

Quarterly Market Perspective

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In the third quarter of 2024, equity market leadership shifted as economic conditions stabilized and investors anticipated the start of an interest rate-cutting cycle. After technology companies led performance for much of the first half of the year, returns broadened out as interest rate-sensitive sectors like real estate, utilities, and financials outperformed. In addition, long-term laggards, such as small-cap and international stocks, experienced periods of sharp gains during the quarter. From a macro standpoint, economic conditions generally showed signs of stabilization after softening during the second quarter. The notable exception was an uptick in unemployment, which raised concerns among investors about an increased probability of a recession. In response, the Federal Reserve preemptively began cutting interest rates, doing so emphatically with a ½ percentage point reduction in the federal funds rate, the interest rate metric they control.

As we enter the last quarter of the year, uncertainty remains regarding the direction and pace of the economy. On the one hand, consumer spending, which has been moderating of late, remains positive, with little indication of a broader, more sustainable pullback. In addition, elevated government spending continues to stimulate the broader economy. We see the greatest risk to economic activity coming from a pullback in either consumer or government spending. While the possibility for both exists, we don't foresee an imminent catalyst that might drive this in the near term. Therefore, we remain constructive on the economy but continue to watch for indicators of a change in spending behavior.

Regarding the markets, a positive economic backdrop and strong secular trends around artificial intelligence and infrastructure needs have led to resilient investor sentiment. Twice during the third quarter, stocks experienced a pullback, only to be followed by investors aggressively buying the dip. Investor optimism is most evident in the options market, where call options are priced at a greater premium than puts—an abnormal phenomenon that exemplifies expectations for future upside participation and limited concern about downside risk.

As it stands today, market optimism is reasonably justified. However, we must balance current conditions with the awareness that this could change. As we exited the quarter, tensions in the Middle East were increasing, uncertainty was building around the outcome of the November election, and a recent uptick in the volatility of government-reported economic activity has captured our attention. These factors might signal that conditions could become less stable moving forward. On top of these concerns, it's no secret that consumers' net worth has been bolstered by higher stock prices and rising home values. In response, consumers have elected to save less and spend more. We worry that if there is a pullback in either measure, we could see restraint among consumers as they choose to save more. This would exacerbate any pullback in asset prices.

Ultimately, we see an equal number of arguments for optimism as for concern in the markets. At a more granular level, there are few segments among traditional stocks and bonds where we see outsized return potential. Given what we view to be an even distribution of potential outcomes in the near term, we believe now is the time to remain invested while being conscious of where

and how much risk you are assuming.

Looking further ahead, we are excited about several long-term secular themes where we aim to add additional exposure for our clients as timing and opportunities allow. Three prominent trends we are actively assessing include:

- **Digital Infrastructure** – Advancements in artificial intelligence (AI) require large capital investments in data centers, network clusters, and software tools to train and utilize AI capabilities. We see opportunities to benefit from this secular trend, recognizing that areas of emphasis may evolve over time.
- **Physical Infrastructure** – Global trends toward onshoring/nearshoring, alongside evolving geopolitical affiliations, are driving a need for more reliable and durable manufacturing capacity and logistical infrastructure. While this transition will be gradual, we view it as an attractive long-term trend.
- **Power and Energy Transition** – Secular trends such as data centers and electric vehicles require significant power, driving a step-change in electricity generation capacity and necessitating an upgrade and restructuring of the power grid.

We continue to evaluate how these trends evolve, along with the best means for positioning portfolios as they progress. As we consider adding exposure to these themes, the timing will depend on fundamental indicators, valuation, and sentiment. We have a great deal of optimism about the long-term value stemming from these trends, but we recognize they are long-term investments and there will be periods when they fall in and out of favor.

This past quarter, we made modest adjustments to positioning. We expect to continue making moderate adjustments to portfolios in reaction to economic and market conditions. Below is a summary of our current positioning.

Conclusion

For the second year in a row, investors appear to be on pace for above-average returns in their portfolios. We remain optimistic about current economic conditions but favor specific industries with long-term secular tailwinds. That said, markets have priced in a great deal of optimism, and risks remain. This keeps us balanced in our posture.

In our view, a key to being a successful investor

SUMMARY	POSITIONING
Economic conditions are stable although markets are not pricing in any changes in geopolitical conditions or a shift in sentiment.	A positive economy leaves us comfortable taking risk, however, limited acknowledgement of risk leaves us balanced in our risk posture.
Large cap U.S. equities, which exhibit attractive growth profiles, are priced at above-average valuation multiples.	We are electing to maintain (but not grow) exposure to large cap U.S. stocks given their elevated valuation, yet strong fundamentals. We favor mid size companies that share positive growth expectations but are priced at more reasonable valuations.
The Fed has begun its rate cutting cycle, but at a cadence and magnitude that remains open ended.	Bond yields reflect more aggressive Fed rate cuts than what we embed in our base case. As such, we have reduced portfolio duration.
Yields on corporate bonds (investment grade and high yield) do not offer sufficient compensation should economic conditions ease.	We prefer to stay up in quality and have reduced exposure during the year to corporate bonds.
There are limited number of price dislocations within public markets. Longer-term we see opportunities within specific secular trends and select opportunities within private markets.	We will look to broaden exposure to attractive secular trends and, where appropriate, add exposure to private investment opportunities for individual clients.

over the long term is knowing when to lean into taking more risk and when to minimize it. Current broad market valuations don't provide investors with a wide margin of safety. However, excluding the largest technology companies, we see opportunities in less crowded parts of the market, including companies levered to our secular themes. Moreover, we believe staying diversified, including exposure to non-U.S. companies and small caps, which have lagged in recent years, is sensible, especially when considering valuation. We prefer a "steady as she goes" mindset, believing this approach is most prudent in the current environment.

We always look forward to interacting with our clients and those who want to learn more about our thinking. Please reach out to your Miracle Mile team if you'd like to discuss our views and perspectives in more detail.



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