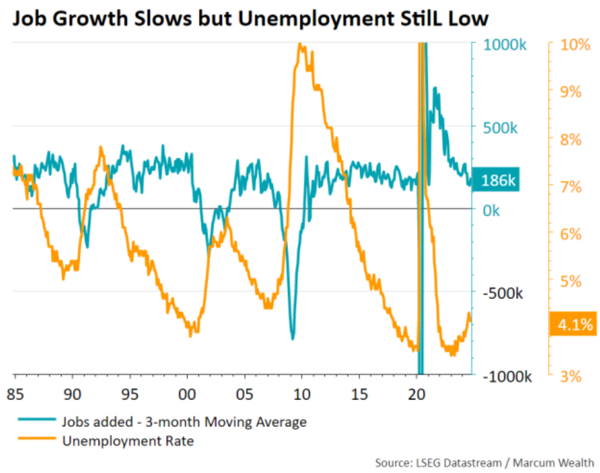
Strategy Newsletter – 4th Quarter 2024

- The Fed shifts its focus from inflation to the labor market.
- Equities post strong results with a rotation to new leadership.
- The first interest rate cut is off to a different beginning than past cycles.
- Lower mortgage rates cannot overcome the freeze in housing.

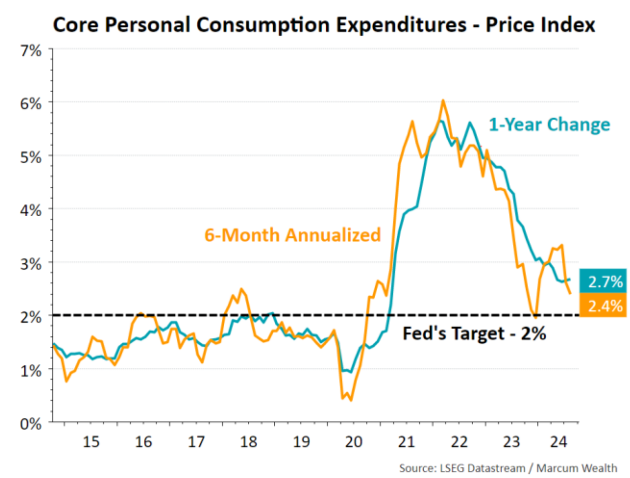
## Economy

Despite downshifting to a lower gear, the economy continues to add new jobs. The 3-month moving average is at 186,000 jobs per month. Economists estimate around 75,000 to 125,000 monthly jobs are required to account for population growth.

The unemployment rate fell to a low of 3.4% in 2023, went up to 4.3%, and now.  A worry is that once the unemployment rate climbs, it often increases. Even though 5% would be relatively low, it would likely mean layoffs for the broader economy.




The slowdown in job growth shifted the Fed's attention from fighting inflation to the other side of its mandate, maintaining full employment. The Fed's first interest rate cut in September came as inflation continued to trend towards the 2% target. A few economists worry that supply chain issues and higher fiscal deficits mean inflation will be above the target. On the other hand, lagging measures of housing point to a possible decline in core prices next year.




Looking abroad, the European Central Bank is also in interest rate-cutting mode. Markets anticipate the third interest rate cut in October as inflation continues to decline.

Similarly, inflation fell to 1.7% in the United Kingdom over the last twelve months. The unemployment rate increased from 3.6% to 4.0%, still near the lowest levels since 1971.

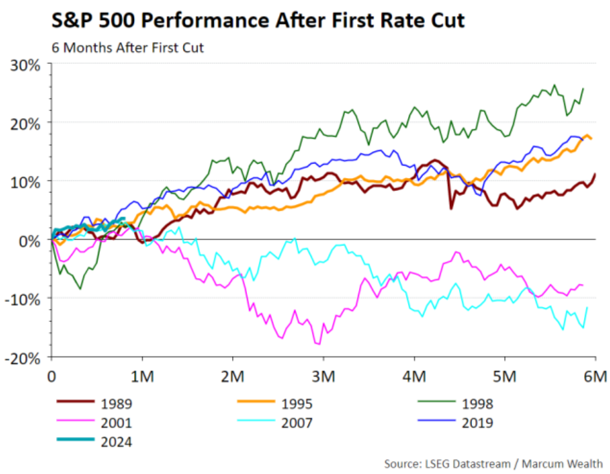
It is a different story in Japan. After struggling with deflation for the last twenty years, Japan's inflation rate has increased to 3% over the past year. The unemployment rate is 2.5%. After holding its policy rate at -0.1% over the prior five years, Japan's Central Bank increased rates to 0.25%.

## Equity

After a strong first half of the year, another positive quarter was tacked on to the results. A rotation in market leadership occurred with small caps and value equities as the top performers.

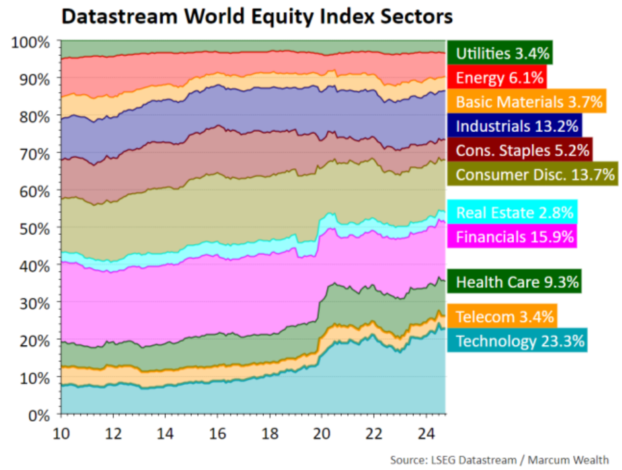
| U.S. Equity | 3Q 2024 |
|---|---|
| **Large Cap Stock** | |
| S&P 500 | 5.9% |
| **Small & Mid Cap Stock** | |
| S&P 400 Mid Cap | 6.9% |
| S&P 600 Small Cap | 9.9% |
| **All Cap Style Indices** | |
| S&P 1500 Value | 9.1% |
| S&P 1500 Growth | 3.7% |
| **International Equity** | **3Q 2024** |
| MSCI EAFE | 7.3% |
| MSCI EAFE Value | 9.0% |
| MSCI EAFE Growth | 5.7% |
| MSCI Emerging Markets (EM) | 8.9% |
| MSCI EM Value | 8.4% |
| MSCI EM Growth | 9.3% |

What does the Fed's rate cut mean for stocks? If we had a crystal ball that told us whether there was a recession or not over the next year, that would be ideal. Since we do not, we can look at the prior six hiking periods. In the recessionary periods, the S&P 500 was down two, four, and six months after the first cut. In the other periods, stocks moved higher.

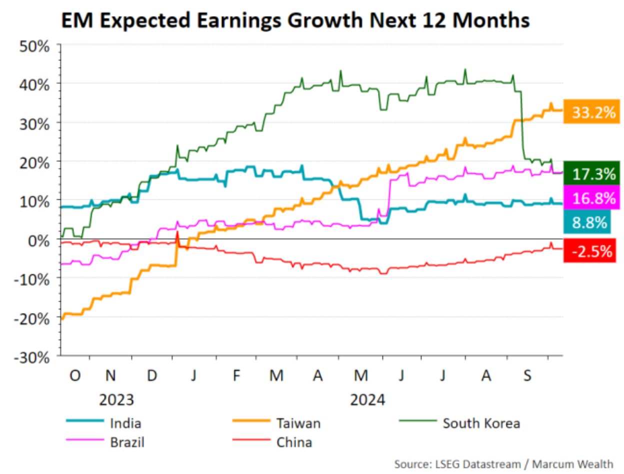



The latest data from the corporate world indicate a soft landing for the economy. Profit margins remain strong. Earnings growth continues at over a 10% pace for large companies.

Earnings have been driven by the technology sector. The free cash flow growth of the largest tech companies in the US stands out. This is a key reason that technology has a weight of nearly 24% of the global equity market, compared to 7% a decade ago.




Some countries in emerging markets are expected to grow faster than US markets over the next 12 months. The story goes beyond the China stimulus headlines. Taiwan, with a robust tech sector and semiconductor plants in the US now, is expected to grow earnings by 33% over the next year.



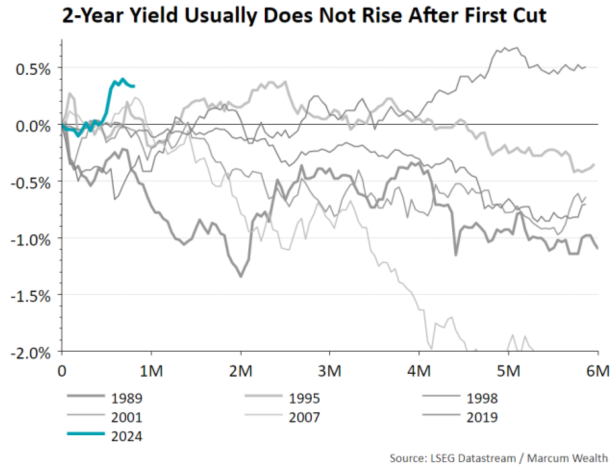

Equities within the Marcum Wealth Asset Allocation Frameworks remain at equal weight.

## Fixed Income

Yields fell sharply during the quarter, providing a tailwind to bond returns. The 10-year began the quarter at 4.48%, fell to a low of 3.61%, and ended at 3.78%.

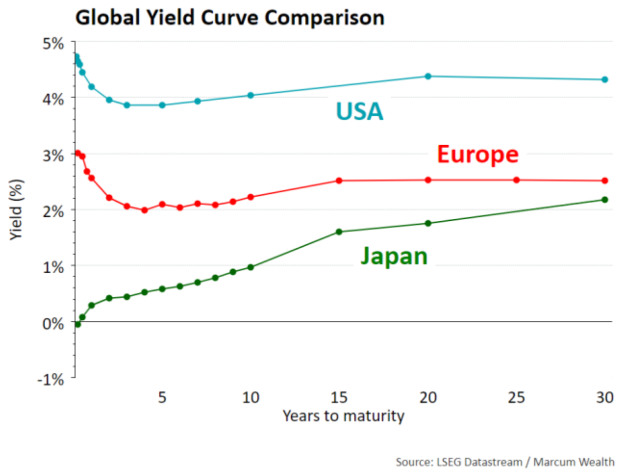
| Fixed Income | 3Q 2024 |
|---|---|
| Bloomberg U.S. Aggregate Bond | 5.5% |
| Bloomberg Corporate Inv. Grade | 6.0% |
| Bloomberg High Yield Bond | 6.0% |
| Bloomberg Global ex. U.S. Treas. | 11.3% |
| Bloomberg Municipal Bond | 2.9% |
| Bloomberg TIPS | 5.8% |

The Fed's much-anticipated first cut of interest rates came 14 months after the last rate hike. This was longer-term than average but within expectations. In the weeks following the hike, Treasury yields rose. Compared to the prior six cycles, this stands out as rates were relatively flat to down.



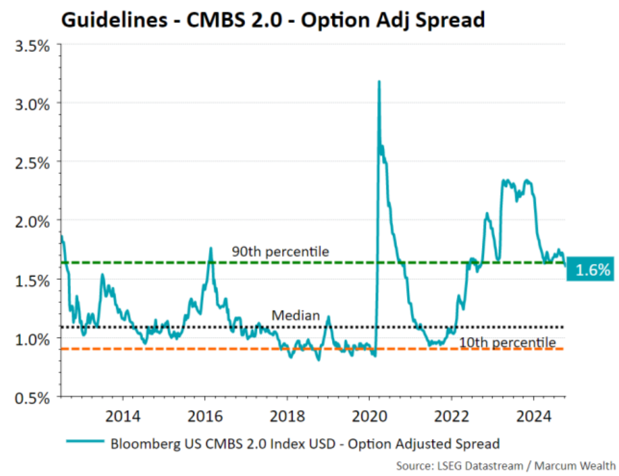

One reason interest rates rose is that the Fed telegraphed the first cut in rates well in advance. In addition, inflation data surprised on the upside for September. This could be more evidence of a soft landing and a less extended cutting cycle. The two closest analogs would be in 1995 and 1998. In both instances, interest rates rose over the following two years after the Fed's first cut. The outcome will depend on how the jobs and inflation data evolves.

The yield curves in the US and Europe are inverted, with short-term rates still higher than long-term rates. Japan has one of the few yield curves that are normal, upward-sloping, and to the right.




Credit spreads across most sectors are very tight. This is a good sign, indicating low expectations of corporate defaults. On the other hand, that means low extra compensation to investors.

The commercial real estate market is experiencing a difficult period. Office buildings are less full due to the work-from-home trend. In addition, investors who took out floating-rate loans may struggle to make payments. For managers with expertise in selecting commercial mortgage-backed securities, the spreads have value relative to history.



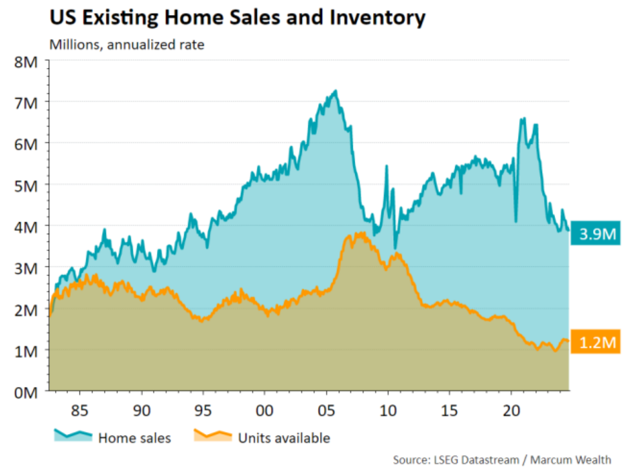

The Marcum Wealth Asset Allocation Frameworks maintain fixed income at equal weight to the strategic targets.

## Real Estate

With the fall in interest rates last quarter, REITs outperformed all sectors in the US except for Utilities. We mentioned the attractive relative value for REITs last quarter, which has normalized back to the long-term average.

| Real Estate | 3Q 2024 |
|---|---|
| Wilshire U.S. REIT | 15.2% |
| Wilshire Int'l REIT | 17.2% |

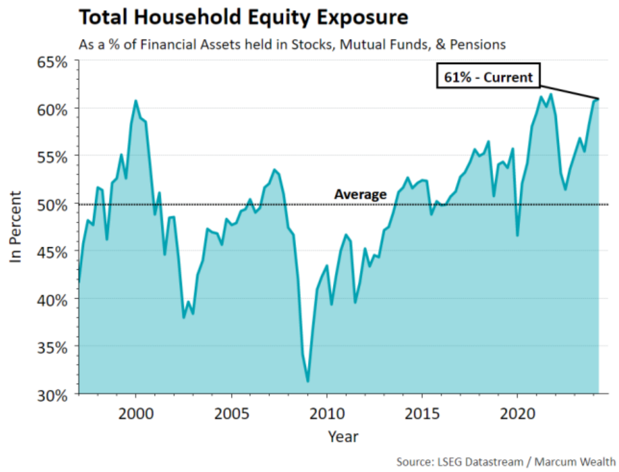
Turning to housing, it remains challenged due to high prices and mortgage rates. The pace of sales is nearly the lowest level in 30 years. Lack of inventory is a key contributor. While the inventory level is climbing, it is near the lows of the last 40 years.




The Marcum Wealth Asset Allocation Framework maintains equal weight exposure to REITs.

## Final Thoughts

Today, households are close to the highest level of equity exposure in history. This includes adding everything from stocks, funds, and pension plans together. Financial assets invested in equities reached these levels previously in 2000 and 2021. Investors may consider rebalancing portfolios closer to the long-term average in the future.



## Marcum Wealth Asset Allocation Frameworks

| | Income | Conservative | Balanced | Moderate | Growth |
|---|---|---|---|---|---|
| **Asset Class** | Strategic | Strategic | Strategic | Strategic | Strategic |
| **Equity** | **20%** | **35%** | **50%** | **65%** | **80%** |
| U.S. Equity | 12% | 21% | 30% | 39% | 48% |
| International Equity | 6% | 11% | 15% | 20% | 24% |
| Emerging Markets Equity | 2% | 4% | 5% | 7% | 8% |
| **Fixed Income** | **77%** | **62%** | **47%** | **32%** | **17%** |
| US Fixed Income | 69% | 56% | 42% | 29% | 15% |
| Global Bonds | 8% | 6% | 5% | 3% | 2% |
| **Real Estate / REITs** | **3%** | **3%** | **3%** | **3%** | **3%** |

The risk designations are relative only to the five Strategic Allocation targets and do not represent comparisons with any other investment or risk of the overall strategies.

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