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QUARTERLY *review*

3RD Quarter 2024

Economic Update

Recalibration: How a Single Word from the Fed Buoyed the Market

The Fed finally delivered on its long-awaited pivot on September 18, trimming its target federal funds rate by 50 basis points (or one half of one percent) to a range of 4.75% to 5.0%.

This was the Fed's first rate cut in over four years, and its decision to reduce rates by 50 basis points instead of the more common choice of 25 basis points was meant to send a clear and convincing message: Inflation is under control, the economy is healthy, and the focus now shifts to job growth.

GDP increased at an annual rate of 3% in the second quarter and the unemployment rate was 4.2% at the end of August.[1,2]

Powell's Positive Message

The Fed's style of communicating and the specific words used by chairman Jerome Powell are almost as important as monetary policy itself.

In May, a survey of academic and professional Fed watchers conducted by the Brookings Institution gave the Fed an average score of B+ for its communications. So, investors took Powell at his word when he characterized the 50-basis-point rate reduction as a "recalibration" of monetary policy aimed at maintaining economic expansion and shoring up the job market rather than an attempt to head off a looming recession.

In other words, the Fed is suggesting that a "soft landing" is likely for the U.S. economy.

The Market's Response

- **Bonds**
  The fixed income market responded to the rate cut almost immediately. The yield on 1-year Treasury Bonds quickly fell to less than 4% and no Treasury bond of any maturity was offering yields of more than 5% as of late September.
- **Stocks**
  Reaction was muted initially, but picked up steam in the days following the announcement. In late September, the S&P 500 Index was up 20% year-to-date and the Dow Jones Industrial Average gained 12% for the year. They both hit new all-time highs on a regular basis throughout the year.
- **Precious metals**
  Some commodities surged. In late September, gold prices were up 29%, hitting or coming close to record highs, cocoa prices were up 90%, and most industrial metals (aluminum, copper, zinc, and tin) were in positive territory.[3] In general, commodity prices rise when investors get defensive and want to hedge against inflation. But stronger demand from China, which announced an aggressive economic stimulus plan on September 23, also contributed to the recent spike.
- **Crude Oil**
  Oil prices were down in July, August, and most of September. But prices improved with the Fed's rate cut and an announcement from OPEC that it will extend its voluntary cuts in production into 2025. The October 1st Iranian attack on Israel further caused oil prices to jump.

Economic Update

We Aren't Fighting the Fed

Monitoring Fed policy is an important part of BLBB's responsibilities as a financial advisor committed to upholding fiduciary standards.

The direction of interest rates influences not only bond yields and prices, but also the stock market and the entire economy. The old mantra, "Don't fight the Fed," is a warning to never underestimate the power of Fed monetary policy. We take that warning seriously.

So, when rates are in flux, we attempt to stay ahead of the curve, anticipate the Fed's next move, and fine-tune our fixed income holdings accordingly.

With the Fed's clear signals in mind, we have been gradually shifting away from bonds with shorter maturities and lower yields and adding bonds with longer durations and more attractive yields. More specifically, we have been extending the average maturity of investment-grade corporate bonds and tax-advantaged municipal bonds, which still offer relatively high interest rates, to a maturity range of roughly 7 to 10 years. We have also moved further up the credit quality scale for corporate and municipal bonds which has resulted in higher quality bond portfolios.

4th Quarter Outlook

Here are just a few things you are likely to see over the next several months:

No one can accurately predict what the coming months will bring to our financial markets.
But we can offer six suggestions with some degree of confidence.

1. **Dire predictions**
   Fed watchers will continue to deliver a barrage of analysis and commentary pointing out how rate cuts have traditionally been followed by recessions. Read with a critical eye.

2. **Slumping stocks**
   Less-than-stellar returns from U.S. stocks, assuming the market follows its normal pattern. Performance usually slips from late September through the end of October, following stronger returns in the summer months.

3. **Election year volatility**
   The fact that there is no incumbent in the presidential race this year adds to the uncertainties surrounding any new policies that might move the market. Volatility will probably ramp up as we get closer to November 5. But the outcome of a presidential election usually has very little sway over long-term market performance.

4. **Economic growth**
   The Philadelphia Fed's most recent survey of economic forecasters on August 9 indicates GDP will increase by 1.7% in the fourth quarter of 2024. That's more optimistic than the 1.5% predicted in the previous survey.[4] Lower interest rates are good for most businesses and the economy because they reduce the cost of borrowing, promote expansion, and encourage more hiring.

5. **Geopolitical Tensions**
   Heightened tensions around the globe, particularly those in Ukraine/Russia, the South China Sea, and the Middle East, pose varying amounts of risk to world financial markets and the global economy. Surging violence between Israel, Iran, Lebanon, Hezbollah, Hamas, and other Middle East actors introduces great uncertainty—something financial markets generally dislike.

6. **Dockworkers strike**
   October 1, 2024 may go down in history as an unusually eventful day—but not in a positive way. In addition to it being the day Iran escalated Middle East tensions by sending 100s of ballistic missiles into Israel, it is also the day all U.S. dockworkers along the East and Gulf Coasts went on strike. The last time this happened was in 1977. In the moment, econo-

mists believed this strike could cost the U.S. economy about $5 billion a day as all sorts of goods—from bananas to automobiles—would be stuck in ports.[5] Fortunately, however, the strike ended after just 3 days when the dockworkers agreed to an extension of their current contract until 1/15/25 and the port operators offered a 62% wage increase over 6 years. We are cautiously optimistic this issue is permanently resolved but also recognize there could be another strike looming should the workers and port operators not be able to reach agreement on the other pressing issues centered upon automating much of the work on the docks.

Is This Time Really Different?

History is a great teacher, and trends can be very useful when setting expectations for the market and economy. But there are exceptions to every rule and trends are broken all the time.

In fact, the Fed's rate cut in September was significant enough to bring the yield curve on U.S. Treasuries back into its normal shape after a long stretch of being inverted—with short-term bonds yielding more than longer-dated bonds.

An upside-down yield curve is considered a fairly reliable indication that a recession is coming.

Maybe this time really is different? Time will tell.

Keep in mind that financial markets face major challenges all the time. But in every case we have experienced, the turmoil eventually faded, and the markets recovered.

It's also worth remembering that the market's best days usually follow closely on the heels of its worst. So, missing the early days of a market recovery can be costly. The key to successful investing is staying focused on your long-term goals, participating in the market without interruption, and a well-diversified portfolio that matches your unique appetite for risk.

As always, your BLBB advisor is available to answer any questions or address any concerns you might have. You can reach us at 215-643-9100.

[1] https://www.bea.gov/data/gdp/gross-domestic-product

[2] https://www.bls.gov/news.release/pdf/empsit.pdf

[3] https://www.investing.com/commodities

[4] https://www.philadelphiafed.org/surveys-and-data/real-time-data-research/spf-q3-2024

[5] https://www.reuters.com/world/us/us-east-coast-dockworkers-head-toward-strike-after-deal-deadline-passes-2024-10-01/

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