Wealth Enhancement®

THE OAKWOOD TEAM

OAKWOOD INSIGHTS

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Market Commentary

Executive Summary

Despite recent bouts of volatility, equity markets marched higher, ending the third quarter at all-time highs. The Fed began a recalibration of interest rates with a 50-basis point cut, as they see balanced risks to both inflation and employment.

What Piqued Our Interest

In recent months, markets have been paying more attention to the softening labor markets. The monthly non-farm payroll jobs report we get on the first Friday of each month have weighed on markets.

Higher unemployment can be a result of companies laying off workers as their outlook for revenue growth sours. Thus, it is no surprise that the unemployment rate tends to track closely with the percentage of respondents to the National Federation of Independent Businesses (NFIB) small business survey, who state that poor sales are their single most important problem.

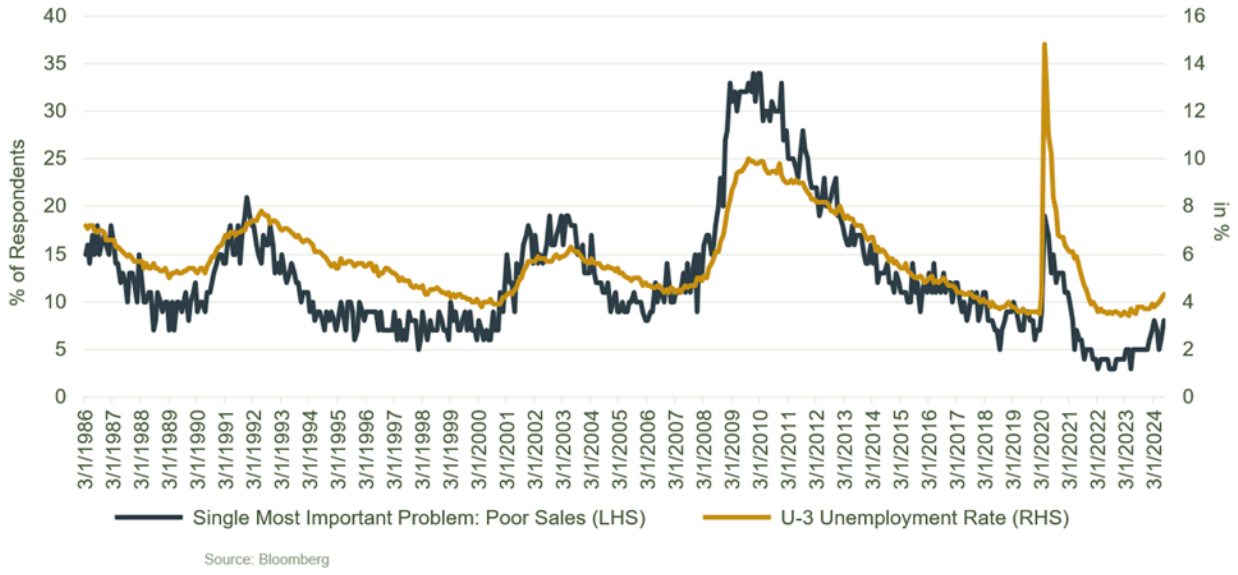
As seen in the graph on the following page, the number of respondents who site poor sales has risen recently but remains slightly below pre-pandemic levels.

Having seen enough progress of moderating inflation, the Fed finally cut interest rates by 50 basis points (0.50%) at their meeting on September 18—a decisive move aimed at bolstering the labor market and sustaining economic growth. This rate cut aligns with a shift in focus back toward the labor side of their dual mandate of price stability and maximum employment. At this stage, upside risks to unemployment appear greater than upside risks to inflation, justifying the Fed's moves. However, economic growth has remained steadfast, and though the labor market has weakened in recent months, 4.2% unemployment is still relatively low by historical standards.

Closing Thoughts

After months of anxiously awaiting lower rates, the Fed delivered on rate cuts and looks to be in a position to support the economy, even as labor markets moderate from here. Despite this support, market volatility can rise with new headlines, such as the recent ones out of the Middle East and the escalating conflict with Israel and Iran. Additionally, the dockworkers strike impacting major East Coast ports may reignite inflation concerns. Lastly, the U.S. presidential election draws closer, and investors may stay on the sidelines until after we know the outcome. New uncertainties and concerns arise, but over time, markets have climbed the wall of worry to post new record highs.

Exhibit 1
Unemployment Rate vs. NFIB Poor Sales



Source: Bloomberg

Global Stocks Continue to Rally

The third quarter saw the continuation of the global rally in stocks after a slow start, and despite a typically low volume and volatile August, markets ended the quarter with momentum after a strong final three weeks of September, typically the worst month of the year for stocks. Emerging Markets performed the best during the quarter, slightly ahead of International Developed Markets ex U.S., but the U.S. continues to be the best performing market year-to-date, up by more than 20%; many global indices ended the quarter at or near record highs. China, India and Japan all outperformed the U.S. during the quarter.

Market enthusiasm over lower interest rates overshadowed growing geo-political uncertainty around the globe, and in the Middle East in particular. The central banks of the European Union, the UK and the United States all lowered rates during the quarter, with the U.S. buoyed by a higher than expected 0.50% cut. It is apparent that the U.S. Federal Reserve (Fed) has been able to engineer a soft landing and avoid a recession for now.

China also made news during the quarter, announcing a stimulus package in late September which helped propel Asian markets in general. Globally, Financials, Real Estate Investment Trusts (REITs) and Utilities were the best performing sectors, while Information Technology lagged after leading for most of the year. Smaller caps stocks also outperformed, not surprising since lower interest rates typically benefit them the most.

The markets enter the fourth quarter in an optimistic mood, with further interest rates cuts expected, both this year and next, and an anticipated strong earnings season beginning the 4th quarter is typically a strong one for stocks, and even October, which is usually a tough month for stocks, has started out strongly.

What could derail the rally? The Middle East remains on the verge of a spreading war between Israel and several proxies for Iran. The war in Ukraine also continues with no end in sight. And of course, the U.S. presidential election is less than a month away. Markets will be as concerned with the aftermath of the election as much as the outcome, as any delayed or challenged results would rattle markets, at least in the short run.

Among developed country stock markets, the U.S. ended as the 4th worst performing market for the quarter despite its strong overall performance for the year as a whole; the only two developed markets to have negative performance in the quarter were the Netherlands and Denmark. Hong Kong and Singapore were the best two performing markets, each up well over 20%. Strength in Asia was also seen in developing markets, as the best four performing emerging markets were Thailand, China, the Philippines and Malaysia. Most emerging markets had positive performance for the quarter, with the exceptions being Columbia, Poland, Mexica, Korea and Turkey.

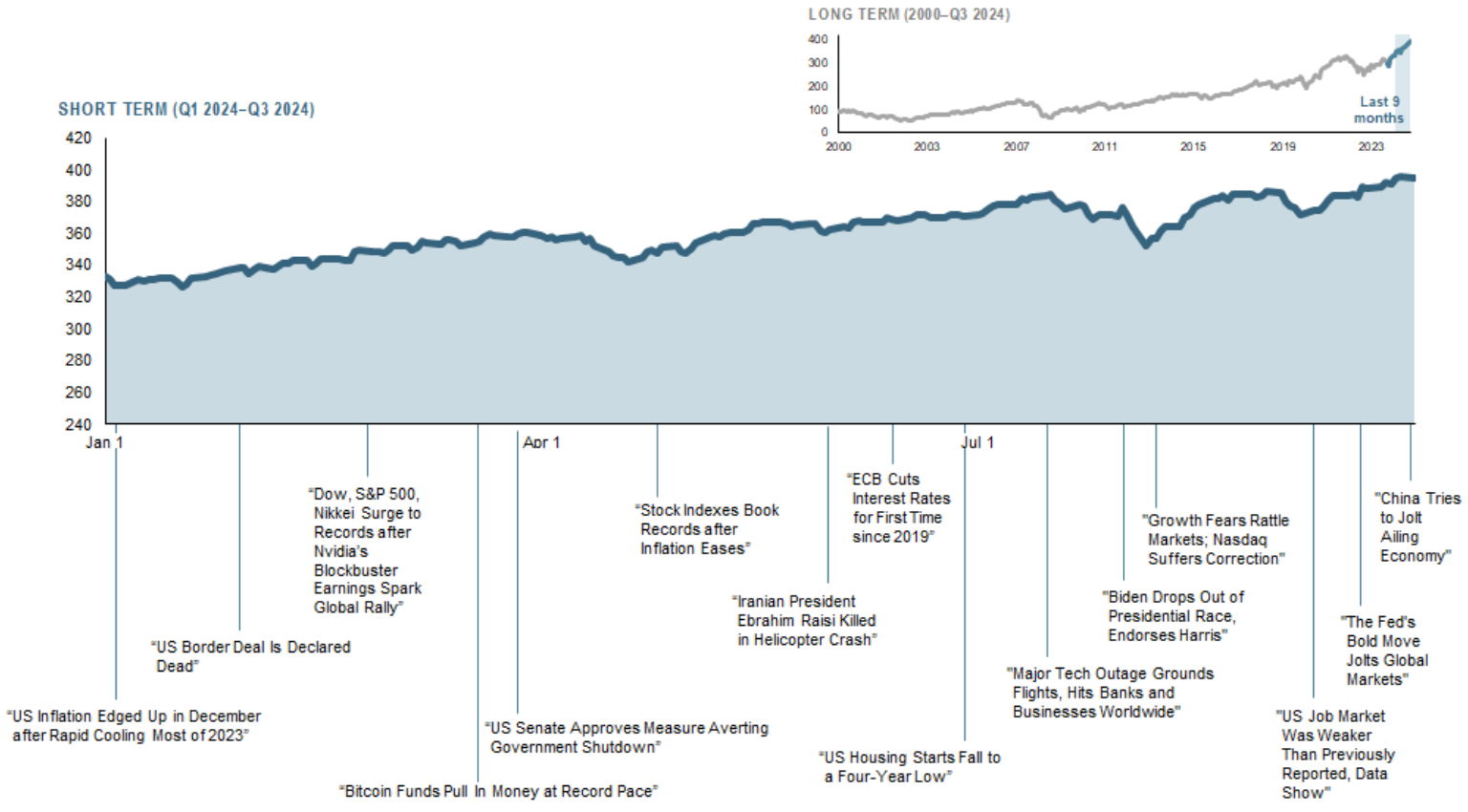
Not surprisingly, interest rates decreased significantly in the U.S. Treasury market for the quarter. On the short end of the yield curve, the 1-Month U.S. Treasury Bill yield decreased 54 basis points (bps) to 4.93%, while the 1-Year U.S. Treasury Bill yield decreased 111 bps to 3.98.%. Looking further out, the yield on the 10-Year U.S. Treasury Note decreased 55 bps to 3.81% and the yield on the 30-Year US Treasury Bond decreased 37 bps to 4.14%.

Interest rates generally decreased across global developed markets for the quarter as well. Realized term premiums were broadly positive across global developed markets as longer-term bonds generally outperformed shorter-term bonds. In Japan, short-term interest rates increased while longer-term interest rates generally decreased. The short-term segment of the yield curve remained inverted in Australia, the UK, Germany, and Canada.

Global REITS had a great quarter, benefitting from declining interest rates and the expected global economic soft landing. Improving financing costs should increase property values. Global REITs ex U.S. slightly outperformed U.S. REITs for the quarter but have underperformed them by almost 6% year-to-date.

World Stock Market Performance

MSCI All Country World Index with selected headlines from past 9 months



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index (net dividends). MSCI data © MSCI 2024, all rights reserved. Index level based at 100 starting January 2000. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

Stumble, recalibrate, and stick the landing

Simone Biles and the U.S. equity markets shared a striking parallel in the third quarter of 2024: both faced adversity, recalibrated, and ultimately stuck the landing. Biles withdrew unexpectedly from the Tokyo Olympics, citing mental health challenges after stumbling during the 2021 games. Her decision to step back sparked debate at the time but allowed the American athlete to recalibrate and return for the 2024 Paris Games, where she clinched three gold medals. Her journey can be distilled down to the classic halftime adjustment — a strategic recalibration after an initial setback — serving as a fitting metaphor for the market's third-quarter events. The third quarter saw initial volatility, including a labor market scare, political shifts, and a Federal Reserve pivot. Yet, like Biles, strategic adjustments produced a strong finish for the quarter.

In late July, following a Federal Reserve policy meeting that bolstered hopes for a September rate cut, worse than expected unemployment data for the month of June was published at 4.3%—below the 40-year average but alarming because the Sahm Rule triggered, a recession indicator that tracks the short-term acceleration of the unemployment rate. Concerns that the Fed had fallen behind the curve surged, and the implied rate path declined sharply. This, combined with Japan's central bank policy, triggered the unwinding of the yen carry trade, amplifying the market sell-off.

The S&P 500 bottomed out at 5,168 on August 5th, significantly below the highs of 5,667 reached in mid-July. However, as the structural damage from the yen carry trade subsided and earnings season surprised to the upside, markets recalibrated and recovered, driven by corporate resilience and a robust economy poised for a Fed cut in September.

The Democratic National Party also subscribed to the need of a halftime adjustment after Biden's debate shattered confidence in the president's capacity. Kamala Harris launched her campaign to a tepid reception in the polls and markets retreated, concerned a Trump presidency would introduce broad inflationary tariffs and increased national deficits under a Republican sweep. As a result, early September saw markets trade lower, particularly as July labor data came in stronger than expected, reducing the likelihood of a 50-basis point rate cut. Polling numbers shifted in Harris' favor after the debate and markets rallied in response to the reduced probability of a Republican sweep, increased confidence in the Inflation Reduction Act's next phase, and the diminished concern over new tariffs.

The final major pivot of the quarter was revealed at the Federal Reserve's September meeting. In the June summary of economic projects, board Fed Board participants penciled in only 1 cut for 2024. The weaker-than-expected unemployment data after the static July meeting signaled a potential misstep by Fed officials. Supported by weak unemployment data, market participants argued that the Fed had fallen behind the curve with their monetary policy. In response, the Fed recalibrated, delivering a 50-basis point rate cut in September and signaling two more cuts before year-end.

This marked a notable shift in the Fed's dual mandate, with unemployment winning priority over inflation. Additionally, Fed Chair Jerome Powell defended the 50-basis points cut while maintaining strong rhetoric on the labor market and economy, daftly threading the needle between reinflation risk and unemployment concerns, driving markets 5.9% higher for the quarter, sticking the landing.

Closing the Gap

As of the end of the third quarter, the U.S. equity market has delivered impressive year-to-date returns of 20.8%, with Q3 seeing a broadening of performance beyond mega-cap names like Nvidia. Smaller-cap utilities, industrials, and real estate stocks outpaced large-cap tech during the quarter, signaling a rotation in market leadership and a focus on interest rates. With the final quarter of 2024 ahead, the key question remains: Can the market stick the landing for 2024 amid multiple headwinds, including a looming election, geopolitical tensions, monetary policy risk, and heightened expectations around AI technologies?

The road will be bumpy, but sound market adjustments are a recipe for long-term returns. We remain focused on secular growth trends, solid fundamentals, and proper diversification. These market adjustments, though challenging, provide the foundation for robust, long-term returns. By maintaining a disciplined approach, we can navigate short-term volatility.



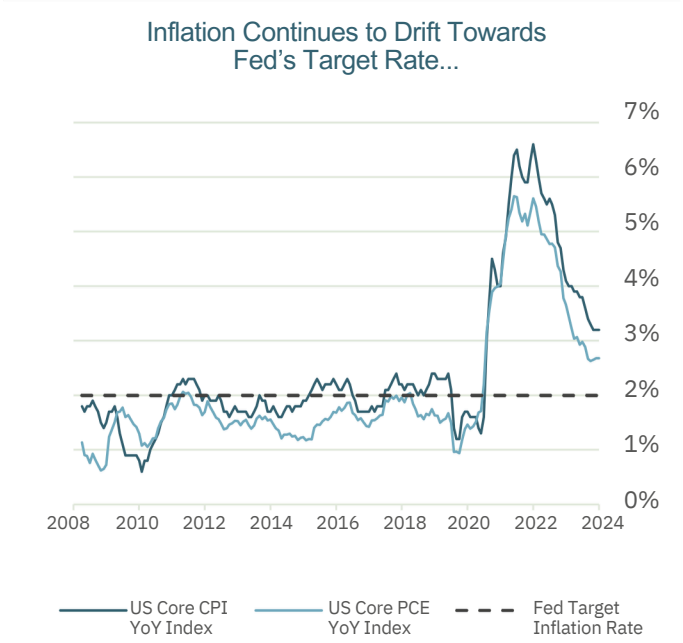
The equal weight S&P 500 out preformed its market weight counter part in the 3rd quarter driven on returns from interest rate sensitive industries.

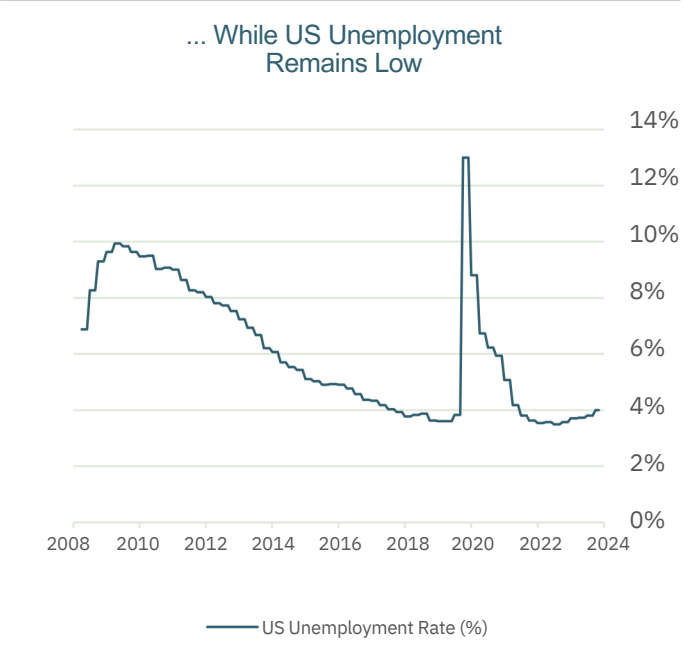
Adjusting the Sail of Monetary Policy

Since March 2022, the Federal Reserve has navigated a turbulent economic landscape akin to a skilled sailor adjusting their sails in a storm. Initially, the Fed raised the federal funds rate from a range of 0-25 basis points to a peak of 5.50%, aiming to combat the rising tide of inflation. However, during the September 18th meeting, the Fed charted a new course, cutting rates by 50 basis points as inflation moved closer to the target of 2%, reflecting their dual commitment to managing inflation and stabilizing employment.

The Fed's future rate cuts will depend on two critical variables: the pace of inflation decrease and the dynamics of unemployment. If inflation declines swiftly to or below the target, expect the Fed to accelerate rate cuts. Conversely, rising unemployment would also prompt more significant reductions, while stable or decreasing unemployment may lead to a more cautious stance. Additionally, the risk of unforeseen "black swan" events—such as a crisis in the real estate market—could significantly alter the Fed's approach.

Thus far, the Fed has orchestrated a delicate soft landing, successfully bringing down inflation while maintaining low unemployment. This balance is reflected in the bond market, where yields have dropped in an orderly fashion, benefiting bond investors with rising prices and enhanced returns from coupon payments.

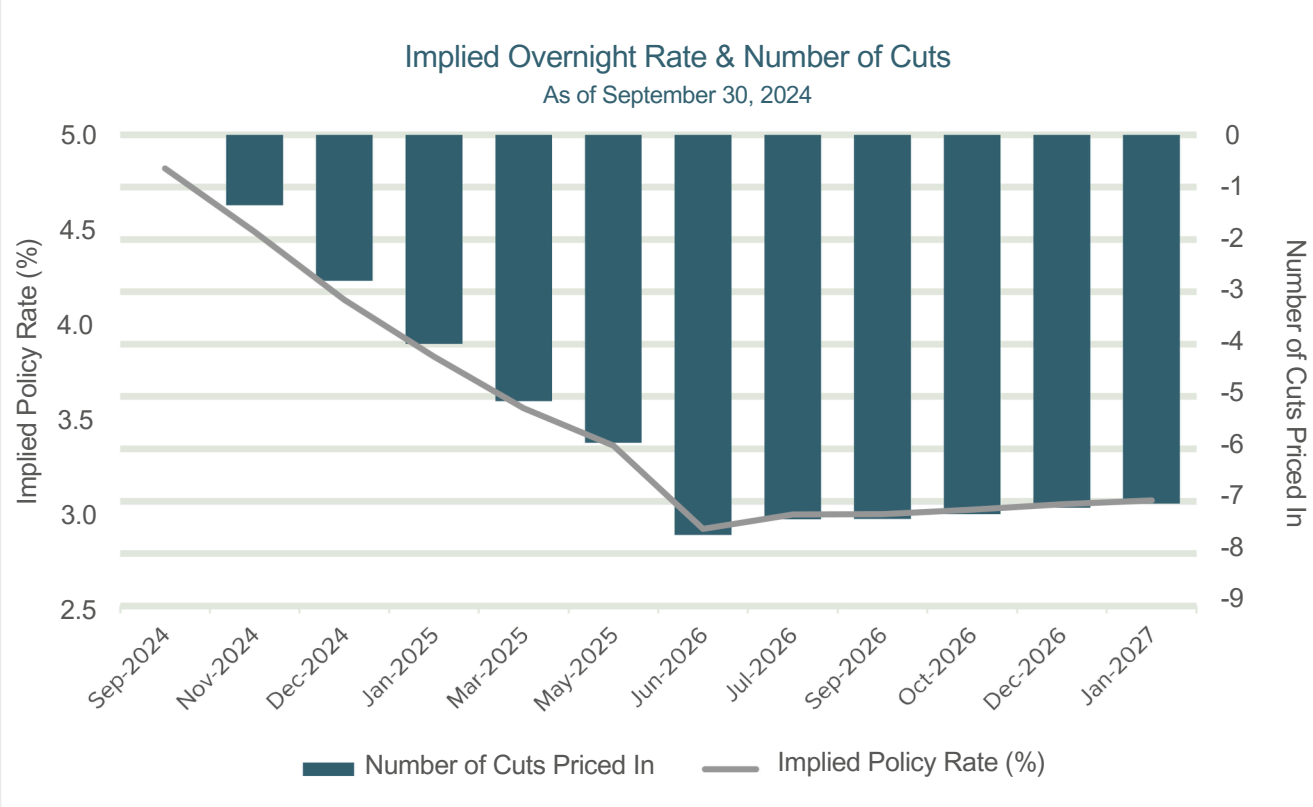




Source: Bloomberg.

Strategy

In response to these evolving conditions, our investment strategy has evolved as well. In the third quarter, intermediate maturities experienced the most significant price increases and yield declines. We have begun unwinding our barbell strategy, which served us well in a rising rate environment, in favor of a more balanced approach. By incorporating shorter-term bonds to fill gaps in our intermediate exposure, we are prioritizing higher credit quality to provide a buffer against potential economic downturns while ensuring liquidity within client portfolios. As the Federal Reserve continues to lower rates, we anticipate that intermediate and longer-dated bonds will appreciate the most, potentially enabling investors to capture higher total returns in their portfolios.

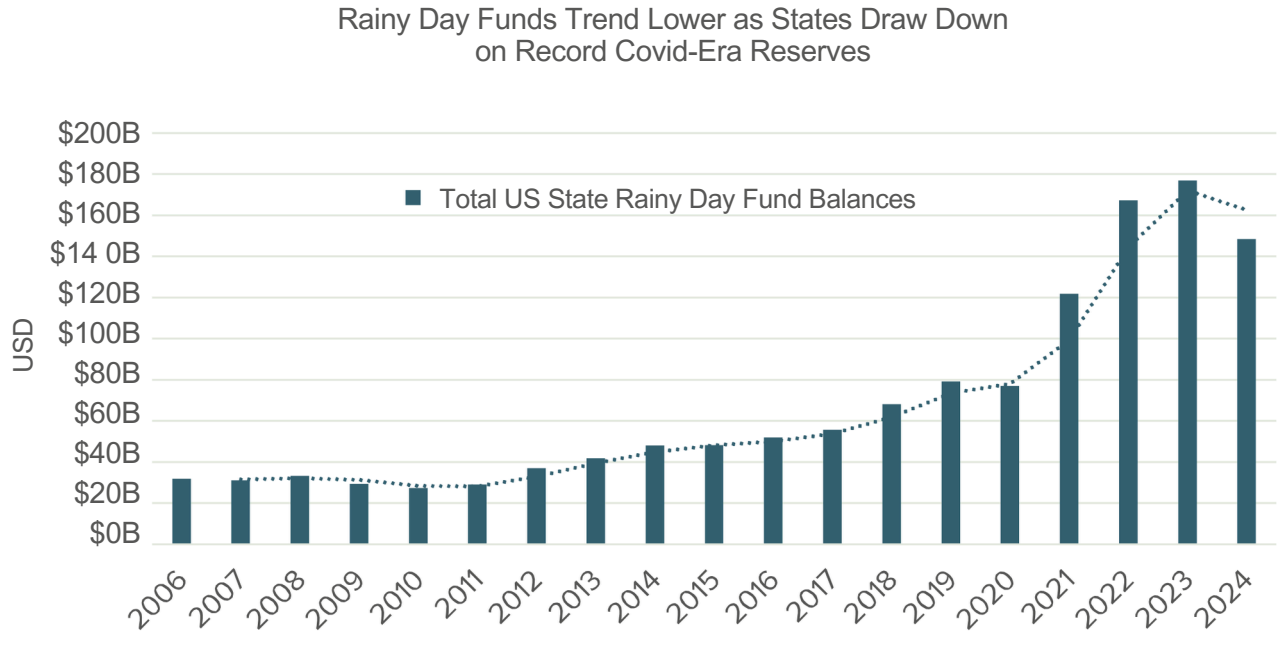


Source: Bloomberg.

Landscaping the Municipal Market

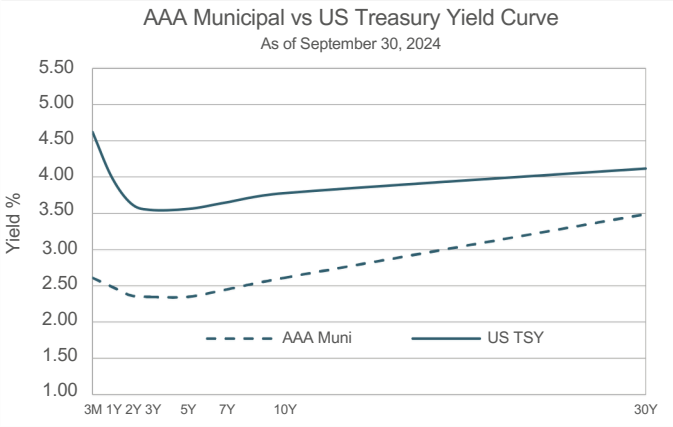
In the evolving landscape of municipal finance, recent shifts in monetary policy can be likened to a gardener adjusting the conditions in which their plants grow. Just as a gardener may alter sunlight, water, and soil nutrients to foster healthier blooms, the Federal Reserve has recalibrated its approach from a restrictive monetary policy—designed to combat inflation—to a more accommodating stance. This pivot has resulted in a notable decline in both taxable and tax-exempt yields from their yearly peaks. The Fed's decision to cut the federal funds rate by 50 basis points during its September meeting has sent ripples through the municipal bond market, much to the relief of existing bondholders, akin to a gardener witnessing a bountiful harvest after a season of careful cultivation.

Municipalities, too, are reaping the benefits of this newfound flexibility in interest rates. With the capacity to issue new debt at more favorable rates than during the previous high-interest phase, municipalities are poised to reinvigorate their financial strategies. Following the exhaustion of COVID relief funds, many states—California being a notable example—are now drawing from their rainy-day reserves. This shift underscores a pressing need for states to engage with primary markets to stabilize their budgets.



Source: National Association of State Budget Officers. Note: 2024 estimate does not include Georgia and Wisconsin.

The prevailing lower rates not only facilitate debt refinancing—similar to a homeowner refinancing their mortgage to alleviate financial strain—but also present a timely opportunity for investors to access a new supply of bonds in a market characterized by limited offerings. Furthermore, this environment is expected to enhance municipal treasury valuations, which, historically aligned around 80% of treasury values, are currently trading at approximately 60%.



Municipal to Treasury Ratios

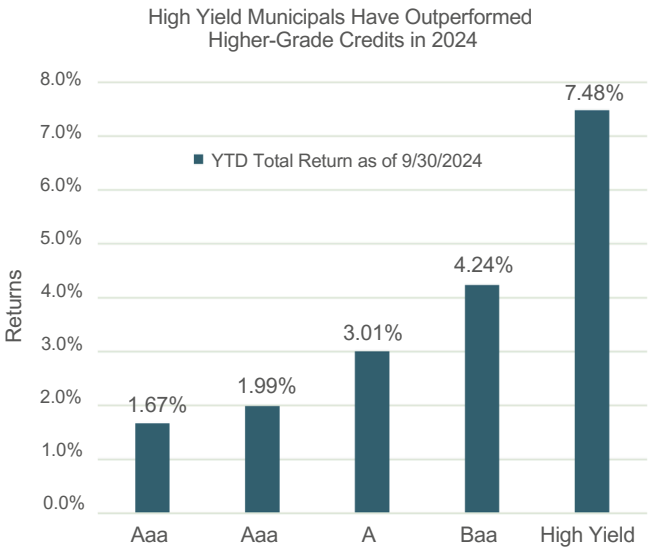
As of 9/30/24	3M	1Y	2Y	3Y	5Y	7Y	10Y	30Y
AAA Muni	2.61	2.49	2.37	2.35	2.35	2.45	2.61	3.49
US TSY	4.62	4.00	3.64	3.55	3.56	3.65	3.78	4.12
Muni-TSY Ratio	56%	62%	65%	66%	66%	67%	69%	85%

Source: Bloomberg.

Strategy

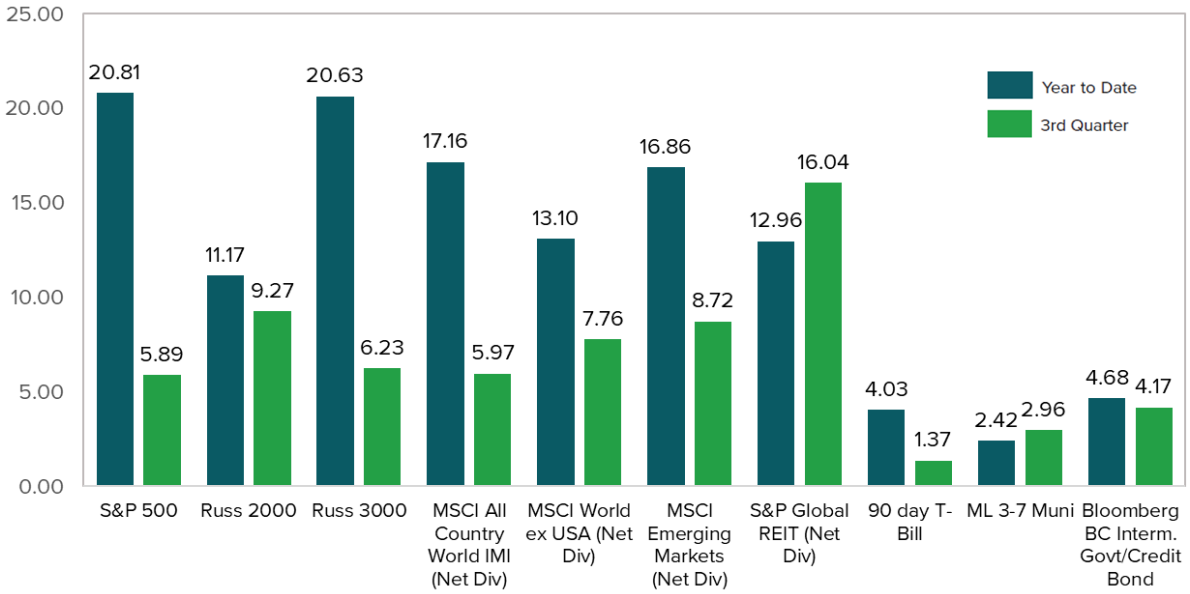
In light of these developments, our investment strategy has evolved. Over the past two years, in response to a rate-hiking environment, we adopted a defensive portfolio structure, characterized by a reduced overall duration and a barbell strategy—maintaining a mix of short and long-duration bonds.

While this approach has served us well, the recent changes in Federal Reserve policy have led to a resurgence in the middle of the maturity structure, prompting us to reassess our strategy. It has become prudent to extend our portfolios' durations and normalize our maturity structure by acquiring bonds in the belly of the curve. Additionally, the year has seen high yield municipals outperforming higher-grade credits, illustrating the Federal Reserve's success in orchestrating a soft landing, which has shielded lower credit quality bonds from severe downturns. Despite this dynamic, we continue to prioritize higher-grade municipal bonds, recognizing their role in preserving capital and liquidity for our clients. Through these strategic adjustments, we aim to navigate the complexities of the current market, much like a skilled gardener tending to their flourishing garden.



Source: Bloomberg

Market Indices 3rd Quarter 2024



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