Market Update
Q3 2024

TOMPKINS Financial Advisors

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The Changing Colors of Autumn

The third quarter of 2024 featured several market dynamics that equity investors had to navigate. Notable among them were: questions regarding the economy's strength, concerns regarding the timing and magnitude of the Federal Reserve's interest rate policy, the unveiling of the Presidential candidates' economic policies, an unwinding of a Japanese Yen carry trade, corporate earnings reports (including Nvidia) and continued global tensions.

In light of these many "headwinds", the markets were positive for the quarter. Most interesting was the broadening out of performance. Recall that performance had been dominated by domestic large cap growth stocks in the first half of the year, with the "Magnificent Seven" (Nvidia, Microsoft, Apple, Amazon, Meta, Alphabet, and Tesla) responsible for 60% of the market's total return according to S&P Dow Jones Indices.

Market strength flip-flopped that trend in July, however:

US Indices	July %	2024%
Russell MicroCap	11.9%	10.9%
Russell 2000	10.2%	12.1%
S&P Midcap 400	5.9%	12.4%
Russell 1000 Value	5.2%	12.1%
Dow Jones Industrials	4.5%	9.5%
Russell 3000	1.9%	15.7%
S&P 500	1.2%	16.7%
Nasdaq Composite	-0.7%	17.7%
Nasdaq 100	-1.6%	15.6%
Russell 1000 Growth	-1.7%	18.6%

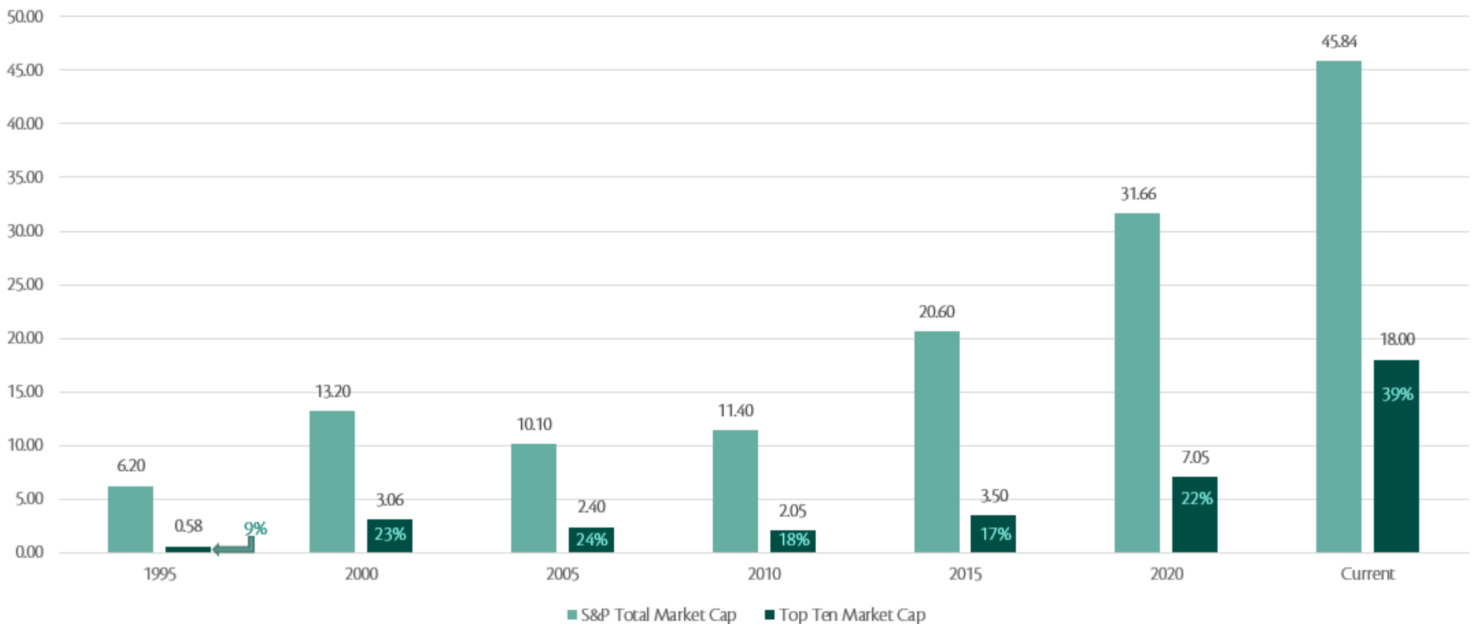
Smaller Cap and Value stocks outperformed Large Cap and Growth stocks. This could easily be attributed to Chairman Powell's press conference post-July Federal Reserve meeting where he suggested the Fed was comfortable with the direction of inflation and was now open to reducing interest rates. This came as a relief to small cap stocks, which have a more difficult time accessing credit markets, as well as value stocks that are more economically sensitive with higher levels of debt than growth stocks.

A continued broadening out of markets is probable as long as the economy remains stable and lower rates drive a pick-up in economic activity. As a result, we remain fully invested across geographies, valuations and capitalization segments. Most importantly, we are conscious of the recent concentration in the market, illustrated in the following charts, whether it be the technology sector or top-10 stocks in the S&P 500. While we own many of these stocks in more measured percentages, our focus remains on maintaining well-diversified portfolios. As the world changes, so to do businesses. None of the top ten companies in 1995 remain in the top ten today. Regimes change, and the markets are nothing if not cyclical. The Nifty Fifty and Internet Boom reversions remain valid historical guideposts.

S&P 500 Top Ten Holdings

1995	%	2000	%	2005	%	2010	%	2015	%	2020	%	Aug-24	%
GE	1.40%	MSFT	4.55%	GE	3.82%	XOM	2.84%	APPL	3.14%	APPL	4.11%	APPL	7.53%
T	1.27%	GE	3.84%	XOM	3.28%	MSFT	2.38%	XOM	1.90%	MSFT	3.79%	NVDA	6.74%
XOM	1.21%	CSCO	2.69%	MSFT	2.87%	WMT	1.79%	MSFT	1.86%	GOOGL	2.91%	MSFT	6.65%
KO	1.06%	WMT	2.33%	C	2.48%	GOOGL	1.73%	BRK/B	1.80%	AMZN	2.89%	GOOGL	4.41%
MO	0.81%	INTC	2.08%	WMT	2.22%	APPL	1.67%	GOOGL	1.74%	META	1.85%	AMZN	3.90%
WMT	0.79%	NOKIA	1.79%	PFE	2.01%	JNJ	1.56%	JNJ	1.42%	BRK/B	1.75%	META	2.86%
MRK	0.77%	PFE	1.55%	BAC	1.88%	PG	1.55%	WFC	1.38%	JPM	1.38%	BRK/B	2.18%
IBM	0.69%	XOM	1.48%	JNJ	1.86%	IBM	1.51%	WMT	1.34%	V	1.32%	LLY	1.96%
PG	0.68%	IBM	1.45%	AIG	1.69%	JPM	1.50%	GE	1.23%	JNJ	1.21%	AVGO	1.60%
EIDP INC	0.61%	C	1.42%	IBM	1.62%	T	1.45%	PG	1.19%	WMT	1.06%	TSLA	1.43%
TOTAL	**9.31%**	**TOTAL**	**23.19%**	**TOTAL**	**23.73%**	**TOTAL**	**17.97%**	**TOTAL**	**17.01%**	**TOTAL**	**22.28%**	**TOTAL**	**39.26%**

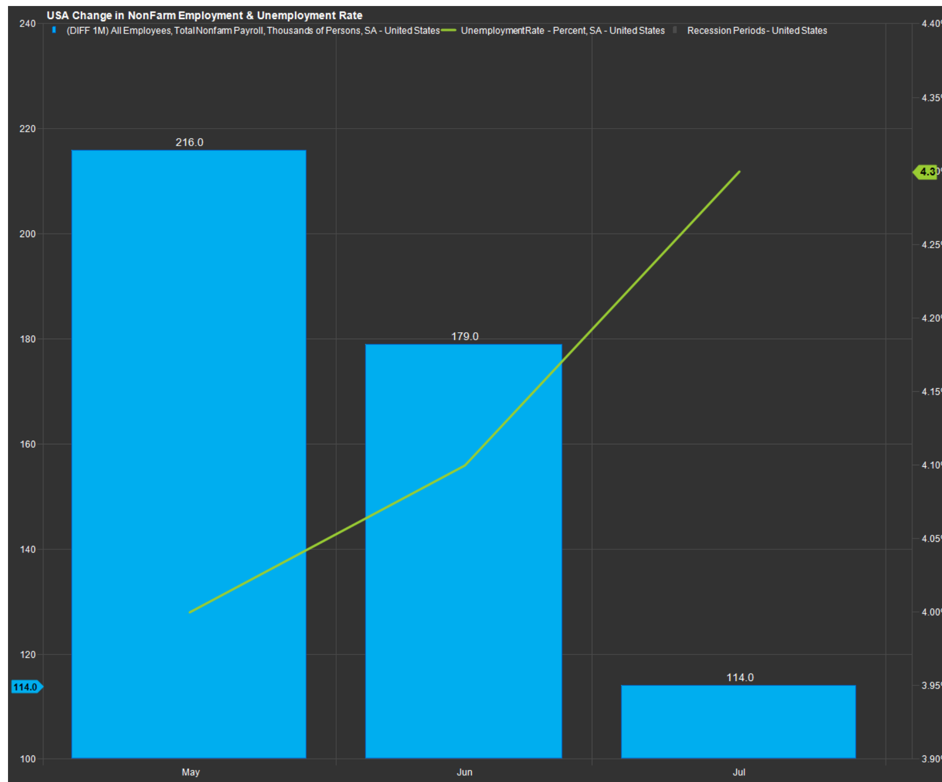
Source: Bloomberg



Source: Bloomberg

In fixed income, the first half of the year was highlighted by volatile swings in bond valuations, as markets were forced to reconcile early expectations of numerous 2024 interest rate reductions, increasingly stubborn inflation and a hawkish Fed delaying rate cuts.

Investors became concerned the Fed might be too late in starting to reduce rates after a very disappointing July payrolls report. Non-Farm employment dropped precipitously from May to June to July (blue columns below) as the unemployment rate (yellow line) rose to 4.3%. Large and small cap stocks then sold off 5% and 7% respectively in the first weeks of August. The impact the labor market has on US economic and monetary policy is significant, and warrants vigilant monitoring for any meaningful deterioration.



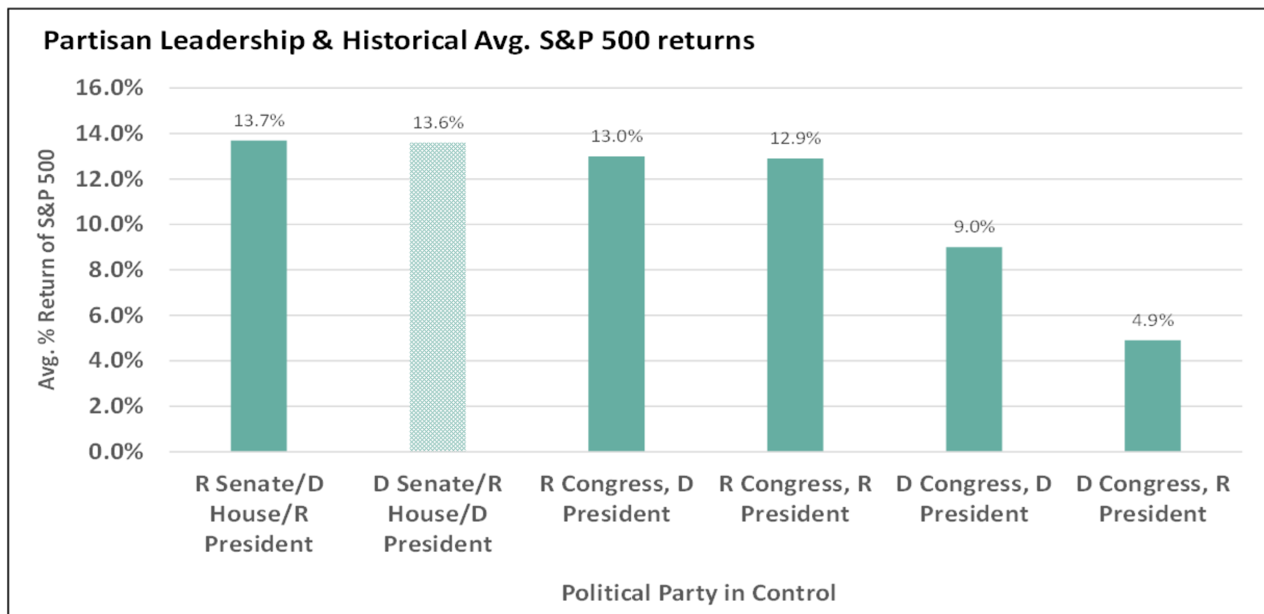
Meanwhile, some market and economic forecasters started calling for an inter-meeting Fed rate cut. We didn't think this a reasonable idea given past inter-meeting cuts happened in response to extraordinary events, such as the:

- 1998 Russian default/LTCM
- 2001 Dot Com Bubble and September 11 WTC terrorist attack
- 2008-2009 Great Financial Crisis
- 2020 Global Pandemic

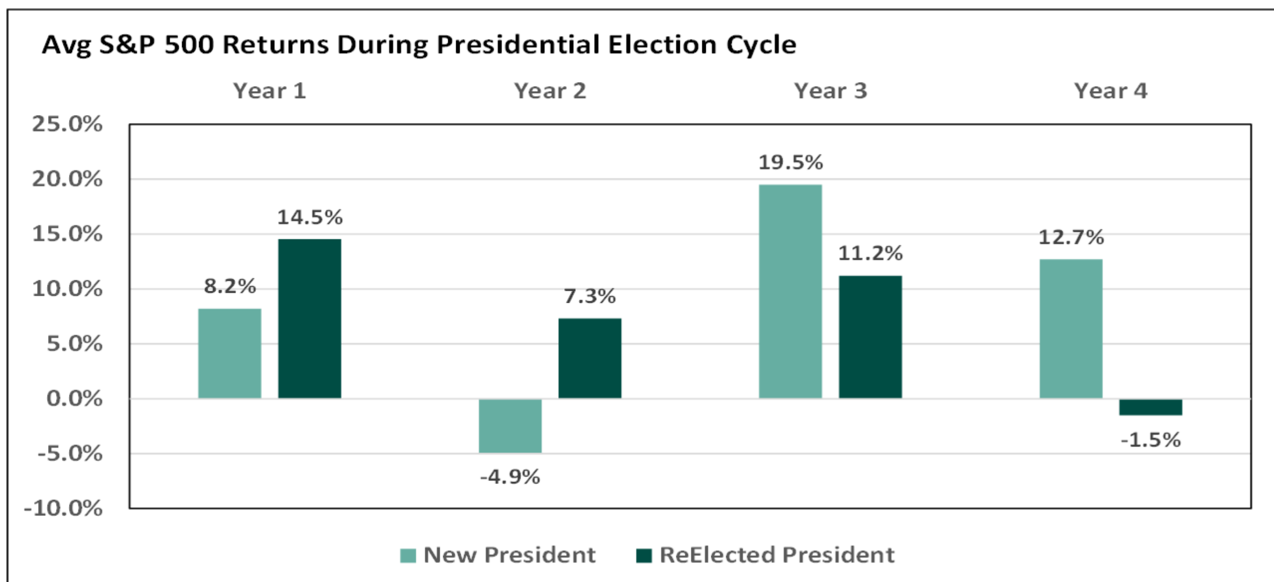
With the current economic and market environments nowhere near these crisis levels, most of the third quarter was peppered with favorable economic data reports that suggested easing inflation pressures. The Price Consumption Expenditure (PCE) numbers, the Fed's preferred measure of inflation, along with the month-over-month CPI prints, continued to decrease in tandem through July and August. Bond yields reacted by falling. During the annual Jackson Hole Economic Symposium, Fed Chair Jerome Powell stated that "the time has come for a policy adjustment" and the "direction of travel is clear."

Those comments cemented the idea of an imminent rate cut and, finally, in September, the Fed began its much-anticipated easing cycle, reducing the Fed funds rate 50bps (0.50%) to 4.74%-5.00%. The news was quickly assimilated by the bond market as the yield curve steepened, finally breaking the two year-long inversion between 2- and 10-year Treasuries. In stocks, markets immediately drifted lower, then rallied broadly, and ended September up.

Lastly, the US Presidential election is likely to create near-term market volatility. As economists, the Fed and the markets may still harbor recessionary concerns, investors appear somewhat complacent with fiscal and monetary issues. Fiscal responsibility is a muted, if not absent, topic in the campaigns. But, as the following chart shows, markets historically are quite positive in the years following national elections. Investors probably would breathe a sigh of relief if the US presidential winner faced a split or hostile Congress, simply because such an arrangement would put a brake on the spending and tax plans of the future administration. Divided government does not necessarily dampen returns.



Election and return data above refers to time period between 1933-2022, excluding '01-'02
2001-2002 are excluded due to Sen. Jeffords changing party mid-2001
Chart & data source: Strategas Research Partners



Election and return data above refers to time period between 1961-2022
1965-1968 (Johnson) treated as cycle of first time elected president
Chart & data source: Strategas Research Partners

Looking forward, we remain cautiously optimistic with respect to US economic growth. The economy has not reacted to sustained higher interest rates in a typical manner, noting that the largest increase in global rates witnessed in 40 years has not caused the type of economic disruption we saw in the 1980s (the Paul Volcker era). Our house view on near-term economic growth is constructive; moreover, we feel the larger-than-expected Fed rate cut in September has certainly bolstered the growth outlook. With 4Q expectations that corporate earnings reports continue positive, that corporate stock buybacks provide substantial equity demand and that Treasury bill maturities provide US households liquidity for near-term investment, the tailwinds of a market rally still blow. That baseline outlook, however optimistic, is tempered by the fading influences of high fiscal spending, reduced labor demand, and a weary US consumer suffering income pressure. Our emphasis on owning companies with fortress balance sheets, free cash flow generation, strong competitive advantages and sustainable earnings should still continue to benefit client portfolios through all manner of market cycles.

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