

October 2024

“Luck is when preparation meets opportunity.”

Seneca

## Q3 Market Recap

Cooling inflation data, rising corporate profit margins, and loosening financial conditions capped by a .50% Fed Funds rate cut in September led to a strong quarter for most asset classes. While mega-cap tech still leads year-to-date stock market gains, the NASDAQ 100 was rangebound during the quarter. Many overlooked asset classes such as small caps and emerging markets led a strong reversal during the past three months. Even bonds participated in the rally with investment grade bonds up over 5% for the quarter, bringing 12-month returns above 11%. The worst of the multi-year bond drawdown may be behind us as the Fed signaled additional rate cuts are on the horizon if inflation cooperates. Gold continues its trend higher driven by a weaker dollar and ongoing U.S. government deficit spending. REITs delivered tremendous returns in the quarter as investors cheered falling interest rates amid rebounding commercial real estate values.

Asset Class	Benchmark	Q3 2024	YTD	12 Month
U.S. Large Cap Stocks	S&P 500 TR USD	5.9	22.1	36.4
U.S. Small & Micro Cap	Russell 2000 TR USD	9.3	11.2	26.8
Intl Dev Stocks	MSCI EAFE NR USD	7.3	13.0	24.8
Emerging Mkt Stocks	MSCI EM NR USD	8.7	16.9	26.1
Global Stocks	MSCI ACWI NR USD	6.6	18.7	31.8
U.S. Municipal Bonds	Bloomberg Municipal TR USD	2.7	2.3	10.4
U.S. Taxable Bonds	BBgBarc US Agg Bond TR USD	5.2	4.4	11.6
U.S. High Yield Bonds	BBgBarc US Corporate High Yield TR USD	5.3	8.0	15.7
Intl Dev Bonds	S&P International Sov Ex-US Bond TR USD	9.3	1.3	12.2
U.S. REITs	MSCI US REIT NR USD	15.8	14.8	32.7
Broad Commodity Futures	Bloomberg Commodity TR USD	0.7	5.9	1.0
Energy Partnerships	Alerian MLP TR USD	0.7	18.6	24.5
Gold	DJ Cmmnty Gold TR USD	12.9	27.2	41.7

Source: Morningstar Data as of 9/30/2024

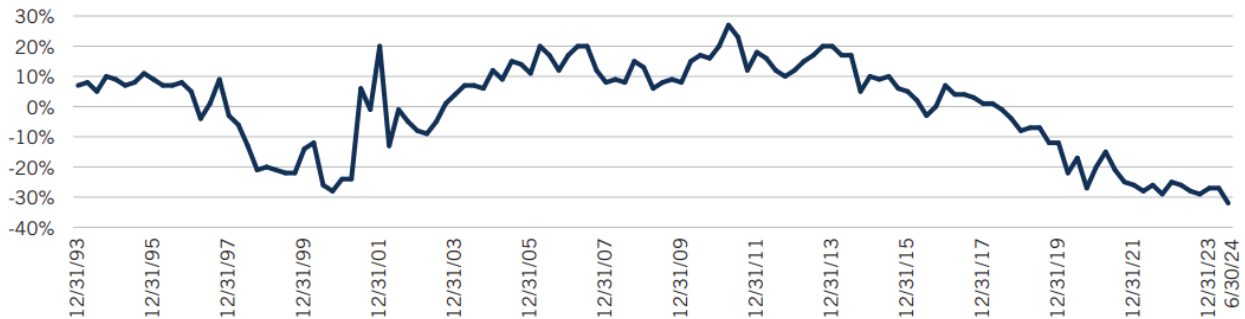
Bulls are clearly in charge as evidenced by the above chart. Yet, we are monitoring risks closely. U.S. job gains continue, but at a declining pace. The lower-end consumer is showing signs of stress as credit card and auto delinquencies are rising amid high interest rates. Investors are concerned that the ongoing violence in the Middle East could further escalate and destabilize the world economy. The U.S. presidential election is less than a month away, with most major polls showing a tight race that will be determined by a handful of swing states.

## Opportunities Await

Large-cap U.S. stocks continue to trade at above average valuations, but opportunities exist in other markets for disciplined investors seeking diversification. Small-cap stocks are trading close to their ten-year price to forward earnings average. On a relative basis, valuations for small caps look much more interesting than for large caps. The valuation spread between the two is the widest it has been since the early 2000s.

### SMALL CAPS ARE TRADING AT AN OVER 30% DISCOUNT TO LARGE CAPS

Relative Forward P/E Ratio, Russell 2000/Russell 1000, 30 Years



Past performance is no guarantee of future results. Source: KAR Performance, Analytics, and Risk, as of 6/30/24.

Small cap earnings are expected to rebound from a 4% earnings growth rate in 2024 to over 26% in 2025, which is far higher than EPS growth estimates for large stocks<sup>1</sup>. Lower interest rates should help levered small companies improve their profit margins. Meanwhile, investors seeking diversification from concentration risk in their portfolios may find small caps interesting at current valuations. Mix it all together and strong performance for profitable small caps may continue.

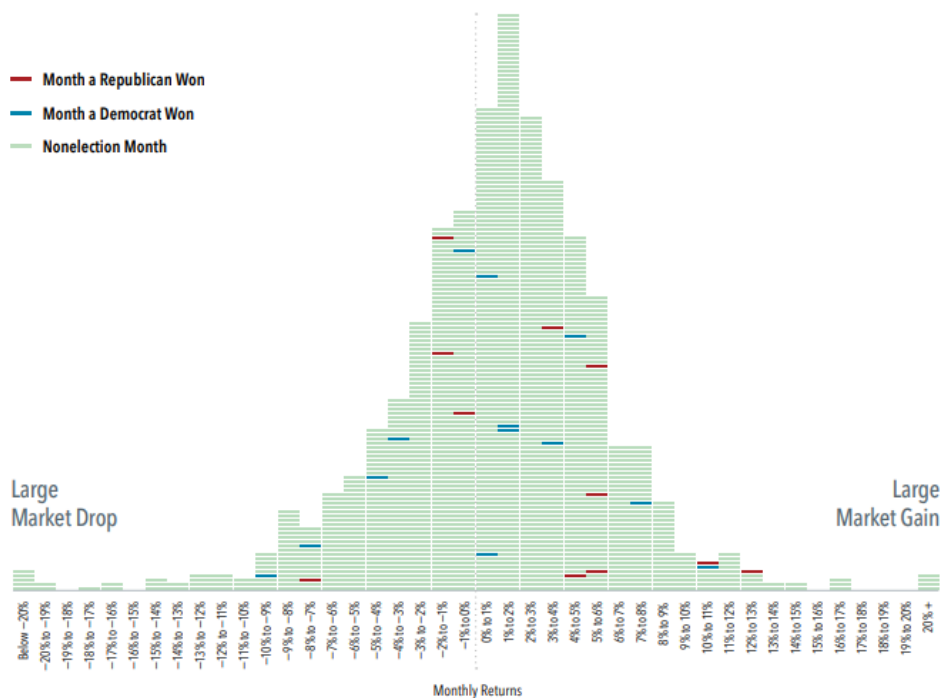
### Elections Drive Uncertainty Not Returns

Election uncertainty often comes with increased market volatility, but this typically subsides after voters head to the polls. Take this summer, for example. Although stock market volatility increased after President Biden announced in July he would not seek re-election, in retrospect the volatility was primarily due to economic uncertainty and geopolitical strife. Since then, the VIX has settled down considerably.

Stock returns have varied widely around elections but have historically been positive regardless of which political party takes office. See the chart on the right for example. It shows monthly returns for U.S. stocks dating back to 1926 with each horizontal dash representing a month, arranged from left to right in 1% return increments. The red and blue highlighted lines represent presidential election months where a Republican or Democrat won.

#### US PRESIDENTIAL ELECTIONS AND MONTHLY RETURNS

Distribution of returns for S&P 500 Index, January 1926–December 2023



Source: Dimensional Fund Advisors

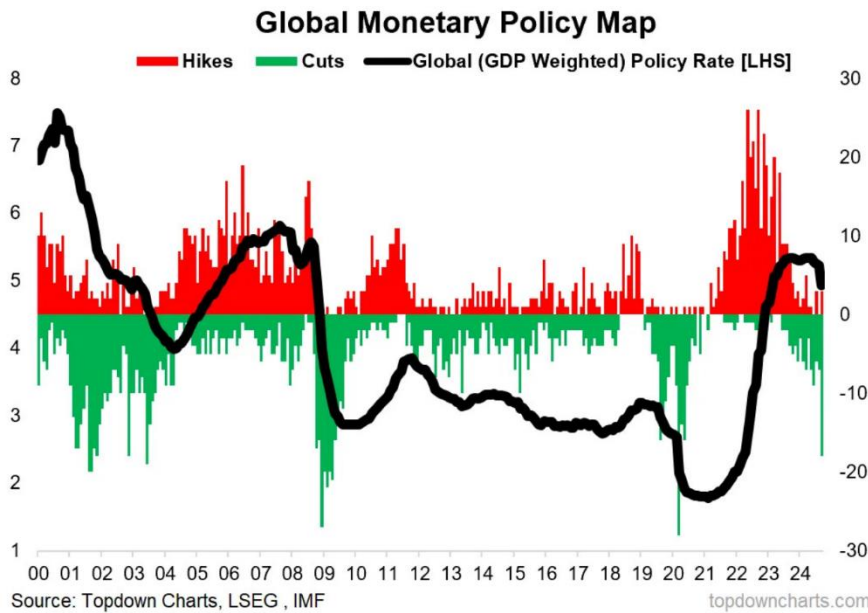
<sup>1</sup> FactSet as of 6/30/2024

The data suggests there is no clear pattern. The party that wins the presidency has not been a reliable driver of market returns. We end up with a similar conclusion when analyzing stock market returns by who holds the majority in Congress. Market behavior in the short term is unpredictable. Long-term returns are driven by fundamentals, making a strong case for relying on asset allocation, not timing, to achieve your investment goals.

**Global Rate Cuts**

While U.S. investors were focused on Federal Reserve policy last month, central banks across the globe cut interest rates. As seen on the chart below, September saw the highest number of rate cuts globally outside of periods of extreme volatility such as the 2020 pandemic, 2008 global financial crisis, and the 2000s dotcom boom/bust.

Unlike crisis periods, September’s rate cuts came during an economic expansion rather than as a response to rapidly deteriorating economic conditions. If inflation stays in check, the Federal Reserve and other central banks have guided that additional rate cuts are on the horizon to balance long-term real interest rates.



What does this mean for today’s investors? Markets currently have priced in another .50% in rate cuts before year-end along with additional easing in 2025. While the Federal Reserve has stated their focus now is on a healthy labor market, further rate cuts could keep inflation a concern. Higher-than-expected inflation surprises could send longer-term Treasury yields higher, creating a headwind for rate-sensitive assets and fixed income.

**Parting Thoughts**

If history is any guide, investors should expect increased market volatility through the upcoming U.S. presidential election. That said, the economy is on solid ground and continued growth is expected into the new year. We are searching for opportunities while balancing risks in client portfolios. As we enter the fourth quarter, we believe now is a great time to reach out to your Private Capital Management advisor to address any year-end planning items that are top of mind. Thank you for your business and your continued trust.

Sincerely,  
The Private Capital Management Team

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