LINSCOMB Wealth

Quarterly Market Update

Q3 | 2024

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Inside

- Consumer resiliency drives U.S. growth
- Disinflation continues, albeit at a slower rate
- Interest rate cutting cycle commences
- Another positive quarter for asset prices
- Mindful of stock market valuations
- What does the election mean for markets

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An ongoing debate amongst investors is whether the economy was headed for a so called “soft landing” or “hard landing”. The former meaning ongoing, but somewhat slower growth along with lower inflation and the latter presumably referring to a recession. But in our opinion this debate is made more for soundbites than it is for constructing portfolios. The global economy is a dynamic entity with no finite end point or “landing”. If we were to use an airplane analogy, it’s likely more appropriate to say that the economy has varying cruising speeds and altitudes, and the rates of acceleration or deceleration is what can impact financial markets.

Our view today is similar to last quarter. The economy remains in growth mode, supported by a solid labor market and positive consumer spending. Inflation rates have continued to trend lower, prompting the Federal Reserve to begin reducing short-term interest rates in September. We are at what we believe is an appropriate “cruising speed”.

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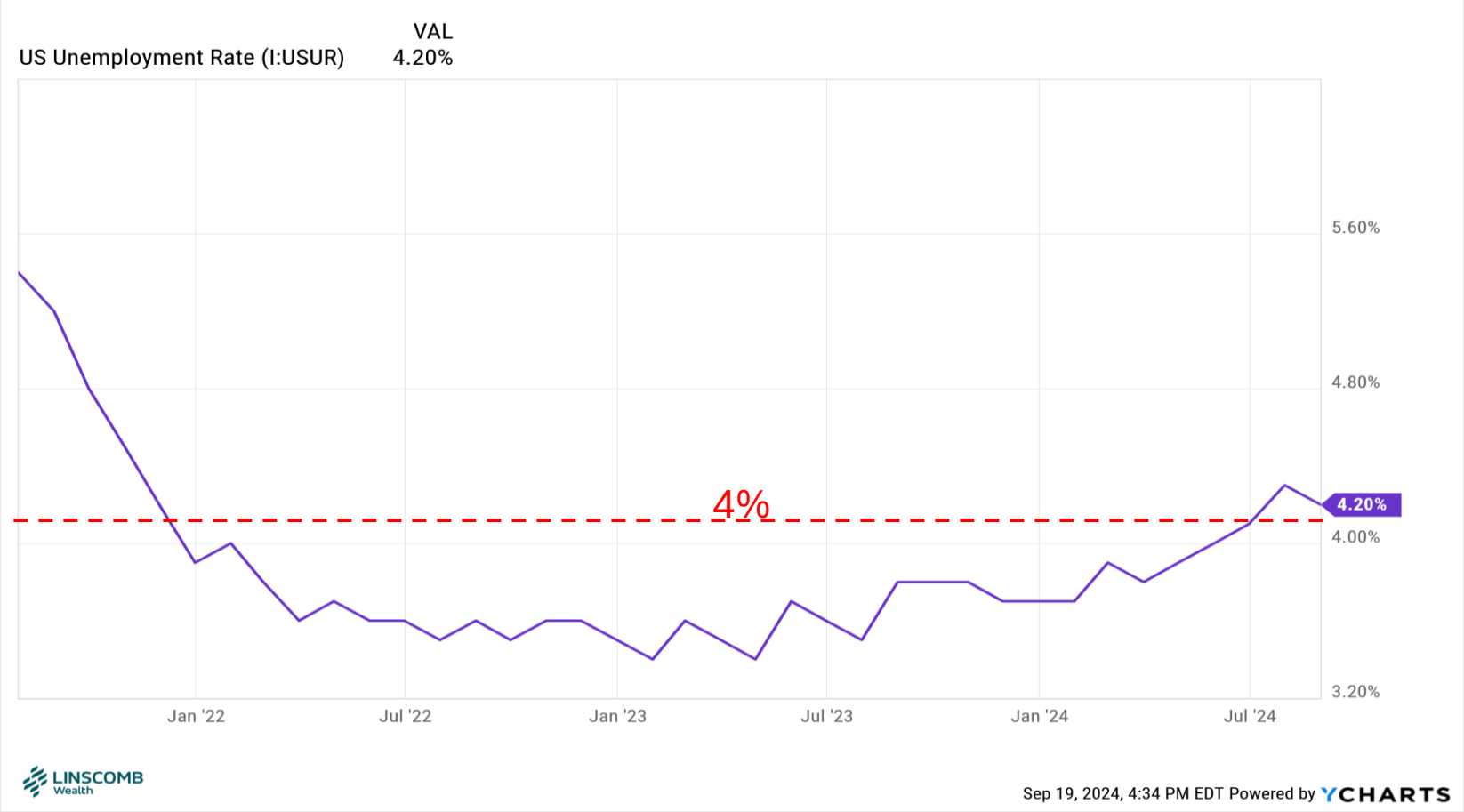
Labor market remains in good shape

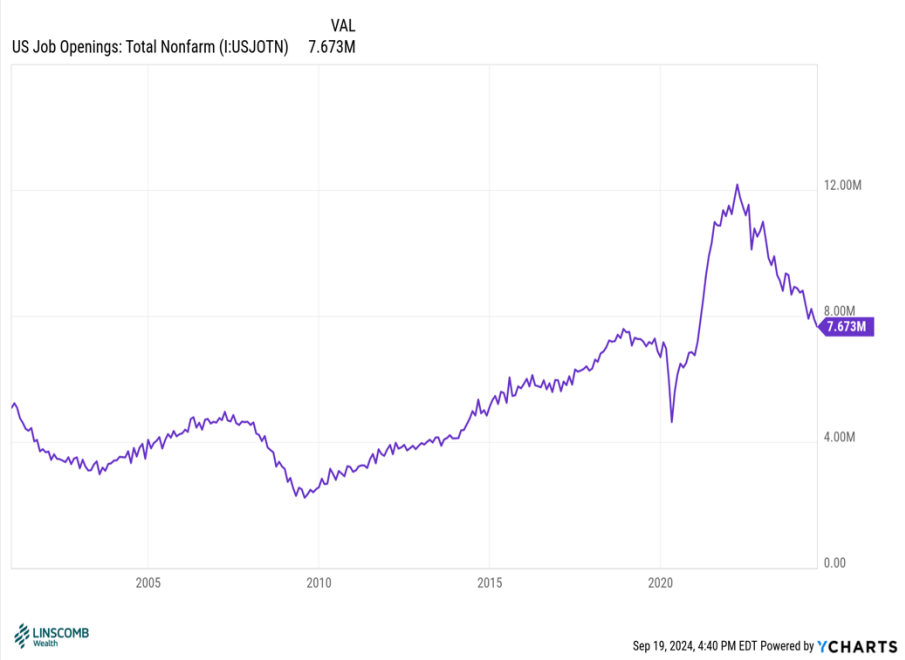
Though it has moved up recently, the unemployment rate remains low at 4.2%. Historically, economic growth has tended to remain positive as long as the employment data cooperates. The recent increase above 4% is due to a growing labor force rather than outright job losses.



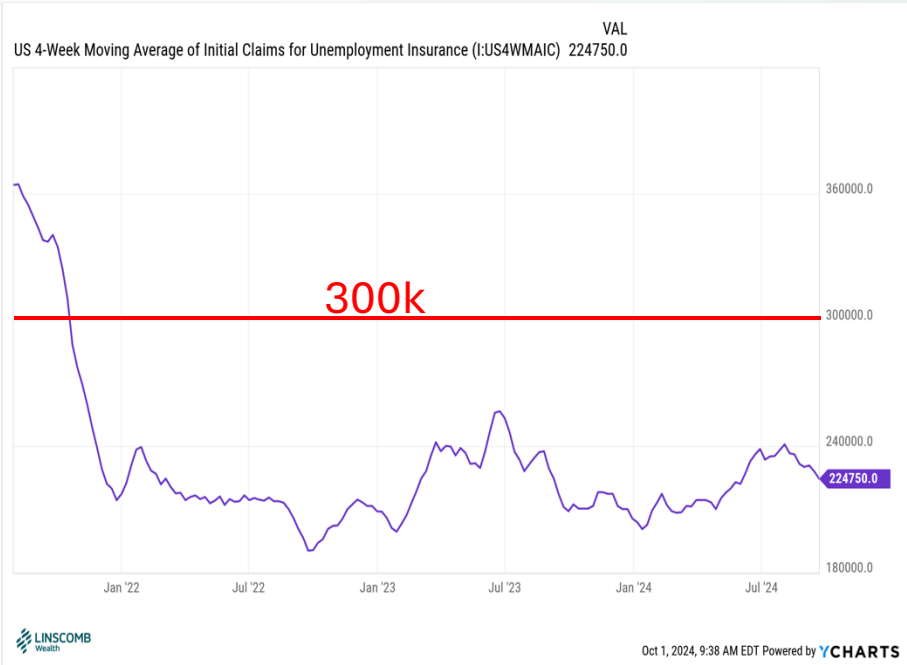
Source: Bureau of Labor Statistics, 8/31/2021 – 8/31/2024

Job openings on the decline, but layoffs still negligeable

Current job openings have fallen by nearly 5 million but are still at a relatively healthy level, and the decline represents more of a normalization of labor market conditions rather than an immediate cause for concern. Initial jobless claims, a good real-time proxy for corporate layoffs, remain low. Initial claims breaking meaningfully above 300k would be more worrying.



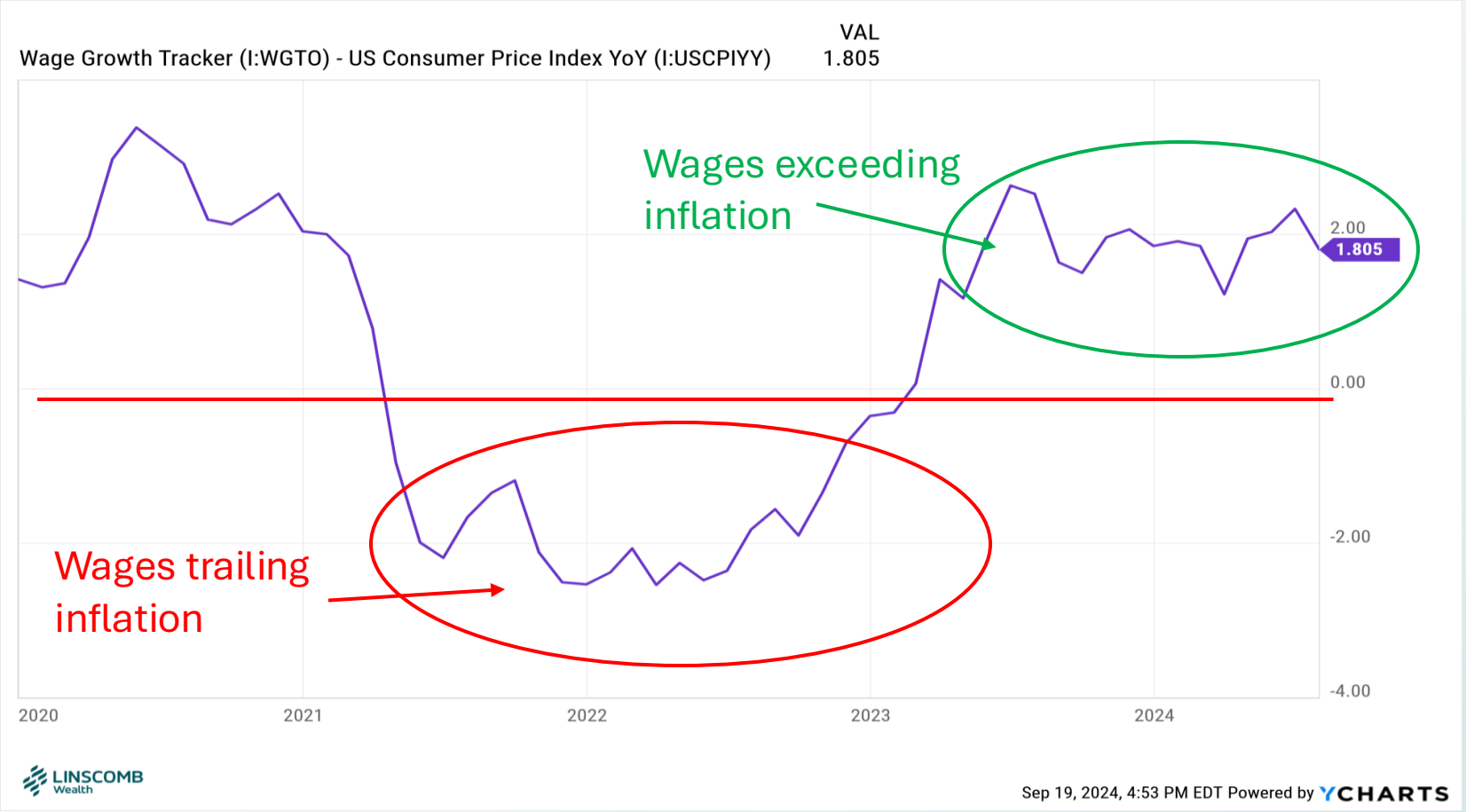
Source: Bureau of Labor Statistics, August 2024



Source: Employment and Training Administration, 9/30/2021 – 9/30/2024

Positive real (after inflation) wage growth drives consumer spending

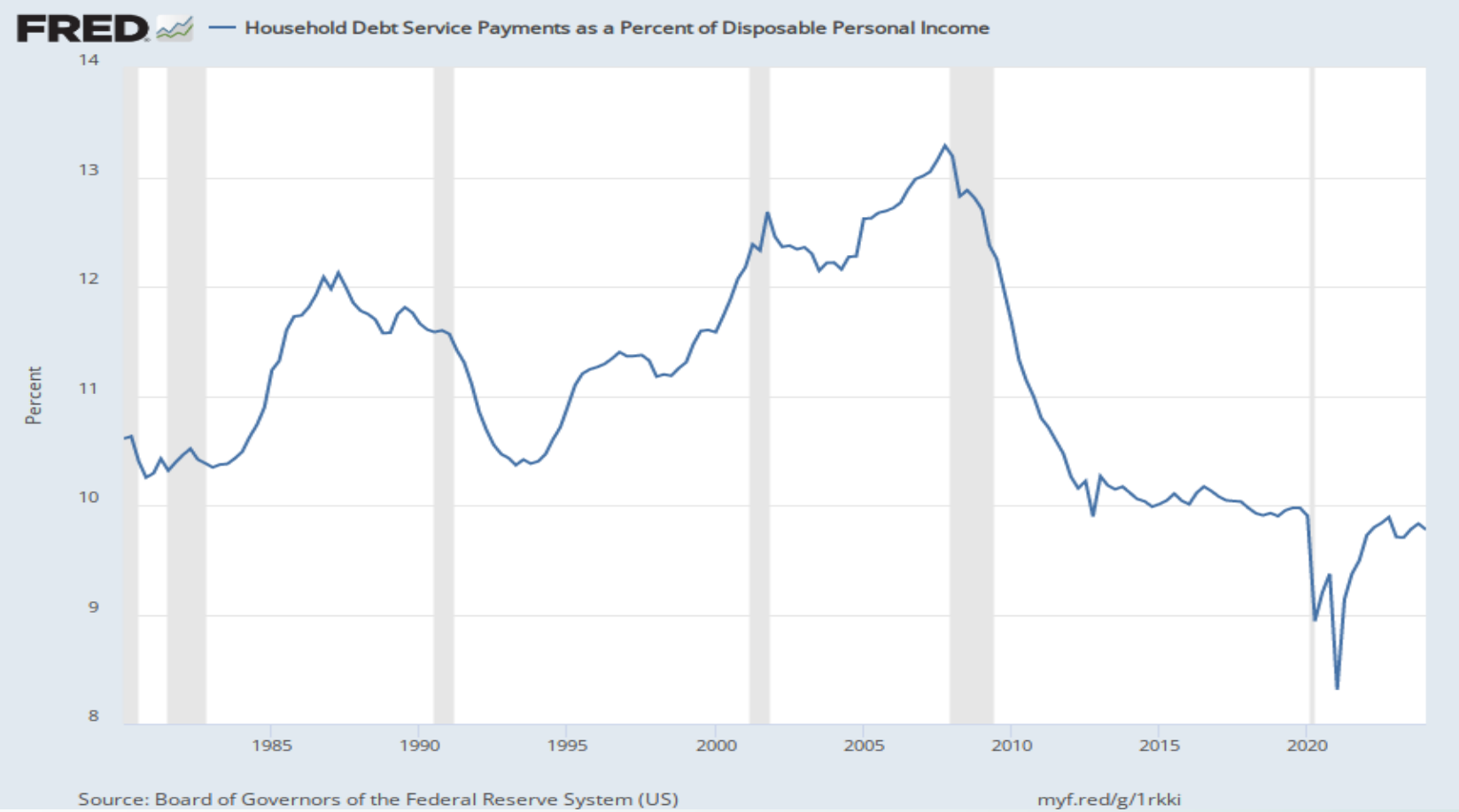
While consumers were flush with cash following pandemic stimulus programs, actual wage growth failed to keep pace with inflation for much of 2021 and 2022. This relationship reversed in early 2023, and we've seen consistent real wage growth since then, providing support for consumer spending, which makes up nearly 70% of GDP.



Source: Atlanta Federal Reserve, Bureau of Labor Statistics , August 2024

Consumer debt has increased, but needs context

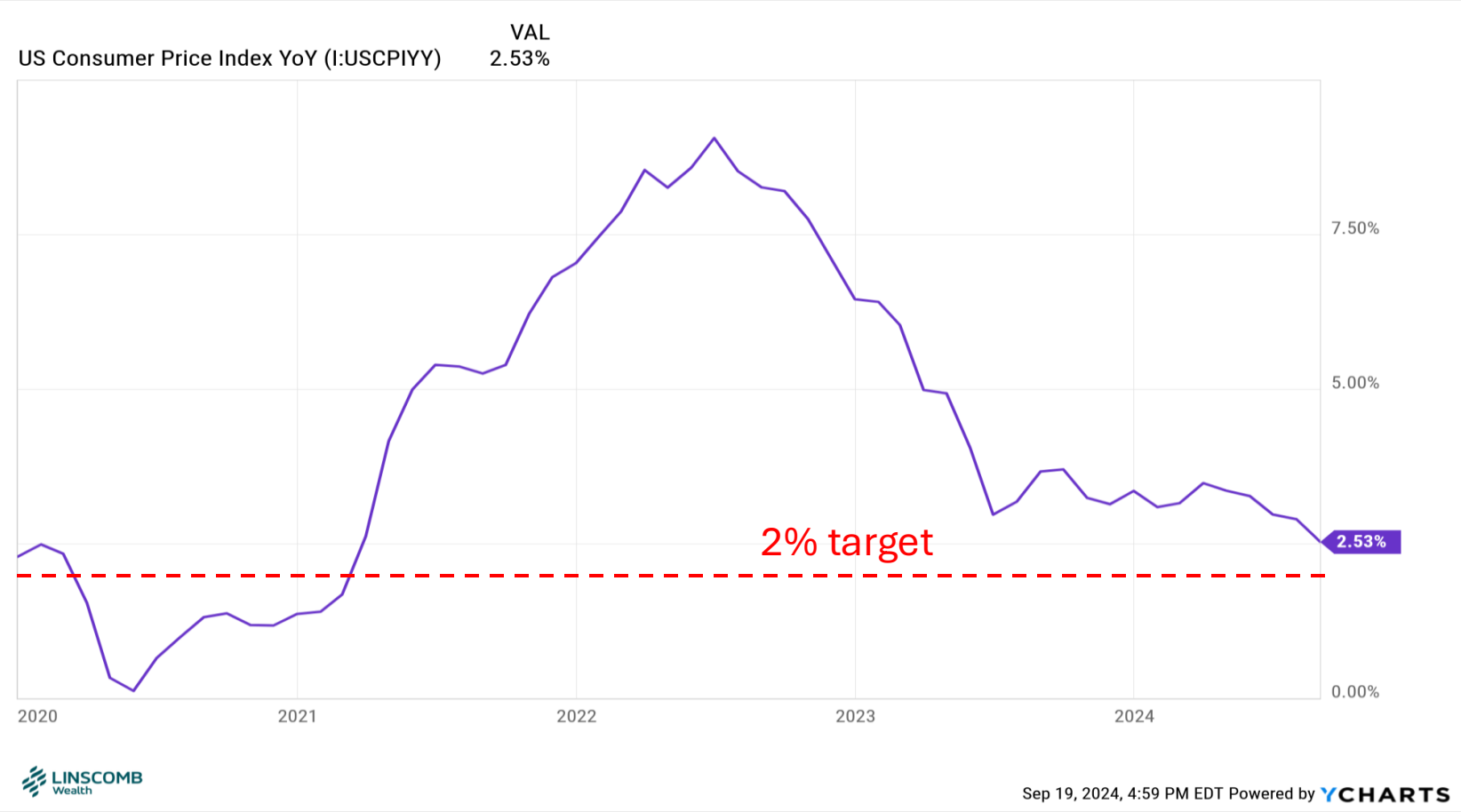
Higher prices have certainly been a challenge, and consumer debt has increased to compensate for it. However, as a percentage of disposable income, debt service payments are still relatively low. The largest liability on most consumer balance sheets is their mortgage, typically a fixed payment so unaffected by the rise in interest rates.



Source: Board of Governors of Federal Reserve System, 3/31/1980 – 6/30/2024

Disinflationary trend to continue, but the "last mile" will take time

Yearly inflation has significantly improved since its peak in mid-2022. It is currently at 2.5%, down from over 9%. We think this disinflationary trend will continue, but the journey from 3% to 2%—the "last mile" of inflation—may prove more challenging compared to the initial decline.



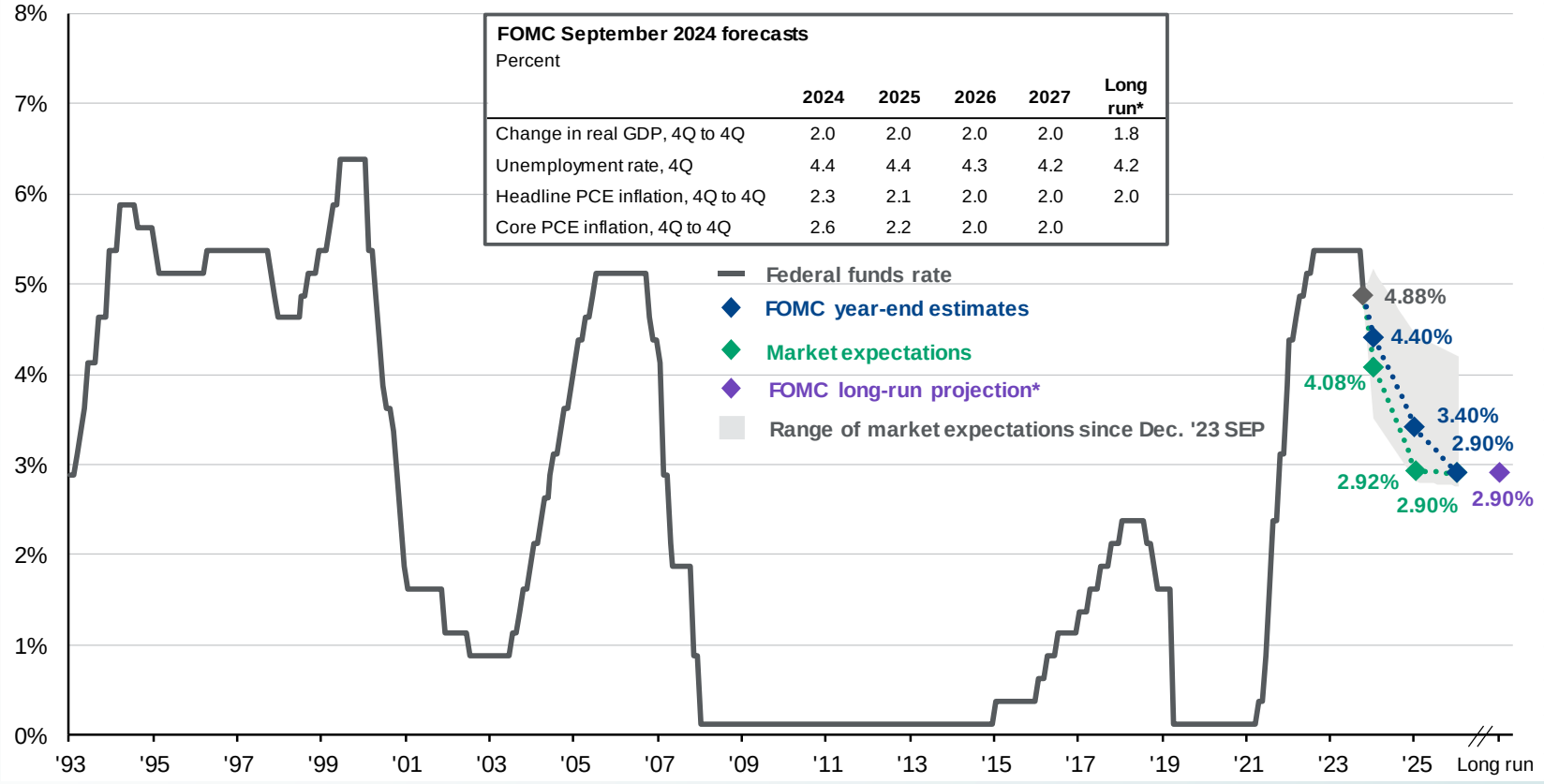
Source: Bureau of Labor Statistics, August 2024

The interest rate cutting cycle commences

The Federal Reserve cut its key interest rate by 50 basis points in September. We believe this reflects continued progress on inflation, which no longer requires restrictive monetary policy. Expectations are for a long-run federal funds rate near 3%. We don't anticipate a return to a 0% rate policy outside of a severe recessionary environment.

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



FOMC September 2024 forecasts

Percent

	2024	2025	2026	2027	Long run*
Change in real GDP, 4Q to 4Q	2.0	2.0	2.0	2.0	1.8
Unemployment rate, 4Q	4.4	4.4	4.3	4.2	4.2
Headline PCE inflation, 4Q to 4Q	2.3	2.1	2.0	2.0	2.0
Core PCE inflation, 4Q to 4Q	2.6	2.2	2.0	2.0	

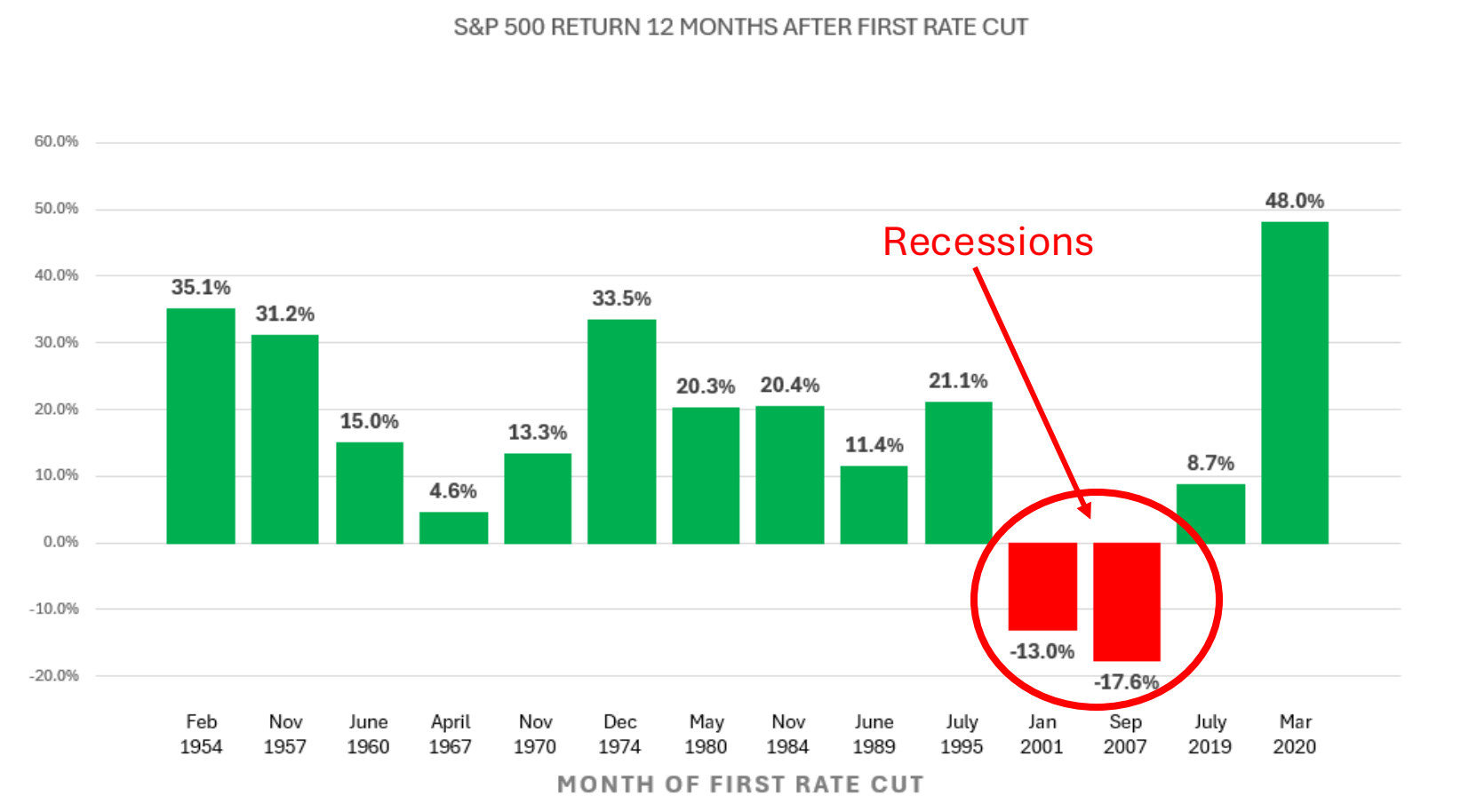
Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.

Market expectations are based off of USD Overnight Index Swaps. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

Guide to the Markets – U.S. Data are as of September 18, 2024.

What do rate cuts mean for future asset returns?

Historically, forward returns for all asset classes following interest rate cuts have been positive, as long as the economy avoids recession. In recessionary environments monetary policy has not been an instant stimulus for asset prices. The most immediate impact of rate cuts is to reduce the potential return on cash and other short-term investments, like Treasury bills.



Source: Morningstar, S&P. Past performance is not indicative of future returns. Chart is for illustrative purposes. Indices are unmanaged, do not include fees or expenses and are not available for direct investment. Returns of indices for periods of less than one year may not be annualized. Please see disclosures for index definitions.

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We often discuss the virtues of a diversified portfolio. Narratives develop around market themes and the inevitable winning companies or sectors, but actual market performance can often differ from those narratives in unexpected ways. In the 3rd quarter for example, small-cap stocks, which had seemingly been left for dead in the 1st half of the year, led the way rising over 9%. Emerging markets also had a standout quarter, gaining nearly 9% thanks to news of a large fiscal and monetary stimulus package in China.

From a sector perspective, after a surge in tech shares early in the year, investors quickly rotated into more traditionally defensive areas of the market last quarter. REITs, utilities, and financials were the top three performing sectors. Technology, communication services, and energy were the laggards for the quarter.

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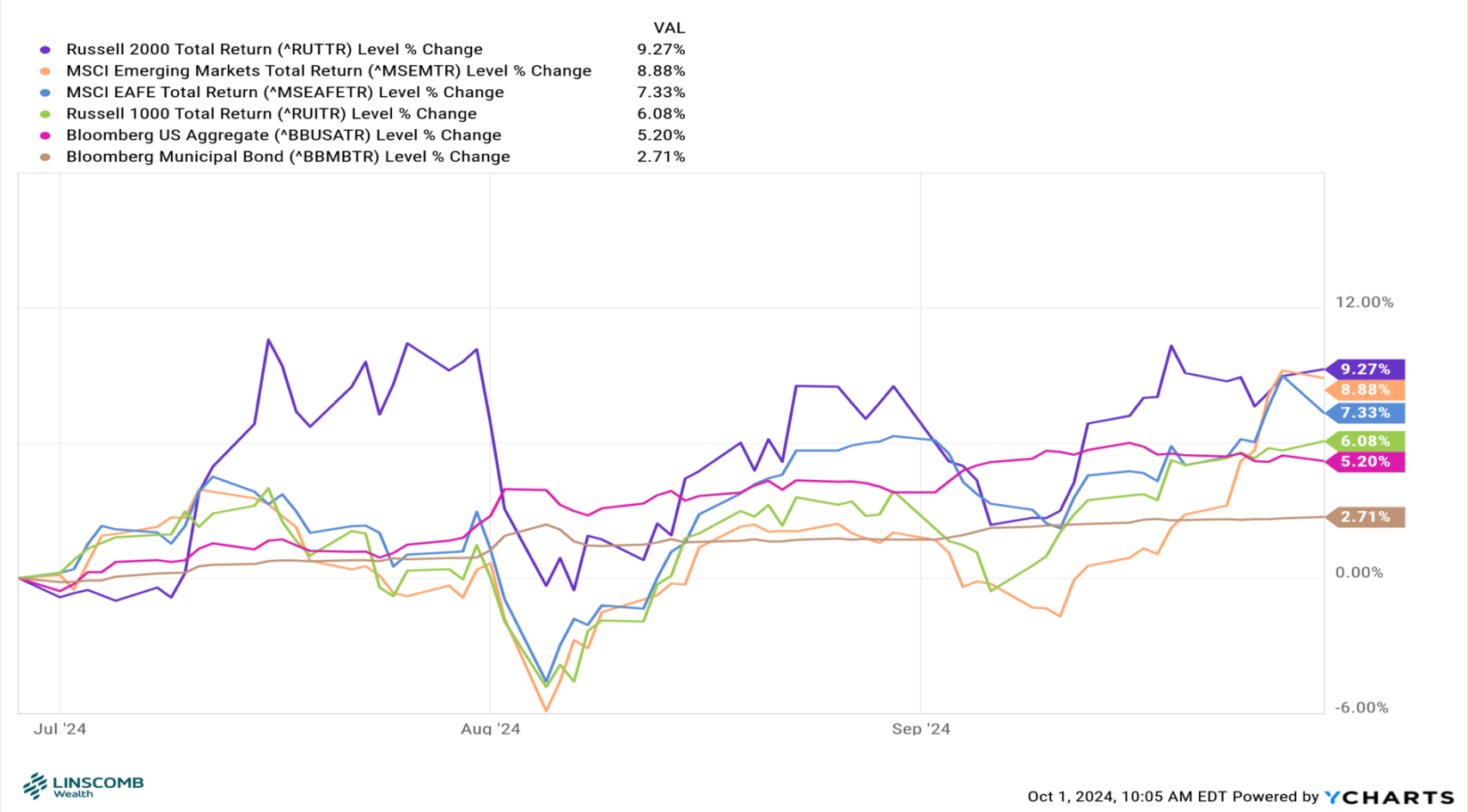
Assets prices continue to rise in the 3rd quarter

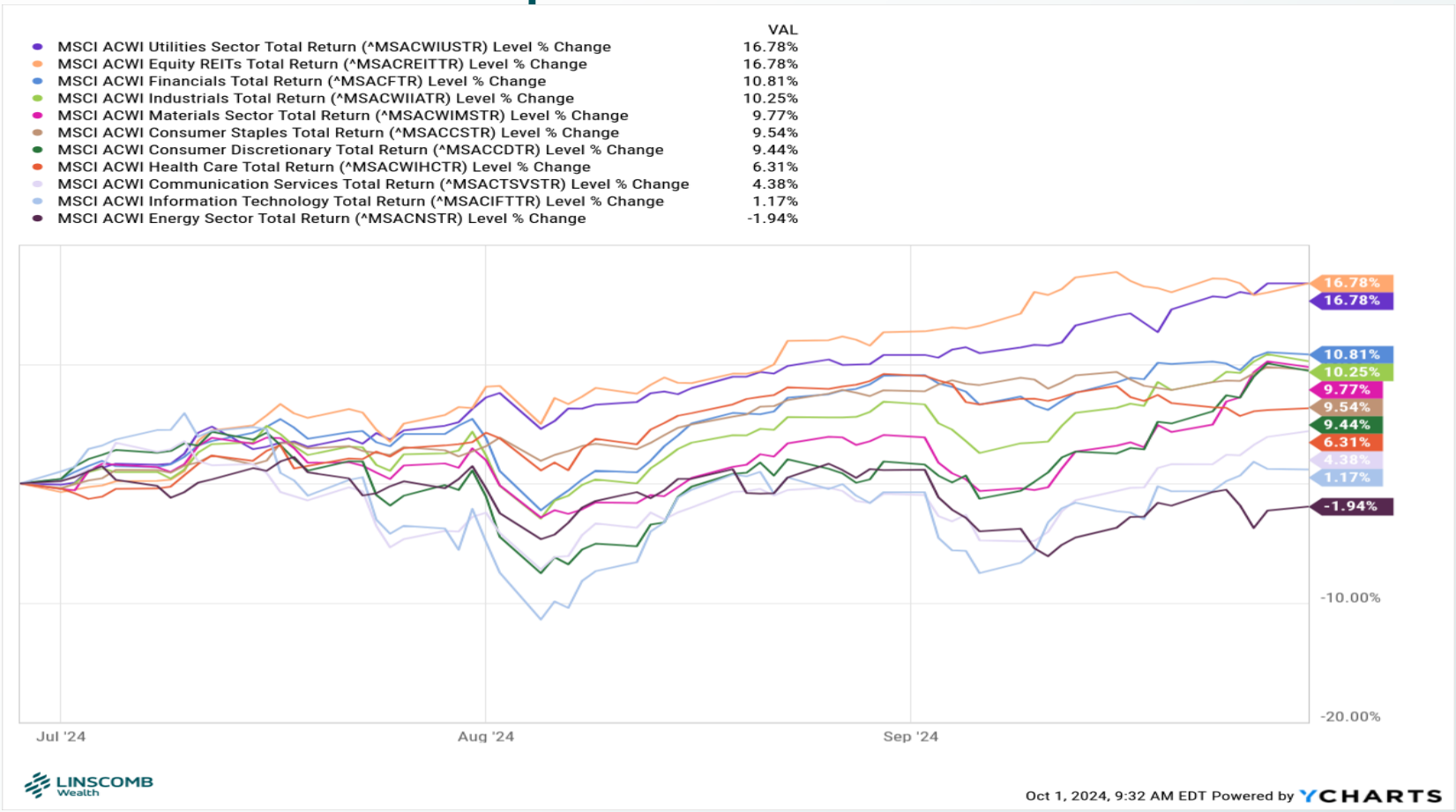
U.S. large cap stocks led asset prices through the first half of the year, but trends shifted in the 3rd quarter. Small-cap stocks were the top performer, up 9.27%. Emerging Markets also performed very well, gaining 8.88% as China implemented a large financial stimulus package. Municipal bonds were the laggards this quarter, but still rose 2.71%.



Source: YCharts, MSCI, Russell, Bloomberg, 6/30/2024 – 9/30/2024. Past performance is not indicative of future returns. Chart is for illustrative purposes. Indices are unmanaged, do not include fees or expenses and are not available for direct investment. Returns of indices for periods of less than one year may not be annualized. Please see disclosures for index definitions.

After 1st half tech surge, rotation to defensive sectors in the 3rd quarter

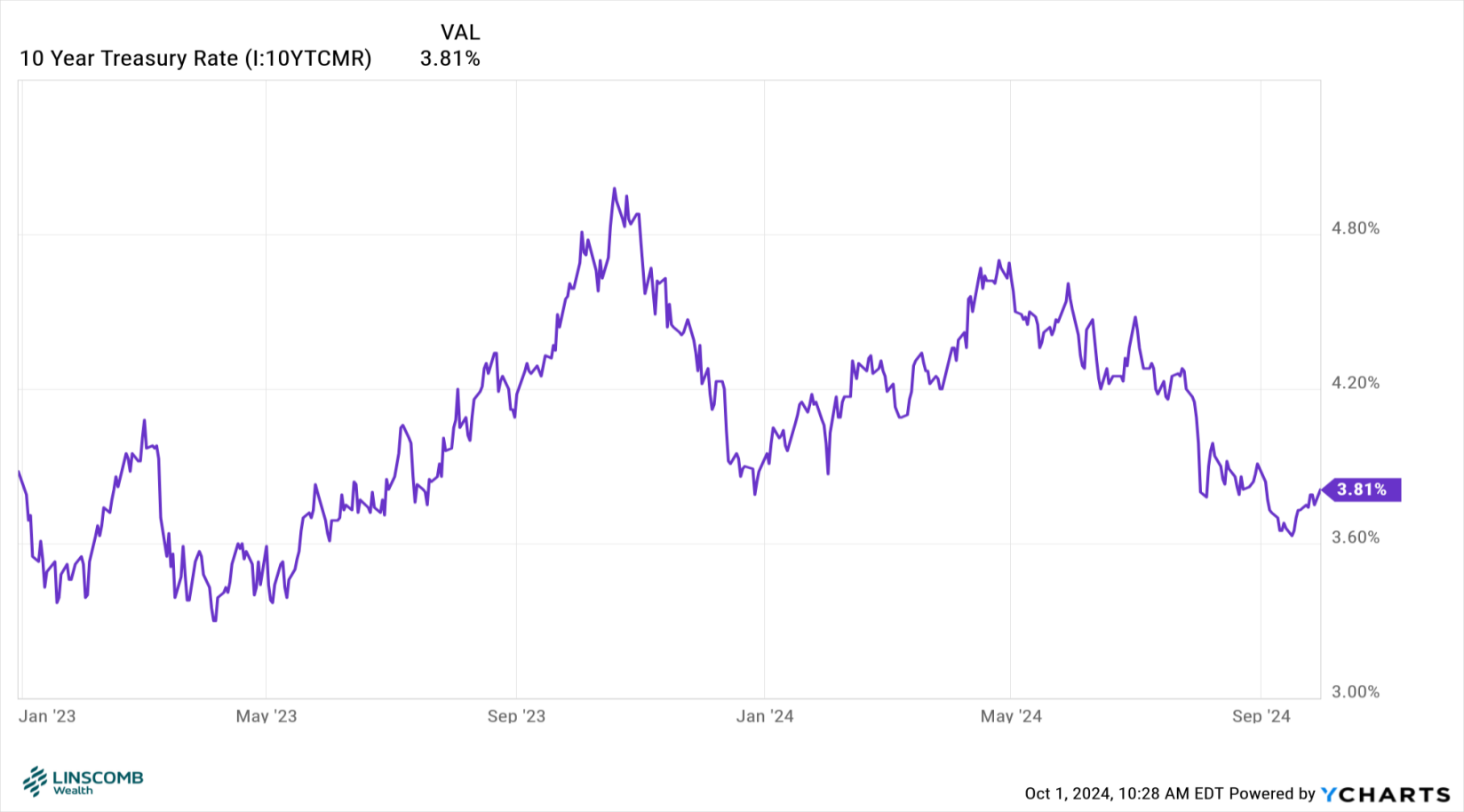
No longer just a tech-driven market, more traditional defensive sectors were the top performers in the 3rd quarter. REITs and Utilities were both up double digits. Technology, communication services, and energy were the laggards for the quarter.



Source: YCharts, MSCI, 6/30/2024 – 9/30/2024. Past performance is not indicative of future returns. Chart is for illustrative purposes. Indices are unmanaged, do not include fees or expenses and are not available for direct investment. Returns of indices for periods of less than one year may not be annualized. Please see disclosures for index definitions.

10-Year yield round trip

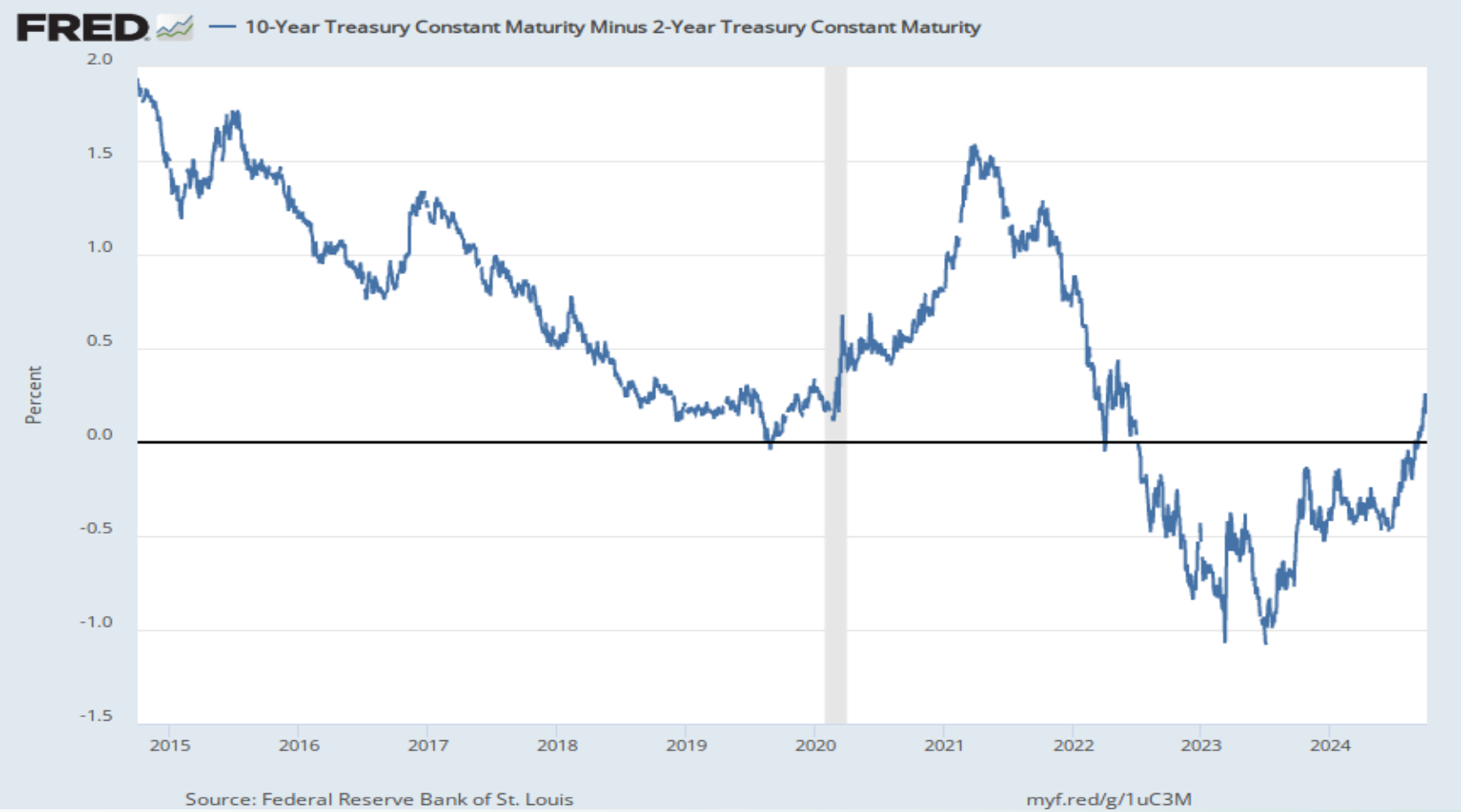
After briefly breaching 5% in October 2023, the 10-Year U.S. Treasury yield is now at 3.81%. The decline coincides with continued progress on the inflation front and anticipation of a policy easing cycle from the Fed. Potential returns from fixed income have decreased, but still exceed current and expected inflation.



Source: YCharts, 12/31/2022 – 9/30/2024. The 10-year treasury yield serves as a benchmark for a wide range of interest rates and provides an illustrative view as to various yield volatility during the analysis period.

2-10 interest rate spread no longer inverted

Historically, yield curve inversions have foreshadowed upcoming economic weakness. But that hasn't been the case this time. The yield curve inversion may have reflected unusual short-term inflation dynamics, rather than a major economic dislocation as it has in the past. An upward sloping yield curve typically means the yield advantage on cash is likely to diminish.



Source: Federal Reserve, 9/30/2014 – 9/30/2024

Mindful of stock market valuations

While we believe the environment can remain favorable for financial assets, we are mindful of elevated stock market valuations, especially for U.S. large-cap securities. The S&P 500 currently trades above 21x forward earnings estimates, a historically high level. The companies that make up this index are high-quality, but we believe a well-diversified portfolio is more important now than ever.

Source: Bloomberg Data ranges from 9/30/2014 to 9/30/2024 represent the Forward P/E. The forward P/E is a version of the ratio of price-to-earnings (P/E) that uses forecasted earnings for the P/E calculation. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

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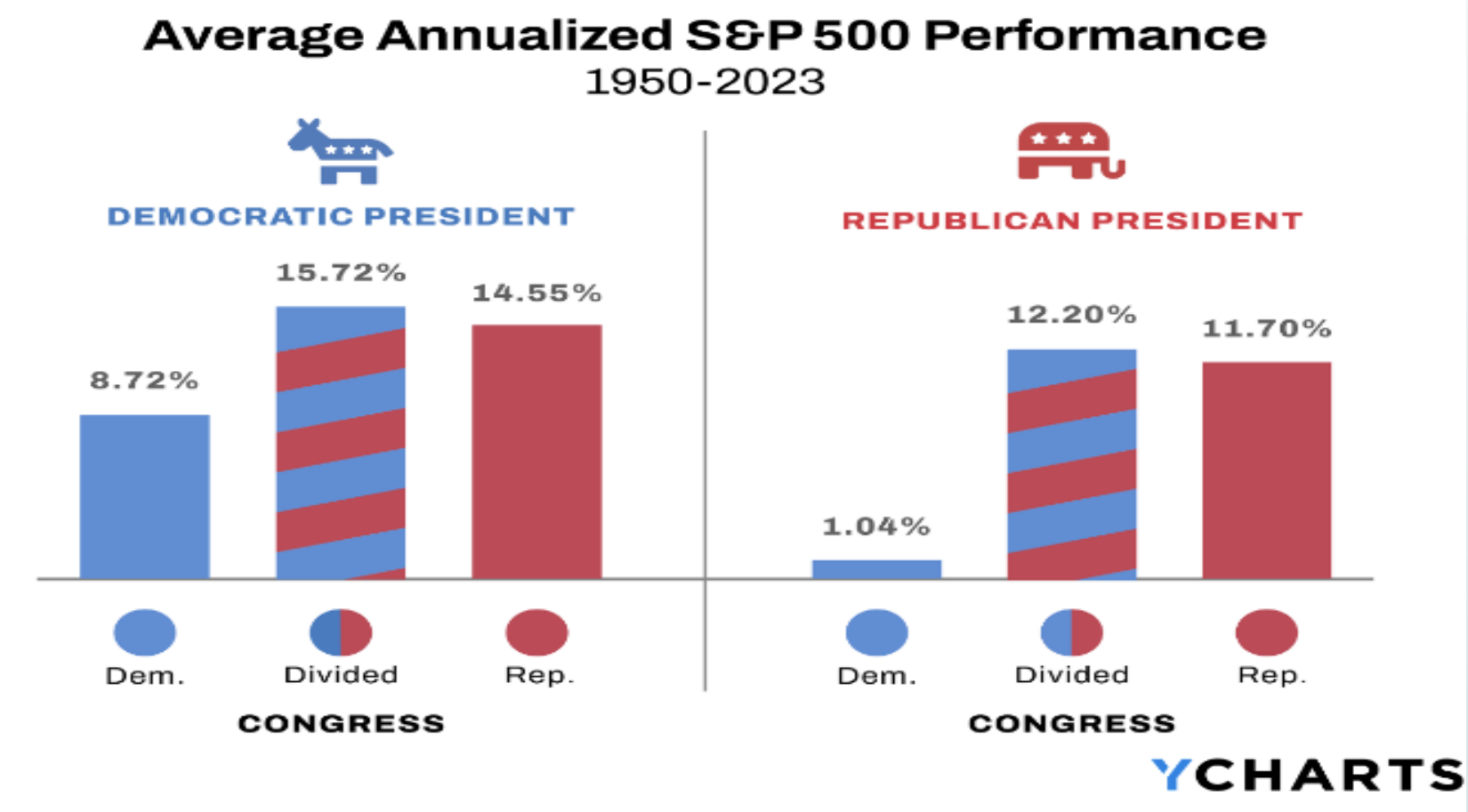
As you're no doubt aware, there's a presidential election just over a month away. And while elections can and do impact financial markets, it is just one many factors that influence the direction of asset prices.

As a starting point, the LW Investment Committee finds it useful to study history – how have markets performed under different regimes? On this the evidence is clear, stocks have risen under all combinations of government. So, we believe it's folly to make investment decisions solely on the basis of election outcomes. Taking that approach has often left significant gains on the table which can be highly detrimental to the attainment of long-term financial goals. It's crucial to stay invested.

That said, we don't want to ignore the influence of politics on portfolios. We tend to focus most not on people, but on policy. More specifically the probability that certain policies will be passed, and the details of their implementation. We highlight a few key differences, but also some important similarities in the ensuing slides.

Markets have performed under all combinations of government

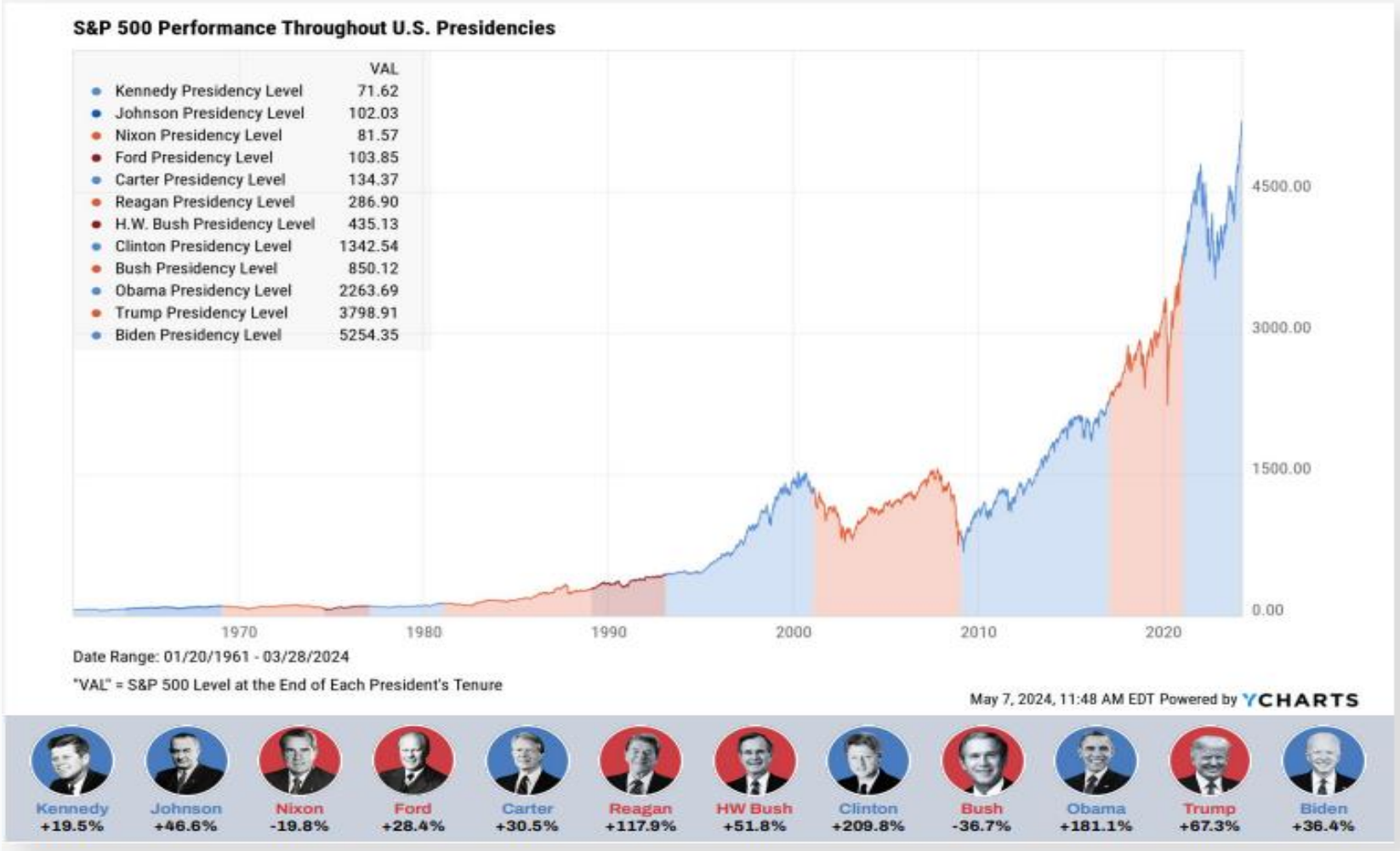
Elections are important and can have meaningful impacts on financial markets, but they are just one factor among many that influence the direction of asset prices. Historically, markets have performed well under all combinations of government, though there is often more volatility in election years.



Source: YCharts, S&P. Chart represents annualized S&P 500 Index returns since 01/01/1950 – 12/31/2023 based on democratic, republican or divided Congress. Returns are cumulative total return, including dividends reinvested for the stated period. Indices are unmanaged, do not include fees or expenses and are not available for direct investment. Past performance is not indicative of future returns. Chart is for illustrative purposes.

Staying invested is crucial

Time invested in the market is what matters, not the president's political party. Markets have typically risen regardless of which party was in power. When managing portfolios, we tend to focus on specific policies rather than people.



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The more things change…

…the more they stay the same. Candidates aim to highlight their differences on the campaign trail, but certain longer-term themes are likely entrenched, though specific policy implementation will vary by candidate. Policies listed below are those we believe are potentially most impactful for financial markets.

Key Similarities

- Large deficits
- "Tough on China"
- Defense spending
- Regulating big tech
- Reshoring/friend shoring
- Strategic AI and semiconductor initiatives

Key Differences

- Tax policy
- Approach to energy policy and regulation
- Drug pricing and healthcare cost control

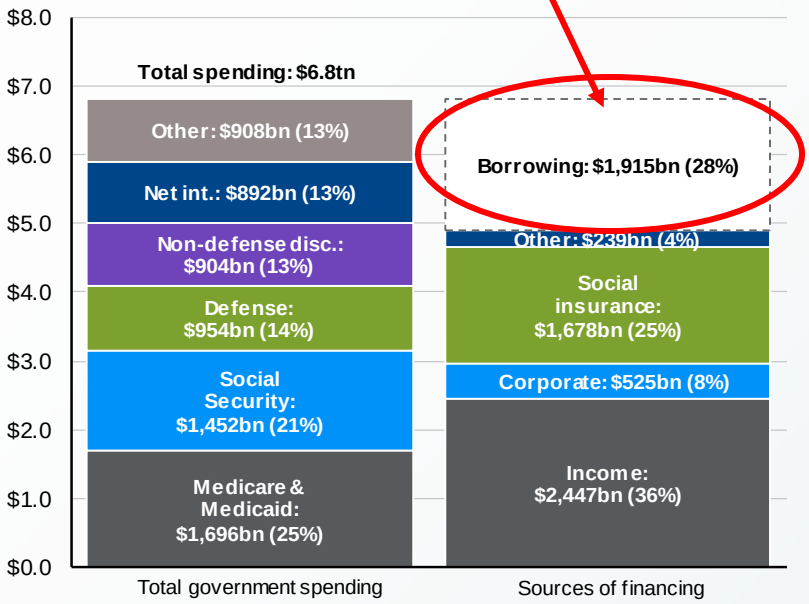
Debt and Deficits

While an increasing national debt has not been an issue for financial markets yet, investors may begin to question the federal government's persistently large deficits. Rising long-term interest rates and a weakening dollar could be indications investors are losing confidence in the government's fiscal policies.

Almost $2 trillion in borrowing

The 2024 federal budget

USD trillions

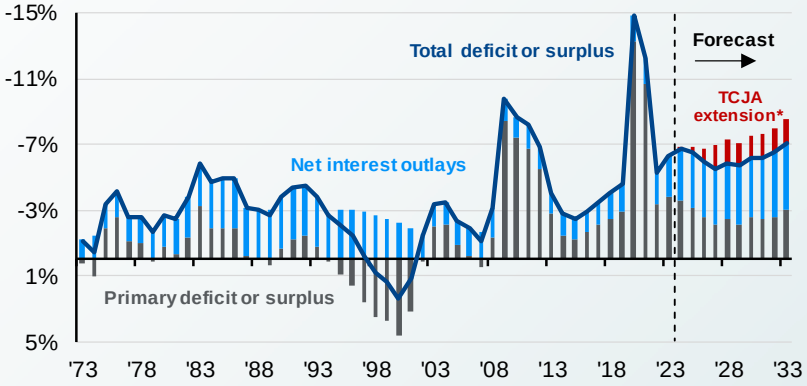


CBO's Baseline economic assumptions

	2024	'25-'26	'27-'28	'29-'34
Real GDP growth	2.9%	2.0%	1.7%	1.8%
10-year Treasury	4.5%	4.0%	3.6%	4.0%
Headline inflation (CPI)	3.2%	2.4%	2.2%	2.2%
Unemployment	3.8%	4.0%	4.3%	4.5%

Federal deficit and net interest outlays

% of GDP, 1973-2034, CBO Baseline Forecast



Federal net debt (accumulated deficits)

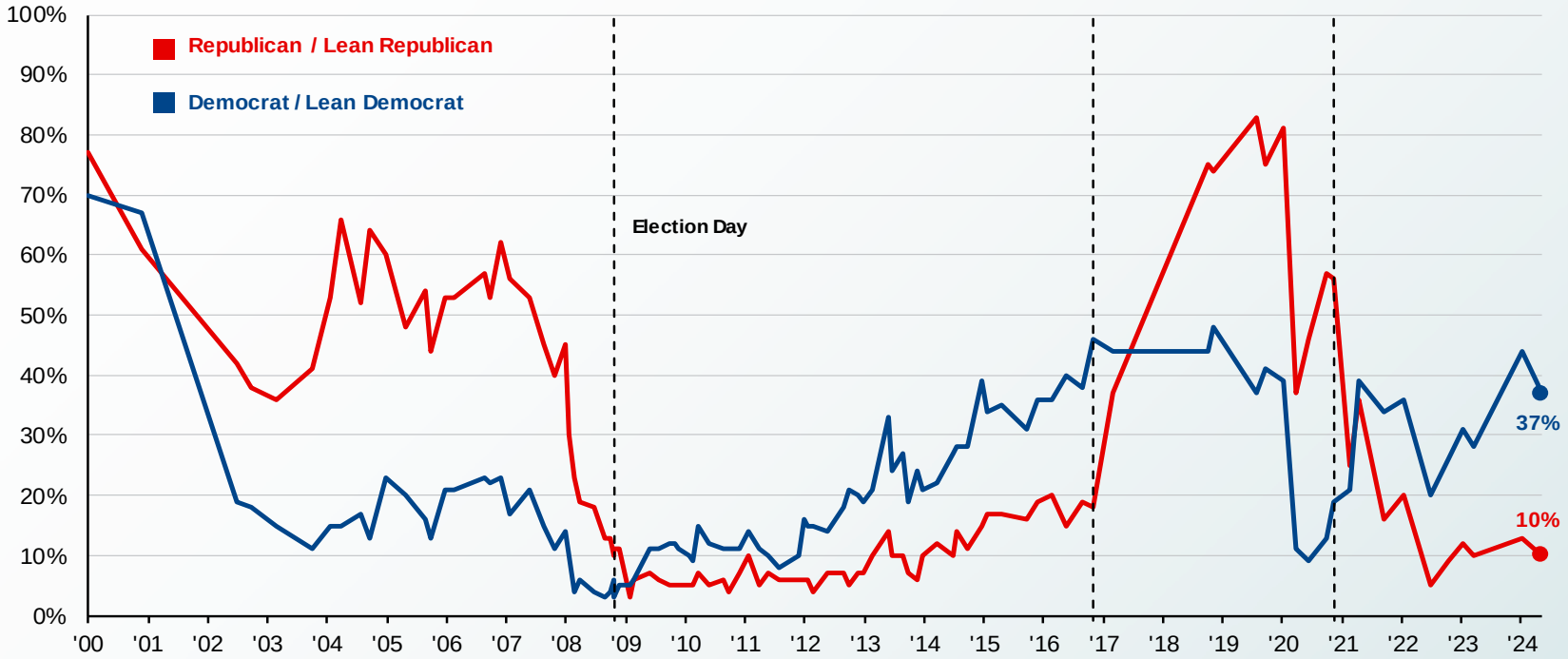
% of GDP, 1940-2034, CBO Baseline Forecast, end of fiscal year

Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department. Estimates are from the Congressional Budget Office (CBO) June 2024 An Update to the Budget Outlook: 2024 to 2034. "Other" spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Years shown are fiscal years. *Adjusted by JPMAM to include estimates from the CBO May 2024 report "Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues" on the extension of TCJA provisions. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

Consumer confidence by political affiliation

Consumer confidence can be highly dependent on election results and political affiliations. But these confidence readings have generally not had a strong relationship with market returns. Don't let emotions drive investing decisions.

Percentage of Republicans and Democrats who rate national economic conditions as excellent or good



Administration	Bush	Obama	Trump	Biden
Dates in office	Jan '01 – Jan '09	Jan '09 – Jan '17	Jan '17 – Jan '21	Jan '21 – Today
S&P 500 return	-4.5%	16.3%	16.0%	12.5%
Real GDP growth	1.9%	2.2%	1.8%	2.8%

Source: Pew Research Center, J.P. Morgan Asset Management. The survey was last conducted in May 2024, "Public's Positive Economic Ratings Slip; Inflation Still Widely Viewed as Major Problem." Pew Research Center asks the question: "Thinking about the nation's economy, How would you rate economic conditions in this country today… as excellent, good, only fair, or poor?". S&P 500 returns are average annualized total returns between presidential inauguration dates and are updated monthly. Real GDP growth are average annualized GDP growth rates. Guide to the Markets – U.S. Data are as of September 19, 2024.

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