

# Quarterly Commentary

---

Q3 2024



## Summary and Implications

- U.S. economic strength and subdued cross-asset volatility imply a middle phase of the current post-pandemic cycle, supportive of both equity and fixed income markets.
- Strong economic fundamentals, robust U.S. consumer spending, and coordinated global central bank easing continue to support inflation-adjusted GDP growth projections of 2.6% for CY 2024.
  - Investors are advised to focus on high quality investments and monitor the pace of U.S. Federal Reserve easing of monetary policy in anticipation of cooling labor market conditions, but also investigate hard asset hedges against a risk of re-acceleration in inflation.
  - Portfolio diversification can have an even more prominent impact on investors as the market navigates the divide between slowing demand in reaction to high interest rates over the past year and the potential reacceleration of activity in anticipation of global central bank easing.

## Investment Summary and Outlook

At the end of the 2<sup>nd</sup> quarter, there were increasing signs that the U.S. was about to hit the pause button on economic growth, following strong post-pandemic spending from U.S. consumers, businesses, and the government. However, despite some further evidence of slowing activity, the U.S. economic outlook remains resilient (i.e. mid-cycle expansion).

Both U.S. equity and fixed income markets advanced on expectations that the U.S. economy would achieve a soft landing of moderate growth and slowing inflation – a slowdown as opposed to a recessionary crash. Third quarter economic releases covering personal spending, jobless claims, industrial activity, and home sales have held up better than expected even in the face of a long period of high interest rates, geopolitical tensions (Ukraine/Russia, the Middle East), and rising uncertainty over the electoral landscape.

The Fed signaled that it was close to easing monetary policy, starting with the September FOMC, as officials warned of the asymmetrical risks from slowing labor market conditions while feeling more comfortable inflation was trending towards year-end targets. Early signs of slowing labor market conditions are showing up in fewer job openings and slower payroll growth as well as slowing industrial production and construction activity, although some of this slowdown is seasonable and attributable to inclement weather.

The Fed also updated its Summary of Economic Projections to account for higher unemployment, anticipating a fed funds rate target of 3.4% by the end of 2025 and 2.9% by the end of 2026. Fed funds futures have priced in 2-3 additional 0.25% rate cuts for the remainder of 2024 and 7-8 cuts by the end of 2025.

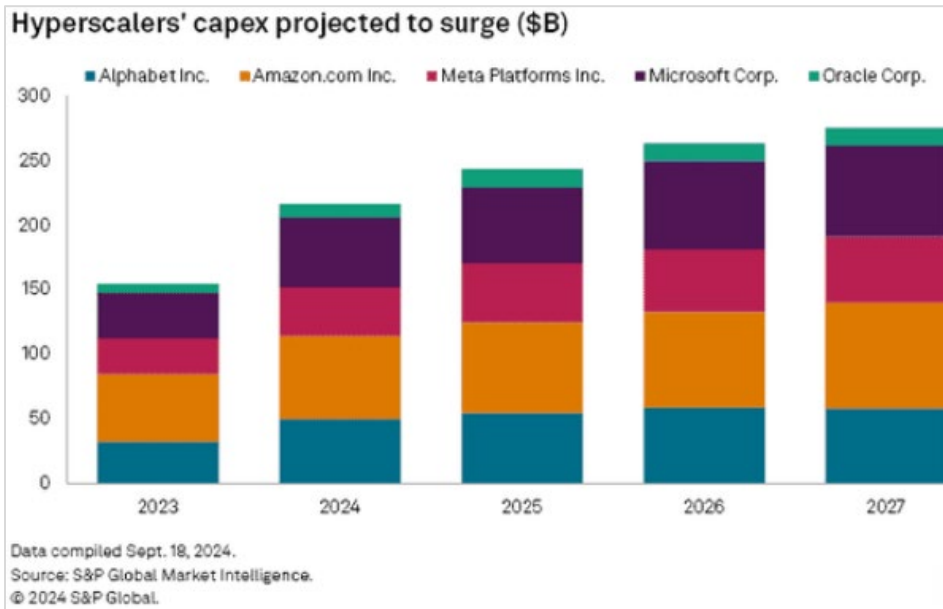
Region: United States »		Instrument: Fed Funds Futures »			
Target Rate	5.00	Pricing Date	09/30/2024		
Effective Rate	4.83	Cur. Imp. O/N Rate	4.821		
Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M. ▲
11/07/2024	-1.350	-135.0%	-0.338	4.484	0.250
12/18/2024	-2.790	-144.0%	-0.697	4.124	0.250
01/29/2025	-3.995	-120.5%	-0.999	3.823	0.250
03/19/2025	-5.088	-109.3%	-1.272	3.549	0.250
05/07/2025	-5.883	-79.5%	-1.471	3.351	0.250
06/18/2025	-6.505	-62.2%	-1.626	3.195	0.250
07/30/2025	-6.905	-40.0%	-1.726	3.095	0.250
09/17/2025	-7.192	-28.7%	-1.798	3.023	0.250
10/29/2025	-7.395	-20.3%	-1.849	2.973	0.250
12/10/2025	-7.496	-10.1%	-1.874	2.947	0.250
01/28/2026	-8.195	-69.9%	-2.049	2.773	0.250

Source: Bloomberg World Interest Rate Probability

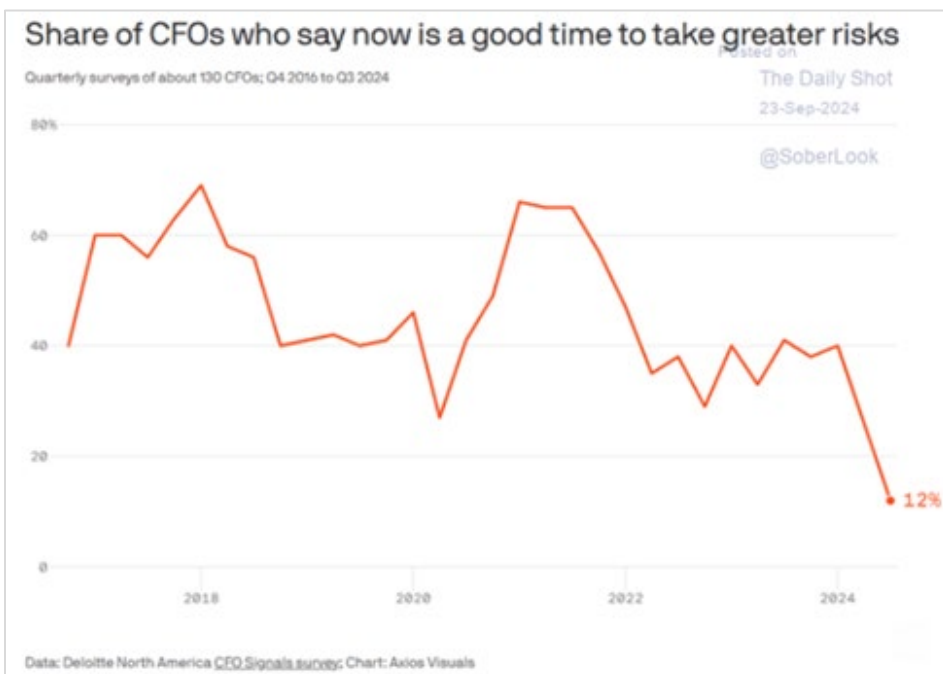
Growth and inflation are anticipated to decelerate; however, the timetable for deceleration keeps getting pushed out as current economic activity shows few signs of slowing demand, despite global central banks maintaining tighter monetary policies longer than initially anticipated. Real Gross Domestic Product (GDP) growth is forecasted to decelerate to 1.8% in 2025 based on Bloomberg economic consensus.

In reaction to lower inflation and signs that the Fed would begin to aggressively cut interest rates starting in September, companies with weaker balance sheets outperformed as well as rate-sensitive segments that had lagged earlier in the year (i.e. utilities, real estate, consumer staples). Technology companies heavily betting on the potential of artificial intelligence also performed well – a secular phenomenon for which long-term prospects seem immune to traditional business cycle dynamics.

The outsized contribution of U.S. technology growth stocks continues to widen the divide between U.S. equity markets, notably large caps, versus the rest of the world, as total U.S. equity market valuation comprises nearly 2/3 of world market capitalization. The rush to build out generative artificial intelligence capabilities through data centers has led to a surge in capital spending for computer hardware and cloud computing services, and increasingly, a need for electricity production to power these energy-intensive datacenters.

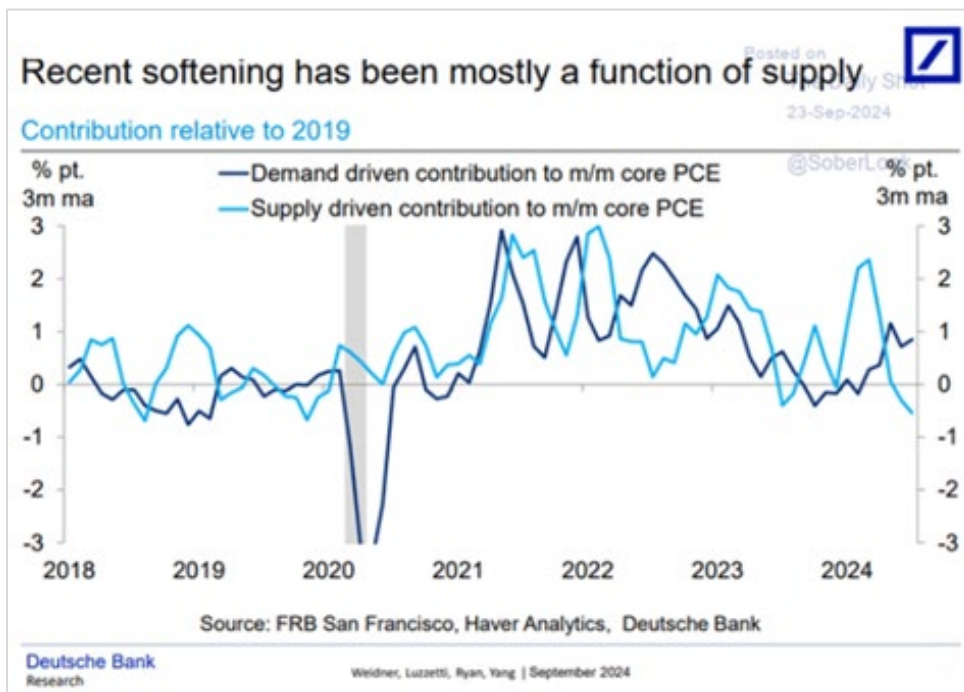


But beyond the unfettered capital spending over blue sky expectations for growth and productivity gains from artificial intelligence, companies remain cautious based on business surveys, having built up inventories in anticipation of renewed supply chain disruptions stemming from geopolitical conflicts and striking port workers.



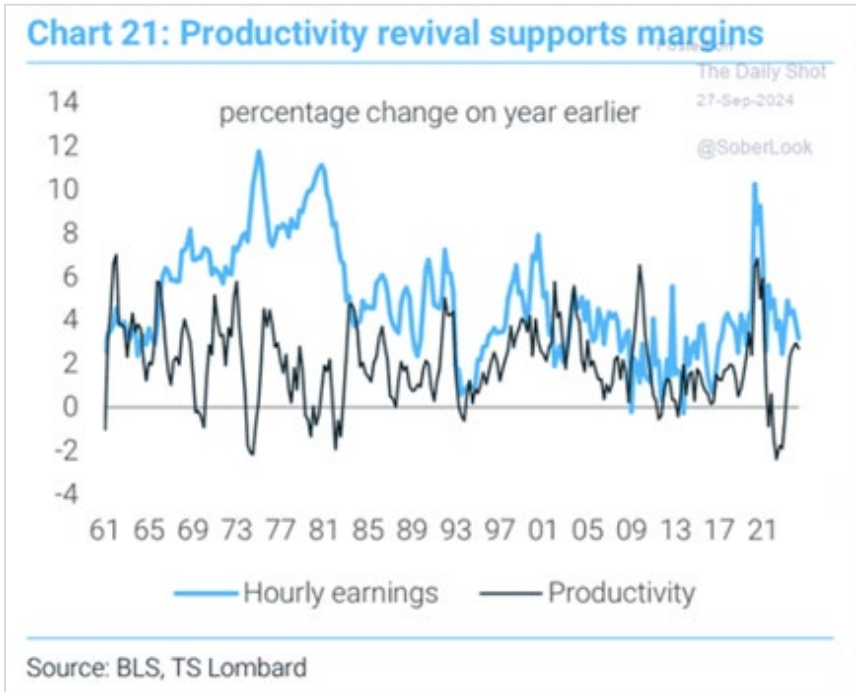
Smaller businesses and lower income consumer cohorts, most sensitive to tight financial conditions, will likely find relief from lower interest rates and narrower borrowing spreads. Bifurcation in both business and consumer spending has produced a widening divide between favored 'haves' and 'have-nots,' including technology-focused themes for business spending and consumer segments favored by high income cohorts such as luxury goods and global travel. Lower interest rates and ongoing fiscal stimulus could help narrow this divide going forward.

Following the early August crash of the Japanese stock market in reaction to an unexpected hike in policy interest rates, investors flocked to the safe-haven segments of the market. However, pre-emptive central bank easing runs the risk of a reacceleration in inflation (as measured by Personal Consumption Expenditure ex Food and Energy, or Core PCE), as demand-push inflation is not subsiding as expected.



Higher commodity prices and supply chain snags resulting from geopolitical tensions and port labor strikes would further complicate the inflation outlook and hamstring the Fed's ability to aggressively cut rates in the face of slowing labor market conditions. Precious metals and hard asset plays are receiving renewed attention as a potential hedge against second wave inflation risk.

Investors continue to give the benefit of the doubt to equity and fixed income markets, pricing in resilient corporate profitability over the next two years. Ahead of the 3<sup>rd</sup> quarter earnings releases, the consensus outlook for S&P 500 company earnings growth is for 10.2% in CY-2024 and 15.4% in CY-2025. Revenue growth is anticipated to slow down, but corporate profit margins have held up due to a combination of pricing power and productivity. And although the AI-driven theme continues to excite investors, the earnings growth picture is starting to brighten across a broader spectrum of companies. For now, the mid-cycle narrative remains the base case outlook even if there are increasing signs of labor market pains.



## U.S. Fixed Income Markets

Index Performance as of 9/30/2024	3Q2024	YTD	1-Year	3-Year (Ann)
Bloomberg US Agg Bond TR USD	5.20	4.45	11.57	-1.39
Bloomberg US Treasury Bill 1-3 M TR USD	1.36	4.08	5.52	3.57
Bloomberg 1-5 Yr Treasury TR USD	3.43	4.17	7.51	0.66
Bloomberg Treasury 5-7 Yr TR USD	5.07	4.48	10.16	-1.22
Bloomberg Treasury 7-20 Yr TR USD	6.62	3.92	13.10	-4.22
Bloomberg US Treasury 20+ Yr TR USD	7.96	1.58	15.18	-9.39
Bloomberg US Agency TR USD	3.40	4.27	8.11	0.13
Bloomberg ABS TR USD	3.35	5.07	8.73	1.81
Bloomberg US MBS TR USD	5.53	4.50	12.32	-1.20
ICE BofA US Corporate TR USD	5.72	5.76	14.13	-0.98
Bloomberg US Corporate High Yield TR USD	5.28	8.00	15.74	3.10
Bloomberg US Convertible Comp TR USD	6.13	8.11	15.24	-0.48
Bloomberg Municipal TR USD	2.71	2.30	10.37	0.09

Source: Morningstar Direct

U.S. fixed income posted strong positive returns with the U.S. Aggregate Bond Index up 5.20% for the quarter, making up earlier losses, as interest rates dropped from peak levels of last spring. Investors seem more convinced that the Fed may pull off a soft landing for the U.S. economy, a scenario in which Fed policy avoids unnecessarily triggering a U.S. recession after having aggressively hiked rates to tame high post-pandemic inflation.

Corporate bonds (both investment grade and high yield) outperformed the broader fixed income market as borrowing spreads narrowed further to below pre-pandemic levels. Corporate bonds have especially benefited from the soft-landing scenario of Fed rate cuts ahead of an economic slowdown combined with earnings growth and profitability.

### Implications: Good But Boring

Duration or Rate-Sensitivity was the clear contributor to positive performance as longer maturity bonds most benefited from the fall in interest rates. The 10-Year Treasury yield ended the 3<sup>rd</sup> quarter at 3.78%, down from 4.40% at the beginning of the quarter. Investment grade corporates narrowly outperformed as corporate credit, especially below investment grade, continues to benefit from lower borrowing spreads. The spread between short-term and long-term borrowing rates widened with the 10-2 year Treasury yield spread positive for the first time since the Fed started raising rates as investors gravitate towards the short-intermediate part of the curve to capture positive roll-down term premium.

For outsized gains to continue, inflation-adjusted rates and borrowing spreads would need to drop further, closer to the 2010-2015 period; however, inflation conditions were more benign than versus today as there was a less stimulative fiscal spending backdrop. Even with reaccelerating inflation posing as a risk to the soft-landing scenario, investors still have an opportunity to lock in moderately high real rates by extending the maturity profile of their fixed income allocation. Asset- and mortgage-backed securities also remain attractive as spreads remain wider on a relative basis as these sectors would benefit from lower rate volatility.

## International Fixed Income Markets

Index Performance as of 9/30/2024	3Q2024	YTD	1-Year	3-Year (Ann)
Bloomberg Global Agg ex US TR USD	8.52	7.39	12.28	-4.42
Bloomberg EuroAgg TR USD	8.04	8.33	15.14	-4.49
Bloomberg Asian Pacific Agg TR USD	9.48	5.76	8.44	-4.44
Bloomberg EM Local Currency USD	9.24	9.94	15.01	-0.29

Source: Bloomberg

In U.S. dollar terms (“USD”), international bonds performed well in the 3<sup>rd</sup> quarter, benefiting from both lower interest rates and currency appreciation against the U.S. dollar. The Bloomberg Global Aggregate Bond Index (USD) and the Bloomberg EM Local Currency Index (USD) returned 8.52% and 9.24%, respectively, outperforming the U.S. Aggregate Bond Index which returned 5.20%, as the Bloomberg Dollar Spot Index dropped 3.68% for the quarter.

As with the U.S., much of the world is experiencing disinflation from post-pandemic peaks, allowing some central banks to start cutting policy rates ahead of the Fed. International bonds also recovered from the 2<sup>nd</sup> quarter volatility following populist (anti-market) election results in France, India and Mexico. The 10-year government bond yields of Germany, France, the U.K., and Japan dropped to 2.12%, 2.92%, 4.00%, and 0.86% at the end of the quarter, respectively, from 2.50%, 3.33%, 4.17%, and 1.06% at the beginning of the quarter.

Most major currencies appreciated against the USD in reaction to the shift in U.S. monetary policy telegraphed at the Jackson Hole Economic Symposium and an unexpected 0.50% rate cut (as opposed to the expected 0.25%) at the September FOMC. Notably, the yen sharply appreciated against the USD in early August following a surprise decision by the Bank of Japan to hike its policy rate by 0.25%. Failing to telegraph this move led to a massive unwind in the so-called USD/yen carry trade that sparked a sharp 1-day sell-off in Japanese equities. For the quarter, the yen appreciated 10.72% against the USD while the euro and UK pound appreciated, 3.94% and 5.77%, respectively.

### Implications: Near-Term Bottom for the USD

Barring a reacceleration in the U.S. economy, the lower rates path into 2025-26 has been firmly established by both the fixed income markets and Fed projections. The USD could depreciate further if the U.S. economic outlook dims, which would compel the Fed to accelerate rate cuts from their current trajectory. Further USD depreciation also presumes the U.S. economy decoupling from the rest of the world instead of moving in lockstep with each other.

Investors with outsized foreign currency exposure should lock in some gains and either hedge to the USD or allocate to U.S.-based fixed income as the interest rate differential and economic landscapes remain wide between the U.S. and the rest of the world. China fiscal and monetary stimulus would likely flow through other trade-heavy economies that rely on weaker currencies to maintain export competitiveness.

## US Equity Markets

Index Performance as of 9/30/2024	3Q2024	YTD	1-Year	3-Year (Ann)
S&P 500 TR USD	5.89	22.08	36.35	11.91
Russell 1000 Growth TR USD	3.19	24.55	42.19	12.02
Russell 1000 Value TR USD	9.43	16.68	27.76	9.03
Russell Mid Cap Growth TR USD	6.54	12.91	29.33	2.32
Russell Mid Cap TR USD	9.21	14.63	29.33	5.75
Russell Mid Cap Value TR USD	10.08	15.08	29.01	7.39
Russell 2000 Growth TR USD	8.41	13.22	27.66	-0.35
Russell 2000 TR USD	9.27	11.17	26.76	1.84
Russell 2000 Value TR USD	10.15	9.22	25.88	3.77
S&P Cmmncton Svces Select Sector TR USD	5.91	25.58	39.45	5.19
S&P Cons Staples Select Sector TR USD	9.05	17.79	24.23	9.41
S&P Consumer Disc Select Sector TR USD	10.22	12.91	25.71	4.71
S&P Energy Select Sector TR USD	-2.88	7.40	0.58	23.75
S&P Financial Select Sector TR USD	10.66	21.91	39.01	8.55
S&P Health Care Select Sector TR USD	6.07	14.35	21.69	8.35
S&P Industrial Select Sector TR USD	11.55	20.20	35.89	13.40
S&P Materials Select Sector TR USD	9.70	14.25	25.31	9.13
S&P Real Estate Select Sector TR USD	17.17	14.31	35.83	3.70
S&P Technology Select Sector TR USD	0.02	18.03	38.93	15.86
S&P Utilities Select Sector TR USD	19.37	30.63	41.82	11.66
S&P 500 Dividend Aristocrats TR USD	11.74	14.18	23.68	9.07
S&P 500 Low Volatility TR USD	11.01	16.55	25.13	8.27
S&P 500 High Beta TR USD	5.91	9.27	28.79	8.00
S&P 500 Momentum TR USD	3.85	39.10	59.47	16.30
S&P 500 Quality TR USD	6.32	25.81	36.53	13.42
DJ US Select Dividend TR USD	13.13	18.82	30.90	9.97

Source: Morningstar Direct

Despite a brief worldwide sell-off in early August following the surprise Bank of Japan rate hike, U.S. equities continued their strong advance from the post-pandemic lows of late 2022. The S&P 500 returned 5.89% while the Russell Mid Cap and Russell 2000 returned 9.21% and 9.27% respectively. U.S. equities are benefiting from a resilient U.S. economy, strong earnings growth and profitability, and Fed rate cuts. S&P 500 earnings announced in the 3<sup>rd</sup> quarter grew 4.9% YOY and are expected to grow 10.2% in CY-2024 and 15.4% in CY-2025.

Small caps and value stocks initially outperformed (a relief rally) earlier in the quarter in response to benign inflation releases that increased the chances of rate cuts starting at the September FOMC. Concerns over a slowing economy and labor market weakness led to a rotation into dividend-paying, rate-sensitive defensive stocks across consumer staples, real estate, and utilities, the latter also benefiting from anticipated electricity demand from artificial intelligence data center buildouts. Large cap growth outperformed in the latter part of the quarter, helped by strong outlooks from AI-centric companies across computer hardware, semiconductors, and cloud-based computing, although investors are now demanding more transparency around return-on-capital expectations.

Left behind the market rally were industrials (both traditional and ex-AI focused computer hardware) and commodity cyclicals as lower energy prices weighed on the energy complex while lower industrial metal prices hurt the materials

sector. Industrials were also weighed down by downbeat outlooks from the transportation sector and overall concerns that we've reached the peak of the traditional capital spending cycle as companies remain wary of making significant capital investments ahead of the election and potential labor strikes.

## **Implications: Stick with High Quality and Value, Diversify Away from Mag-7, and Hedge Reacceleration Risk with Hard Assets**

U.S. equity leadership in the form of market valuation and profitability is well recognized by global investors as the U.S. share of worldwide market capitalization has risen to nearly 67%. The S&P 500 Index trades at 21.8x forward 12-month earnings according to Bloomberg estimates. This is near the top end of its 10-year range, although earnings multiples can stretch further should the Fed cut interest rates more aggressively. The valuation gap between large cap growth and small cap value also remains historically wide with the former trading at 13.0x price/book versus 1.5x price/book for the latter.

The good news for investors is that the earnings picture is starting to broaden out beyond the AI-thematic segments, but investors continue to discriminate between the winners and losers (case in point is the dispersion in consumer discretionary stocks). Such a broadening of breadth can reward portfolio diversification as well as encourage fundamentally driven price discovery, a tailwind for active management.

Although Freedom Investment Management anticipates that we are more likely in the mid-cycle rather than late cycle phase of the post-pandemic period, we continue to favor U.S. stocks with strong balance sheets and durable profitability trading at reasonable valuations. We remain neutral on relative positioning between large and small caps and value and growth stocks. We also advise investors to investigate hard asset plays across natural resources and real estate as a potential hedge against inflation reacceleration risk with global central banks now firmly committed to an easing of monetary policy despite elevated demand-driven inflation pressures.

## International Equity Markets

Index Performance as of 9/30/2024	3Q2024	YTD	1-Year	3-Year (Ann)
MSCI ACWI NR USD	6.61	18.66	31.76	8.09
MSCI ACWI Ex USA NR USD	8.06	14.21	25.35	4.14
MSCI ACWI Ex USA Growth NR USD	6.92	14.06	26.75	0.81
MSCI ACWI Ex USA Value NR USD	9.26	14.40	24.04	7.49
MSCI ACWI Ex USA Mid Growth NR USD	9.62	11.55	23.14	-0.96
MSCI ACWI Ex USA Mid NR USD	9.66	11.89	22.80	1.84
MSCI ACWI Ex USA Mid Value NR USD	9.70	12.17	22.44	4.62
MSCI ACWI Ex USA Small Growth NR USD	8.45	11.17	22.48	-1.89
MSCI ACWI Ex USA Small NR USD	8.90	11.93	23.25	1.39
MSCI ACWI Ex USA Small Value NR USD	9.36	12.70	24.05	4.67
MSCI China NR USD	23.49	29.34	23.89	-5.56
S&P Japan BMI NR USD	6.93	11.98	20.86	2.21
MSCI AC Asia NR USD	8.73	17.95	26.30	1.39
MSCI Europe NR USD	6.58	12.77	25.23	6.66
MSCI EM NR USD	8.72	16.86	26.05	0.40

Source: Morningstar Direct

In USD terms, international equities outperformed the U.S. market in the 3<sup>rd</sup> quarter, helped by strengthening currencies and a sharp recovery in the long-suffering Chinese equity market. The MSCI All-Country World ex-USA Index (ACWI Ex USA) returned 8.06%, outperforming the U.S. market (S&P 500 returned 5.89% for the quarter). The international equity performance was largely driven by pan-Asia, notably China, as the rest of the world markets struggled to keep pace. Small caps outperformed large caps and value outperformed growth but all within a narrower band when compared to the relative performance of U.S. equity styles.

MSCI China was the standout performer across global markets, although much of that performance surge came late in the quarter. Propelled by sudden announcements of monetary policy relief measures and fiscal stimulus proposals, the Chinese stock market had surged from a 52-week low to a 52-week high in the span of a few weeks late in the quarter. The People's Bank of China (PBOC) provided relief to the banking system by lowering reserve requirements and deposit rates while mandating that rates also be lowered on existing mortgages to grant relief to overleveraged, underwater property owners. China also opened the door for asset managers and brokers to tap the PBOC to fund stock purchases. MSCI China returned 23.49% for the quarter, far outpacing the broader MSCI EM return of 8.72%.

International markets had largely lagged the U.S. for most of the quarter until the surge in China's stock market although a handful of other markets performed well, notably Canada, the European region ex France, and property-heavy markets such as Singapore and Hong Kong. The Japanese stock market experienced a record sell-off following an unexpected rate hike from the Bank of Japan ("BOJ") that contributed to the massive unwind of so-called yen carry trades. Japanese stocks would later recover over assurances that the BOJ would be more cautious in further policy tightening. France's market remains under pressure following the fractious parliamentary election results that failed to produce a stable governing coalition.

Markets dominated by semi-conductor component makers and equipment manufacturers (South Korea, Netherlands) were down for the quarter, as concerns started to creep in on a slowdown in order activity (mostly driven by supplies not keeping pace with demand). Denmark's stock market also came under pressure due to the underperformance of its

health care sector as weight loss medication is coming under increased regulatory scrutiny and competitive pricing from US pharmaceuticals.

## **Implications: Questionable Sustainability of China's Recovery and Renewed Concerns of Trade Protectionism and Currency Devaluations to Maintain Export Competitiveness**

Global markets continue to be valued at a discount to the U.S. with developed markets, as proxied by MSCI EAFE Index, and emerging markets, as proxied by MSCI EM Index, trading at 14.4x and 12.5x forward 12-month earnings, respectively. Earlier in the year, investors had been hopeful that international growth prospects and profitability were looking brighter, notably in Japan. But unlike the U.S., much of the rest of the world lacks robust internal demand to fuel domestic consumption and so must rely on industrialization and exports to generate marginal growth.

Attractive valuations offset by lackluster profitability keep us neutral on regional allocations, as investors maintain a watchful eye on the sustainability of China's financial recovery and whether global central banks try to keep pace with the Fed on easing monetary policy. As with the U.S. market, we emphasize positioning in high quality stocks trading at reasonable valuations and that fundamental price discrimination should provide a tailwind for active stock pickers.

## Conclusion

Investors maintain optimism about equity and fixed income markets, anticipating resilient corporate profitability over the next two years. The growing consensus outlook is mid-cycle, though labor market challenges and reaccelerating inflation present risks to a soft landing. Despite these concerns, fixed income investors have opportunities to secure moderately high real rates by extending maturities, while asset- and mortgage-backed securities remain appealing due to their favorable spreads. For investors with significant foreign currency exposure, hedging to the USD or reallocating to U.S.-based fixed income is advised, given the wide interest rate differentials between the U.S. and other regions.

U.S. equities remain favored, particularly those with strong balance sheets and sustainable profitability, trading at reasonable valuations. The broadening earnings landscape beyond AI-driven sectors suggests that diversification and active management could be increasingly rewarded. In addition, investors are encouraged to explore hard assets like natural resources and real estate to hedge against inflation risks, as global central banks are focused on easing monetary policy despite persistent inflationary pressures. Global markets, while trading at a discount to the U.S., continue to face subdued profitability, dampening earlier optimism about international growth. Attractive valuations abroad are balanced by concerns about weaker demand and reliance on exports. This keeps regional allocations neutral, as investors remain cautious about China's financial recovery. Across both U.S. and global markets, a focus on high-quality, reasonably valued stocks, coupled with active stock picking, is emphasized for future returns.



# FREEDOM

INVESTMENT MANAGEMENT

---

1-800-949-9936 ■ [freedomadvisors.com](https://freedomadvisors.com)

Advisory services are offered through Freedom Investment Management Inc. ("Freedom"), a registered investment adviser. Investment strategies carry varying degrees of risk, including the total loss of principal. Freedom does not provide tax or legal advice.

The index data shown was obtained through Morningstar unless otherwise specified. Other specific figures shown were obtained through Bloomberg unless otherwise specified. While Freedom believes the data to be reliable, no representation is made as to, and no responsibility, warranty or liability is accepted for the accuracy or completeness of such information. Indexes are unmanaged and cannot be invested in directly. Past performance is not a guarantee of future performance. This material reflects the opinions of Freedom and is an assessment of the market environment at a specific time. This is not intended to be a forecast of future events or a guarantee of future results.

This should not be considered a recommendation to buy or sell individual securities, nor should this information be relied upon as research or investment advice regarding any security in particular. Diversification does not ensure a profit or protect against loss.

Except as otherwise specifically stated, all information and portfolio manager commentary are as of October 8, 2024.