HIGHLAND

# Multi-Asset Solutions Weekly Commentary

*September 30, 2024*

## What We're Watching:

- Eurozone Manufacturing Purchasing Managers Index (PMI) for September is released Tuesday with a reading of 45.0 expected, which would be a modest improvement from an already weak 44.8 reading in August. An index reading above 50 signals an increase or growth compared to the previous month, below 50 signals a decrease or contraction.
- The U.S. Institute for Supply Management (ISM) Services Purchasing Managers Index (PMI) for September is released Thursday and is expected to improve modestly month over month to 51.8 from 51.5 in August. A reading above 50 indicates that the non-manufacturing economy is generally expanding; below 50 percent, that it is generally declining.
- The September Nonfarm Payrolls report is released Friday. The U.S. economy is expected to have created 150k jobs during the month, which would be modest increase from 142k in August. Average hourly earnings are expected to rise 0.3% month over month and 3.8% year over year, and the unemployment rate is expected to remain static month over month at 4.2%.

## Key Observations:

- Chinese regulators announced a relatively aggressive stimulus package compared to past iterations that provided a spark for global equity markets last week, boosting foreign stocks relative to domestic equities.
- The uptick in risk-sentiment and further easing of monetary policy amongst the world's two largest economies led to modest repricing of potential growth and inflation expectations, resulting in upward pressure on U.S. treasury yields.
- Mixed readings on consumer confidence and sentiment highlight the disconnect in survey data, with confidence falling by the most in over three years while consumer sentiment reached a five-month high, leaving cyclicals and economically sensitive sectors behind as a result.

| | Price/Yield | Total Return (%) | | | | | |
|---|---|---|---|---|---|---|---|
| | 9/27/2024 | 1 Week Ago | 1 Month Ago | Year to Date | 1 Year | 3 Years | 5 Years |
| S&P 500 | 5738.17 | 0.64 | 2.74 | 21.55 | 35.40 | 11.37 | 16.00 |
| NASDAQ | 18119.59 | 0.96 | 3.28 | 21.37 | 38.29 | 8.46 | 18.90 |
| S&P Mid Cap 400 | 3119.24 | 0.52 | 2.10 | 13.39 | 26.18 | 6.88 | 11.90 |
| S&P Small Cap 600 | 1418.14 | 0.22 | 1.54 | 8.96 | 24.60 | 3.43 | 10.17 |
| MSCI World ex US | 357.36 | 4.25 | 4.12 | 15.42 | 27.25 | 4.33 | 7.76 |
| MSCI EM | 1174.52 | 6.21 | 7.28 | 17.22 | 27.62 | 0.31 | 5.80 |
| Bloomberg U.S. Aggregate | 4.17 | -0.01 | 1.18 | 4.69 | 11.77 | -1.28 | 0.39 |
| Bloomberg Corporate | 4.68 | -0.01 | 1.53 | 5.51 | 14.43 | -1.13 | 1.20 |
| Bloomberg U.S.High Yield | 6.98 | 0.13 | 1.66 | 7.98 | 15.91 | 3.09 | 4.71 |
| Bloomberg EM USD Aggregate | 6.27 | 0.12 | 1.64 | 8.15 | 17.02 | -0.18 | 1.35 |
| Bloomberg Global Aggregate | 3.30 | 0.47 | 1.49 | 3.78 | 12.51 | -3.07 | -0.82 |
| Bloomberg Municipal Bond | 3.32 | 0.07 | 0.89 | 2.24 | 10.77 | 0.03 | 1.38 |

| | Price / Yield | | | | | | |
|---|---|---|---|---|---|---|---|
| | 9/27/2024 | 1 Week Ago | 1 Month Ago | 12/31/2023 | 1 Year Ago | 3 Years Ago | 5 Years Ago |
| SOFR (yield) | 4.84 | 4.83 | 5.35 | 5.38 | 5.32 | 0.05 | 1.82 |
| 30 Year Mortgage (average rate) | 6.69 | 6.64 | 6.83 | 6.99 | 7.83 | 3.13 | 3.74 |
| 2 Year Treasury (yield) | 3.56 | 3.59 | 3.90 | 4.25 | 5.14 | 0.28 | 1.63 |
| 10 Year Treasury (yield) | 3.75 | 3.74 | 3.82 | 3.88 | 4.61 | 1.49 | 1.68 |
| 30 Year Treasury (yield) | 4.10 | 4.08 | 4.11 | 4.03 | 4.72 | 1.99 | 2.13 |
| WTI Crude (closing price) | 68.18 | 71.92 | 75.53 | 71.65 | 93.68 | 75.45 | 55.91 |
| Gold (NYM $/oz) | 2644.30 | 2622.40 | 2516.00 | 2071.80 | 1872.30 | 1750.00 | 1499.10 |

**Source: Bloomberg (3- and 5-Year Annualized)**

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# What Happened Last Week:

## Stocks: Synchronized Easing In The World's Top Economies Send Domestic Stocks To New Highs; Renewed Risk Appetite In Foreign Equities But Left Small Caps Sequestered.

- **More All-Time Highs For The S&P 500 As Stocks Continue To Melt-Up On The Heels Of The FOMC's Super-Sized Rate Cut, Long-Awaited Stimulus Out Of China.** U.S. large cap stocks ended last week with a modest gain, evidenced by the S&P 500's 0.6% return, but under the surface price action and leadership remained encouraging with over 75% of S&P 500 constituents still trading above their 50- and 200-day moving average as of last Friday. The information technology sector was among this week's leaders, as it rallied 2.1%, pulled higher by semiconductor stocks with the Philadelphia Semiconductor Index, or SOX, jumping 4.3% on the heels of impressive earnings results out of Micron which boosted demand for names tied to the ongoing build out of artificial intelligence (AI) technology. The materials sector was the biggest winner on the week, rallying 3.4% as China's announced fiscal and monetary stimulus measures are expected to boost demand for industrial and precious metals and the profits of companies tied to the metals complex. Notably, while the sector underperformed the S&P 500 last week, utility stocks have quietly kept pace with information technology and communication services and the sector is now the 3rd best performer year-to-date and the 2nd best performer, trailing only consumer discretionary, over the last month. On the other end of the spectrum, the energy sector continued to falter, falling 0.8% on the week despite China's stimulus measures, and has eked out just a 6% gain this calendar year to claim the unenviable reputation as the only sector without a double-digit gain. After underperforming by such a wide margin this year, contrarians are likely circling the energy sector looking for opportunities to buy this beaten down pocket of the market, but price is truth and we would much rather focus our shopping list on winners with strong price momentum in the information technology, communication services, industrials, and materials sectors tied to secular growth themes such as the rise of artificial intelligence and the build out of data centers.

- **Stepped Up China Stimulus Boosts Sentiment For International Stocks.** Equities in the far east were top of mind last week, as the Peoples' Bank of China (PBOC) broadcasted renewed efforts to stimulate economic growth by cutting the monetary policy rate and introducing sweeping measures to boost the property and stock market. These actions lowered reserve requirements, to boost lending and alluded to further cuts in the pipeline while announcing a $71B dollar liquidity support facility for local stocks with ongoing pro-business policies in the works. This new wave of stimulus is broader than previous attempts to revive economic activity and comes as short interest was approaching 5-year highs, leading to the MSCI China index ultimately returning 16.9% on the week, marking the county's strongest weekly gain since 2007, and contributing to the broader MSCI EM index return of 6.2%. Prior stimulus efforts have been short-lived in markets, but recent moves by regulators in China represent a new sense of urgency as the country's 5% growth projection appeared in jeopardy after August data disappointed and elevated trading volume suggests the market is taking notice. Stimulus efforts in China had second order effects on select developed economies as well, with the projected return of Chinese consumer spending on luxury goods resulting in the consumer discretionary sector leading within the MSCI EAFE index, bringing the benchmark to a 2.5% gain on the week.

- **Gap In Consumer Confidence And Sentiment Suspends Small Caps.** There was no shortage of skepticism in small cap stocks early last week, as the Conference Board Consumer Confidence measure fell by the most in three years, leading the S&P 600 Small Cap Index to a meager 0.2% return through Friday. The lag relative to global equities would have been even greater had University of Michigan Consumer Sentiment not surprised to the upside on Friday to the highest level since April while inflation expectations waned. That disconnect between the consumer surveys appears to be the gap between labor market concerns, at the forefront of the weaker confidence measure, while progress on inflation reflected in the lowest consumer inflation expectation since 2020 helped sentiment advance. Macroeconomic forces are playing a significant role in small caps as of late, evidenced by the lag in cyclically oriented sectors including financials, discretionary, and energy as investors took profits after the run-up through the FOMC

meeting wtih attention bouncing between unemployment and by extension health of the consumer.

## Bonds: Stimulus Abroad Prompts Investors To Revisit Economic Projections, Pressuring Yields Higher; Though Cash Balances and Domestic Inflation Suggests Fair Value Isn't Far Off.

- **China's Stimulus Leads Investors To Revisit Their Inflation And Global Growth Expectations.** There was modest upward pressure on yields of U.S. Treasury securities maturing 3-years and out last week as the Chinese government finally announced a series of measures to boost consumer confidence and consumption. China's government has balked at stepping up support in the post-COVID world for fear it would lead to inequality and laziness amongst its citizenry, but last week it announced both fiscal and monetary measures to spur consumption, support the real estate market, and prop up lackluster economic growth. While far from what may ultimately be required to get China's economy out of the doldrums, last week's moves are a concrete start and could put upward pressure on commodity prices and some goods in the coming quarters, as well as put a floor under global economic growth projections. At the margin, China's moves could make U.S. inflation stickier and calls even more into question the aggressive path forward market participants have expected the FOMC to take when it comes to making monetary policy less restrictive over the coming quarters. Fed funds futures are still pricing in 185-basis points of rate cuts between now and September of 2025 and believe a 50-basis point rate cut at the Committee's November meeting is the most likely outcome, albeit by a slim margin. Our baseline forecast calls for U.S. economic growth to trend back to around 2% in '25, with inflation getting back to the FOMC's 2% target around year-end 2025. As a result of this view, the FOMC likely won't need to be as aggressive in cutting rates as the market expects, and China's stimulus may give them even more pause and reason to move more slowly/gradually. Our base case still calls for two 25-basis point rate cuts this year, with one in November and another in December, as we don't see a case to be made for a larger cut at present. Given this view, we still see risks as skewed to the upside for yields on long-term U.S. Treasury securities.

- **Cash Could Increasingly Find Its Way Into Corporate Bonds As The Fed Funds Rate Falls.** At last count, there was some $6.3T still hiding out in money market funds, this compares to money market fund balances that were consistently in the $2.5T to $3T range from 2010 through 2019 prior to the COVID-19 outbreak and the U.S. Government's response to it. However, as the Fed funds rate falls over the coming quarters as the FOMC makes monetary policy less restrictive, returns on cash will continue to fall as well, likely forcing some, not all, of this cash hoard into higher yielding assets. As the yield on cash approaches 3% between now and year-end 2025, some capital could find its way into safer higher dividend yielding stocks, but with many investors hiding out in cash likely more risk averse or focused on capital preservation as opposed to appreciation, we suspect the lion's share could go into investment-grade (IG) corporate bonds. This is another dynamic likely to continue putting downward pressure on credit spreads of higher quality IG corporates as well as on lower quality and higher yielding high yield corporate bonds.

- **Fed's Favored Inflation Gauge Stems Recent Rise In Yields.** Core Personal Consumption Expenditure (PCE) registered at just 2.7% year over year, above last month's reading of 2.6% but in line with expectations and only fractionally higher as the gauge was rounded up instead of down this month. Month over month Core PCE was 0.1%, the lowest in the last three months, a welcome sign for the FOMC and in keeping with the 50-basis point cut mid-month. Bond traders took the print, that came alongside cooler personal income and spending data, as a comforting signal that near-term upside risks to inflation may be overblown with the 10-year drifting lower to 3.75% from weekly highs near 3.80%. The modest uptick in rates left broader fixed income assets flat to lower on the week as the Bloomberg Aggregate Bond index declined by 0.1% while the longer duration Bloomberg Investment Grade Corporate Bond index fell in equivalent fashion. We're not yet ready to signal the selling pressures are receding in fixed income, as the next technical barrier for the 10-year note is another 10bps higher at 3.86%, but current yields appear far closer to fair value than they've been for the better part of September.

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