ANCHOR
CAPITAL ADVISORS LLC

GLOBAL INVESTMENT COMMENTARY
THIRD QUARTER 2024

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Overview

During the third quarter there were dramatic swings in the markets.[1] For a two-week period the S&P 500 index dropped by 8%, only to rebound and end the quarter at new highs. Three key factors drove this market volatility. First, technology stocks surged fueled by investments in artificial intelligence (AI).[2] However, third-quarter earnings for some tech companies were below expectations, leading to a pullback in their share prices. Second, employment figures came in weaker than anticipated, causing the unemployment rate to rise to 4.3% in July.[3] This triggered the Sahm rule, a potential recession signal, when the three-month moving average of the unemployment rate was .53 percentage points above its 12 month low.[4] Lastly, the Bank of Japan raised interest rates, strengthening the Yen and triggering a major market sell-off.[5] In spite of these disruptions, markets quickly recovered.

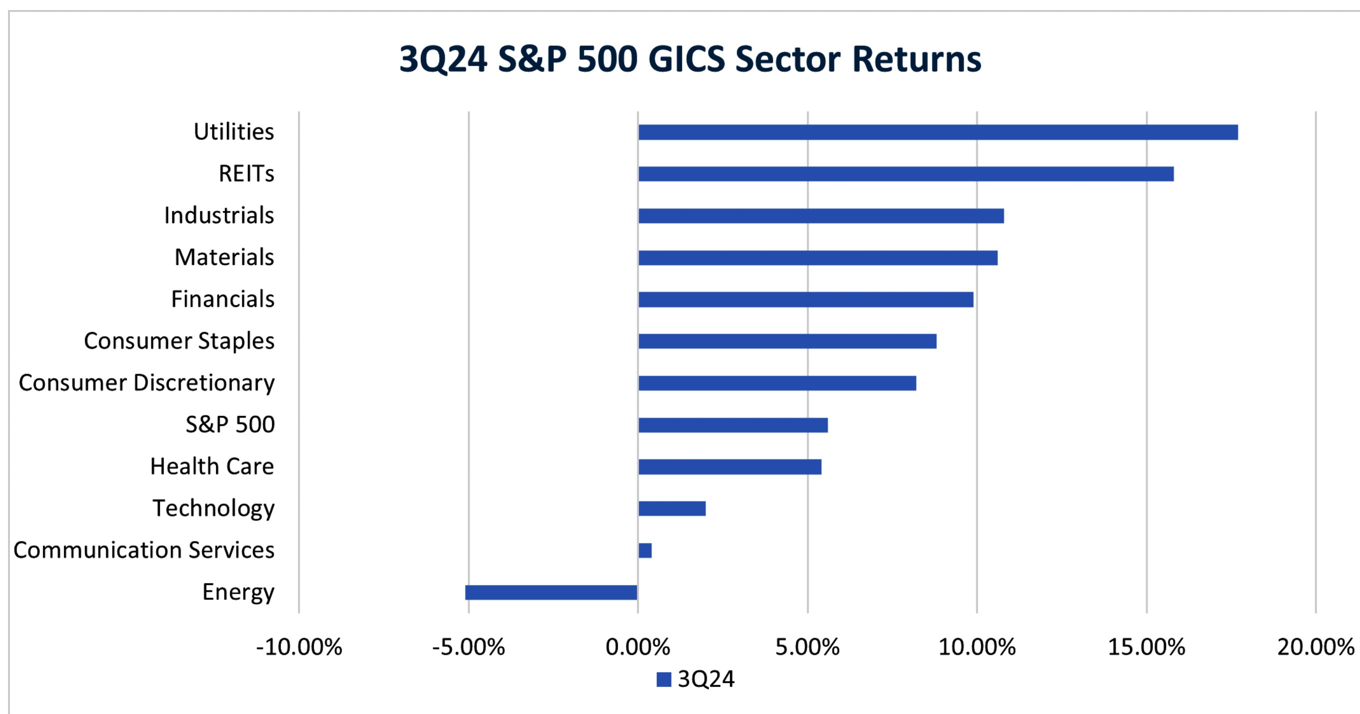
Despite the noise, equity markets performed well, with a shift from large technology stocks to other areas, most notably value and small cap stocks.[6] Overall, third-quarter earnings were positive, with average earnings per share (EPS) growth exceeding 11%, and fourth-quarter EPS is forecasted to grow by 4.6%.[7] At the company level, there are no major signs of an economic slowdown. The primary concerns have been the valuation of the S&P 500 index and concentration risk. S&P 500 index has reached 21x next twelve months earnings - well above the historical average of 16x, and the top 10 stocks account for 34% of the index, an all-time high.[8] Encouragingly, valuations outside of these top stocks have been more reasonable, indicating broader market participation.

While worries about a potential recession exist, we believe that scenario is likely avoided. Many investors have held cash, attracted by short-term interest rates of 5% or more. Bonds also attracted assets this year due to higher interest rates and expectations of Federal Reserve rate cuts. Equities have remained relatively stable, with no significant inflows. The Fed has started reducing interest rates, which could benefit both companies and consumers, as equity markets have historically done well during cutting cycles. Additionally, with a presidential election approaching – a period historically positive for the stock market – investor sentiment could remain upbeat.

Source: FactSet financial data and analytics

U.S. Equity Markets

The U.S. equity markets extended their positive run into the third quarter, though under new leadership. While large-cap technology stocks, especially the “Magnificent Seven” (the seven largest by market capitalization), dominated earlier in the year driven by substantial AI investments, many of these stocks pulled back in the third quarter. As a result, the Nasdaq index ended the quarter with only modest gains.[9] The standout performance during the quarter came from a broadening market rally, particularly benefiting value and small cap stocks. As interest rates declined, small caps and the bond proxy sectors (REITs and Utilities) were the best performers.



Source: FactSet financial data and analytics

U.S. Fixed Income

Following a peak in April 2024, the yield on the 10-year Treasury has been steadily declining, leading to improved bond prices and overall positive fixed income performance. The 10-year Treasury yield dropped from 4.48% on July 1 to 3.73% by the end of the third quarter, a substantial shift that supported bond markets.[10] Investment-grade corporates, high-yield bonds, leveraged loans, and securitized credit have all delivered solid returns in response. With the Federal Reserve cutting rates, we expect investors will move from short-dated bonds towards those in the mid-range of the curve (3-7 years), which stand to benefit most from falling yields.

Inflation/Interest Rates/Fed Reserve

Inflation, as measured by the Consumer Price Index (CPI), continues to decline, with August’s reading at 2.5%.[11] Lower energy and food prices have contributed to this trend. Shelter costs, a lagging indicator, have shown an increase recently but are expected to decrease soon. There has been an uptick in unemployment, which remains low by historical standards, and there have been downward revisions to payroll numbers. The combination of easing inflation and a potentially weakening labor market led the Federal Reserve to cut interest rates by 0.50% in September. Most analysts believe that the economy is headed for a “soft landing”, and the Fed appears focused on being less restrictive rather than forced into stimulating growth to avoid a recession.

The significant shift in interest rates also resulted in a modest re-steepening of the Treasury yield curve. The curve, which represents Treasury yields at different maturities from 0 to 30 years, had been inverted (2-year yields exceeding 10-year yields), historically a sign of a potential recession. However, with the 2-year yield now below the 10-year yield, the curve is beginning to normalize.[12] Historically, a re-steepening yield curve can precede a recession, but there have been instances where this was not the case.

U.S. Economic Outlook

The US economy has shown remarkable resilience given all the challenges, though there is a divide between high- and low-end consumers. High-end consumers have benefited from greater household wealth due to gains in the rising stock market and home values, while low-end consumers continue to struggle with higher costs for essential goods like gas, food, and rent. Despite this, it has been retail sales remain on the rise, though some retailers have noted reduced spending from lower-income consumers.[13] Industrial production has softened, with the Purchasing Managers Index (PMI) showing weaker expansion, and the housing market has seen a modest rebound with lower interest rates.[14] Overall, the economic environment remains solid, with GDP growth projected to stay above trend levels.

Commodities

Commodity markets pulled back in the third quarter largely due to weaker growth expectations in China. Oil prices saw the biggest decline, dropping 10% over the quarter. Copper fell by 9%, while silver and nickel each dropped over 7%.[15] The only commodity in positive territory on a year-to-date basis has been gold, which increased 14.2% during the quarter.[16] Despite recent declines, we remain optimistic about copper given demand created from clean energy initiatives and the existing supply shortage.

China

China has faced numerous challenges since the Pandemic, including sluggish growth, deflationary pressures, issues with indebted property developers, and high youth unemployment. GDP growth for the second quarter came in at 4.7% annualized, falling short of the 5.1% expectation.[17] The government aims for 5% growth for 2024, but economic difficulties persist. To counter these challenges, China launched a significant stimulus plan at the end of September to reduce interest rates, lower mortgage rates and support spending.[18] As a result, the Chinese stock market has surged from its lows and is now in positive for the year.[19]

Europe

The economic environment is Europe varies by country. France and Germany, two of the largest EU economies, are dealing with weaker growth and political challenges, while Ireland is experiencing a boom. Overall, GDP growth in the EU is expected to be around 1% in 2024.[20] Although a recession has been avoided, growth remains weaker. The European Central Bank (ECB) began cutting rates earlier than the U.S. and made a second rate cut in September.[21] Despite lower growth, European stock indices have delivered positive returns, although only about half of what has been achieved in U.S. markets.[22]

Outlook

With the Federal Reserve beginning its rate-cutting cycle, employment levels stable, and earnings growth continuing we remain generally positive about the outlook for equity and bond markets. As previously noted, we believe money could flow from money market funds into stocks and bonds, helping to sustain the markets' upward momentum. As long as employment remains strong and key macroeconomic trends are favorable, we expect positive market performance for the coming quarters.

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The Standard and Poor's 500, or simply the S&P 500, is a stock market index tracking the stock performance of 500 large companies listed on stock exchanges in the United States. It is one of the most commonly followed equity indices. The Bloomberg Barclays U.S. Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. The MSCI Europe Index is a stock market index that measures the performance of large and mid-cap companies across developed countries in Europe. With 432 constituents, the index covers approximately 85% of. the market capitalization across developed countries in the European region. For a complete listing of all strategies contact Anchor Capital Advisors LLC (617) 338-3800. The views expressed are those of Anchor Capital Advisors, LLC ("Anchor") as of the date written and are subject to change at any time. Anchor does not undertake any obligation to update the information contained herein as of any future date, nor does it have liability for decisions based on this information. Certain information (including any forwardlooking statements and economic and market information) has been obtained from sources we deem reliable, but is not guaranteed by Anchor, nor is it a complete summary of available data. The information is for educational purposes only and should not be considered investment advice or a recommendation of any particular strategy or investment product. These opinions are not intended to be a forecast of future events or a guarantee of future results. No part of this document may be reproduced in any form, or referred to in any other publication, without express written permission of Anchor. Past performance is not guarantee of future results. Inherent in any investment is the possibility of loss. The benchmark returns include in reinvestment of income. Time-weighted portfolio returns are calculated for each monthly period in the prior quarter. Quarterly results are linked to determine annual returns. Individual client portfolio results may vary from the results presented for the model because of different investment objectives, tax status and other considerations. Returns of individual client accounts will be reduced by advisor fees and other expenses which might be incurred to provide investment management, custody, administrative, actuarial, accounting or other services to the client. A complete list of each security that contributed to performance is available upon request.