HIGHLAND

Multi-Asset Solutions Weekly Commentary

October 7, 2024

What We're Watching:

- The National Federation of Independent Business (NFIB) small business optimism survey for September is released Tuesday with a reading of 92.0 expected, which would be a modest improvement from the 91.2 reading in August.

- U.S. Consumer Price Index (CPI) for September is released Wednesday. Headline CPI is expected to rise 0.1% month over month and 2.3% year over year after 0.2% and 2.5% readings in August. Core CPI, which excludes food and energy, is expected to rise 0.2% month over month and 3.2% year over year versus 0.3% and 3.2% readings the prior month.

- The University of Michigan's Consumer Sentiment Index for October is released Friday with a 70.5 reading expected, which would be slightly above the 70.1 reading in September.

Key Observations:

- Rising tensions in the Middle East pushed energy prices higher and weighed on investor sentiment and risk appetite over the balance of the week, leading to choppy and rudderless price action. A series of U.S. economic data releases were better than expected, broadly speaking, creating uncertainty surrounding the path forward for economic growth, inflation, and monetary policy, contributing to heightened interest rate volatility in the process.

- Markets in mainland China were closed for Golden Week, but Chinese stocks traded in Hong Kong continued to rally and the MSCI China index is now higher by over 37% in the past month. While we remain constructive on emerging markets broadly and believe China's stimulus efforts will put a higher floor under global economic growth, we question the sustainability of the rise in Chinese stocks as much of the move appears to have been driven by short covering, and the rally in the U.S. dollar in recent weeks could also pose a headwind to this cohort of stocks.

- Bonds had a rough week as encouraging economic data releases created uncertainty surrounding the outlook for U.S. growth, inflation and the path forward for monetary policy, putting upward pressure on U.S. Treasury yields. Lower yielding and more interest rate sensitive U.S. Treasuries and investment grade corporates fared poorly on an absolute and relative basis while riskier high yield bonds and emerging market debt also gave ground but performed well on a relative basis due to higher yields and/or shorter maturity profiles.

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	Price / Yield	Total Return %					
	10/4/2024	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
S&P 500	5751.07	0.26	4.32	21.87	37.04	11.52	16.13
NASDAQ	18137.85	0.12	6.25	21.51	38.24	8.77	18.79
S&P Mid Cap 400	3118.26	0.03	4.03	13.42	30.07	7.00	12.12
S&P Small Cap 600	1407.46	-0.68	2.98	8.22	28.30	3.01	10.39
MSCI World ex US	349.45	-2.21	3.57	12.88	26.99	4.01	7.65
MSCI EM	1179.34	0.42	10.07	17.72	30.04	1.09	5.99
Bloomberg U.S. Aggregate	4.43	-1.24	-0.60	3.40	11.33	-1.70	-0.02
Bloomberg Corporate	4.88	-1.03	0.00	4.42	14.52	-1.44	0.82
Bloomberg U.S.High Yield	7.10	-0.15	1.44	7.82	16.97	3.07	4.78
Bloomberg EM USD Aggregate	6.40	-0.45	1.06	7.66	18.03	-0.21	1.17
Bloomberg Global Aggregate	3.46	-1.75	-0.58	1.96	11.10	-3.58	-1.30
Bloomberg Municipal Bond	3.34	0.03	0.77	2.27	10.71	0.09	1.27
				Price/Yield			
	10/4/2024	1 Week Ago	1 Month Ago	12/31/2023	1 Year Agc	3 Years Ago	5 Years Ago
SOFR (yield)	4.83	4.84	5.35	5.38	5.32	0.05	1.82
30 Year Mortgage (average rate	6.96	6.69	6.76	6.99	7.88	3.11	3.71
2 Year Treasury (yield)	3.92	3.56	3.75	4.25	5.05	0.28	1.40
10 Year Treasury (yield)	3.97	3.75	3.76	3.88	4.73	1.48	1.53
30 Year Treasury (yield)	4.25	4.10	4.06	4.03	4.86	2.04	2.02
WTI Crude (closing price)	74.38	68.18	69.20	71.65	84.22	77.62	52.81
Gold (NYM $/oz)	2645.80	2644.30	2502.70	2071.80	1818.50	1766.20	1506.20

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

What Happened Last Week:

▲ Stocks: Rising Tensions In The Middle East Force Energy Prices Higher, Weighing On Investor Sentiment And Risk Appetite; China A Standout For Another Week, But We Remain Skeptical.

▲ **U.S. Stocks Moe Sideways To Kick Off The Month As Geopolitical Tensions Weigh On Risk Appetite, Offsetting Encouraging Economic Data.** The S&P 500 finished the week with a modest 0.1% gain as the communication services, energy, financial services, industrials, and utilities sectors each turned out a 0.5% or greater return on the week. Energy was far and away the best performing sector with a 6.8% weekly gain, On the other side of the ledger, consumer discretionary, consumer staples, health care, materials, and real estate lagged. Given the strange mix of sectors in the leaders and laggards categories, we take very little away from last week's price action. Investors may be looking to sell into strength in the lead-up to earnings season and the election in November, but we will continue to take our cue from market breadth, and with over 70% of S&P 500 constituents trading above their 50- and 200-day moving average as of last Friday, U.S. large cap stocks appear to be on strong footing into year-end. Notably, after faltering early in the week, the S&P Small Cap 600 index staged a comeback on Friday as a blowout September nonfarm payrolls report boosted optimism surrounding the U.S. economy and sentiment for stocks of smaller companies that have lagged the S&P 500 meaningfully since the end of July.

▲ **Crude Oil, Energy Stocks Rise As Fears Of Escalation In The Middle East Build, But Inventories Remain High.** Tensions in the Middle East continued to escalate last week, rekindling concerns that global crude oil supply could be negatively impacted. Prices of "black gold" rose because of these fears with West Texas Intermediate (WTI) crude jumping from $68.18 to 74.38 a barrel. The 9% weekly jump in WTI led to positive price momentum in the beleaguered S&P 500 energy sector, evidenced by its 6.8% gain, the sector's strongest weekly performance since March of 2023. The bounce in energy stocks shows the value of maintaining a diversified equity portfolio and staying close to market-weight in undervalued areas, but it's notable that the energy sector is still lagging even some of the historically least volatile sectors such as utilities and consumer staples year to date. Approximately 1.5M barrels per day, or roughly half of OPEC's daily production, could potentially be offline should a targeted attack on Iran take place, but it's worth noting that OPEC is holding back roughly 6M in spare capacity that could reenter the market if oil prices top $75 to $80 per barrel. This supply dynamic is reflected in the futures curve with prices of oil contracts for delivery in the coming months trading below the current month contract, signaling prices are expected to fall in coming months as demand shrinks and/or supply picks up to take advantage of currently elevated prices. The supply/demand imbalance appears to be widening after U.S. crude oil inventories have surprised to the upside in recent weeks as potential buyers may be willing to stay on the sidelines for now and await lower prices in the coming months.

- **Chinese Equities, While Overbought, Drive Continued Gains For Emerging Market Indices** The MSCI Emerging Markets (EM) index ended the week with a 0.4% gain and outperformed U.S. stocks for the 3rd consecutive week. The MSCI China index gained another 11.7% on the week and was easily the best performing country exposure in the EM index. The rally in Chinese stocks began with stimulus announcements two weeks ago and has persisted into early October, leading the MSCI EM to its best performance stretch since May. Investors have been clamoring to get back to market-weight exposure to Chinese stocks after being consistently underweight post-COVID as the country's economy has lagged. The advance last week comes as onshore markets were closed for the Golden Week holiday, a potential indication that it wasn't news flow but instead the prospect of further easing that is enticing traders to chase recent gains. With momentum carrying the country's stock market well into overbought territory regardless of how you slice it, we'd prefer to see some sideways price action above key levels to confirm a trend change from bearish to bullish. Admittedly, we're skeptical this ongoing China trade is anything more than that for now but stand ready to re-evaluate that stance should we see follow-through. It's notable that while Chinese stocks had another good week, those gains appeared to come at the expense of India, South Africa, South Korea, and Taiwan, among others, with indices tied to those four countries falling between 1.7% and 4.3% on the week.

Bonds: Rough Week For Longer Duration Bonds As Treasury Yields Close The Week Higher As Better Economic Data Forces Investors To Revisit Growth And Inflation Expectations; Strong Payrolls Report Forces Market Participants To Temper Expectations For Rate Cuts Through Year-End.

- **Treasury Yields Close Higher As Labor Market Data, Global Central Bank Easing Rekindles Inflation Concerns.** U.S. Treasury yields pushed higher over the balance of last week as stronger economic and labor market data forced market participants to reconsider their views on economic growth and inflation. Tuesday's JOLTS report was notable as job openings rose more than expected by 347k and was followed by the ADP employment report that saw an upside surprise of 18K with both figures registering upward revisions to the prior month's data. Lastly, on Friday, September Nonfarm Payrolls growth shattered expectations to the tune of 254K jobs added during the month, well above the consensus estimate of 150K, with an upward revision to both the July and August data that sent the 10-year Treasury yield higher by 13-basis points on the day to 3.98%. While these data releases on an individual basis are less than reliable given low response rates and seasonal adjustments, among other reasons, but when taken together these metrics gives us a useful baseline on current employment trends which currently suggest that concerns surrounding a weaker labor market and economic downturn are overblown.

- **Better Labor Market Data Throws Cold Water On The Economic Slowdown Narrative.** Last week was an active one on the economic data front and, on balance, releases pointed toward a stabilizing labor market and potentially a reacceleration of U.S. economic growth in September. Initial and continuing jobless claims were again in-line with expectations on Thursday and the September nonfarm payrolls report on Friday showed 254k jobs were created during the month, well ahead of the 150k estimate, with the unemployment rate falling to 4.1% from 4.2% the prior month. On balance, these releases point toward stability returning to the labor market which should be supportive of improved consumer confidence, and potentially spending, in the coming months.

- **Market Participants Recalibrate Rate Cut Expectations In A Big Way.** Outside of the nonfarm payrolls report on Friday, one other notable economic release during the week contributed to upward pressure on Treasury yields. The Institute for Supply Management (ISM) Services Purchasing Managers Index (PMI) headline reading jumped to 54.9 from 51.7 in August (a reading above 50 indicates expansion or growth), and the prices paid component of this index rose to 59.4 from 56.0 the prior month. Strength in the services sector has been a hallmark of the U.S. economy in the past couple of years, but the month over month rise in the Services PMI is indicative of potential economic reacceleration taking root, and the sharp rise in the prices paid component of the index shouldn't be dismissed as it could point toward building inflationary pressures in the coming months, calling into question how aggressively the FOMC may be able to

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cut the Fed funds rate between now and year-end. On the heels of the stronger payrolls report and Services PMI, Fed funds futures reduced the likelihood of a 50-basis point rate cut the FOMC's November or December meeting and now expect a total of 50-basis points of rate cuts between now and year-end, down from 75 after the FOMC's September meeting. Also of note, futures now show the Fed funds rate hitting 3% in January of 2026 versus July of 2025 as strength in the labor market is expected to allow the FOMC to gradually make monetary policy less restrictive.

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