Buckingham
STRATEGIC WEALTH

Q4 2024

# Quarterly Outlook

## Perspectives on Markets and Economic Conditions

Portfolio allocations and investments are not adjusted in response to market news or economic events; however, we evaluate and report on market and economic conditions to provide our investors with perspective and to put portfolio performance in proper context.

# Inflation Continues to Moderate, Fed Policy Shifts

## Main Takeaway

The economy has remained resilient, with strong real GDP growth in the second quarter and inflation easing in the U.S. and globally. However, the economy is beginning to show some signs of stress, as unemployment has started to tick up and job growth has slowed. Against this backdrop, Federal Reserve Chair Jerome Powell signaled a significant policy shift was appropriate, with the Fed cutting the federal funds rate 0.50% at its September meeting.

## Top Risks

With their recent rate cut, Fed policymakers signaled that they believe a slowing U.S. economy is becoming the primary risk. Moving forward, the markets will be watching consumer spending and unemployment closely to determine if the Fed can engineer a soft landing. U.S. national debt continues to be a concern with the debt-to-GDP ratio approaching 100%. A protracted outcome to the U.S. presidential election could lead to additional market volatility.

## Sources of Stability

Globally, inflation continues to moderate with the Fed now joining other central banks, such as the Bank of Canada and the European Central Bank, in reducing their respective target interest rates. The combination of lower interest rates and strong wage growth is expected to spur businesses and consumers to increase spending. Although unemployment has begun ticking higher, this is likely because more people are returning to the workforce as permanent layoffs have stayed relatively constant.

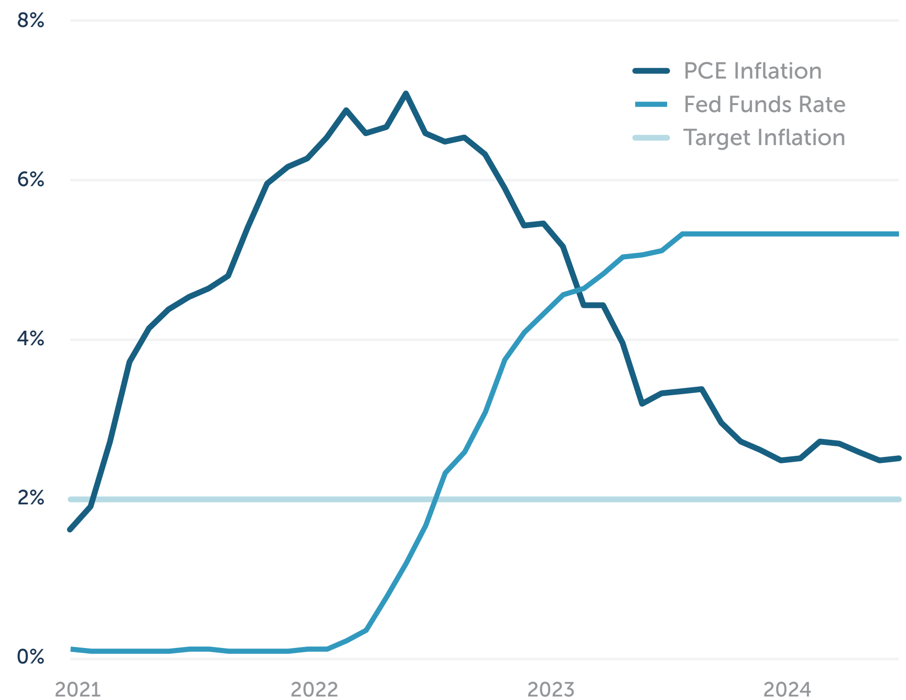
ECONOMIC SPOTLIGHT:

# Why Did the Fed Decide to Lower its Target Rate?

To answer this question, we need to look at what economist Milton Freidman coined “the long and variable lag” of monetary policy. This refers to the length of time it can take for changes in monetary policy to begin influencing the economy. While estimates vary, Atlanta Fed President Raphael Bostic noted in a 2022 piece[1] that changes in monetary policy generally take anywhere from 18 months to more than two years to make a significant impact. You can clearly see the monetary policy lag in action when examining the most recent Fed tightening cycle. While the Fed began raising interest rates in March 2022, personal consumption expenditures price index (PCE) inflation remains above the Fed’s 2% target, over two years since the cycle began, but is continuing to moderate.

With the economy beginning to show signs of slowing, the Fed felt comfortable lowering interest rates now because the effects won’t be felt for several months. The Fed believes the lag will keep policy restrictive in the short term, enabling inflation to move below the Fed’s 2% target. Eventually, this should provide the spark needed to reignite the economy before it tips into recession, allowing the Fed to achieve its goal of a soft landing.

**U.S. Inflation Has Fallen but Is Still Above 2% Target**




Source: St. Louis FRED Database.

# Key Areas to Watch

## U.S. Economic Growth

The U.S. economy has remained resilient with third-quarter GDP expected to come in around 3.1%. Consumer spending on services has remained robust and is now approaching pre-pandemic levels.[2] Manufacturing, on the other hand, continues to sputter with August seeing the largest contraction in basic materials production since early 2023.[3] While unemployment has risen slightly and job growth has slowed, positive real GDP growth is expected for the next four quarters.[4]

## Inflation Trajectory

Inflation continues to moderate with August CPI coming in at 0.2%, or 2.5% year over year, the lowest reading since February 2021. Motor vehicle insurance and shelter costs were two of the biggest drivers of inflation over the past 12 months, rising 16.5% and 5.2% respectively.[5] Despite the recent downward trend, inflation is expected to remain above the Fed's 2% target over the next 12 months due to a robust consumer and government deficit spending (currently 7% of GDP).[6]

## Monetary Policy

As the market expected, the Fed began the easing process by lowering the federal funds rate 0.50% at its Sept. 18 meeting to a range of 4.75%-5%. According to the Fed's latest Summary of Economic Projections, also known as the dot plot, the committee is expecting to lower interest rates another 0.50% by the end of 2024, with additional cuts expected next year, which would bring the target rate to the 3.25%-3.50% range by the end of 2025. However, Chair Powell also stressed the Fed is not on a preset course and will adjust policy based on incoming data.

## Fiscal Policy

The U.S. continues to operate in the red with the Congressional Budget Office (CBO) estimating the 2024 federal deficit to be $1.9 trillion, or 7% of GDP.[6] Total debt is expected to end the year at roughly $28 trillion (99% of GDP) and grow to over $50 trillion (122% of GDP) by 2034.[6] The large uptick in debt coupled with higher interest rates means the U.S. government is now paying $3 billion in interest daily.[7]

# Key Areas to Watch (Cont.)

## Labor Market

The labor market has been gradually cooling with unemployment ticking up to 4.2% in August from 3.8% a year ago.[1] Job growth has also slowed recently with the three-month average falling to 116,000 compared to 211,000 in August 2023.[2] Labor Department data showed that employers are hiring at their slowest pace since 2014 while workers are quitting their jobs at the lowest rate since 2018.[2] The good news is permanent layoffs, a traditional harbinger of recession, have been relatively stable.[2]

## Consumer Lending

Although the U.S. economy continues to chug along, households are showing signs of stress. Credit card and auto loan delinquency rates continue to rise with credit card delinquencies now topping out at 10.9%.[3] Fed data also shows household debt continues to eat into savings with the personal savings rate falling to 2.9% in July from 4.4% the previous year.[4] There are signs of life, though, as consumer credit card balances grew at a lower rate of 8.6% in the second quarter.[5]

## Global Economy

Inflation continues to moderate globally with Canada and eurozone inflation falling to 2.5%[6] and 2.2%[7] respectively. Central bankers are continuing the process of easing monetary policy with the Bank of Canada and the European Central Bank cutting interest rates for the third and second consecutive meeting respectively in September. The U.K. saw a slight uptick in inflation[8] causing the Bank of England to pause momentarily in its rate cutting cycle, but the bank is expected to resume cuts in November.

## Yield Curve

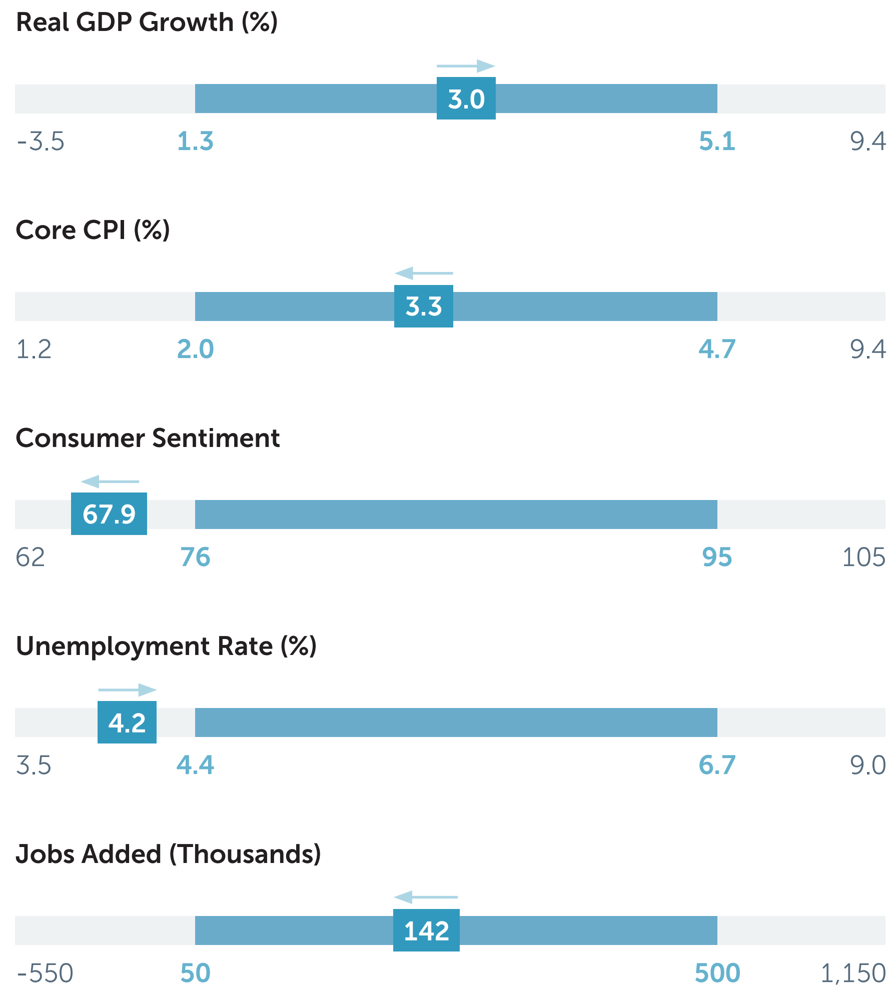
Under normal circumstances, yields on longer-dated bonds are higher than shorter-dated securities. Since July 2022, the yield curve has been inverted with the 10-year Treasuries yielding less than two-year Treasuries. Historically, an inverted yield curve has been one of the biggest leading indicators of a recession. Recently, the yield curve has normalized with 10-year Treasury yields finally breaking above two-year yields[9] possibly indicating a decreasing probability of a U.S. recession.

# Economic and Market Snapshot

**Global equity markets produced solid returns in the third quarter with international stocks leading the way.** Small value stocks flexed their muscles during the quarter both domestically and internationally with U.S. small value stocks outperforming the broad U.S. market by 4.0% and international small value outpacing broad international markets by 2.8%.

**Fixed income returns** were buoyed by dramatically lower interest rates in the third quarter as it became more and more clear to the market that a Fed rate cut was likely coming.

## Key Economic Indicators*




## Major Asset Class Returns*

Q3 2024

| | | Quarterly Return | Past 12 Months |
|---|---|---|---|
| **Stocks** | | | |
| U.S. Stocks | ▲ | 6.2 | 35.2 |
| International Stocks | ▲ | 8.1 | 24.8 |
| Emerging Markets Stocks | ▲ | 8.2 | 25.6 |
| **Bonds** | | | |
| U.S. Government Bonds | ▲ | 3.9 | 8.3 |
| Global Bonds | ▲ | 3.0 | 7.4 |

*See Appendix on page 8.

# Investment Planning Implications

## Where do markets go from here?

**Sky-high Mag 7 expectations.** Despite Magnificent 7 darling Nvidia posting second-quarter revenue of $30 billion, 122% higher than one year ago[1], the stock posted a loss of 1.7% over the quarter. This demonstrates the enormous growth expectations that are baked into the current prices of these high-flying stocks.

**Small caps.** The Fed cut the federal funds rate 50 basis points (bps) at its September meeting and is slated to reduce interest rates a further 50 bps by year-end. Lower interest rates should be a boon to small cap stocks as they tend to rely more heavily on external financing than large cap stocks, so falling borrowing costs are a tailwind.[2]

**Interest rate volatility.** Interest rates are expected to remain volatile with continued uncertainty around the future path of monetary policy. That uncertainty can be seen clearly in the discrepancy between the Fed's dot plot, indicating 150 bps of cuts through 2025, and the market's expectation of 200 bps of cuts as seen in Fed Funds Futures.[3]

## What are the investment planning implications?

**Tune out the politics.** Investors naturally want to look for a connection between who wins the White House and how markets are expected to perform. Looking at almost a century worth of returns clearly shows that stocks have trended upward no matter which party controls the presidency. We recommend against making any portfolio changes based on elections.

**Stay diversified.** U.S. equity valuations remain significantly elevated in comparison to their international counterparts. Forward price-to-earnings (P/E) ratios for the U.S. market sit at 24 versus 14.8 for developed ex-U.S. stocks. While imperfect, valuations are the best predictor of future expected returns, meaning we should expect higher returns from international stocks moving forward.

**Value isn't dead.** Small value stocks performed strongly in the third quarter with the Russell 2000 Value Index outperforming the Russell 3000 Index by 4.0%. The valuation spread between small value stocks and the overall U.S. stock market remains close to its all-time high, informing investors of higher expected returns for small value socks.

# About the Buckingham Team

## Kevin Grogan, CFA, CFP®

**Chief Investment Officer**

Kevin is a member of Buckingham's Investment Policy Committee and helps lead the firm's investment strategy, portfolio management and fixed income teams. He has co-authored three books on investment topics and enjoys educating others on concepts that will have a tangible effect on their financial lives.

## Blerina Hysi

**Director, Fixed Income**

Blerina works with fixed income and advisory teams to help construct and maintain customized bond portfolios, with an eye toward finding the best way to implement comprehensive financial plans. Her duties include fixed income analysis, bond trading and building tailored, client-focused portfolio solutions.

## Brian Haywood

**Investment Strategy Advisor**

Brian takes pride that in an industry where decisions are often driven by commissions and not conscience, he and his team spend their time customizing portfolios on behalf of clients, upholding their fiduciary responsibility by doing what's in their best interest. Brian is also a member of the firm's IPC.

Additional economic and investment resources are available at **buckinghamstrategicwealth.com/resources**

Buckingham's Investment Policy Committee (IPC) is a committee for Buckingham Strategic Wealth, LLC and Buckingham Strategic Partners, LLC (collectively Buckingham Wealth Partners) and not a committee for independent members of the Buckingham Strategic Partners community.

# Appendix

**Page 2:**

[1]Federal Reserve Bank of Atlanta. "On Long and Variable Lags in Monetary Policy" Nov. 15, 2022.

**Page 3:**

[1]Atlanta Fed GDPNow estimate as of Sept. 18, 2024.

[2]Apollo. "Services Spending Normalizing as a Share of Total Consumer Spending" Aug. 21, 2024.

[3]S&P. "Steepest decline in Basic Materials production since February 2023" Sept. 5, 2024.

[4]Philadelphia Federal Reserve Survey of Professional Forecasters Third Quarter 2024. Aug. 9, 2024.

[5]U.S. Bureau of Labor Statistics. 12-month percentage change, Consumer Price Index, selected categories. August 2024.

[6]Congressional Budget Office. "An Update to the Budget and Economic Outlook: 2024 to 2034" June 2024.

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[1]U.S. Bureau of Labor Statistics. August 2024

[2]CNBC. "U.S. job market slows, but it's not yet a three-alarm fire, economist says" Sept. 6, 2024

[3]Federal Reserve Bank of NY. "Household Debt and Credit Report" Q2 2024

[4]Federal Reserve Bank of St. Louis. "Personal Savings Rate" July 2024

[5]Transunion. "Consumers Tap Existing and New Credit in Q2 as Household Budgets Remain Tight" Aug. 21, 2024

[6]CBC. "Bank of Canada cuts key interest rate to 4.25%, citing cooling inflation" Sept. 4, 2024

[7]European Central Bank. "Inflation and Consumer Prices"

[8]Reuters. "Bank of England to hold Bank Rate this month but cut in Nov, economists say" Sept. 11, 2024

[9]Federal Reserve Bank of St. Louis. "10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity" Sept. 23, 2024

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Major Asset Class Returns: The index representation for the Major Asset Class Returns is as follows: U.S. stocks are represented by the Russell 3000 Index, international stocks by the MSCI World ex U.S. IMI Index, emerging markets by the MSCI Emerging Markets IMI Index, U.S. government bonds by the Bloomberg Government Intermediate Total Return Index, and global bonds by the FTSE World Government Bond 1-5 Year Index. Past performance is not a guarantee of future results. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Information from sources deemed to be reliable, but its accuracy cannot be guaranteed.

Key Economic Indicators: Sources: Bureau of Economic Analysis (BEA) for real GDP growth. Real GDP is the annual rate of change of real gross domestic product, seasonally adjusted. Bureau of Labor Statistics (BLS) for core CPI. The core consumer price index (CPI) is the annual rate of change, seasonally adjusted, and excludes food and energy. Consumer sentiment is from the University of Michigan's consumer sentiment index. Unemployment rate is reported by the BLS, and jobs added is based on nonfarm payroll employment reported by the BLS. Retrieved from FRED, Federal Reserve Bank of St. Louis. For all indicators, the boxed number reflects the latest reading, and the line above the box shows the change since the last update. The shaded areas reflect normal readings compared to history (based on the 25th-75th percentile of historical measures), while areas outside the dark blue reflect more extreme readings compared to history. The ranges are based on the percentile values of historical readings for each economic figure. The lowest number reflects the 5th percentile value, the bottom of the blue range reflects the 25th percentile, the top of the blue range is the 75th percentile, and the highest value reflects the 95th percentile. All ranges are based on the full period available. To account for population and employment, the ranges presented for jobs added are based on the percent change in employment numbers, using December 2022 as the base year.

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**Page 6:**

[1]DFA. Nvidia's $30 Billion Letdown. Sept. 16, 2024.

[2]Calamos Investments. Small-Cap Stocks Could Surge After Interest Rate Cuts. Sept. 18, 2024.

[3]CME FedWatch.