MARKET PERSPECTIVES

PREPARED BY SMITH GROUP ASSET MANAGEMENT

SEPTEMBER 30, 2024

Market Summary

U.S. Equity Markets (%)	3Q'24	1 Year	3 Years	5 Years	10 Years
S&P 500	5.9	36.4	11.9	16.0	13.4
Russell 1000 Growth	3.2	42.2	12.0	19.7	16.5
Russell 1000 Value	9.4	27.8	9.0	10.7	9.2
Russell 2000	9.3	26.8	1.8	9.4	8.8
Russell 2000 Growth	8.4	27.7	-0.4	8.8	9.0
Russell 2000 Value	10.2	25.9	3.8	9.3	8.2

Top/Bottom Sectors (%)	3Q'24 (sorted)	1 Year
Utilities	19.4	42.0
Real Estate	17.2	35.4
Industrials	11.6	35.7
Comm. Services	1.7	42.7
Info. Technology	1.6	52.0
Energy	-2.3	0.9

Price Comparison (in USD)	Sep. 30, 2023	Sep. 30, 2024
Oil (WTI spot)	$90.77	$68.35
Natural Gas	$2.93	$2.91
Gold	$1,865	$2,654
Fed Funds Rate (Upper Target)	5.50%	5.00%
10-Yr Treasury	4.58%	3.79%
VIX	17.52	16.73

Non-US Equity Markets (in USD) (%)	3Q'24	1 Year	3 Years	5 Years	10 Years
MSCI AC World Ex-U.S.	8.1	25.4	4.1	7.6	5.2
MSCI EAFE (Developed)	7.3	24.8	5.5	8.2	5.7
MSCI Emerging Markets	8.7	26.1	0.4	5.8	4.0

Non-US Regions (in USD) (%)	3Q'24	1 Year
Developed Americas	12.3	27.8
Developed Asia	8.5	23.8
Developed Europe	6.6	25.9

Non-US Regions (in USD) (%)	3Q'24	1 Year
Emerging Americas	3.8	3.3
Emerging Asia	9.6	29.0
Emerging EMEA	7.3	19.4

Source: MSCI, S&P Global, LSEG; Refinitiv, St. Louis Federal Reserve Bank; Periods greater than one-year have been annualized; EMEA: Europe, Middle East, Africa

Executive Summary

In Q3, U.S. equity markets rallied with the S&P 500 posting its best first nine months of the year since 1997, bonds also saw a significant rise as rates fell across the yield curve. Equity markets underwent a sharp downturn in mid-July due to heightening recession fears, trade tensions and the yen carry trade unwind. However, the reversal was short-lived and markets turned-up on the outlook for central bank easing, stronger U.S. economic data, and stimulus from China (announced in September). At the height of the mid-quarter market reversal VIX spiked to its highest level in four-years, and the S&P 500 and Magnificent 7 were down -8.2% and -18.1% peak-to-trough, respectively. The estimated (year-over-year) earnings growth rate for the S&P 500 for Q3 2024 is 5.3%, which is below the 5-year and 10-year average of 10.0% and 8.5%, respectively. If the energy sector is excluded, the growth rate improves to 7.3%. After reporting year-over-year earnings growth of 1.5% in 2023, the S&P 500 is now poised for double digit earnings growth of 10.0% for CY 2024 and 15.0% for CY 2025. If growth holds up and recession risks abate, risk assets should continue to rise as the earnings back drop appears favorable and, other than the Bank of Japan, global central banks have a clear accommodative posture.

Market Highlights

- **U.S. equity markets were off to the races to begin the quarter**, with the S&P 500 hitting record highs in 10 of the first 11 sessions and closing at an all-time high on July 16. Over the two-week period the 10-year Treasury yield fell from 4.40% to 4.16%. The CPI report released on July 11, showed the weakest core CPI since 2021, fueling rate cut speculation.
- **Equities markets faced a mid-July downturn** as the mega-cap, Technology-plus heavy Russell 1000 Growth index declined 13.0% peak to trough while the S&P 500 dropped by 8.2% from mid July through early August.
  - The initial catalyst for the sell-off seemed to be a Bloomberg report on July 16 saying the Biden administration was considering more restrictive trade rules on semiconductors.
  - Then on July 19, a software update from CrowdStrike caused a widespread outage of Microsoft Windows systems which led to widespread disruptions of critical infrastructure including travel, health care and payments systems.
  - Early August saw high volatility, with the VIX index spiking to March 2020 levels. A weak U.S. jobs report with lower-than-expected nonfarm payrolls (+114k vs. +175k expected) and a higher unemployment rate (4.3%) sparked recession fears. In response the S&P 500 fell 6.1% and the Russell 1000 Growth declined 7.3% in the first three trading days of August.

- On August 5th, the Bank of Japan rate hike caused a yen strengthening, unwinding the yen carry trade, leading to a -12.2% fall in the TOPIX index.

- **Market calm returned following positive economic data** in the form of jobless claims and retail sales beating expectations, along with a dovish tone from Fed Chair Powell and BoJ reassurance on a cautious path for further rate increases. The S&P 500 bounced 11.1% from early August thru quarter-end to finish the period up 5.9%. While retail sales data beat expectations retail stocks like Ulta, Dollar General, Bath & Body Works, Kohl's and Macy's fell on weak outlooks while supercenter chains Wal-Mart and Costco delivered more favorable results. Consumer Discretionary stocks had the largest decline in their forward 12-month outlook for earnings, at the median stock level, of any sector in the S&P 500.
- **Value and small caps dramatically outpaced mega-cap Technology-plus** during the quarter, although mega-cap Technology-plus resumed leadership following the mid-September 50bps rate cut by the Fed. For the quarter the Russell 1000 Value rose 9.4% and the small-cap Russell 2000 gained 9.3%. In July the Russell 2000 rose 10.2% for its best month relative to the S&P 500 since February 2000.
- **Utilities was the top-performing sector in the S&P 500**, rising 19.4%. The sector is also benefitting from declining interest rates and a surge in electricity demand (after more than a decade of little to no growth) largely attributable to data center growth.
- The **Real Estate** sector in the S&P 500 returned 17.2%, **trailing only Utilities**. Once seen as a potential catalyst for a significant economic downturn, Real Estate has been supported by private capital and rate cut expectations. However, office properties remain weak, as occupancy rates and property values are still sliding.
- **European markets showed resilience despite economic challenges**, with the STOXX Europe 600 index recording moderate gains. Growth remains fragile with continued mixed data on retail sales and industrial production. Favorable profit margins are countered by weakening consumer demand.
- **Emerging market equities outperformed their developed counterparts**, largely due to Chinese stimulus announced in September leading to a 6.7% gain for the MSCI Emerging Markets Index for the month and 8.7% for the quarter.
- Following the 50bps rate cut at the September Fed meeting, **U.S. Treasury Market forecasts are indicating a cycle of rapid cuts** to bring the Fed Funds rate to 3.25-3.5% by September 2025. ***Of significant note is that this path of cuts is typical of a recession.*** 2-year and 10-year U.S. Treasury yields are projected to reach 3.50% and 4.05%, respectively, by mid-2025, versus current yields of 3.60% and 3.75%.
  - Since 1950, the period between when the Federal Reserve first lowers the benchmark rate and when it stops lowering and begins raising rates again varies widely, but has averaged 12-24 months. Since 1990, the cycle has lengthened considerably with rate cycles averaging 41 months and the benchmark rate on average declining by 3.6% in an easing cycle and rising by 3.1% in a tightening cycle.
  - Equity market performance following the onset of a rate cutting cycle is highly varied. Over past 50-years the S&P 500 has averaged a 6.4% return in the 12-months following the start of an easing cycle, with a median of 10.5%. However, the range of returns is +36.5% to –36.0%, with three of the 13 cycles down double digits.
- The **U.S. election looms as a large risk**. The election has plenty of potential to disrupt the global financial markets and the outcome will play a key role in adjusting the earnings and economic outlook into late 2025 and 2026. Forecasting the market response to elections can be quite challenging as evidenced by the consensus calls for a market sell-off to a Trump victory in 2016 (*CNBC Market Insider, Nov. 7, 2016*). U.S. Equity markets rallied 5.0% from the election through year-end following Trump's 2016 victory.
- **Inflation concerns are heightened by central bank rate cuts**, which has boosted gold prices. Money supply growth is also contributing to inflation fears. Over the past 12-months U.S. M2 money supply is up 2.0%, versus a 4.0% contraction a year ago. Since the turn of the century global money supply growth has outstripped global nominal GDP growth by 2.0% per year. Money supply growth should match nominal GDP growth in order to maintain a stable inflation rate. From 2000-2023, the global money supply increased from USD 26 trillion to USD 125 trillion, indicating an annual growth rate of 7.1% versus the 5.1% per year increase in global nominal GDP and 3.1% per year gain in global real GDP, over the same time period.
- **China's recent rate cuts and policy easing are expected to benefit markets more than the economy**. Mortgage refinancing is proposed but unlikely to revive property market confidence. The stimulus may boost cyclicals, luxury goods, and commodities, especially in Europe and Southeast Asia. Currency appreciation could occur to match gains by other Southeast Asian currencies, and to prepare for potential devaluation if U.S. tariffs rise.

Source: Bloomberg, S&P Global, St. Louis Federal Reserve Bank, Deutsche Bank

Earnings & Valuation Highlights

The estimated (year-over-year) earnings growth rate for the S&P 500 for Q3 2024 is 5.3%, which is below the 5-year and 10-year average of 10.0% and 8.5%, respectively. If the energy sector is excluded, the growth rate improves to 7.3%. After reporting year-over-year earnings growth of 1.5% in 2023, the S&P 500 is now poised for double digit earnings growth of 10.0% for CY 2024 and 15.0% for CY 2025. For Q3 2024, eight of the eleven sectors are expected to report year-over-year earnings growth, led by the Information Technology (+15.4%), Health Care (+11.2%), and Communication Services (+12.3%). Three sectors are projected to report year-over-year decline in earnings, led by the Energy (-19.7%). If NVIDIA were excluded, the estimated (year-over-year) earnings growth rate for the Information Technology sector would fall to 7.9%. Estimated year-over-year revenue growth for Q3 2024 is 4.7%, marking the 16th consecutive quarter of revenue growth. Ten sectors are expected to see revenue growth, led by Information Technology (+11.7%) and Communication Services (+6.8%). Net profit margin for Q3 2024 is projected at 12.2%, roughly equal to the previous quarter and year-ago period. The forward 12-month P/E ratio for the S&P 500 is 22.4, which is above the 5-year average of 19.5 and the 10-year average of 18.0. Metrics like the CAPE ratio are quite elevated at levels comparable to the dot-com bubble. Exhibit 1 examines the earnings outlook for the S&P 500 (excl'g Real Estate) by sector over the next two years. The largest variance between sector weighting in the index and the earnings contribution is Information Technology which accounts for 32.4% of the index weight but only 23.4% of earnings; however, the sector accounts for 32.2% of the earnings "growth" in the index. Financials looks like an extremely attractive sector based on current valuations; however, the earnings growth of the sector is 45% below the index projected growth rate.

Exhibit 1: Source: Factset, S&P Global, Bloomberg

S&P 500 Earnings Outlook and Valuation

Sector	Index Weight	Est. CY 2024 Earnings Weight	Variance	Est.CY 2025 Earnings Growth	Contribution to Index Earnings Growth	Aggregate Fwd 12-Month P/E	Median Fwd 12-Month P/E
Communication Services	9.0%	10.2%	1.2%	16.4%	10.9%	18.7	12.6
Consumer Discretionary	10.4%	8.8%	-1.7%	13.2%	7.5%	25.4	19.2
Consumer Staples	6.0%	6.4%	0.4%	6.7%	2.8%	21.4	18.5
Energy	3.4%	6.0%	2.6%	11.1%	4.3%	12.6	13.0
Financials	13.2%	18.7%	5.5%	8.4%	10.2%	16.1	13.0
Health Care	11.9%	12.9%	1.0%	21.2%	18.1%	19.6	17.8
Industrials	8.7%	8.3%	-0.4%	16.5%	9.2%	22.1	24.4
Materials	2.3%	2.3%	0.0%	19.0%	3.3%	20.5	19.8
Technology	32.4%	23.4%	-9.0%	21.2%	32.2%	28.8	26.1
Utilities	2.6%	3.1%	0.5%	9.0%	1.4%	18.2	18.0
TOTAL (excl'g Real Estate)	**100.0%**	**100.0%**		**15.0%**	**100.0%**	**22.4**	**19.2**