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*Planning for a Lifetime®*

# Quarterly Letter October 2024

*Comments as of October 11, 2024*

Dear Clients and Friends,

## *EXECUTIVE SUMMARY*

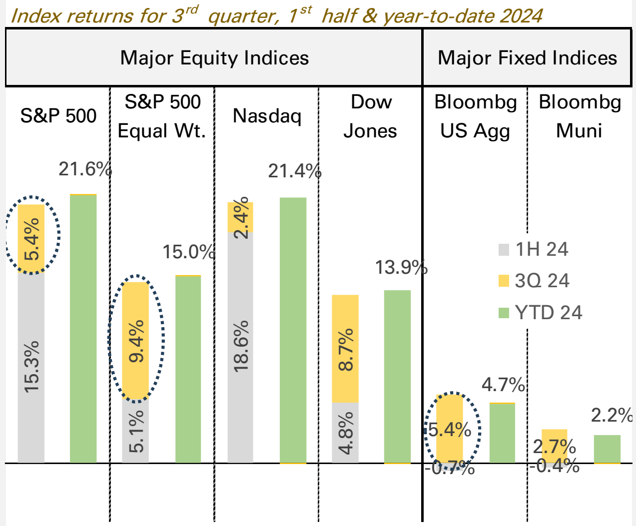
Markets rose in the 3rd quarter, aided by an economy that has threaded the needle, with macro activity moderating enough to cool inflation and provide a path for rate cuts, but not so much that it causes a recession. Exhibit 1 shows that the S&P 500 gained 22% year-to-date, adding 5% in the 3rd quarter. Unlike the narrow breadth we saw in the 1st half of 2024, a resilient economy alongside the onset of a new rate cutting cycle were the rising tides that lifted all boats, with 2/3rds of S&P 500 stocks outperforming in the quarter. To that end, we saw increased participation for the typical stock, as seen in the S&P 500 Equal Weight, and a reversal in leadership, with non-Magnificent 7, SMID-Cap and Value stocks beating Magnificent 7, Large-Cap and Growth stocks. Bonds were also up, as seen in the Bloomberg US Agg., with Treasuries firmer and the 10-year less 2-year Treasury yield curve steepening, ending the quarter at +15bps after being inverted since 2022.

Into year end, markets are most focused on the path of interest rates and the election. On rates, the Fed began a new rate-cutting cycle in September, with a 50-basis point rate cut, and provided an updated Summary of Economic Projections (SEP) calling for two more percentage points of rate cuts through 2026 alongside a healthy economy with moderating inflation. This "soft-landing" macro outlook, should it prove accurate, has historically been a tailwind for markets. On the election, markets usually go up and history suggests an election year is no different, with median 11% returns ranking 2nd out of the four-year election cycle and seasonal strength into year-end as political uncertainty is removed, irrespective of the election outcome. While 20% year-to-date returns may raise doubts that seasonals hold from here, Exhibit 2 shows past years of similar year-to-date strength have also ended the year higher. We will continue to monitor the economy, as well as fiscal and monetary policy, and manage portfolios accordingly.

Separately, Social Security and Supplemental Income benefits will increase 2.5% in 2025, with maximum earnings subject to tax increasing to $176.1k.

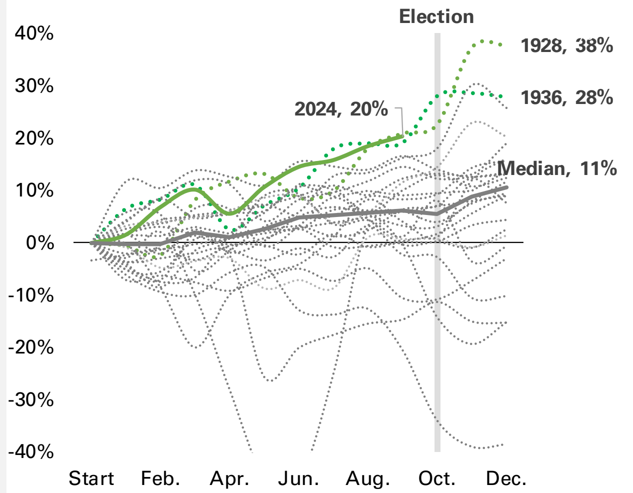
**Respectfully submitted by the Professional Staff at United Asset Strategies.**

**Exhibit 1: Markets continued their march higher in the 3rd quarter, aided by broader participation.**
*Index returns for 3rd quarter, 1st half & year-to-date 2024*




*Source: United Asset Strategies, Bloomberg*

**Exhibit 2: 2024 return ranks 2nd among election years through 3Q, which bodes well for 4Q.**
*S&P 500 price returns for each election year, since 1928*




*Source: United Asset Strategies, Bloomberg*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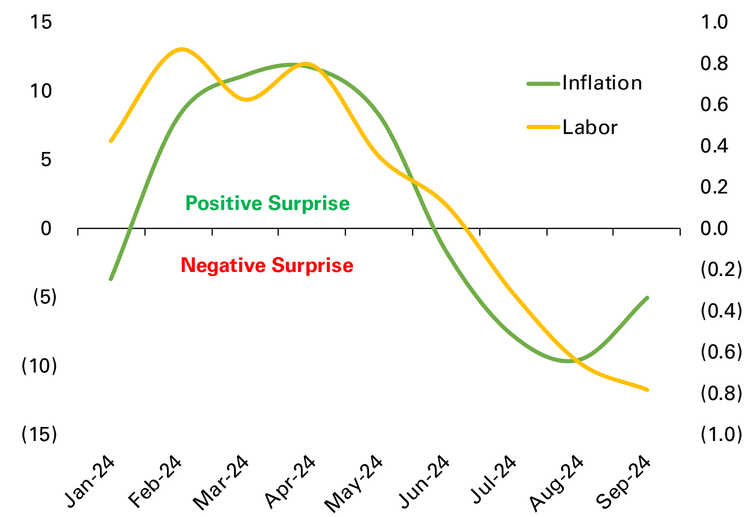
## Recent macro misses provide window for rate cuts.

Exiting the 2nd quarter, the Fed sought "greater confidence" that inflation was moving sustainably toward its 2% target. The summer was a key turning point on that front, as June headline CPI dropped sequentially for the 1st time since 2022 (-0.1% m/m), and core CPI missed expectations (+0.1% m/m vs. +0.2% consensus), supporting the disinflation narrative. In July, non-farm payrolls (+114k vs. +175k consensus) and the unemployment rate (4.3% vs. 4.1% consensus) also missed expectations, refocusing the Fed on the labor side of its dual mandate and triggering recession concerns via the Sahm rule (when the three-month average unemployment rate is 0.5% above its low over the prior 12 months). Exhibit 3 highlights a clear shift toward cooler macro data in the 3rd quarter via negative readings for both the Citi inflation and Bloomberg labor market surprise indices. Still, data remains mixed, with hotter than expected data since the end of the quarter.

**Exhibit 3: Inflation & employment below expectations, providing Fed with the path to begin cutting rates.**

*Citi Inflation Surprise Index* *Bloomberg Labor Market Surprise Index*




*Source: United Asset Strategies, Bloomberg*

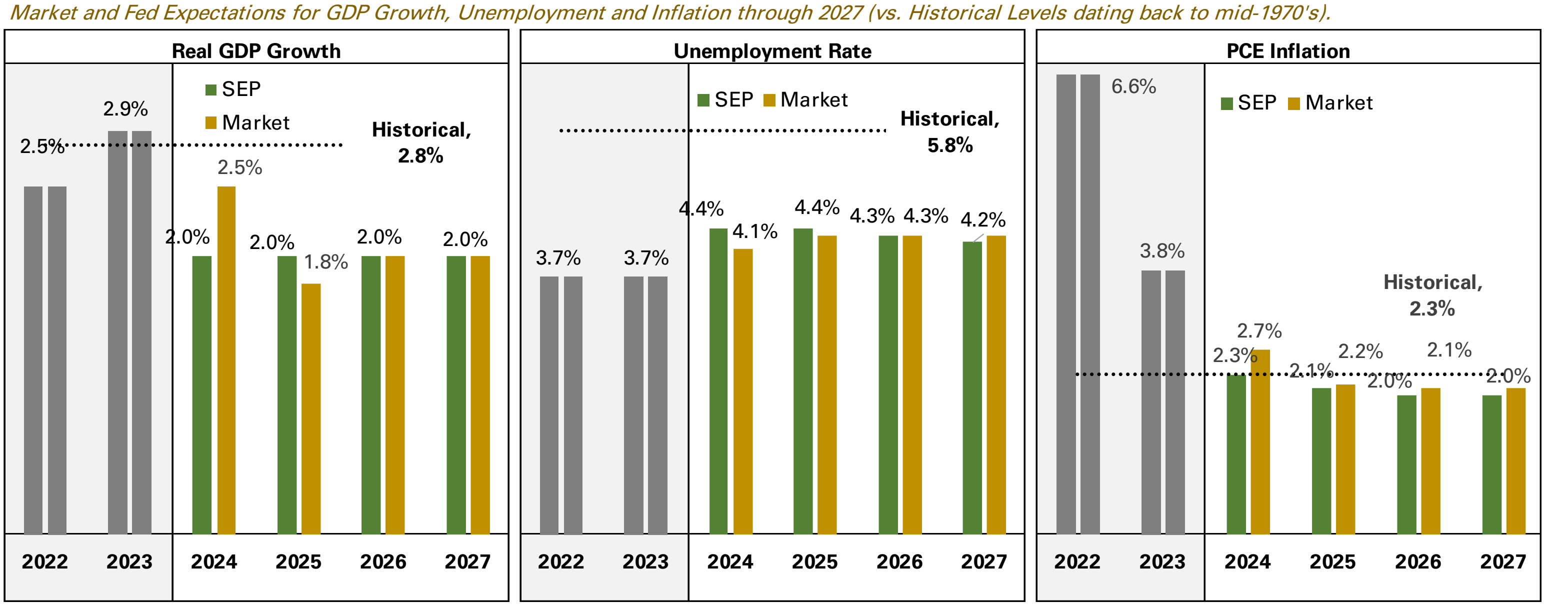
## … But the overall economic outlook remains healthy.

While economic data has been weaker than expected, it is not yet weak. The economy continues to thread the needle, with activity moderating enough to cool inflation and provide a path for Fed rate cuts, but not so much as to drive a recession so far.

Market participants and the Fed anticipate a "soft-landing" scenario that avoids a recession. Exhibit 4 shows forecasts for 2% GDP growth, stable and below average 4% unemployment and moderating inflation toward the Fed's 2% target. Further, the Index of Leading Economic Indicators (LEI) has improved and is no longer calling for a recession, while consensus expectations for a recession have declined to a 30% probability over the next 12 months, down from 50% earlier this year.

**Exhibit 4: Market and Fed expectations for a "Soft Landing" macro backdrop, as seen as GDP growth, stable and below average unemployment and inflation moderating toward target levels.**

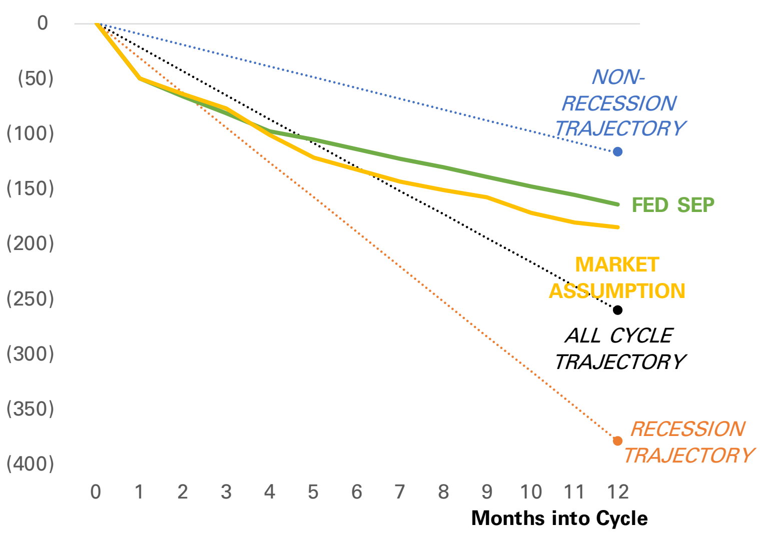
*Market and Fed Expectations for GDP Growth, Unemployment and Inflation through 2027 (vs. Historical Levels dating back to mid-1970's).*




*Source: United Asset Strategies, Bloomberg (PCE) and FactSet (GDP Growth, Unemployment Rate, PCE Inflation)*

**Exhibit 5: Inflation & employment continue to come in below expectations, providing fed with path to begin rate cuts.**

*First 12-Months of a New Rate Cutting Cycle, since 1970*




*Source: United Asset Strategies, Bloomberg*

## Start of a new fed rate cutting cycle.

Following a string of underwhelming data, Fed Chairman Powell noted in August at Jackson Hole that "the time has come for policy to adjust," adding that the Fed would "not welcome further labor-market cooling." In September, the Fed opted to start easing with a 50-basis point (bp) cut, near the high end of the 25-50bp range expected by the market heading into the Fed meeting.

Further, the Fed SEP guides to another 50bp cuts by year-end, and 150bp cuts through 2026, to end the year at a 2.9% Fed Funds Rate. These expectations are faster and larger than the guidance provided in June, and now approach the size and pace assumed by the market. As highlighted in Exhibit 5, however, history suggests the pace of cuts expected are modestly more aggressive than one would expect in a non-recessionary backdrop, such as the one outlined in the Fed SEP.

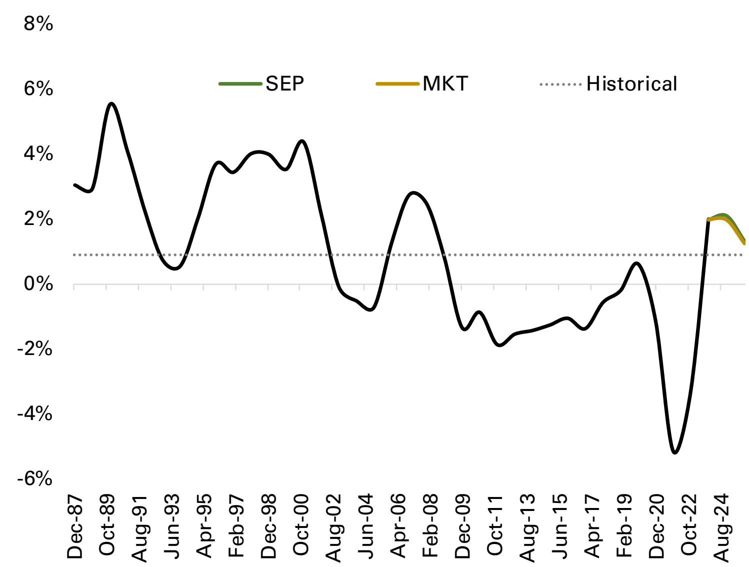
## Cuts aimed at preventing, not addressing, a recession.

Rather than cut rates in a recession to jumpstart a recovery, the Fed is doing so alongside a healthy economy with moderating inflation to ensure real rates (the difference between nominal rates and inflation) do not become overly restrictive to economic activity and risk a recession. Said another way, these rate cuts appear more proactive, than reactive.

Exhibit 6 charts the real Fed funds rate (the Fed funds rate less PCE inflation) from the mid-1980's through 2025, as per the Fed's SEP and market expectations. Just ahead of the September 50 bp rate cut, the August real Fed funds rate was 2.7% (5.4% Fed Funds rate less 2.7% Core PCE), relatively restrictive compared to the 0.9% historical average. And as the exhibit shows, the pace and magnitude of rate cuts guided by the Fed no longer seem overly aggressive, simply implying a glide path toward normal real rates over the next 12 months.

**Exhibit 6: Motivation to cut rates alongside healthy macro to ensure real rates aren't overly restrictive on economy.**

*Forecasts real fed funds rate (FFR less PCE) vs. historical since the mid-1980's*




Source: United Asset Strategies, Bloomberg

## 2024 Election cycle likely to come down to the wire.

After a 2nd quarter depicted by large and volatile swings in the 2024 election betting odds, those odds have since stabilized and narrowed significantly; now limited to a back-and-forth between modest Trump and Harris leads over the last few months. To that end, Exhibit 7 shows data from Real Clear Politics that aggregates betting site odds and shows the outcome as a near flip of a coin, with Trump at 52% and Harris at 46% odds and the eventual outcome still highly uncertain.

The presidential election features candidates with significant policy differences. We summarize a few of those differences for illustrative purposes, but we acknowledge the existence of other policies and details that are not covered to avoid our letter turning into a novel.

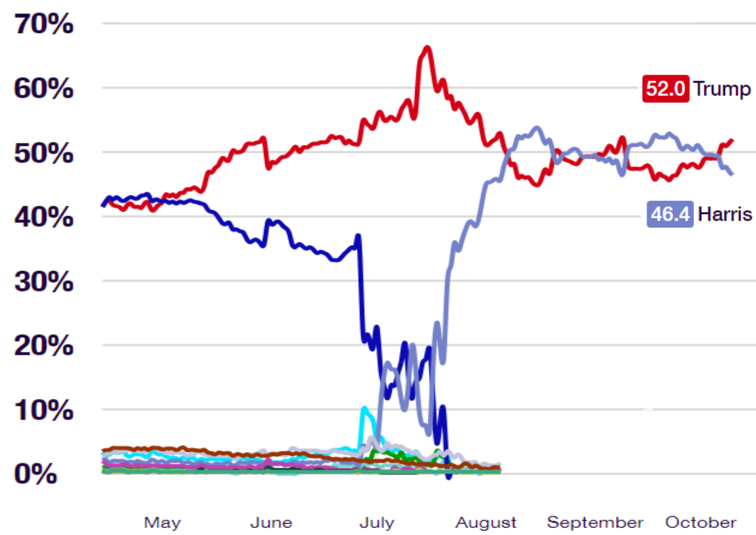
- Trump has proposed lower tax rates for corporations and individuals, while Harris has proposed higher tax rates.
- Harris has proposed targeted tariffs, while Trump has proposed more expansive, broad-based tariffs.
- Trump wants to lower regulations broadly, while Harris wants new laws on price gouging and minimum wages.

- Trump proposes increased drilling of fossil fuels while Harris wants green energy spending in the Inflation Reduction Act.
- Both target lower drug prices, though Harris plans to expand the number of drugs subject to Medicare price negotiations
- Harris proposed more border enforcement, while Trump targets more restrictive immigration policy and deportation.
- Both candidates favor easy money policy, although Trump has more vocally challenged the Fed's independence.

Of course, Congress's composition will considerably impact the candidates' policy proposals. And, according to Polymarket (one of the betting sites aggregated by Real Clear Politics), odds favor Democrats in the House (55%) and Republicans in the Senate (75%), resulting in a divided government (46%, vs. 35% Republican sweep, 19% Democratic sweep). Regardless of the election outcome, tight odds suggest a narrow margin of victory, implying that many of the proposed policies will likely be diluted as they work through negotiations in Congress.

**Exhibit 7: 2024 Election likely to be one of the least predictable; odds shifting back and forth in recent months.**

*Aggregated Betting Odds by Political Candidate, Trailing 6 Months*




*Source: United Asset Strategies, Real Clear Politics*

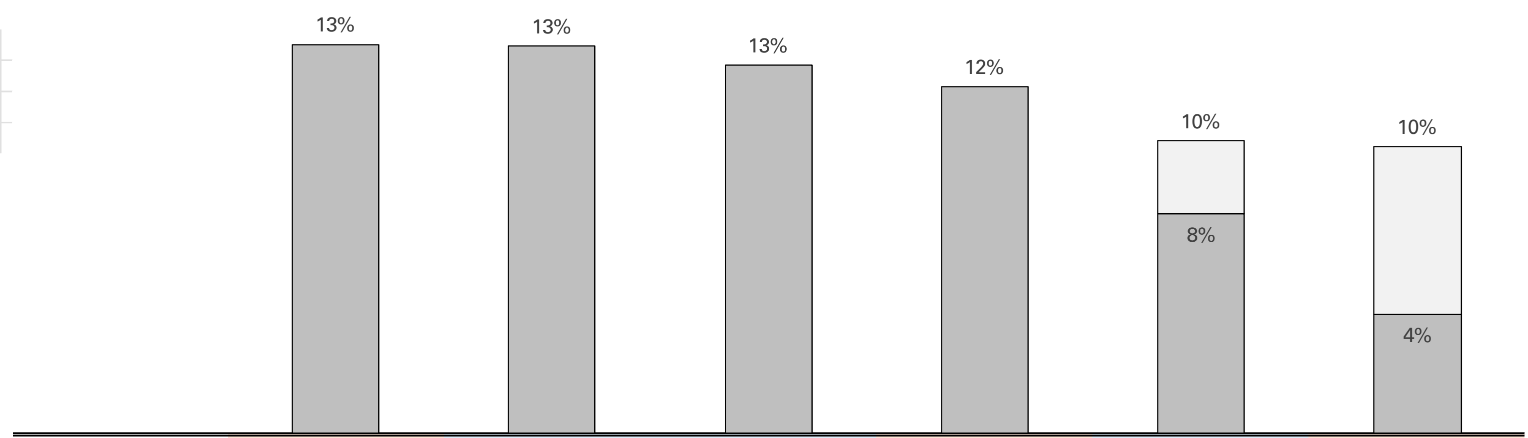
# *Investment Management*

**It is about policy, not politics.** Our last quarterly outlined the usual cadence of markets in an election year, with markets consolidating and volatility higher in the months prior to the election due to political uncertainty but volatility moderating and financial markets resuming their usual upward trajectory afterwards, as political uncertainty is removed. Perhaps most important, this is true irrespective of the outcome. And while the market is already up 20% year-to-date, we note that past election years of such strength similarly closed the year higher.

Exhibit 8 builds on that analysis by dividing the last 90 years of returns into various presidential and congressional outcomes to show similarly healthy returns. Indeed, elections matter deeply to our country, but history suggests they matter less to markets in aggregate. That is not to say that elections do not matter at all, however, as resulting policy can drive winners and losers under the surface, at the security level. While there are many cross currents to consider when investing, next we will provide examples on how policy implications may vary by security.

**Exhibit 8: While election results matter deeply to our country, they matter less to our financial markets in aggregate. Historically, we have seen healthy double-digit returns across a range of administrations.**

*Average annual price performance of S&P 500 since 1934, across leadership combinations.*




| | | | | | | |
|---|---|---|---|---|---|---|
| President | Republican | Democrat | Democrat | Republican | Democrat [2] | Republican [2] |
| Congress | Divided | Divided | Republican | Republican | Democrat | Democrat |

*(1) Excludes 107th Congress (2001–2003), as control of Congress changed hands several times.*

*(2) Inclusive and exclusive of the Calendar year bear markets during the Great Depression (1929-1939), Global Financial Crisis (2007-2008), and OPEC Embargo (1973-1974), which included the three worst Calendar year returns during this time series.*

*Source: United Asset Strategies, Bloomberg*

**Policy implications in the stock market.** Taxes are one of the areas in which the candidates differ in policy. For an example of how policy impacts securities differently, Exhibit 9 highlights the earnings impact from the 2017 Tax Cuts and Jobs Act, which decreased the corporate federal tax rate from 35% to 21%. At the market level, we saw tax rates decrease from 29% to 23%, implying a 9% earnings benefit. Stocks were not equally impacted, however, as those that already paid low taxes saw less earnings upside (3% to Healthcare, Energy) than those that paid the most taxes (15% to Utilities, Staples). Still, this is a partial analysis, as how tax cuts are funded, or tax increases are spent, drive another set of winners and losers.

On monetary policy, while the Fed operates independently, the next President may nominate a new Fed Chair in 2026 when Powell's term expires. And while that is well into the projected rate-cutting cycle, a new Chair would influence policy beyond that. To illustrate how policy impacts securities differently, Exhibit 10 highlights the valuation impact from the Fed's 2022 decision to rapidly increase rates to cool inflation. Higher rates make bonds more competitive, reducing the price investors are willing to pay for stocks. As a result, the S&P 500 saw a -12% decline in its multiple. That said, those securities with high multiples saw more multiple contraction (-56% to Small Growth) than those with lower multiples (-10% to Large Value).

**Exhibit 9: As seen in the 2017 TCJA, the impact of new US tax policy varies by sector - Creating relative winners/losers.**

*Median company tax rate (before and after TCJA), and implied EPS impact*

| Tax Rate (%) Pre-TCJA 2015-17 | Post TCJA 2018-20 | Sector | Standalone EPS Impact |
|---|---|---|---|
| 32% | 22% | Utilities | 15% |
| 33% | 23% | Consumer Staples | 15% |
| 31% | 23% | Communications | 12% |
| 32% | 25% | Consumer Cyclical | 11% |
| 28% | 22% | Financial Services | 10% |
| 29% | 23% | S&P 500 | 9% |
| 30% | 23% | Industrials | 9% |
| 24% | 20% | Technology | 6% |
| 14% | 10% | Real Estate | 5% |
| 26% | 23% | Basic Materials | 4% |
| 28% | 25% | Energy | 3% |
| 25% | 23% | Healthcare | 3% |

*Source: United Asset Strategies, Morningstar*

**Exhibit 10: As seen in the recent Fed interest rate hiking cycle, a change in rate policy creates winners & losers.**

*Change in P/E multiples by style box ; Start of Fed hike to peak in 10 year*

| Multiple Contraction | Style Box | P/E Beginning 1/31/22 | P/E Ending 10/31/23 |
|---|---|---|---|
| -56% | Small Growth | 70x | 31x |
| -29% | Mid Growth | 37x | 26x |
| -28% | Large Growth | 41x | 29x |
| -20% | Large Core | 23x | 18x |
| -20% | Small Core | 18x | 15x |
| -20% | Mid Core | 18x | 15x |
| -14% | Mid Value | 13x | 11x |
| -12% | S&P 500 | 20x | 18x |
| -12% | Small Value | 10x | 9x |
| -10% | Large Value | 14x | 13x |
| | 10Y Treas. Yld % | 1.8% | 4.9% |
| | Fed Funds Rate % | 0.1% | 5.3% |

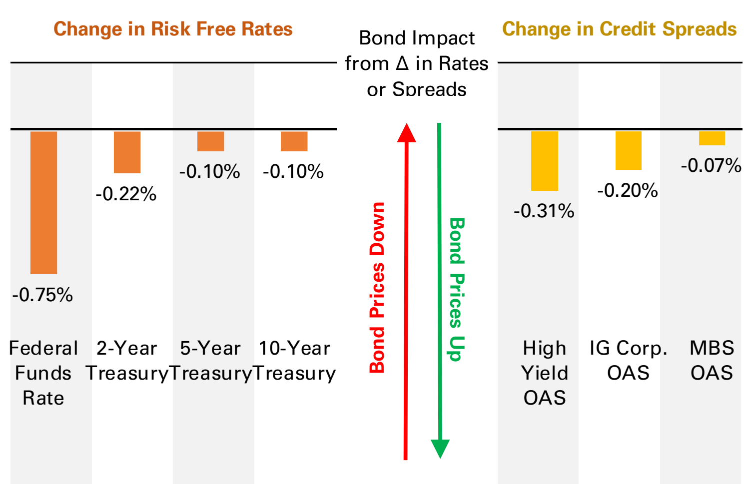
*Source: United Asset Strategies, Bloomberg*

**Policy implications in the bond market.** Monetary policy also influences bond prices. With the Fed embarking on a new rate cutting cycle, Exhibit 11 shows the relative yield reaction of select bonds (by term and credit quality) the last time the Fed cut rates in late 2019, amid domestic macro concerns resulting from slowing global growth and ongoing trade disputes.

The Fed funds rate (a short-term, overnight rate) was cut by 75bp, which understandably impacted shorter term bonds (-22bp, 2-Year Treasury) more so than longer term bonds (-10bp, 10-year Treasury). And given the cheaper financing, credit spreads tightened more for the corporates reliant on that outside financing (-31bp, High Yield) than it did for those less reliant on it (-20bp, Investment Grade).

**Exhibit 11: As seen in the Fed's 2019 rate cutting cycle, the impact of a change in policy varies by maturity & quality.**

*Change in Rates/spreads by fixed income category, from 7/1/19 to 12/31/19.*




*Source: United Asset Strategies, Bloomberg*

Tax policy also drives winners and losers in the bond market. We own municipal bonds on behalf of our clients in taxable accounts due to their tax-free income at federal and sometimes state and local levels. These bonds are evaluated on tax equivalent yields. All else equal, an investor with a 37% tax rate would be indifferent between a 4.25% tax-free Municipal and a 6.75% taxable bond given the similar after-tax income.

As a result, should individual tax rates increase, municipals would be more valuable to taxable investors relative to the rest of the bond market in which they can invest. Exhibit 12 provides an illustrative example of the expected price appreciation for a municipal bond should individual tax rates increase, a result of its tax-shielded income becoming more valuable.

**In closing,** patience is the best approach to an election year. While elections matter deeply to our country, history suggests they matter less to our markets in aggregate. Rather than base portfolio decisions on unpredictable political winds, it is best to stay invested, wait for election uncertainty to be resolved and take a long-term view on policy winners and losers.

**Exhibit 12: When tax rates increase, Munis become more valuable to taxable investors**

*Illustrative Price Impact to Municipal Bond (Nassau County, New York 3% 9/18/54, non-callable)*

| | Interest Rates | | |
|---|---|---|---|
| Tax Rate | Rise 25 bp | Unchanged | Drop 25 bp |
| 39.6% | -1.1% | 3.4% | 8.1% |
| 37.0% | -4.4% | 0.0% | 4.7% |

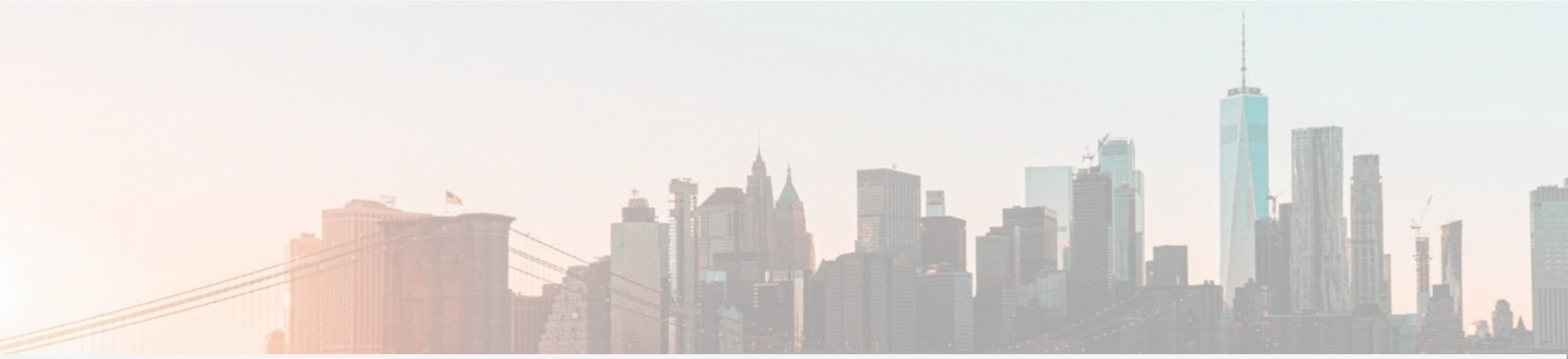
*Source: United Asset Strategies*

## *Financial Planning*

**Cost of Living Adjustment (COLA) released for 2025.** Social Security and Supplemental Security Income benefits will increase by 2.5% to start 2025. Also, the maximum earnings subject to Social Security tax has increased, to $176,100.

On this subject, our planning team has been working on a series of videos on social security and other financial planning topics. Be on the lookout for these in the near future.

## *Stay tuned for our upcoming **Quarterly Insights Webinar***



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