

Market Commentary

November 2024

The American Dream

Key Takeaways

- U.S. large-cap stocks declined 0.9% in October while small-cap stocks declined by 1.4%. Bonds also fell; the Bloomberg U.S. Aggregate Bond Index decreased 2.5%.
- Headline inflation eased to 2.4% year-over-year, and even with a solid labor market, markets still expect an additional 0.5% in rate cuts by year end.
- Treasury yields and mortgage rates have risen since the September Fed rate cut, leading to elevated mortgage rates and increased home prices, as well as a decline in home sales.
- Polls going into the election showed a very close election, creating uncertainty around the future monetary and fiscal policies that will significantly shape market returns. Regardless of the election outcome, the fiscal deficit is expected to grow.

Overview

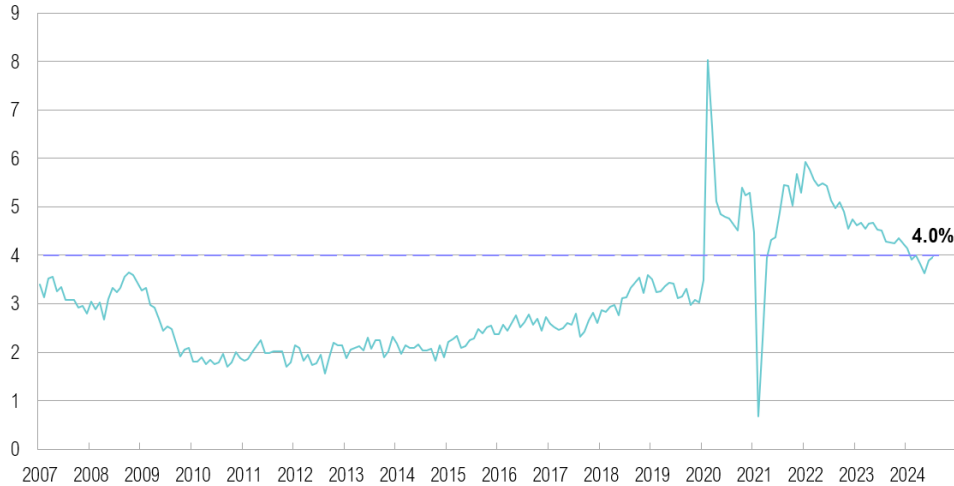
Markets posted mostly negative returns in October. U.S. large-cap stocks, as represented by the S&P 500, declined 0.9% while the Russell 2000 small-cap index fell by 1.4%. The Bloomberg U.S. Aggregate Bond Index dropped 2.5%. The September inflation report, released on October 10, showed headline inflation easing to 2.4% year over year, reaching the lowest level since February 2021. Core inflation, however, edged up slightly from 3.2% to 3.3%.¹ Both headline and core inflation were 0.1% above forecast for September, largely due to rising food prices, which offset declines in gasoline and energy costs. Notably, food-at-home prices increased by 1.3% year over year, marking the highest increase since January 2023.

In October, despite job growth coming in below expectations (likely due to storms and strikes), the unemployment rate remained steady at 4.1%.² Wage growth also remained robust, increasing by 4.0% year-over-year.² Outside of COVID-19, this continues to be the highest wage growth over the past 20 years. Initial jobless claims, which averaged 236,500 in October, are at pre-COVID-19 levels.³ Preliminary estimates indicate the U.S. economy grew at an annualized rate of 2.8% quarter over quarter in the third quarter.⁴ Economic growth was primarily driven by increases in consumer and government spending. Consumer spending, which comprises nearly two-thirds of U.S. economic activity, rose by 3.7%—its strongest growth since the first quarter of 2023.⁴ Federal government spending, which drove the 2024 fiscal budget deficit to \$1.8 trillion, increased by 5.0%. Imports, which detract from GDP, grew by 11% and offset the 8.9% rise in exports. Additionally, investment in residential real estate declined by 5.1% in the third quarter.⁴

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Wage Growth Remains Robust, at 4.0% Year-over-Year

Wage Growth, Y/Y %



Source: Bloomberg

There was no Federal Open Market Committee (FOMC) meeting in October; however, minutes from the September 18 meeting were released on October 9. The minutes revealed a “robust debate” over the size of the September rate cut, though the 11-to-1 vote casts doubt on just how robust this debate truly was.^{5,6,7} Markets continue to anticipate a total of 0.5% in rate cuts by year end, implying a 0.25% cut at each of the remaining FOMC meetings, the next of which is scheduled for November 7.⁸ By the end of October, markets were pricing in an additional 1.0% in rate cuts through the end of 2025.⁸

October marked the beginning of the third-quarter earnings season, and 70% of S&P 500 companies had reported earnings by the end of the month. Current estimates indicate that S&P 500 earnings grew by 3.6% year over year in the third quarter, driven by strong performances in the technology (16.0%), communication services (11.5%), and financial (5.7%) sectors.⁹ The “Magnificent Seven”—Amazon, Apple, Alphabet, Microsoft, Meta, Tesla, and Nvidia—are expected to report an impressive 18.1% year-over-year earnings growth for the quarter. Excluding these seven companies, the remaining 493 S&P 500 companies would report only 0.1% year-over-year earnings growth for the period.¹⁰ Earnings growth for both the Magnificent Seven and the remaining 493 companies is projected to be in double digits over the next five quarters.¹⁰ For 2024, overall S&P 500 earnings growth is expected to rise by 9.3%.

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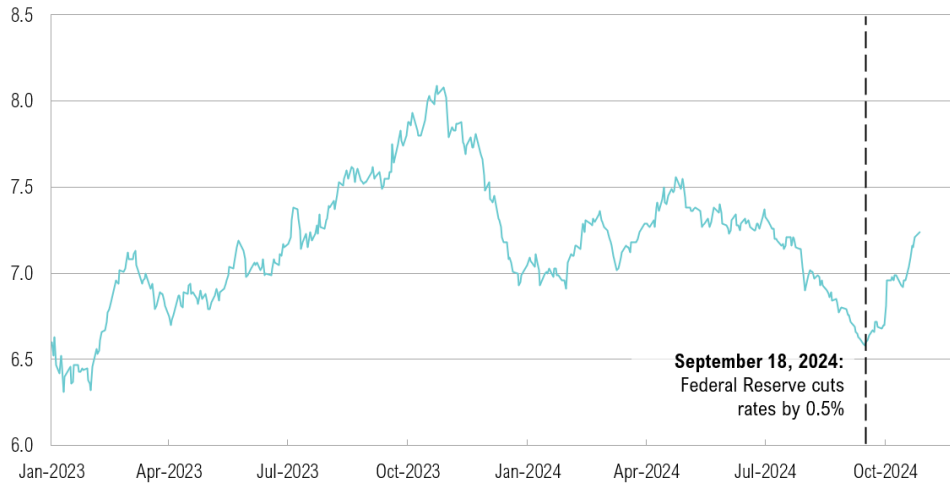
The relatively elevated interest rate environment of the past few years has weighed heavily on the U.S. housing market. Hopeful homebuyers’ purchasing power plummeted as mortgage rates increased in late 2023 to their highest level in over 20 years. Although mortgage rates declined to 6.5%—the lowest since February 2023—in the days leading up to the Federal Reserve’s anticipated rate

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reduction on September 18, this reprieve was short lived. Rates climbed higher throughout October, and the 30-year fixed mortgage rate ended the month at 7.24%, the highest since early July 2024. Similarly, U.S. Treasury yields ended October at 4.2%, marking their highest level since late July 2024.

Mortgage Rates Have Reaccelerated Since the Fed Rate Cut on September 18

U.S. 30-Year Fixed Mortgage Rate



Source: Bloomberg

Mortgage rates tend to follow longer-term Treasury yields. Today, yields are rising partly due to the growing U.S. fiscal deficit, which ended the 2024 fiscal year at \$1.8 trillion and is now the largest deficit on record in a non-crisis year and the third largest in U.S. history. In addition, stronger-than-expected inflation and labor market data have also pushed 10-year Treasury yields higher, and mortgage rates have followed suit.

Driven by imbalances in supply and demand, house prices are elevated. The average price of a home sold in the U.S. reached \$501,100 in the third quarter.¹¹ Although this marks a decrease from the record high of \$525,100 in the second quarter of 2022, it remains more than 30% above pre-pandemic trends.¹¹ The National Association of Realtors' housing affordability index stood at 98.6—40% below the 40-year average of 137—indicating that a median-income family has less than the income required to afford a median-priced home.¹²

Existing home sales are on track for their worst year since 1995, as elevated prices and mortgage rates deter potential buyers.¹³ Approximately two-thirds of existing home loans have mortgage rates of 4% or less, making homeowners reluctant to sell and give up their favorable rates, thus limiting the supply of existing homes on the market.^{13,14} In September, existing home sales fell by 1% from the prior month to 3.84 million, reaching the lowest monthly rate since October 2010.^{13,15} New home construction has also declined from a peak of 1.8 million units in April 2022 to 1.35 million in September. According to David Auld, the CEO of D.R. Horton, one of the largest U.S. homebuilder companies: “While mortgage rates have decreased from their highs earlier this year, many potential

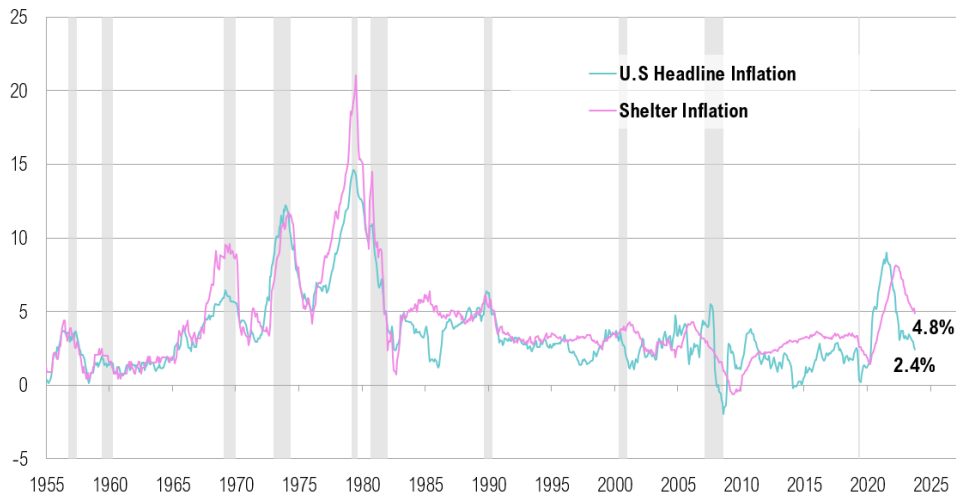
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homebuyers expect rates to be lower in 2025. We believe that rate volatility and uncertainty are causing some buyers to stay on the sidelines...”¹⁶

Renters also face higher costs. Rent prices increased by 3.3% year over year in September, rising in 49 of the 50 largest metro areas. Rent remains 34% higher than pre-pandemic levels, and the shelter component of inflation (at 4.8% year over year) continues to outpace the overall headline inflation rate (at 2.4% year over year).^{17,18,19}

Shelter Inflation is Expected to Remain Elevated Through Mid-2026

U.S. Headline Inflation & Shelter Inflation, Y/Y %



Source: Bloomberg

The Cleveland Federal Reserve recently examined why rent inflation remains elevated at 4.8% year over year. The study found that during the COVID-19 pandemic, new tenant rent inflation surged and then later declined. Overall rent inflation, which includes both new and continuing tenants, increased more slowly and remains high, however. This persistence is largely due to smaller rent increases for continuing tenants, resulting in a notable “rent gap” of 5.5% as of the end of September.²⁰ The paper projects that rent inflation will likely stay above pre-pandemic levels (and average around 3.5%) until mid-2026.²⁰ Rent inflation is expected to play a significant role in dictating the final phase of reducing inflation, due to shelter’s substantial weight in the overall inflation calculation (36.5%) and the concerns that recent inflation trends could reverse.¹⁹ Rising long-term Treasury yields may reflect worries that the Federal Reserve has underestimated the risk that inflation could remain above its 2% target or increase even further.

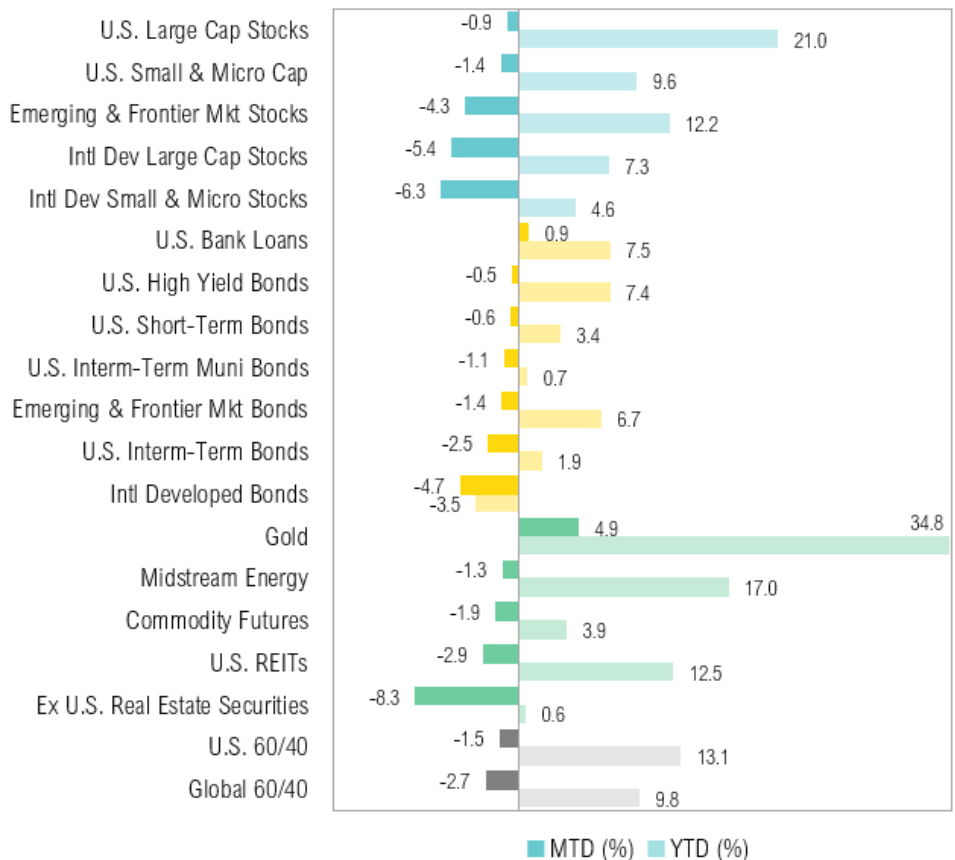
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Not one equity asset class finished October with positive returns. U.S. large-cap stocks declined by 0.9%, while U.S. small-cap stocks declined by 1.4%. International equity markets performed worse. Developed market stocks fell 5.4%, and developed market small-cap stocks decreased 6.3%.

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Emerging and frontier markets also struggled, ending the month down 4.3%. Despite September’s interest rate cut, Treasury yields climbed throughout October. U.S. intermediate-term bonds fell by 2.5%, and rate-sensitive U.S. REITs ended the month down 2.9%.

October 2024 Key Market Total Returns



Source: Bloomberg

Looking Forward

Investors continue to face ambiguity around interest rates, the deficit, and election results. Policymakers seem content with decisions that prioritize the here and now at the expense of long-term fiscal stability, thereby limiting their ability to respond to future crises and threatening the role of the U.S. dollar in global trade.

As with any election cycle, various sectors of the economy and markets stand to benefit depending on the winning candidate, with the primary market drivers expected to be shifts in monetary, fiscal, and tax policies. One certainty remains, regardless of the outcome: the growing deficit will continue

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to go unaddressed. With battleground polling still within the margin of error, we advise caution in assuming clear winners or losers before election results are finalized.

Our position on the markets remains unchanged. We continue to be cautious with risk assets as the current cycle plays out. We expect the uncertainty and increased volatility in markets to continue in the coming weeks and months. Although lower asset prices would be a welcome development and an opportunity to put additional capital to work, typical election year seasonals—coupled with still-high equity valuations—suggest that there is no rush. We remain biased towards high-quality companies within our core stock portfolios. We have been well-positioned within core bond portfolios with a low weight toward shorter-duration corporate bonds and a higher weight toward longer-duration treasury bonds. We believe clients are best served reminding themselves of the timeless principles of patience and diversification. The key to successful investing is often remaining committed to long-term investment plans.

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Performance Disclosures

All market pricing and performance data from Bloomberg, unless otherwise cited. Asset class and sector performance are gross of fees unless otherwise indicated.

Citations

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Index Definitions

The **S&P 500 Index** is widely regarded as the best single gauge of the United States equity market. It includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 focuses on the large cap segment of the market and covers approximately 75% of U.S. equities.

The **Bloomberg Barclays U.S. Aggregate 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. Duration is roughly 5 years.

The **Bloomberg U.S. Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is

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Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded.

The **Russell 1000® Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected and historical growth rates.

The **Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term (2 year) growth and higher sales per share historical growth (5 years).

The **Russell 2000® Index** measures the performance of the small-cap segment of the US equity universe. It includes approximately 2000 of the smallest US equity securities in the Russell 3000 Index based on a combination of market capitalization and current index membership. The Russell 2000 Index represents approximately 10% of the total market capitalization of the Russell 3000 Index. Because the Russell 2000 serves as a proxy for lower quality, small cap stocks, it provides an appropriate benchmark for RMB Special Situations.

MSCI EAFE Index*: an equity index which captures large and mid-cap representation across 21 of 23 Developed Markets countries around the world, excluding the U.S. and Canada. With 926 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Emerging Markets Index* measures equity market performance in the global emerging markets universe. It covers over 2,700 securities in 21 markets that are currently classified as EM countries. The MSCI EM Index universe spans large, mid and small cap securities and can be segmented across all styles and sectors.

The U.S. Dollar Index is used to measure the value of the dollar against a basket of six foreign currencies: the euro, Swiss franc, Japanese yen, Canadian dollar, British pound, and Swedish krona.

The **Deutsche Bank EM FX Equally Weighted Spot Index**, an equal-weighted basket of 21 emerging market currencies.

MSCI U.S. REIT Index is a free float-adjusted market capitalization weighted index that is comprised of equity Real Estate Investment Trusts (REITs). The index is based on the MSCI USA Investable Market Index (IMI), its parent index, which captures the large, mid and small cap segments of the USA market. With 150 constituents, it represents about 99% of the US REIT universe and securities are classified under the Equity REITs Industry (under the Real Estate Sector) according to the Global Industry Classification Standard (GICS®), have core real estate exposure (i.e., only selected Specialized REITs are eligible) and carry REIT tax status.

MSCI China NR Index: designed to measure the performance of the large and mid cap segments of the Chilean market. With 12 constituents, the index covers approximately 85% of the Chile equity universe.

MSCI South Africa NR Index: designed to measure the performance of the large and mid cap segments of the South African market. With 37 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in South Africa.

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