yourself at your own game.”

**-Benjamin Graham,**

The Intelligent Investor (1949)

## Economic Overview

Stocks continued their move higher this quarter with market participation broadening substantially beyond the mega-cap technology and AI-related names that have dominated market performance through the first half of 2024. The S&P 500 increased 5.9% in Q3, while the equal-weighted S&P 500 rose 9.6%. As inflation continued showing signs of cooling in July, the market began anticipating rate cuts by the Federal Reserve. August was more volatile amidst disappointing economic data that fueled concerns of a possible recession, and the unwinding of the Japanese yen carry trade. The tech-heavy Nasdaq dropped nearly 6% over the course of three days, but by the end of the month, stocks had bounced back, and the rally continued through September.

The Federal Reserve joined other central banks and cut its target rate by a half percentage point in September, ending the 13-month pause following significant rate increases in 2022 and 2023, and marking the first rate cut since 2020. The economy added 254,000 jobs in September, significantly more than the 150,000 economists expected and an increase from the 142,000 in August. This brought the unemployment rate down to 4.1% in September. The Atlanta Fed projects Q3 GDP to rise 3.2%, primarily driven by consumption and non-residential investment, and partially offset by a decrease in residential investment. The U.S. economy has been growing closer to its 2% trend year-to-date, allowing inflation to return toward the 2% target. While geopolitical uncertainty has increased in recent months, and the U.S. election looms large, the stock market seems to be reflecting a high likelihood of a soft landing, and the path of least resistance appears higher, as of this writing.

# Outlook

## Constructive Observations

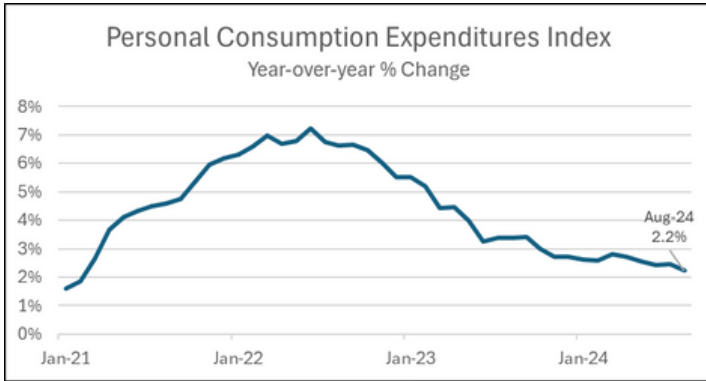
- Corporate balance sheets and profit margins appear strong by historic standards.
- Improving market breadth suggests a sentiment shift from momentum to fundamentals.
- First half stock market strength generally persists in the second half.
- A near-term recession is unlikely due to the lack of any obvious economic excesses.
- Consumer consumption data paints a resilient picture of demand conditions.

## Cautious Observations

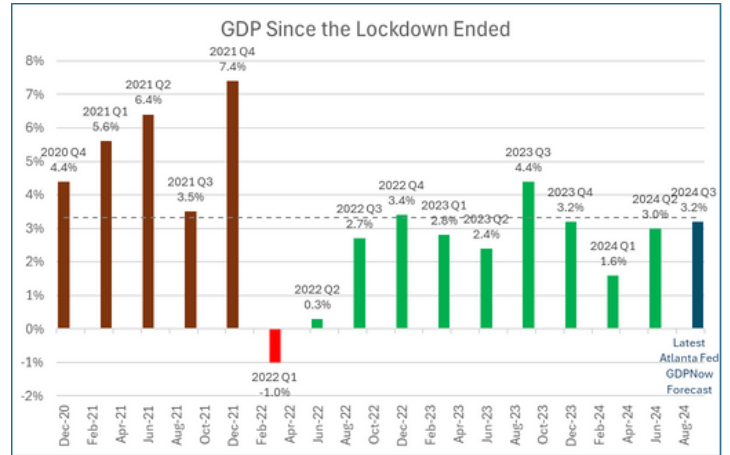
- Recession risks are increasing as higher interest rates curtail economic expansion.
- Defaults are rising among lower quality borrowers: both consumers & businesses.
- Geopolitical risks remain heightened as Iran has been brought directly into the fray.
- Leading employment data suggests labor market conditions are slowing.
- The Federal Reserve continues to move the goal posts on inflation targets.

- Our outlook for equity markets became marginally more constructive in September following the FOMC rate cut and the persistently resilient U.S. consumer. While the relatively aggressive 50 bps rate cut by the Fed does address the 'behind the curve' risk, we find ourselves focusing more and more on the possibility that they risk re-igniting inflationary pressures.
- We have upgraded our intermediate-term view on equity market beta from an underweight back to neutral. Commensurate with our more constructive view on equity market beta and early signs in the third quarter of a market rotation toward value and small caps, we have upgraded our view on both value and small/mid caps to overweight from neutral.
- We are maintaining a neutral stance with respect to U.S. versus non-U.S. equity markets as we await more clarity on prevailing geopolitical considerations and currency dynamics.
- From a fixed income duration standpoint, while acknowledging an upside bias on rates due to the improved growth outlook and potential inflationary pressures, we are maintaining a neutral duration stance currently. Our view on corporate credit risk has marginally improved in sympathy with our view on the overall growth backdrop and our opinion that an imminent consumer-led recession is unlikely in the foreseeable future, leading us to upgrade both high yield and loan market outlooks from underweight to neutral.

# Macro Overview

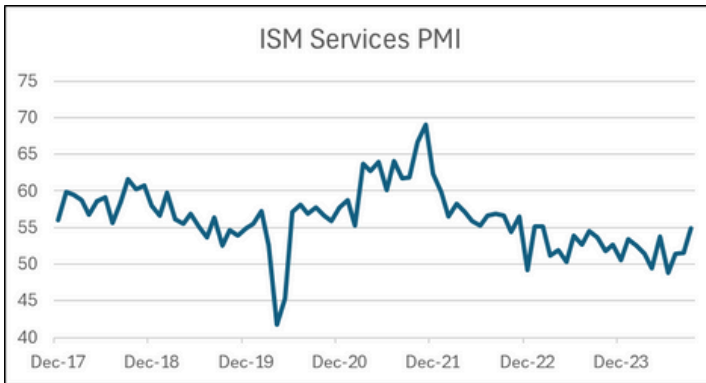


Source: U.S. Bureau of Economic Analysis, Taiber Kosmala

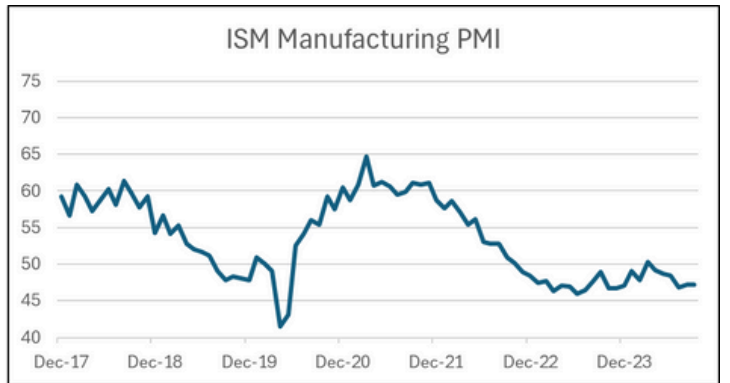


Source: St. Louis Fed, Taiber Kosmala

- The PCE price index, the gauge the Fed focuses on to measure inflation, rose 0.1% in August, putting the 12-month rate at 2.2%, down from 2.5% in July and the lowest since February 2021.
- The third and final estimate of Q2 GDP in late September indicated that real GDP increased at an annual rate of 3.0% in the second quarter. The latest estimate for Q3 GDP is 3.2%. Economic growth appears to be broadly moderating towards the Fed's near-term projection of 2.0%.
- Since inflation indices are moving closer to target and the labor market is slowing, the FOMC reduced fed funds by 50 bps at its September meeting.



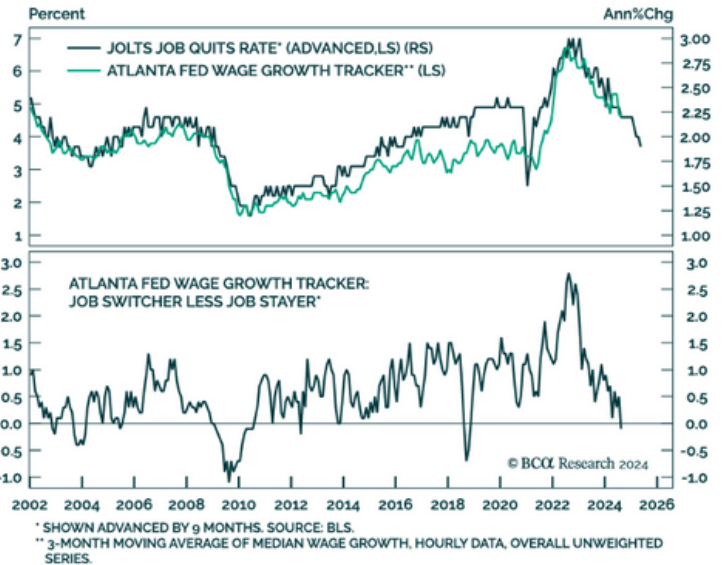
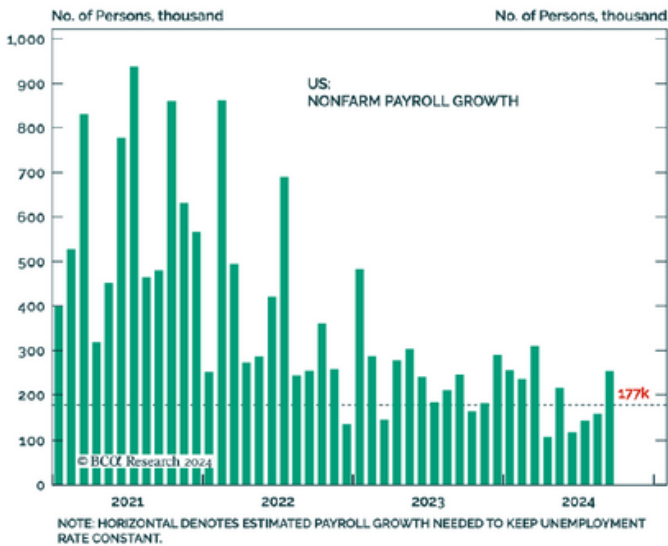
Source: YCharts, Taiber Kosmala



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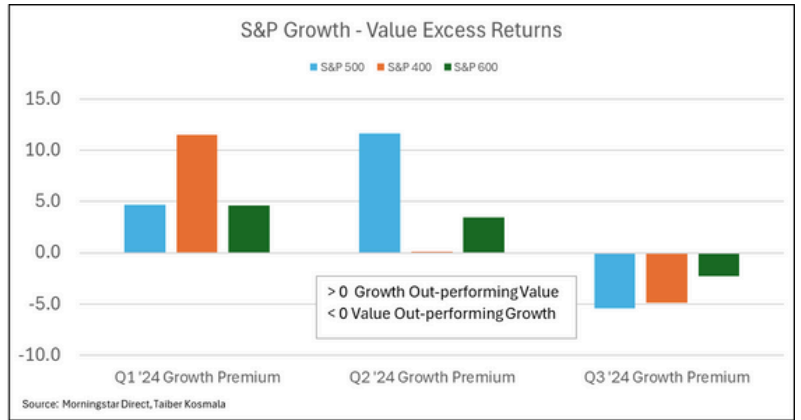
- ISM services PMI grew in September from 51.5 to 54.9, beating expectations with 12 out of 17 industries reporting growth. This is the index's highest level since February 2023. Conversely, manufacturing PMI registered 47.2 in September, indicating contraction of economic activity for the sixth consecutive month and the 22nd time in the last 23 months.

# Macro Overview

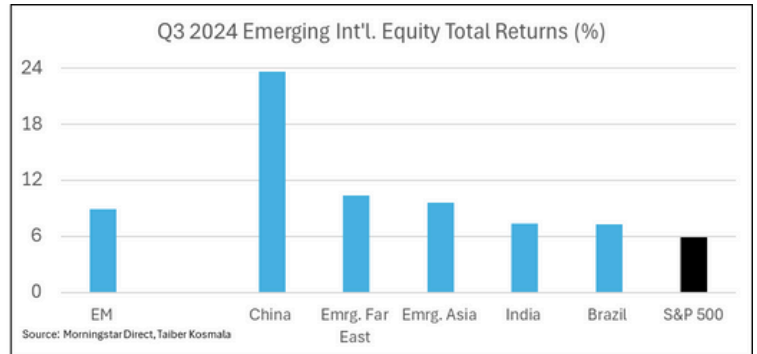


- U.S. job gains increased by 254,000 in September, the most in six months and the unemployment rate fell to 4.1%, pointing to a resilient economy.
- The prior two months' numbers were also revised 72,000 higher.
- Average hourly earnings ticked up 4.0% year-over-year.
- August's JOLTS report points to a decelerating labor market and further deceleration in wage growth:
  - The August hires rate fell to 3.3% and July's hires were revised lower, indicating slower labor demand.
  - The quits rate edged lower in August to 1.9% and July's number was also revised down, indicating reduced employee bargaining power.
  - The Atlanta Fed Wage Growth Tracker moved lower to 4.6% in August.
  - The spread between job switchers and stayers dipped below zero, indicating employers are bidding up wages to attract staff and opportunities for job seekers are harder to come by (corroborating lower quit rates).

# Equity Overview



- A larger than expected 0.5% cut by the Fed and new stimulus measures unveiled by China helped lift the S&P 500 to record highs this quarter.
- The expectation of more rate cuts and an increased likelihood of a soft landing caused a reallocation of capital from mega-cap Tech. stocks to the broader market.
- So far this year, the S&P 500 index's total return is a strong 22.1%.
- Leadership shifted dramatically in the third quarter, fostering increased market breadth.
  - Value stocks outperformed growth stocks across all market-cap segments.
  - The leading sectors year-to-date as of 6/30 were the laggards in Q3: Info. Tech., Communication Services & Energy.
  - Mid-cap and small-cap stocks outperformed large-cap stocks.
  - Developed international and emerging markets (especially Chinese) stocks outperformed U.S. large-cap stocks.
- Eight of S&P 500's eleven sectors outperformed the index in Q3; by comparison only Info. Tech. & Communications sectors outperformed the broad index in the first half of the year.
- Q3 performance of the S&P 500 was driven primarily by multiple expansion centered around falling interest rates. Performance was concentrated in rate-sensitive sectors, with Utilities and Real Estate performing the best.
- Ironically, the top six Tech. stocks saw a 5.3% increase in EPS estimates coupled with multiple contractions of 4.7%, while the other 494 S&P stocks saw a 0.5% EPS increase in conjunction with 7.2% multiple expansion.



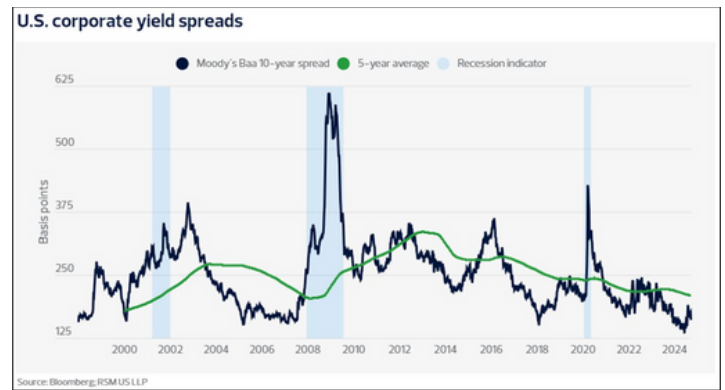
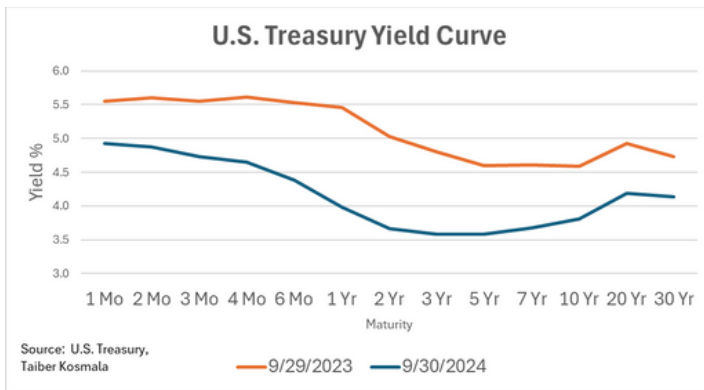
- Most developed international markets out-performed the S&P 500 in the third quarter. The MSCI EAFE index returned 7.3% vs. the S&P 500's return of 5.9% for the quarter.
- Similarly, emerging markets (driven primarily by China's advance) also out-performed domestic large-cap stocks. The MSCI Emerging Markets index returned 8.9% in the third quarter.

# Equity Overview



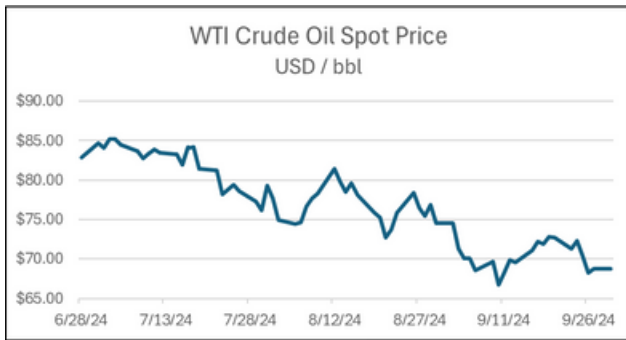
- During the last full week of September, China rolled out a series of monetary policy moves intended to shore up the economy, particularly the property market. Various short-term interest rates were lowered to levels not seen since at least 2016. Lending facilities were introduced by the PBoC that allows state-owned firms to borrow up to 100% of the purchase price of unsold property inventory, effectively subsidizing the financing of distressed property purchases in an effort to clean up property firm balance sheets.
- Fiscal stimulus measures were also introduced whereby the central government would issue 2trn CNY (\$284bn) in sovereign bonds, with the proceeds used to support domestic household consumption, as well as cleaning up of local government debt.
- A 500bn CNY (\$71bn) swap facility was unveiled that will allow financial firms access to the PBoC balance sheet to finance equity market purchases. That facility can be doubled if necessary. In addition, a separate facility will make 300bn CNY (\$43bn) available to finance stock buybacks by listed companies and share purchases by existing large investors.
- These measures resulted in a dramatic surge in Chinese equities. The Shanghai CSI 300 index gained close to 26% since September 13th and went from 52-week lows to 52-week highs in less than two weeks. Despite the recent gains, Chinese stocks remain in a drawdown of over 30% and are still down modestly relative to where they were two years ago, and are essentially unchanged over the last five years.

# Fixed Income Overview

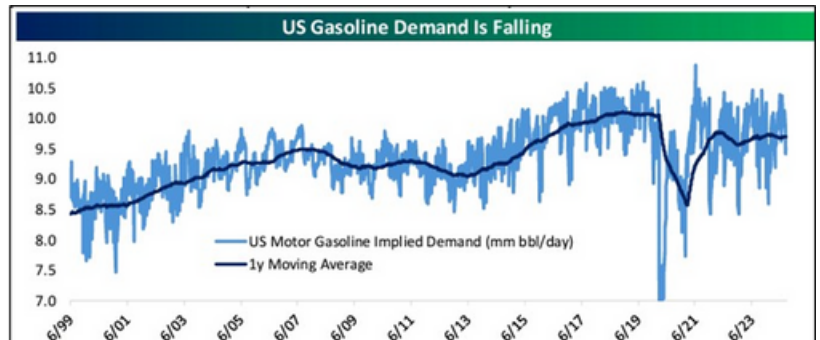


- Investors have been anticipating the Federal Reserve’s first cut in the federal funds rate for nearly a year. It finally happened on September 18th.
- Bond market expectations had already resulted in a notable decline in 10-year Treasury yields. By mid-August, they had fallen to 3.8%, well below the 4.0% - 4.5% trading range that has persisted since January. In the days preceding the Fed’s announcement, yields had fallen to between 3.6% - 3.7%.
- Fed officials penciled in another half percentage of rate cuts this year and a full point for 2025, bringing the benchmark range to 3.25% - 3.5%.
- Despite heightened geopolitical uncertainty, spreads remain narrow as credit fundamentals have remained relatively solid.
- While growth is moderating, central banks have switched their focus to spurring growth and appear on track for achieving soft landings.
- With short rates falling as central banks ease policy and longer rates consolidating, the yield curve is poised to continue gradually steepening.
- Fixed income asset classes performed well in the third quarter:
  - Bloomberg Aggregate Bond Index: +5.2%
  - U.S. Treasury 1-3 Year Index: +2.9%
  - U.S. Treasury 3-5 Year Index: +4.2%
  - U.S. Treasury 5-7 Year Index: +5.1%
  - U.S. Treasury 7-10 Year Index: +5.7%
  - U.S. Treasury 10-20 Year Index: +7.6%
  - U.S. Treasury 20+ Year Index: +8.0%
  - Bloomberg U.S. High Yield Index: +5.3%
  - S&P/LSTA Leveraged Loan Index: +2.0%

# Real Assets Overview



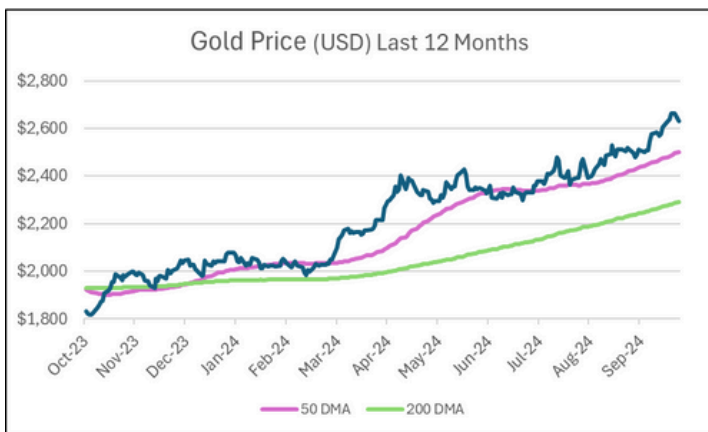
Source: YCharts, Tailber Kosmala



Source: Bespoke

- Oil prices fell meaningfully in the third quarter. Initial fears of supply disruptions stemming from escalating tensions in the Middle East seemed poised to push prices upward, but softening global demand dynamics trumped the geopolitical concerns.
  - Brent Crude: -12.1%
  - WTI Crude Oil: -11.8%
  - Heating Oil: -15.4%
  - Unleaded Gas: -11.5%
  - Natural Gas: -10.2%
- The price declines were due to a combination of factors, including:
  - Weakening Demand: China, the world's largest oil importer, experienced a slowdown in manufacturing, shrinking for the fifth consecutive month in September, raising concerns that demand wouldn't recover quickly. In the U.S., electric vehicles are consuming the equivalent of 15 nuclear plants' worth of energy. As their adoption grows, gasoline demand falls.
  - Saudi Arabia's Production Shift: Reports surfaced indicating Saudi Arabia was preparing to push up production in December in an effort to regain market share, while also planning to abandon its soft \$100 per barrel price target, triggering concerns about an oversupply, worsening the demand-supply imbalance.
  - Resilient Supply Despite Geopolitical Tensions: While tensions raised concerns about supply disruptions, actual oil production remained unaffected. As a result, prices were primarily impacted by the aforementioned demand concerns and increased production expectations.

# Real Assets Overview



Source: YCharts, Taiber Kosmala



Source: Bespoke

- Gold continued to reach new record highs, increasing 13% in the third quarter.
  - Gold has risen rather steadily since the Fed cut rates. It surged earlier in the year before trading in a rangebound sideways pattern from April through July. As summer ended and the Fed's penchant for easing became more certain, investors have been bidding up gold to a series of record highs.
  - All-time highs for gold are relatively rare. Since 1976, it has closed at a record high on just 2% of all trading days, and these were generally concentrated in three distinct periods: the late 1970's, the great financial crisis and briefly during Covid (see red sections in chart on the right).
  - This year, the pace of new highs has been pretty heavy with 36 instances, or about an average of once a week. Said differently, 14% of all the record closing highs for the price of gold have occurred this year.
- Agricultural commodities rose almost 4% in the third quarter, led by coffee and sugar. Grains were flat to modestly negative. Hog prices rose 14%, cattle prices were flat. Industrial metals rose, led by zinc, copper and aluminum, up 5%, 4% and 3% respectively. Silver rose 6%.



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