Perspectives

A Quarterly Newsletter for Clients of Parsons Capital Management

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by John Mullen and Ruth Mullen

With a return of 2.14% in September, the S&P 500 recorded its strongest nine month start to a year since 1997. The September gain is even more noteworthy considering the month began with a decline of -4.25% over the first four trading days, leaving investors to wonder if September would live up to its well-earned reputation of poor returns. Following that four-day decline, the S&P would go on a nearly uninterrupted run higher through month end, advancing 6.55%. The initial move higher was driven by relatively tame inflation numbers, giving investors hope that the Fed would finally join the rate cutting party that had begun in much of the rest of the world. That hope became reality on the 18th, with the Fed cutting its rate by a half percentage point and communicating more could come. While the S&P 500 had a strong return, it was a relative laggard for the quarter. Domestically, value stocks bested growth by over 6 percentage points to help close the year-to-date performance gap. Internationally, emerging markets enjoyed an incredibly strong September to take the leadership edge. The month's gains were driven by China, where policymakers unleashed the stimulus investors have been clamoring for.

Data as of September 30, 2024	Sept. '24	Qtr. 3 '24	YTD '24
S&P 500	2.14 %	5.89%	22.08%
MSCI AC World Index (incl. US)	2.36%	6.72%	19.07%
MSCI EAFE (Europe, Asia, Far East)	0.97%	7.33%	13.50%
MSCI EM (Emerging Markets)	6.72%	8.88%	17.24%
Russell 1000	2.14%	6.08%	21.19%
Russell 1000 Growth	2.83%	3.19%	24.55%
Russell 1000 Value	1.39%	9.43%	16.68%
Russell Midcap	2.22%	9.21%	14.64%
Russell 2000	0.70%	9.27%	11.17%
Bitcoin	7.39%	1.04%	49.84%

Data provided by Tamarac Inc.

Fixed Income Markets

The fixed income market roared back in the third quarter after posting negative returns for the first half of the year. The combination of moderating inflation and central banks spanning the globe cutting rates sent investors piling into bonds, with positive returns across the maturity table. Long bonds led the march higher, with the Bloomberg U.S. Treasury 20+ Year index at 7.96% compared to the 1-3 Year Index at 2.91%. Like the returns seen in the stock market, international bonds paced the returns for the quarter with a showing of 6.98% for the Bloomberg Global Aggregate compared to the Bloomberg U.S. Aggregate at 5.20%. Due to underperformance in the first half of the year, international still lagged U.S. 3.60% vs. 4.45% for the nine months of 2024. The high yield market continued to indicate a healthy economy, with the ICE BofA High Yield index posting returns of 5.31% and 8.05% for the quarter and year, respectively.

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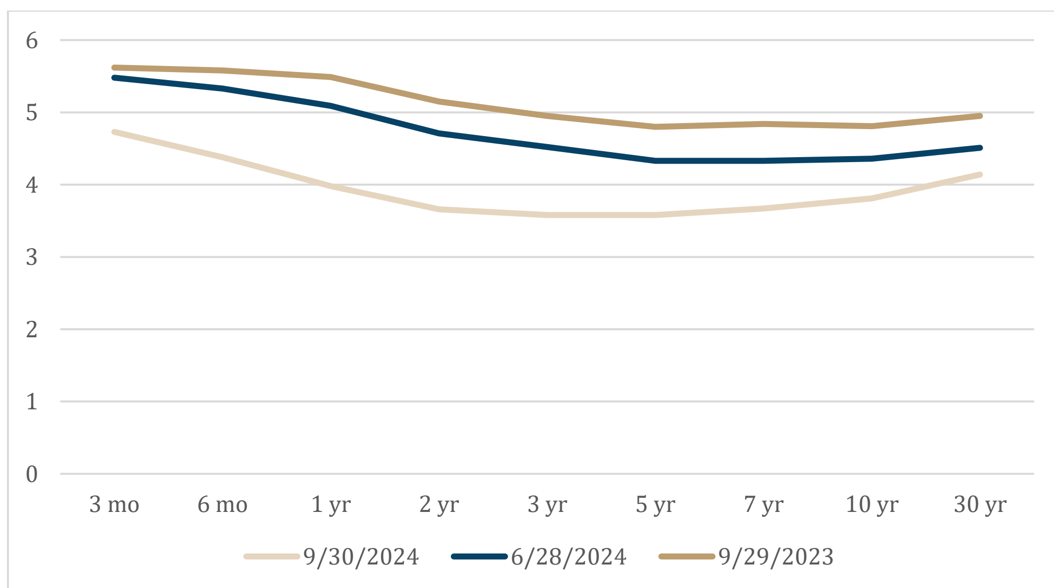
US Treasury Yields

Fed goes big with their first cut in four years…

As the third quarter unfolded, the question surrounding the Fed shifted from if they would cut rates to how big they would go. After passing on the opportunity in July, stating that they needed to see more data, a September cut became all but a foregone conclusion. The Fed delivered on September 18th, with a 50 basis point (0.50%) cut to the Fed Funds Rate, marking the first move lower since March 2020. The other notable occurrence in the quarter was the un-inversion of the yield curve as measured by the spread between the 2-year and 10-year yields. While yields for both time periods fell, the 2-year dropped more, ending the longest yield curve inversion in history, which began in July 2022.

Longest 2-10 inversion in history finally ends…



Data from U.S. Treasury

Commodities

The CRB Index ticked lower in the third quarter, dragged down by weakness in the energy complex. A plunge in the price of oil during the three months brought the year-to-date performance into negative territory. Ample supply along with constrained demand combined to pull oil prices lower. In a relief for consumers, lower oil prices bled through to gasoline prices which dropped by an even greater percentage, -22% in the quarter.

Metals continue to shine…

Gold continued to attract investors as a hedge against real (geopolitical) and potential (inflation) instability.

Copper prices, on the back of the stimulus announcements from China, rallied strongly in the final weeks of September, +11% to eke out a gain of 4% for the quarter.

Commodity	Qtr. 3 '24	Year to Date '24
CRB (broad index)	-0.75%	12.22%
Oil	-16.39%	-4.85%
Gold	13.67%	28.36%

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Economic Overview

The U.S. economy continued to muddle through in the third quarter, as restrictive monetary policy collided with a stimulative fiscal backdrop. While a tight labor market and government largesse have been able to keep the economy growing, cracks became evident during the quarter, ultimately resulting in a pivot by the Fed to rate cuts.

Soft landing still the call…

While job growth clearly slowed from the height of the pandemic rebound, the domestic economy continued to incrementally add jobs monthly. September posted a blow-out figure with an addition of 254,000 jobs. This compared to 159,000 in August and dramatically exceeded expectations for a gain of 150,000. The unemployment rate has ticked up over the past few months (though the strong September numbers actually sent it lower by 0.1%), driven by more workers entering the workforce. This is a welcome relief from recent upward pressure on wages, which could threaten to begin a wage/price inflation spiral.

Labor market remains resilient…

Further reinforcing the point that the labor market remains healthy is the modest number of initial jobless claims. The final weekly reading for this report in the third quarter came in at 218,000, below the expected 224,000 and the previous reading of 222,000.

While the Manufacturing PMI (Purchasing Managers Index) survey remained in contraction territory with a reading of 47.3, there were some early green shoots giving hope that this important sector of the economy may be positioned to turn up. At the regional survey level, both New York and Chicago had notable moves higher into expansion territory in September.

Services strength offsetting manufacturing weakness…

Turning to the service sector, the Services PMI slipped lower in September but remained firmly in expansion with a reading of 55.2. While the new business reading posted a solid increase, concerns regarding the economy led to a drop in business confidence to the lowest level since October 2022.

Looking to the international picture, a similar trend of choppiness begins to emerge. From Japan to the Euro zone, economic activity hovered between expansion and contraction. Generally, Services were showing signs of weakening but still in expansion territory, and Manufacturing remained in contraction territory mostly due to weakening new orders. In China, however, September was a mirror image to much of the rest of the world. Here, manufacturing PMI remained below 50 but rose .7 points to 49.8. Meanwhile, the Services reading remained barely in expansion after falling 1.3 points to 50.3. Of note, these readings covered activity before the wave of stimulus released by the Chinese government.

China officials finally pushing stimulus…

The above data show a clear theme running through much of the world economy: the service industry has been able to just manage to prop up economic growth, while manufacturing has struggled after the whipsaw action of Covid lockdowns and re-openings. Said another way, consumers are once again the engine of growth, and not just in the U.S. The job market and confidence from rising wages and net worth (speaking broadly) in major economies support the continuation of this trend.

The overall muted economic activity around the globe together with moderating inflation set the stage for monetary policy to turn accommodative. Central banks in developed countries had begun to cut interest rates in March, and the U.S. Fed finally joined the party in September. Japan became the only major economy not lowering rates (they hadn't raised them when everyone else was doing so either).

On the fiscal front, the U.S. federal government continued to handily outspend revenue received, boosting the economy with more expected as the election nears. The Chinese government unleashed their own bazooka of stimulus in September. While helpful in the near term, these last two items bear watching for their ability to reignite inflation. More on that in the next section.

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Investment Implications

Notable strength in the first three quarters…

In posting the best nine month start to a year since 1997, and the ninth best such start of all time, the S&P 500 managed to plow through a dizzying array of global events that could conceivably have caused a tailspin. A change in the top of the ticket for Democrats, two assassination attempts against the Republican candidate, conflicts escalating in the Middle East and Europe, a jump in the Japanese Yen leading to a sharp U.S. market contraction in August and slowing labor market growth all proved to be merely speed bumps as the S&P 500 continued to mark all-time highs.

Can value leadership prove durable…

Perhaps as notable is how the S&P managed it in the quarter. Information Technology and Communication Services (the latter, being dominated by Google and Meta, is essentially another Tech sector) had been the driving forces behind the market advance that began in late 2022. In the third quarter, the only industry those two managed to best was Energy. Utilities, Real Estate and Industrials took the top spots. This leadership change of Value over Growth has happened occasionally and briefly since the Global Financial Crisis in 2008-2009; up to now, it has always proved fleeting.

The broadening out of market performance in the quarter, where the Magnificent Seven (for one quarter at least) ceded the leadership mantle, is another positive. The questions now are: Can the bull market be sustained? How? Will there be more durable leadership changes within the market?

High P/E ratio means earnings growth essential to continue the bull…

Global growth looks steady with a real chance to accelerate in a synchronous way. This steady growth with (so far) tame inflation and lower interest rates has allowed companies to grow earnings faster than revenue, supporting stock prices. The bull case is that, even with price/earnings levels at the high end of historic ranges, earnings can bring up the bottom of that equation. That would go hand in hand with the broadening out of performance beyond the top tier of mega-cap growth stocks and also support the leadership shift to value/cyclical stocks.

Also helping the bull case is the combination of record U.S. oil production and weak demand from China, which have led to a notable decline in energy prices despite the prospects for an escalation of hostilities in the Middle East. Lower fuel prices are adding to consumer spending ability in an election year, as we've seen in the still buoyant service sector domestically and internationally. And of course, the Fed's accommodative pivot with the indication of more to come provides an expected continued stream of liquidity, the lifeblood of markets.

Spending and liquidity propping up stocks through year-end…

The bill will come due, and that may be next year. Both presidential candidates' policies and plans call for government spending without a comprehensive explanation of how it will be funded, promising further increases to federal deficits. Divided government would buffer such stimulative action, but the ensuing dysfunction presents other problems. The liquidity wave should carry the market through these impediments until it has run its course. At some point, we would expect the bond market to rebel against the ever-rising deficits and the debt service crowding out other categories of government spending. That would have an impact on the stock market.

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