

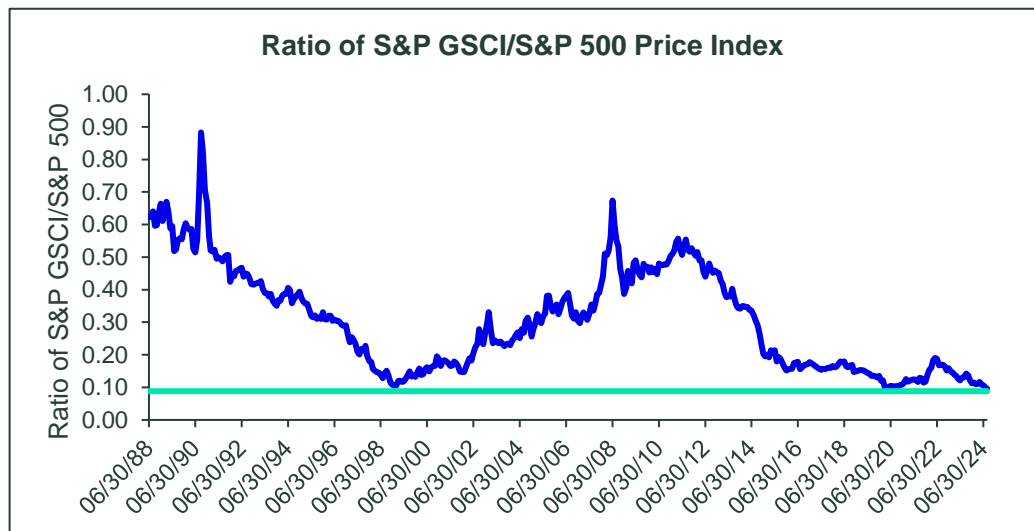
September 19, 2024  
Commentary

## Weekly Market Update

### Insight of the Week

### Structural Trends for Commodities

Despite a strong 2022 during the spike of inflation, the last 15 years have been unkind to commodities which have significantly underperformed equities. More recently since inflation was at its peak and began rolling over in mid-2022, the S&P GSCI index—an index for commodity prices—trailed the S&P 500 price index by an astonishing 68.4% (measured from 5/31/22 to 8/31/24). Consequently, as of August 31, commodities are trading at very cheap levels. From June 30, 1988, to August 31, 2024, the S&P 500 cumulative price gain was around 1,965%, while the S&P GSCI recorded a modest gain of just 213%.



Source: FactSet. Monthly data from June 30, 1988 until August 31, 2024.

There are a few structural macroeconomic conditions that may suggest some tailwinds for commodity prices moving forward. First, deglobalization—evidenced by the increasing imposition of trade barriers which was exacerbated by supply chain disruptions from the COVID-19 pandemic—signals a partial retreat from globalization, likely contributing to upward inflationary pressures that could buoy commodity prices. Second, the decarbonization movement is facilitating a global transition toward renewable energy, necessitating the gradual phase-out of older, carbon-intensive fuels and fostering an environment conducive to commodity price appreciation amid anticipated tighter energy supplies. Third, the escalating demand for artificial intelligence applications requires substantial computational power, which is expected to drive energy consumption higher and, consequently, elevate energy prices.

Over the more tactical short term, we don't necessarily think now is the time move into inflation protection assets. However, as investors look forward and re-visit their longer term investment policy statements, we think inflation will be structurally a bit higher than we saw in the 2010's, so it may be beneficial to allocate a bit more to inflation protecting assets than investors did back then.

*Source: State Street Global Advisors, FactSet.*

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## Equities

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### Fed Cuts 50bps: Review of How Markets Fared, and What's to Come

The Fed's pause ends after 13 months with the FOMC's latest decision to cut interest rates by 50 basis points bringing the Federal Funds target policy rate to 4.75-5%. Since the Fed began their rate hiking cycle, here's a look at how the equity market has performed.

From the first interest rate hike in March of 2022 until Sept 18, 2024 the S&P 500 has returned 32.8% with the best performing sector, Technology, up 62.8% and the worst performing sector Real Estate up 4.2%. World factor performance over this horizon has favored quality and growth with the MSCI World Quality and Growth indices up 35.4% and 29.1% respectively. Interest rate sensitive small caps struggled with the Russell 2000 returning 10.5%. Around the world countries such as India and Japan had impressive performance up 58.3% and 43.2% respectively in local currency terms.

Specifically in the U.S. large cap arena, sales per share marched higher amid a restrictive environment, while earnings and margins faltered in 2023 but recovered in 2024. The S&P 500 NTM EPS rose 16% while valuations expanded moving from a NTM PE of 19x to 21x.

The initial market reaction on the day of the Fed's decision was mixed. The S&P 500 initially rallied on the larger rate cut, seeing less restrictive conditions as a positive development, but ended the day down 0.2% as investors pondered if the Fed foresees challenges to growth ahead.

Moving forward, the Fed will attempt to lower interest rates while avoiding a recession, something that has rarely been accomplished throughout history. The chart below illustrates how US large cap sectors have fared during easing cycles over the past two decades. Defensive sectors such as Consumer Staples, and Health Care outperformed on a relative basis, though performance was still negative, as the economy entered recession during each of these periods.

S&P 500 Sector	Easing Cycles		
	2001-2003	2007-2008	2019-2020
Energy	-16.2%	-30.5%	-53.9%
Financials	-18.3%	-63.2%	-28.5%
Industrials	-26.0%	-43.9%	-27.2%
Utilities	-43.1%	-27.6%	-15.7%
Health Care	-18.0%	-25.9%	-10.1%
Consumer Staples	-8.7%	-14.6%	-11.0%
Information Technology	-51.1%	-40.2%	-9.8%
Real Estate	N/A	-51.9%	-21.7%
Materials	-2.1%	-42.6%	-29.1%
Communication Services	-48.5%	-36.6%	-16.2%
Consumer Discretionary	-17.0%	-42.3%	-24.1%

Source: FactSet, S&P. Price return calculated from day of first interest rate cut, to day of last cut in easing cycle. Real Estate S&P 500 sector returns are not available for the first observed easing cycle.

Though the 50 basis point cut was a decisive move to support labor markets, we continue to believe the U.S. economy is in fair shape and the Fed can navigate a soft landing. Although easing warrants a calculated approach, we continue to favor sectors in the equity market that exhibit strength through quality characteristics, as opposed to going outrightly defensive.

Source: FactSet. Data in total return terms as of 9/18/2024. Performance measured from first day of interest rate hike in this cycle 3/17/2022 to 9/18/2024.

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## Fixed Income

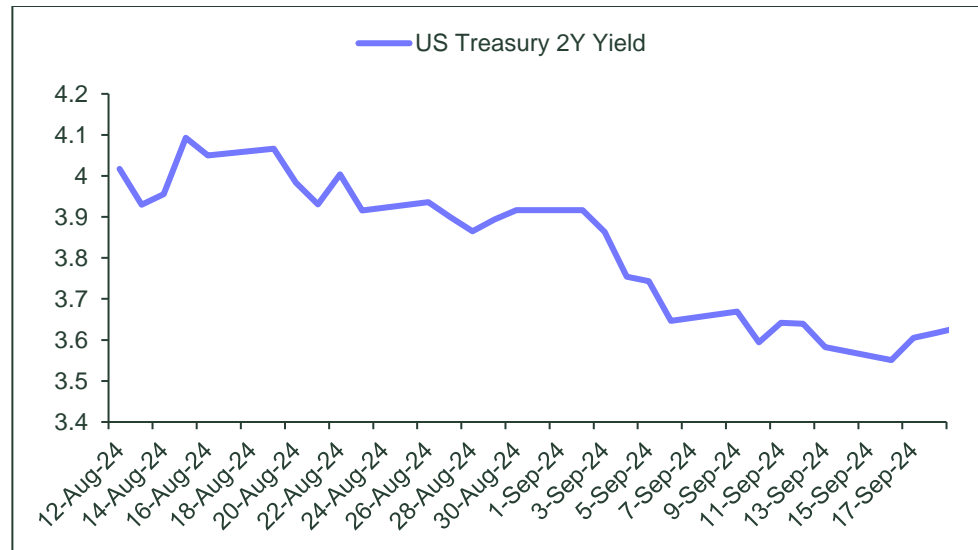
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### A Soft Landing, the Holy Grail of Monetary Policy, Is Possible

Since March 2022, the Federal Reserve raised interest rates 11 times in 16 months to combat high inflation resulting from supply chain issues following the pandemic and the Russia Ukraine war. After holding the Fed Funds rate in a restrictive range of 5.25% to 5.50% for over a year, Chair Powell (at the Jackson Hole Conference) indicated that the Federal Reserve was finally ready to pivot.

Leading up to the meeting, markets remained conflicted as to the magnitude of the rate cut that would be delivered. Having initially priced in a 25bp rate cut after the Jackson Hole Conference in August, market expectations increased to price in a 65% chance of a 50-bps cut just hours before the FOMC meeting. The 50bps cut, though not a total surprise, did result in some market chatter due to the almost 50/50 split in expectations.

At his speech after the FOMC meeting, Chair Powell stated that the decision to initiate a higher rate cut was driven by data that pointed to easing inflation and a softening of the labor market. He reiterated that the Fed's focus has shifted to the downside risk of employment as the labor markets continued to cool with job gains slowing, wage growth easing, and the jobs to workers gap narrowing. He also stressed that the economy continues to expand at a solid pace, and is supported by a strong labor market, resilient consumer spending, and stronger supply data.



Source: Bloomberg as of September 18, 2024

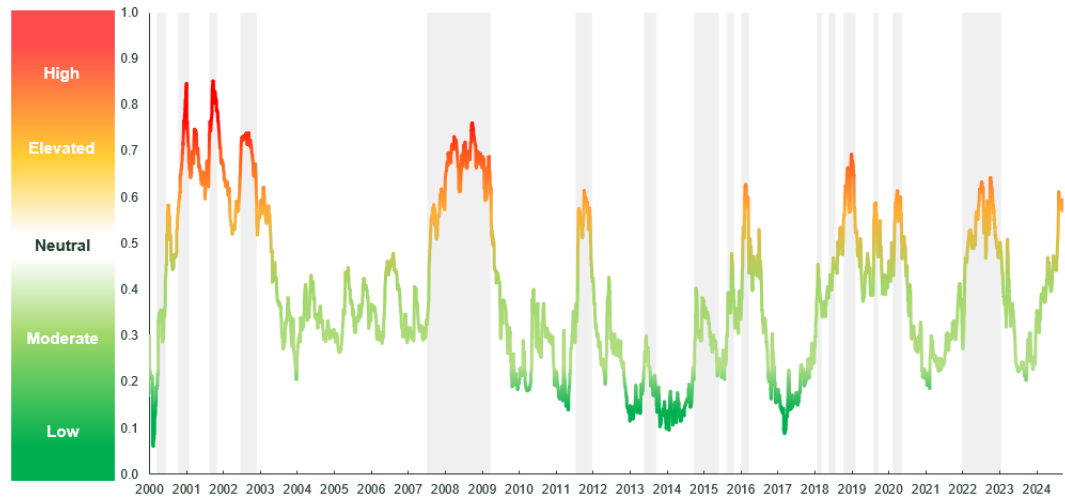
Yields at the front end of the curve, especially 2-year yields (which are more closely tied to the Fed rate decisions than longer maturities) have recently hit their year-to-date lows.

Although a 50-bps cut was not our base case for this meeting, we also believe that the holy grail of monetary policy, a soft landing, is a strong possibility given the strong state of the economy, and the Fed's nimbleness to cut rates as appropriate.

Source: State Street Global Advisors, Bloomberg.

**Market Regime Indicator**

*The Market Regime Indicator (MRI) represents a proprietary multi-asset class model designed to characterize risk appetites within the capital markets.*



*Source: State Street Global Advisors, Investment Solutions Group (ISG). As of September 18, 2024. The data displayed is not indicative of the past or future performance of any SSGA product. The above data represents a back-test of the MRI model, which means that those results were achieved by means of the retroactive application of the model which was developed with the benefit of hindsight. Data displayed beyond this date is not backtested, but is still generated by the model referenced. All data shown above does not represent the results of actual trading, and in fact, actual results could differ substantially, and there is the potential for loss as well as profit. The Market Regime Indicator (MRI) is a quantitative framework that attempts to identify the current market risk environment based on forward-looking market indicators. We believe the factors used are good indicators of the current risk environment as they are responsive to real-time market impacts and in theory should include all current and forward views of those markets. These factors are combined to create a single measure and used to identify one of four risk regimes: Low Risk, Moderate, Normal, Elevated and High Risk..*

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\*Pensions & Investments Research Center, as of 12/31/23.

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