



3Q24 Market Overview: Gravity Rides Everything

While financial assets generally were strong in the third quarter, volatility trended higher as markets continued to be buffeted by participants' efforts to read the rate-cut tea leaves.

When all was said and done, there were signs of rotation away from the performance dynamics that had dominated the first half of the year, as value outperformed growth, small outperformed large, and non-US outperformed the US. The S&P 500 Index returned 5.9% for the period, while the MSCI World Index gained 6.4%.¹

An idiosyncrasy investors have been forced to contend with for much of 2024 has been the presence of two distinct gravity wells of influence. On one side is the Goldilocks scenario in the US, as cooling inflation, a softer labor market, continued economic growth and strong corporate earnings have converged to raise hopes that a soft landing may yet be realized. Risk appetites in the US have remained elevated, supporting equity markets and credit spreads. On the other side is the weakness in China, where both structural and cyclical issues have weighed down the country's manufacturing base as well as global assets dependent on it, including a range of industrial commodities like copper and oil. Risk appetites in China have been depressed and have also weighed down other countries in the region.

As we discuss, however, there were developments toward the end of the third quarter to suggest the strength of this US/China duality may be waning.

KEY TAKEAWAYS

- Though volatility shifted higher during the third quarter, most financial assets delivered solid gains.
- While hopes for a soft landing have helped fuel risk appetites in the US, persistent labor market strength could bring the Fed's newly launched rate-cut cycle to a premature end.
- A large-scale package of monetary stimulus boosted China's long-suffering asset markets as well as expectations for real economic activity globally. Overcoming the country's structural issues—especially its property-market challenges—likely will require more substantial, targeted action.
- Gold continued to push higher, as falling interest rates and a weaker dollar combined with a tumultuous geopolitical backdrop to send the metal's price to a series of new nominal highs.

1. Source: FactSet; data as of September 30, 2024.

Push and Pull

More recently, however, signs have emerged that the strength of this duality may be waning. In mid-September, the Federal Reserve kicked off its much-anticipated rate-cut cycle, announcing the first federal funds rate reduction since the early-2020 onset of Covid-19. The oversized 50 basis point cut was broadly in line with market expectations and brought the central bank's key policy rate to a range of 4.75–5.00%. Fed Chair Powell characterized the move as a “recalibration” of policy that reflected the committee's growing confidence that labor market strength could be preserved amid healthy economic growth and further cooling in inflation. The latest summary of economic projections suggests an additional 50 basis points of cuts in 2024 and 100 basis points in 2025.²

Data released subsequent to the Fed meeting appeared to back up the central bank's confidence in the jobs market's resilience. Unflagging labor strength runs the risk of sparking inflationary pressures anew, however, a risk of particular concern given that wage growth, while well off its peak, remains above levels consistent with the Fed's 2% inflation target. A Fed shift back to a hawkish policy bias sooner than expected could bring a recalibration of investor risk appetites and herald an untimely end to this Goldilocks tale.

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In China, meanwhile, policymakers were finally spurred to action in late September, as the latest slew of uniformly downbeat releases—from retail sales and consumer confidence to industrial production and fixed investment—appeared to disabuse them of any notions that they would be able to reach their full-year economic growth target organically. The government announced a series of stimulus measures to combat mounting deflationary pressures, stabilize housing and restore market optimism. On the monetary side, the People's Bank of China (PBOC) cut the reserve requirement ratio for banks and its benchmark short-term reverse repo rate, while instructing commercial banks to trim rates on outstanding mortgages and introducing new liquidity mechanisms to support equity markets.³ While officials had suggested that significant fiscal stimulus also was on tap, further details have yet to be announced.

News of Beijing's stimulus package was greeted enthusiastically by markets. The MSCI China Index, which began the third quarter down more than 50% from its early-2021 peak, surged 23.6% during September, with most of the gains coming in the last week of the quarter.⁴ Similarly, yields on 10-year Chinese government bonds rose from all-time lows, green shoots of relief for policymakers concerned about the financial risks of such low yields. The potential for improved activity in China also prompted a positive inflection in expectations for real economic activity globally, helping push the prices of certain real assets higher.

Though we're still waiting on details, the contours of a fiscal complement may be integral to the success of the PBOC's monetary blitz. To date, fiscal support has largely focused on the supply side of the economy, not on stimulating demand—particularly consumption, which remains less than 40% of GDP compared to 68% in the US.⁵ Further, it seems likely to us that China's deeper economic challenges likely will persist without measures targeting the oversupply of real estate in lower-tier cities and the bad debts related to it, as well as local governments' heavy reliance on the property market.

2. Source: Federal Reserve; data as of September 18, 2024.

3. Source: Reuters; data as of September 24, 2024.

4. Source: MSCI; data as of September 30, 2024.

5. Source: CEIC; data as of December 31, 2023.

All that Glitters

As we think about the potential trajectories of the world's two largest economies, we're cognizant of the many risks that threaten to upend any sort of fundamental analysis. Unrestrained government debt globally has raised the specter of currency debasement and other adverse financial outcomes, for example, while geopolitical risk—headlined by Ukraine/Russia and broadening military engagement in the Middle East—shows no sign of relenting. Nearing the end of what was a very active year in national politics, all eyes now have turned to the contentious race for president in the US, the results of which may have broad policy implications affecting both domestic and cross-border actors.

Given gold's history as a perceived "safe haven" during periods of turmoil, recognition of these and other global risks—alongside with traditional tailwinds like falling real interest rates and a weaker dollar—likely supported its strong rally during the third quarter, helping the metal set a series of new nominal highs as it climbed 12.9%.⁶ Risk sensitivity also may have contributed to gold's performance in the first half of the year, as the metal gained ground despite conditions like rising real rates and a stronger dollar that generally would be considered headwinds to its price. In fact, gold's resilience throughout 2024 and its disparate macroeconomic backdrops underscores why we advocate for strategic exposure to gold as a potential hedge against adverse market outcomes.

While we remain concerned about the many risks facing investors in the current environment, we also see opportunity. But rather than making bets on the direction of markets, we continue to focus on investing in individual assets we believe represent scarce quality and value and the potential to demonstrate resilience across multiple states of the world.

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6. Source: World Gold Council; data as of October 8, 2024.

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All investments involve the risk of loss of principal.

A principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value. "Value" investments, as a category, or entire industries or sectors associated with such investments, may lose favor with investors as compared to those that are more "growth" oriented.

There are risks associated with investing in foreign investments (including depository receipts). Foreign investments, which can be denominated in foreign currencies, are susceptible to less politically, economically and socially stable environments; fluctuations in the value of foreign currency and exchange rates; and adverse changes to government regulations.

Investment in gold and gold-related investments present certain risks, and returns on gold related investments have traditionally been more volatile than investments in broader equity or debt markets.

Definitions

Currency debasement is the intentional reduction of a currency's value by a government.

Federal funds rate is the interest rate at which depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight on an uncollateralized basis.

A **soft landing** refers to a gradual economic slowdown that comes to an end without triggering a recession.

Volatility represents the degree to which an investment's price has deviated from its average over time.

MSCI China Index (Net) measures the performance of large and midcap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings. A net-return index tracks price changes and reinvestment of distribution income net of withholding taxes.

MSCI World Index (Net) measures the performance of large and midcap equities across developed markets. A net-return index tracks price changes and reinvestment of distribution income net of withholding taxes.

S&P 500 Index (Gross/Total) measures the performance of the large cap segment of the US equity market but is widely recognized as a proxy for the US market as a whole. It is composed of 500 constituent companies across the US economy, weighted by float-adjusted market capitalization. A total-return index tracks price changes and reinvestment of distribution income.

Indexes are unmanaged and do not incur management fees or other operating expenses. One cannot invest directly in an index.

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