

Quarterly Market Commentary

Third Quarter 2024

The Great Recalibration



DBR & CO
412.227.2800
dbroot.com

436 Seventh Ave.
Suite 2800
Pittsburgh, PA 15219

“Today, unemployment is up to 4.2 percent, inflation’s down to a few tenths above 2. So, we know that it is time to recalibrate our policy to something that is more appropriate given the progress on inflation, and on employment, moving to a more sustainable level, so the balance of risks are now even.”

- Jerome Powell, Chairman of the Federal Reserve

After thirty long months, the Federal Reserve officially began easing monetary policy in September. The Central Bank slashed its benchmark rate with a front-loaded 50 basis point reduction. The first cut may be the deepest. Chairman, Jerome Powell, characterized the move as a “recalibration” intended to shift policy action from fighting inflation toward safeguarding employment and economic growth. Since peaking at 9% in 2022, inflation has steadily declined toward the Fed’s 2% target.

The decision to cut rates by 0.50%, as opposed to the 0.25% expected by investors, was deemed necessary not only because inflation had fallen faster than anticipated, but also because the labor market deteriorated at a swifter pace than forecast. The magnitude of the cut helped the Fed get back on sides with both dynamics. In general, we agree that relative to the employment and inflation data – the two components of the Federal Reserve’s “dual mandate” – interest rates well above 5% were too restrictive.

Goldilocks Without Her Bears

Policy reset was arguably the Fed’s best response to protect an economic soft-landing. Volatility gripped the markets in early August, as investors balked at back-to-back weak Non-Farm Payrolls reports from the Bureau of Labor Statistics. The data revealed a significantly slowing labor market and rising unemployment. Alongside high interest rates,

this string of data points caused investors to question the economy’s footing.

In our view, softening the jobs market was exactly what the Fed had hoped to accomplish, as the pandemic distorted labor’s supply / demand balance and rapidly boosted wages – a disconcerting driver for future inflation. While normalization of the labor market may point to a slowing economy, there are few signs of recession. As such, the volatility experienced in August subsided and gave way to new highs throughout the remainder of the quarter.

Quarter To Date as of September 30, 2024¹

S&P 500 Total Return Index	5.9%
Dow Jones Industrial Average	8.7%
Nasdaq Composite Index	2.6%
Russell 2000 Index	9.3%
MSCI EAFE Index	7.3%
MSCI Emerging Markets Index	8.7%
Bloomberg Aggregate Bond Index	5.2%

Year To Date as of September 30, 2024²

S&P 500 Total Return Index	22.1%
Dow Jones Industrial Average	13.9%
Nasdaq Composite Index	21.2%
Russell 2000 Index	11.2%
MSCI EAFE Index	13.5%
MSCI Emerging Markets Index	16.9%
Bloomberg Aggregate Bond Index	4.5%

¹ Black Diamond

² Black Diamond

Market returns have since broadened beyond the Magnificent 7 and the secular growth theme of Artificial Intelligence. The prospect of lower borrowing costs should disproportionately help smaller businesses, such as those in the Russell 2000, as those companies have more exposure to changes in interest rates. Furthermore, household consumption should get a modest bump with falling interest expenses on credit cards and a more affordable home and auto market. Continued economic growth and modest inflation remains our base case, and drives our constructive view on most asset classes.

Higher for Longer, and Longer...

While jobs gains have moderated, income growth continues to power forward. Union workers, which represent six percent of the labor force, have enjoyed wage gains of roughly 6.5% this year. State and local employees, which represent four percent of the labor force, have enjoyed wage gains of 5.5%. So far, wage gains across the labor market have broadly outpaced inflation.

As long as this trend is intact, the economy can continue to remain on solid footing. The risk to the cycle, however, is an inflection higher in unemployment or inflation. These dynamics present a clear challenge to the Federal Reserve and are opposite sides of the coin requiring two different policy approaches.

There are several inflationary trends that we are watching closely. Heightened geopolitical tensions in oil producing nations have recently pushed up oil prices. The conflicts in the Middle East, and particularly along the Red Sea, are also impacting the cost of shipping, as the Shanghai Freight Index has risen 269% year-over-year. When the cost of moving things around the globe rises, so do the prices consumers pay.

While I have attempted to circumnavigate the topic, there is a hotly contested election scheduled for early November. We can debate many aspects of the respective candidates' policy agendas, but what is not for debate is that both candidates support policies that will continue, if not increase, deficit spending. Therefore, regardless of who occupies the Oval Office in the new year, we are likely to see a flurry of initiatives that could have long tails and fan inflationary pressures.

Cautiously Optimistic

In summary, our view on the markets and economy can be characterized as cautious optimism. Our dynamic economy has been driven by innovation, adaptation, and a well-positioned consumer largely insulated from the restrictive interest rate cycle. With the Fed loosening monetary policy and easing financial conditions, we believe the current cycle's runway has extended.

Heading into the final months of 2024, we have much to be thankful for. As investors, the economy has been resilient, and the markets have provided a lift for asset owners. On behalf of the entire team at DBR & CO, we are sincerely thankful for your partnership and remain committed to providing full support toward all your financial goals.

Respectfully,

Michael J. Aroesty, CFP®
Investment Committee Chair
Chief Investment Officer
✉ maroesty@dbroot.com



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