Your Weekly Investment
Insights
September 16, 2024

VERDENCE
CAPITAL ADVISORS

Key **Takeaways:**

- FED day is upon us with announcement on Wednesday.
- The end is near for one of the most aggressive tightening cycles in history.
- Real rate offers the Fed some flexibility.
- History suggest S&P 500 rally has already priced in rate cuts.
- History can be a guide and a tool but all economic environments have been different.

FED Day is Here…A Look at Historical Easing and Tightening Cycles

The Federal Reserve meets this week with a rate announcement and press conference on Wednesday. By the time they make their announcement it will have been ~14 months since their last rate hike. Going back to 1945, it will be the fourth longest stretch that a Federal Reserve has remained on hold before starting a rate cutting cycle. We expect the Fed will cut their benchmark rate by 25 bps as opposed to the 50 bps that the futures market has priced in at a ~40% chance. In this weekly, we take a look at historical rate tightening cycles and compare them to the current cycle. In addition, what historically happens when the Fed starts cutting rates?

- **One of the most aggressive tightening cycles:** Going back to 1945, the median average of rate hikes in a tightening cycle has been 225 bps. However, by raising 525 bps in ~17 months (March 2022-July 2023), this tightening cycle has been one of the most aggressive by magnitude and length. The only two tightening cycles that were more aggressive were the 1973 and 1980 tightening cycles. Both resulted in deep recessions.

- **Real rate suggests it is time:** Historically, the median average real Fed Funds rate when the Fed starts raising interest rates in a tightening cycle is 0.55%. However, the Fed was late to hiking rates in this cycle with the real Fed Funds rate at -8.25% when they started hiking. However, by hiking aggressively and inflation slowing, they have raised the real Fed funds rate to 3.00% (using CPI year over year as of August 2024). This is above the historical average of the real Fed Funds rate at the peak of past tightening cycles (2.30%).

- **The Fed is typically too late:** The Fed tends to be late in cutting rates and has not had the best track record of orchestrating a soft landing for the economy. In fact, going back to 1945, 60% of the easing cycles started when the economy was already in recession or headed towards one.

- **Is rate cut priced into equities?** The S&P 500 tends to struggle in the time leading up to the first rate cut. This is typically because they are cutting rates because the economy is heading towards a recession. On average, the S&P 500 is negative in the 12 months leading up to the first rate cut. However, as of Friday, the S&P 500 has been up 28% in the trailing 12 months. That is the most the S&P 500 has ever been up in the 12 months leading to the first rate cut.

The Bottom Line:

While history can be a guide and an interesting exercise to examine, it is not an overriding factor when it comes to investing. Instead, we are focused on the macro outlook and specifically what is priced into the market. Every tightening and easing cycle that we monitored has also been accompanied by very different economic environments. Instead, we are looking at the current situation where the economy is slowing, select areas of inflation remain stubborn and equities at current levels may already be reflecting the Fed's actions this week. In fact, they may be too optimistic about what the Fed has the flexibility to do. We will be watching closely the Fed's new economic assumptions to see how many rate cuts they can deliver in the coming months and into 2025.

Megan Horneman | Chief Investment Officer
mhorneman@verdence.com
Past performance is not indicative of future returns.

Weekly Economic Recap –

Inflation Opens Door For Fed

Small business optimism as measured by the NFIB Small Business Optimism Index fell for the first time in five months in August. The weakness was led by pessimism on the economy, future sales, and the expectation for future earnings.

Consumer credit jumped at the fastest pace in 10 months in July. Revolving credit (which includes credit card debt) rose at the fastest pace in five months.

Inflation as measured by the Consumer Price Index rose in line with expectations at the headline and core level. At the headline level, inflation is growing 2.5% on a year over year basis which is the slowest pace of annual growth seen since February 2021. At the core level, inflation is growing 3.2% (YoY) as service inflation and shelter continue to remain stubbornly high.

Inflation at the producer level also came in relatively in line with expectations in August. However, at the super core level, which excludes food, energy and trade, prices rose slightly more than expected. These prices are rising 3.3% (YoY) which is higher than the 3.2% rate seen in July.

The preliminary reading on the University of Michigan Consumer Confidence Index for September showed confidence improved for the second consecutive month. Both confidence on the current economic situation and future expectations rose for the month. In addition, one year ahead inflation expectations fell for the fourth consecutive month.

Key Takeaways:

- Small business optimism still weak.
- Inflation cooling; services and housing sticky.
- Consumers more confident.
- Global equities rally as tech resumes its leadership.
- Bonds rally on likely Fed rate cuts.
- Commodities rally on soft landing hopes.

Weekly Market Recap –

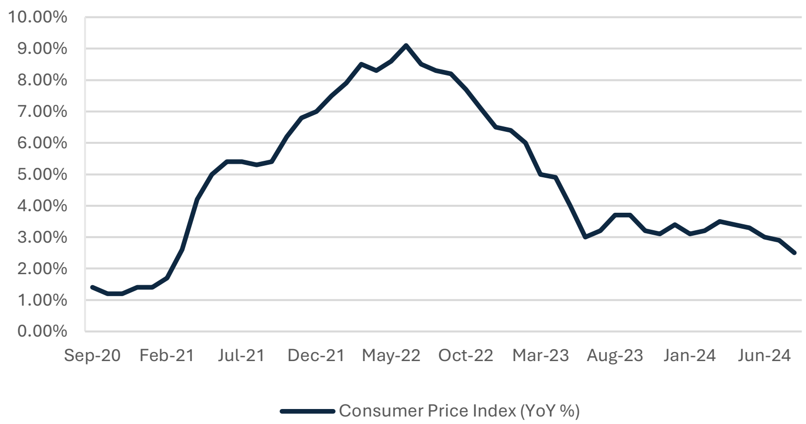
Global Equities Rise on Rate Cut Hopes

Equities: The MSCI AC World Index posted its best one week rally in the past four weeks. Cooling inflation data in the U.S., an ECB rate cut and optimism around Fed rate cuts this week fueled the global rally. In addition, technology resumed its leadership with the NASDAQ in the U.S. posting its best one week rally since November 2023. Large cap growth outperformed large cap value by 400 bps.

Fixed Income: The Bloomberg Barclays Aggregate Index rallied for the second consecutive week as investors are anticipating at least a 25 bps rate cut at the Fed meeting this week. All sectors in fixed income were higher but it was led by TIPS and investment grade credit.

Commodities/FX: The Bloomberg Commodity Index rallied the most in 17 weeks last week. All the major commodity categories rallied as slowing inflation and global central bank rate cuts are fueling hopes for a global soft landing.

Inflation Growing at Slowest Pace in Three Years



Footnotes: Data is as of August 2024.
Data Source: Bloomberg Finance LP, Verdence Capital Advisors.

Megan Horneman | Chief Investment Officer
mhorneman@verdence.com

Global Equities Rally on Rate Cut Hopes

U.S. Equities	Current	1WK	1MO	3MO	1YR	YTD
Dow Jones Industrial Average	41,394	2.6%	4.4%	7.6%	22.1%	11.4%
S&P 500	5,626	4.1%	3.7%	3.9%	27.8%	19.1%
Russell 1000 Growth	3,690	6.0%	3.4%	1.4%	32.5%	21.5%
Russell 1000 Value	1,825	2.0%	4.1%	7.1%	20.6%	13.8%
Russell Midcap	3,429	3.2%	4.1%	6.0%	21.9%	11.4%
Russell 2000	2,182	4.4%	4.3%	7.4%	20.3%	8.7%
Nasdaq	17,684	6.0%	3.0%	0.3%	29.1%	18.4%

International Equities	Current	1WK	1MO	3MO	1YR	YTD
MSCI AC World (USD)	827	3.1%	3.7%	3.8%	23.6%	15.1%
MSCI EAFE (USD)	2,411	1.2%	4.5%	3.7%	19.0%	10.1%
MSCI Europe ex UK (USD)	2,702	1.8%	4.4%	2.4%	20.1%	9.6%
MSCI Japan (USD)	4,035	0.2%	4.6%	4.1%	15.9%	10.2%
MSCI UK (USD)	1,294	0.8%	3.4%	5.4%	20.3%	13.6%
MSCI EM (USD)	1,082	0.8%	1.3%	1.6%	13.9%	7.9%
MSCI Asia ex Japan (USD)	693	0.9%	1.8%	0.9%	14.7%	10.1%

Fixed Income	Current Yield	1WK	1MO	3MO	1YR	YTD
U.S. Aggregate	4.1%	0.5%	1.9%	5.0%	10.0%	4.9%
U.S. Govt/Credit	4.0%	0.5%	1.9%	4.8%	10.0%	4.8%
U.S. 10 Year Treasury	3.7%	0.5%	1.9%	5.8%	9.1%	4.6%
U.S. TIPS (1-10YR)	3.7%	0.7%	1.3%	3.6%	7.7%	4.8%
U.S. High Yield	7.2%	0.4%	2.1%	4.3%	13.4%	7.0%
EM Bonds (USD)	6.4%	0.6%	2.3%	4.7%	14.2%	7.4%
Municipal Bonds	3.3%	0.2%	0.8%	2.4%	7.1%	2.0%

Commodities	Current	1WK	1MO	3MO	1YR	YTD
Bloomberg Commodity Index	229	2.7%	1.1%	-5.2%	-5.1%	1.2%
Crude Oil (USD/bbl)	$70.2	2.1%	-6.5%	-8.3%	-20.6%	-1.5%
Gold ($/oz)	$2,577.7	3.1%	3.1%	10.8%	34.3%	25.3%
Copper	$417.5	3.1%	1.7%	-6.3%	11.9%	8.3%
Wheat	$594.8	3.1%	6.1%	-9.8%	-13.3%	-12.4%
U.S. Dollar	101	-0.8%	-1.7%	-4.6%	-4.4%	-0.6%
VIX Index	16.6	-26.0%	-8.6%	38.7%	22.8%	33.0%

Footnotes: Data is as of September 13, 2024.
Data Source: Bloomberg Finance LP, Verdence Capital Advisors.

Megan Horneman | Chief Investment Officer
mhorneman@verdence.com
Past performance is not indicative of future returns.

Megan Horneman | Chief Investment Officer
mhorneman@verdence.com