SEPTEMBER 2024 MARKET REVIEW

	9/30/2024 Level	QTD Change	1 Year Change
S&P 500	$5,762	5.9%	36.4%
MSCI ACWI Ex USA	$332	8.1%	25.4%
MSCI Emerging Markets	$624	8.7%	26.1%
Bloomberg US Aggregate	$2,258	5.2%	11.6%
10 Year Treasury Rate	3.81%	-55 BP	-78 BP
Bloomberg Commodity Index	$240	0.7%	1.0%
Bitcoin	$65,664	7.9%	143.9%

Historically, the third quarter of the year tends to be a difficult one across financial markets. It is often difficult to pinpoint specifically why this is and given the volume of potential culprits over the past three months, it is intriguing that markets bucked the trend and produced strong positive returns for investors. As we have discussed in recent reviews ad-nauseum, the last quarter may have brought about the beginnings of a potential rotation out of the largest public stocks and into their smaller peers. Unsurprisingly, as the rotation within US equities began, so too, did a rotation into international markets, such that global equities (as measured by the MSCI All Country World Index) returned over 6.6% in the quarter, outperforming the US market by over 0.7%. On the bond side, both interest rates (dramatically) and credit spreads (marginally) fell, driving a 5.2% total return for US bonds in the quarter and increasing the 1-year return to over 11.5%.

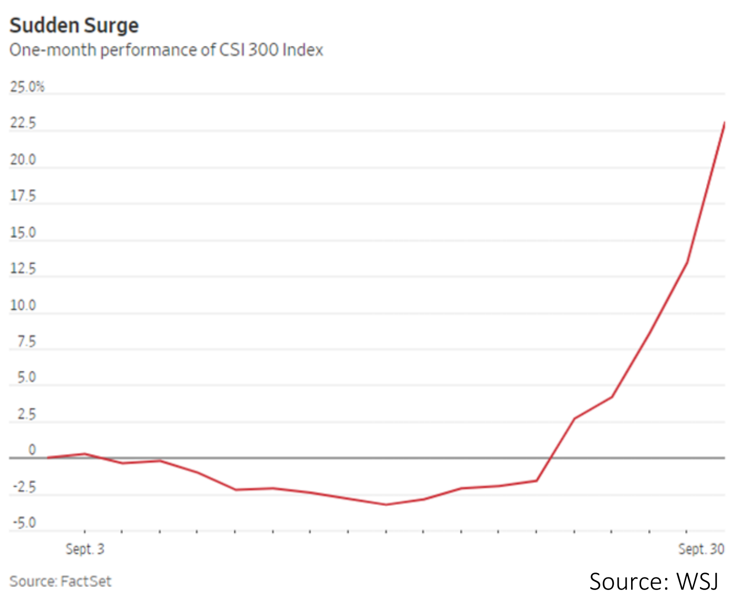
However, it was not entirely smooth sailing during the third quarter. There was a market correction in July & August that drove the fourth largest bout of equity market volatility ever (as measured by the popular VIX index). The turbulent couple of weeks stemmed from an unwinding of leveraged positions in Japan and coincided with political instability in the US when President Biden announced he would discontinue his campaign for re-election. Markets have been conditioned in recent years to bid up safe haven assets such as treasuries during market turbulence, before digesting the news and continuing their ascent higher. This event mirrored just that.

In this quarter's update, we will first highlight the two major themes that drove markets over the past 3 months, and then discuss a handful of near-term risks we are watching closely.

Theme I: A Chinese "Bazooka"

We like to think of the global economy as having three distinct but interconnected drivers of growth; the US, Europe, and China. Since Covid, the strength from the US economy has more than made up for a struggling Europe and disastrous China. Much of China's struggle has been self-inflicted, through questionable Covid policies and a culling of major technology companies after a long period of gains, similar in fashion to their North American peers. In late September, however, the Chinese government enacted major policy measures that could propel China to carry their economic weight alongside the US.

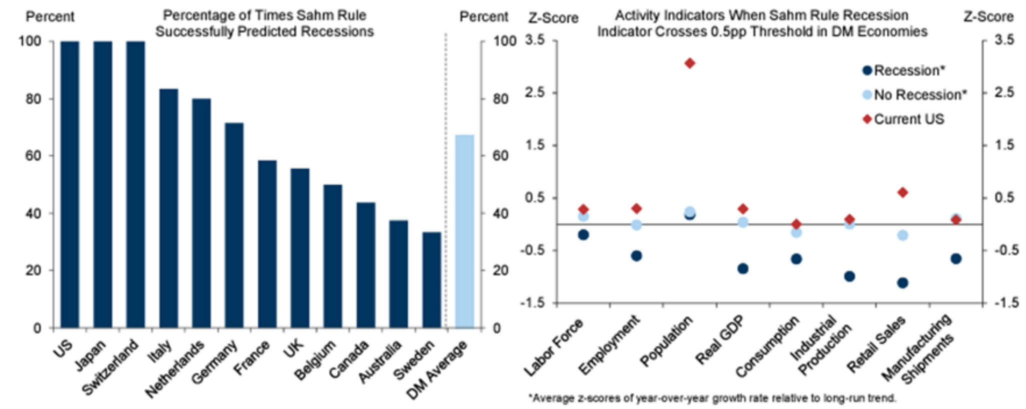
The Chinese economy has underperformed expectations for years now and has held back local equity markets. The People's Bank of China (Chinese central bank) passed three forms of easing in late September; increasing liquidity through the lowering of reserve requirements at banks (and lowering interest rates), directly reducing mortgage rates for existing properties, and establishing a loan facility to increase the level of stock buybacks. The collective nature of these policy measures has been viewed by markets as much more impactful than China's other attempts to stabilize the economy in recent years. This is evidenced by the massive rally in Chinese equities to the tune of a 23% gain in the Shenzhen index in September. The timing of this is curious and most likely relates to gathering momentum to hit President Xi's 5% growth target as we head into the final quarter of the year.



Source: WSJ

Theme II: A new Monetary Policy Cycle

Exhibit 2: The "Sahm Rule" Has Only Reliably Signaled Recession When Other Activity Indicators Were Also Weak



Source: Haver Analytics, Goldman Sachs Global Investment Research

Having seen other major central banks begin a cutting cycle in recent months, in September, the Fed jumpstarted its cutting cycle with a 50 basis point cut to the base rate. While the Fed has largely been focused on bringing inflation down to acceptable levels, their attention seems to have shifted to the employment market. There are certainly market participants and pundits who argue that Fed rate cuts are a bearish market signal, and "they must know something we don't", but that is not our take. While the tighter monetary policy stance over the past two years has clearly cooled inflation, the broader economy appears to be in decent shape, despite a rising unemployment rate. The direction of equity markets has more to do with the economic environment (recession versus no recession), than it does with the Fed lowering rates.

Those who are more negative on the economy and markets point to the recent triggering of the "Sahm Rule", named after Claudia Sahm, a former Federal Reserve economist. The rule states that a 0.5% increase in the unemployment rate over a 12-month period indicates an impending recession, and historically the rule has had a high degree of predictive power. The issue with applying the historical accuracy of the "Sahm Rule" to the current environment, is that the actual economy today appears to be significantly stronger than what one would expect from a struggling economy (as shown in the above chart from GS). We also know there are major distortions currently in the labor market, due to high levels of immigration, that are artificially inflating the headline unemployment rate. Recessions can invariably sneak up quite quickly, which would validate the above worries; however, our base case remains a growing economy, which makes the rise in unemployment a false trigger.

Risks: Near Term Risks All Over

With easing cycles beginning across the globe and continuing AI exuberance, it is prudent to spend a bit of time discussing the many near-term risks. Fortunately for Americans who are sick of hearing from wildly unpopular presidential candidates in horrible advertisements, the US election is only several weeks away. But, unfortunately for investors, this means that markets are attempting to predict a winner, and will be pricing in expected policy changes over the coming weeks, which has the potential to drive volatility higher. The US election instability also impacts the US' position in relation to the two ongoing hot wars and the quasi-cold war with China. One of the risks that seems to have been avoided in the very near term, but could pop up again in 2025, is the recent dockworker's strike in the US. The strike has been driven by negotiating higher pay for the International Longshoremen's Association members, while also protecting the longevity of their careers against automation. The length of any strike ultimately determines the economic damage it will have – many companies planned for the strike in recent months by re-routing shipments and accelerating deliveries, which should help reduce the impact. But if no agreement takes place over the coming months and another strike ensues, there will certainly be a hit to US GDP and fewer bananas on grocery store shelves.

Despite these risks, we maintain our moderately optimistic outlook. Underlying fundamentals, Chinese policy reflation, and sustained growth in AI innovators can push markets higher while simultaneously improving market breadth. In other words, the blue sky scenario is a "catch up" of the average stock to the high flyers, rather than a "melt down" of the high flyers to the average stock. We have begun to see this pivot in fundamentals, wherein the earnings expectations for value-oriented companies are improving, while growth companies are experiencing earnings downgrades. The knock-on effect here will be a convergence in valuation levels of the average stock as it catches up to the Magnificent 7. While we believe this rotation will continue, it is important to also maintain sizable exposure to those companies that will be driving the AI boom. That does not necessarily mean portfolios should have a massive exposure to semiconductors, like Nvidia. Growth in AI will drive second order effects across the energy, utility, real estate, and industrial sectors – many of which have a valuation cushion that semiconductors may not. Finally, one change we have made in many client portfolios is an increase to China exposure through a broad-based emerging markets ETF. We feel the recent changes to the policy regime in China, as discussed earlier, put a floor under Chinese equity markets at a time where valuations are quite attractive. Therefore, increasing our exposure brings client portfolios closer to benchmark weight.

	Growth	Core	Value
12-Month Change in Forward EPS Growth (%)			
Large Cap	-18.7	13.3	20.1
Mid Cap	-1.7	2.1	4.0
Small Cap	5.9	1.4	-3.5
12-Month Change in Forward P/E Ratio (%)			
Large Cap	49.7	6.2	-3.2
Mid Cap	19.1	7.0	1.1
Small Cap	3.7	7.0	3.9

Note: Blue (Red) = Better (Worse); source: Bloomberg Finance L.P.

Source: Alpine Macro