NOTTINGHAM ADVISORS
ASSET MANAGEMENT

Rate Cut Cycle Has Begun - Q3 2024

As the third quarter of 2024 approached its close, the Federal Reserve meeting that concluded on September 18th finally gave the markets what they had been anticipating for so long. Chairperson Jerome Powell announced a 50 basis-point reduction in the Federal Funds Target Rate. This oversized initial cut likely being the first in a significant series of interest rate reductions that signal the Fed's confidence that it has subdued inflation, and potentially leading to additional economic stimulus through the loosening of monetary policy.

Domestic equity returns for the third quarter were broadly positive, adding to strong returns realized in prior periods, and pushing year-to-date returns into the double digits or very close to it. The S&P 500 (Large Cap) exposure has produced greater returns throughout 2024 for investors, but in the third quarter, it was outshone by even stronger returns from the smaller companies in the S&P 400 (Mid Cap) and S&P 600 (Small Cap) indices.

Q3 RETURNS FOR DOMESTIC EQUITY

NAME	MTD	QTD	YTD	1YR	3YR	5YR
S&P 500 Index	2.14	5.89	22.08	36.33	11.88	15.94
S&P 400 Mid Cap Index	1.16	6.94	13.52	26.76	7.42	11.73
S&P 600 Small Cap Index	0.83	10.11	9.29	25.76	3.91	10.13
S&P 500/Citi Growth Index	2.84	3.70	28.14	41.06	10.05	17.52
S&P 500/Citi Value Index	1.12	9.05	15.36	31.07	13.08	13.17

Source: Nottingham Advisors. Data as of September 30, 2024

After lackluster returns for the second quarter, Small and Mid-Caps seemed revitalized in Q3. Smaller company returns have lagged for some time now, so some of the catchup in performance could be attributed to a reversion to mean. There was also talk of a political trade influencing the bump in returns. A Trump presidency is seen as a positive for smaller companies, with his talking points on tariffs and deregulation being beneficial to domestic companies. Market prices have begun to reflect that possibility, benefitting the exposures in our portfolios.

Growth had been leading the way for much of 2024, but in the third quarter it took a backseat to a Value trade surge, likely correlated to the Fed's action in Q3 to loosen monetary policy. A growing expectation of falling interest rates may spur investors to migrate towards stocks that offer significant dividend yields, or holdings that typically see their prices increase as interest rates decline.

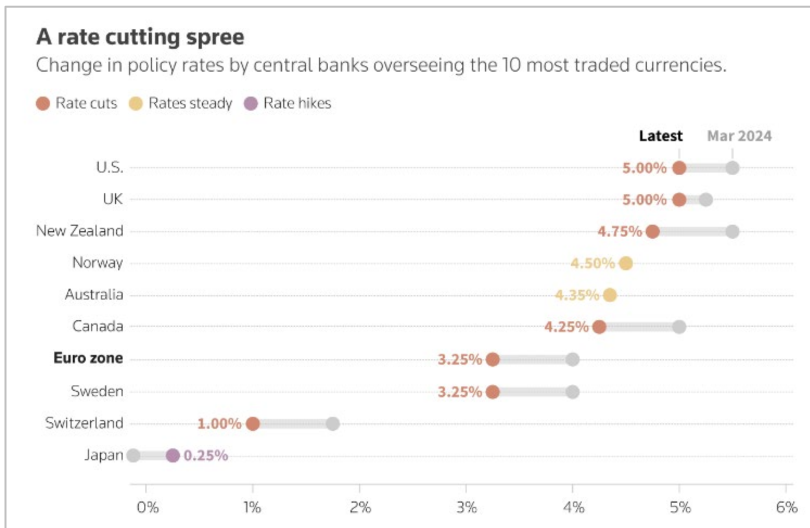
Q3 RETURNS FOR INTERNATIONAL EQUITY

NAME	MTD	QTD	YTD	1YR	3YR	5YR
MSCI ACWI Index (USD)	2.36	6.72	19.08	32.35	8.61	12.72
MSCI EAFE Index (USD)	0.96	7.35	13.55	25.45	6.10	8.81
MSCI EM Index (USD)	6.68	8.82	17.13	26.41	0.75	6.09
FTSE 100 Index (GBP)	-1.54	1.79	9.79	12.32	8.99	5.88
Nikkei 225 Index (JPY)	-1.30	-3.56	15.05	21.08	10.98	13.91

Source: Nottingham Advisors. Data as of September 30, 2024

International stocks trail the S&P 500 on a year-to-date basis, while still putting up attractive returns for 2024. While the Japanese market started the year off extremely strong, it has given back roughly a third of its first quarter gains over the balance of 2024. The remaining international indices tracked have experienced a fairly steady upward progression during the year. The MSCI Emerging Markets index led the way in Q3, with a positive return approaching 9%. Some of this upside could be related to the monetary loosening being experienced in the respective countries, as interest rates have begun coming down.

International Central Banks are ahead of the U.S. Federal Reserve when it comes to loosening monetary policy. Many of these Central Banks, including the European Central Bank (ECB), Bank of Canada, Swiss National Bank (SNB), etc. have been busy lowering rates for some time now. The notable exception is the Bank of Japan (BOJ), which has only recently exited nearly a decade of negative target rates. The current Bank of Japan overnight call rate target is only 25 basis points…



Note: Countries are sorted in descending order of current interest rates.
Source: LSEG | Sumanta Sen | Oct 17, 2024 | Reuters

The global progression towards lower interest rates fueled Fixed Income returns during the third quarter. As interest rates decline, bond prices increase, adding to total return performance. While the High Yield market has notched up strong performance throughout 2024, most of the other bond indices tracked had posted returns that were slightly negative through Q1 and Q2 of 2024. It was not until the third quarter of the year that bond returns rallied broadly, pushing year-to-date performance into the black. Investment Grade Corporate bonds have also posted very strong performance, even as they trail non-investment grade bond (High Yield) returns. A driver of performance for both investment grade and high yield performance has been the "risk on," environment in the bond market. The spread, or yield

Source: Bloomberg

premium, that is offered by corporate bonds in exchange for their higher risk, has been shrinking consistently. The yield spread is very close to all-time lows, making it unattractive to be overweight significant risk in the fixed income markets.

Q3 RETURNS FOR FIXED INCOME

NAME	MTD	QTD	YTD	1YR	3YR	5YR
Bloomberg US Government Index	1.20	4.71	3.85	9.68	-1.72	-0.16
Bloomberg US Agg Index	1.34	5.20	4.45	11.57	-1.39	0.33
Bloomberg US Corporate Index	1.77	5.84	5.32	14.28	-1.18	1.16
Bloomberg US Corporate High Yield Index	1.62	5.28	8.00	15.74	3.10	4.71
Bloomberg EM USD Agg Index	1.76	5.82	8.17	16.93	-0.18	1.35
Bloomberg Global Agg Treasuries USD Index	1.07	3.95	3.80	9.47	-0.36	0.13
Bloomberg Municipal Index	0.99	2.71	2.30	10.37	0.09	1.38

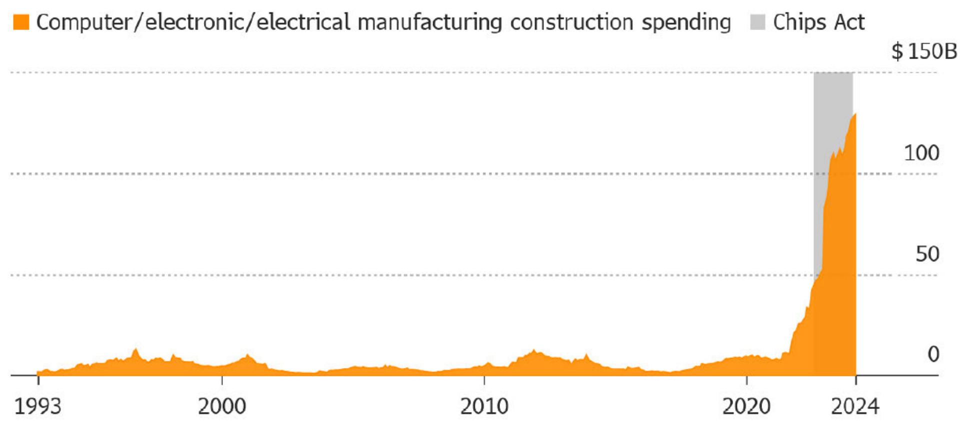
Source: Nottingham Advisors. Data as of September 30, 2024

Value in fixed income can be found through other exposures. Mortgage and Asset Backed bonds, and high-quality Collateralized Loan Obligation bonds have presented attractive yields and reasonable valuations in 2024. These exposures allow a portfolio to maintain an attractive yield without being forced into owning parts of the bond market that appear overvalued, like traditional Investment Grade and High Yield corporate bonds.

The U.S. economy has held up well, remaining significantly stronger than many naysayers had predicted. Even with many recession indicators, including the bond market's inverted yield curve, predicting an impending economic slowdown. Employment indicators remain fairly robust, as inflation has fallen to levels that are less taxing on the consumer which drives our economy forward.

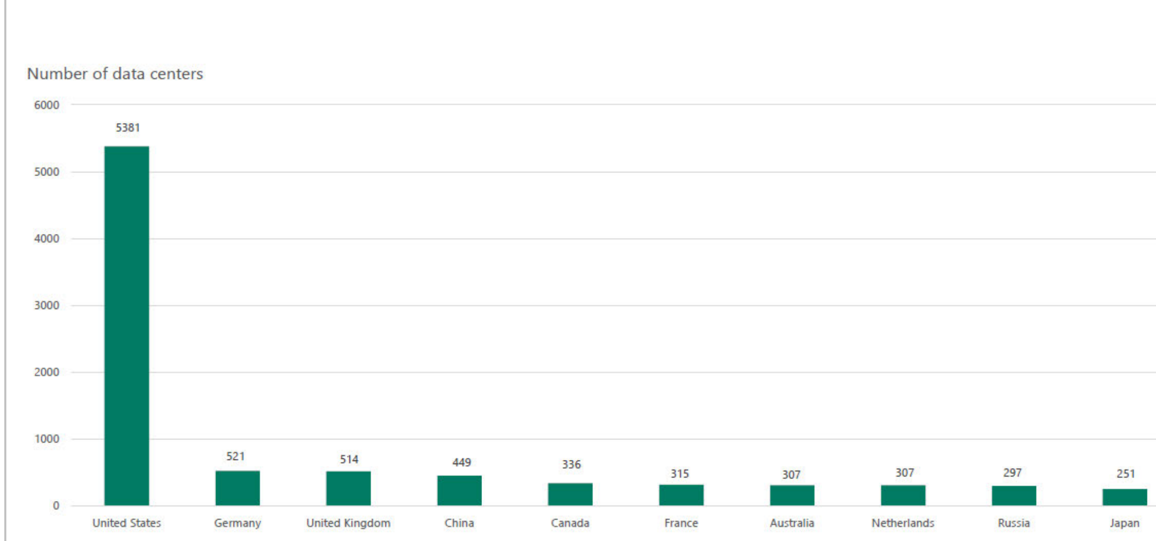
That is not to say that the cost of living is cheap. We have experienced a significant amount of price inflation in the recent past, and those increases have not reversed. The rate of further increases has slowed, and that is helpful, but not curative.

Why has the U.S. economy held up so well? Why is it so much stronger than other economies around the world? It is driven by a combination of unique factors.



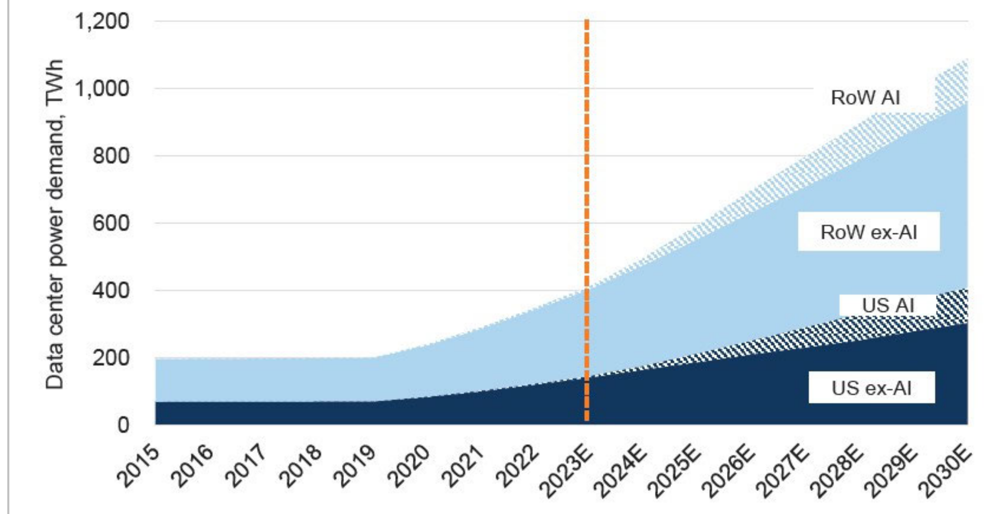
Source: Peterson Institute of International Economics. Analysis of US Census Bureau data by Martin Chorzempa

The domestic Technology/Data Center/AI boom has spurred significant corporate spending and government support. Large companies do not want to be left behind in the war for technological ability or talent. The U.S. government wants to be sure that adversaries do not gain an advantage in this arena. This is why the checkbook is wide open, public and private spending steadily flowing. Infrastructure and technological spending will continue to support economic growth.



Source: Statista, Cloudscene, Apollo Chief Economist. Note: Data as of March 2024.

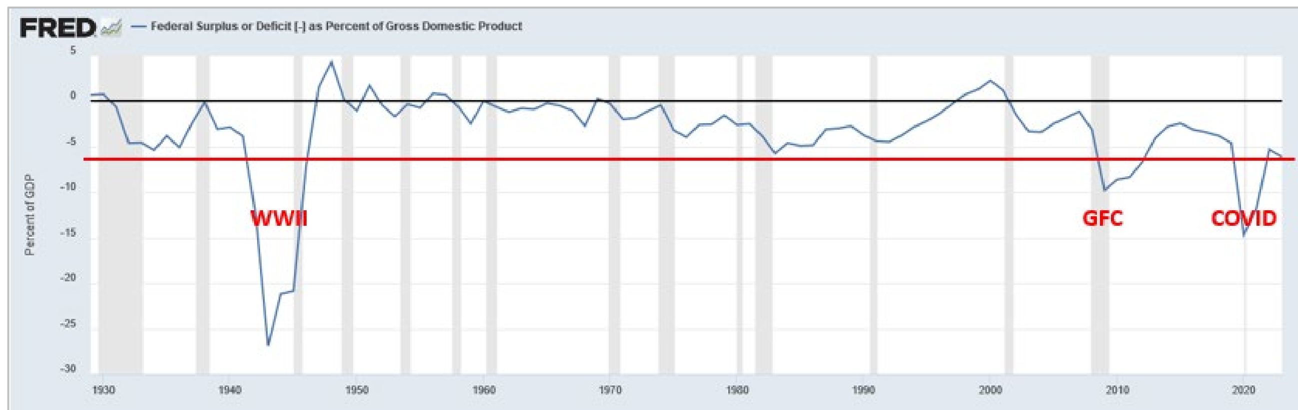
This tailwind of investment is projected to continue to such a degree that it will drive knock-on spending/investment by utilities to grow their electrical production capacity, to power all the data centers and AI fueled energy consumption. Our positioning in Utilities and Pipelines/Infrastructure have performed strongly due to this trend.



Source: Masanet et al. (2020), Cisco, IEA, Goldman Sachs Global Investment Research

For now, it would seem that this virtuous circle of growth supporting investment has helped to protect the U.S. economy from significant damage stemming from the recent rate hike cycle.

A related economic stimulant is the elevated level of overall government spending. It is not an aberration for the U.S. government to spend more money than it takes in. That happens most years. During "good times," when employment is strong and economic growth sufficiently positive, the government may run a small deficit of 2% or 3% of GDP. When difficult economic times rear their head, Big Brother increases government spending to try to spur an economic recovery and assist those citizens most negatively affected. This leads to a larger budget deficit and concerns over fiscal sustainability. An asset that does well during this type of situation is Gold, which we have a longstanding allocation to.



Sources: OMB; St. Louis Fed

The U.S. Government is currently running a large budget deficit of roughly 6% of GDP. This is unheard of during “good times.” It is particularly bizarre to be borrowing and spending so much money during a period of elevated inflation, while the Federal Reserve is attempting to lower inflation to their target range.

While it is hard to understand the justification, the deficit spending is clearly simulative to the economy, and has helped economic growth to remain vigorous domestically, while the rest of the world experiences less robust outcomes. The interest rate cuts that are expected from the Federal Reserve are likely to extend the strength that is currently being experienced.

Please reach out with any questions. We are always happy to discuss to opportunities that we are seeing.

Timothy D. Calkins, CFA
Co-Chief Investment Officer
November 2024

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