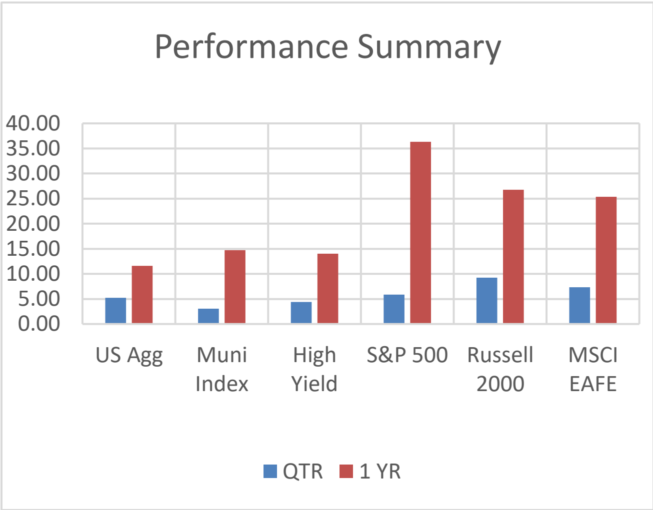
U.S. stock returns were positive for the fifth straight month, rose to several new highs in September, and posted strong returns for the quarter. Foreign stocks performed even better for the quarter, led by emerging market stocks. The bond market also put up robust returns for the quarter as inflation and interest rates trended down.



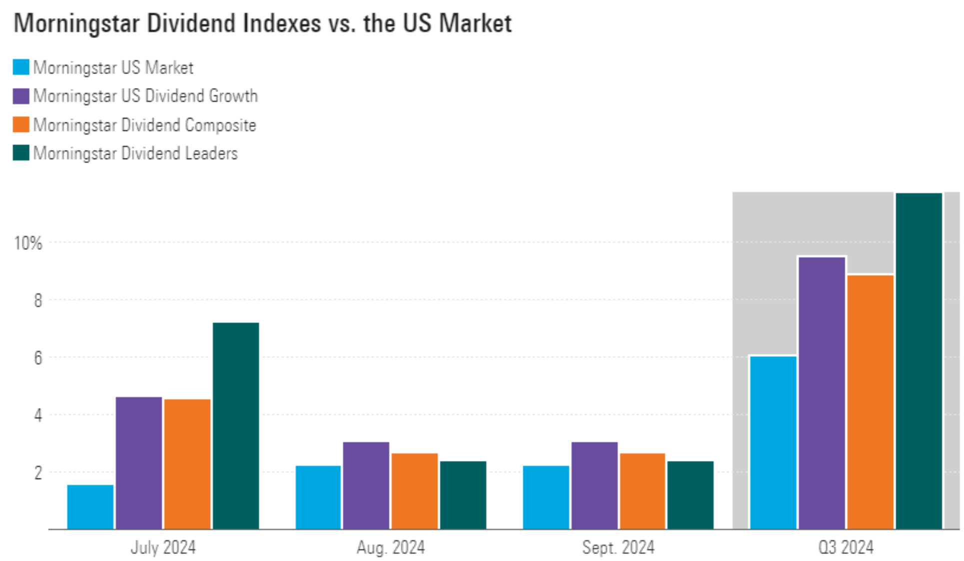
- The S&P 500 gained more than 2% in September as inflation slowed, economic growth continued, and the Federal Reserve began cutting interest rates. For the quarter the index was up 5.9%. Small-cap stocks performed even better up 9.3% for the quarter.
- Technology stocks lagged as investors moved into other areas. Value stocks were up 9.4%, outperforming the broader market and growth stocks by a wide margin for the quarter.
- Dividend stocks outperformed the broader market by nearly 3% for the quarter and were up 8.9% for the quarter.
- Foreign developed market stocks were up 7.3% for the quarter, while emerging market stocks did a little better, up 8.9%
- With inflationary pressures fading, the Federal Reserve cut interest rates for the first time since 2020.
- U.S. bonds were up 5.2% for the quarter and 11.6% the past year.

Market Rotation

The biggest stock market story in the quarter was the start of a significant rotation out of technology stocks into parts of the stock market that had previously lagged. During the quarter some of the mega-cap technology stocks that have led the market for the past couple of years turned negative, with Nvidia down 1.7%, Microsoft down 3.6%, and Alphabet (Google) down 8.8%. Most analysts are still bullish on the potential for artificial intelligence (AI), however, concerns about stretched valuations and excessive concentration in the stock market weighed on these names for the quarter. We have highlighted a few charts that illustrate the rotation that happened in the U.S. stock market during the quarter.

The table to the right illustrates that both small and mid-cap stocks outperformed large-cap stocks by over 3% for the quarter. There was also a significant divergence in the performance of value stocks relative to growth stocks. For the quarter, large-cap growth stocks were up 8.7% compared to 2.2% for growth stocks. The outperformance of value relative to growth was consistent across all market cap size stocks; small, mid, and large.

Dividend-paying stocks outperformed the broader market for the first time in 2024. The chart to the right, from Morningstar, shows the performance of several different dividend stock indexes, all of which outperformed the broad U.S. stock market for the quarter. The highest-yielding stocks, represented by the MS Dividend Leaders in the chart, led the way up close to 12% for the quarter.



Source: Morningstar Direct. Data as of Sep. 30, 2024.

Stock Sector Performance

Name	Q3 2024
Basic Materials	9.86
Communication Services	1.79
Consumer Cyclical	10.45
Consumer Defensive	8.11
Energy	–2.83
Financial Services	10.40
Healthcare	6.17
Industrials	10.88
Real Estate	16.92
Technology	2.35
Utilities	19.81

Source: Morningstar Direct. Data as of Sep. 30, 2024. Performance in %.

At the sector level, the rotation into new leading sectors was even more pronounced. For the quarter, utility stocks led the way, up close to 20%, and real estate stocks were a close second at almost 17%. Both sectors are sensitive to interest rate changes and rallied strongly as it became clear the Fed would start cutting interest rates. The laggards for the quarter were energy stocks down 2.8% followed by communication and technology stocks which were up modestly at 1.8% and 2.3% respectively.

Overall, the macroeconomic environment is undergoing some shifts in terms of moderating inflation, an easing cycle, high valuations, reasonable economic growth, and Chinese stimulus. All of these factors may be conducive for the rotation to continue for a while, we will be following this trend closely.

China Goes All In

The Chinese economy and stock market have suffered from several structural problems for years, including:

- **China overproduces relative to what it consumes**. A lack of faith in the economic system has led to a very high savings rate and a lack of spending on the part of Chinese consumers. This contributed to chronic deflation in the Chinese economy and efforts to export their goods, and deflation, to the rest of the world.
- **A housing bust**. For years the Chinese government overbuilt their housing supply. Currently, they are experiencing a sharp downturn in housing starts, sales, and prices.
- **A demographic time-bomb.** After years of a 1 child policy, their population is rapidly aging. For example, the US foresees a 70% drop in the working-age population

However, to offset the above structural issues and lingering debt issues the Chinese government recently enacted sweeping monetary and fiscal policies to bolster their equity and real estate markets, boost consumption and employment, and support troubled financial companies. The policy actions have led to an over 20% stock market rally in just a few weeks. Some strategists are comparing the recent Chinese policy actions to actions taken by other governments after the Great Financial Crisis in 2008-09. According to Goldman Sachs, the magnitude, breadth, and comprehensiveness of the Chinese easing package is arguably the most significant in recent history. Since valuations in the Chinese stock market had reached single-digit price-to-earnings (very low valuations), and are under-owned, there is a chance the rally may continue for a while. Similar to the rotation of the U.S. stock market discussed above we are seeing a rotation into foreign and emerging market stocks, which have outperformed the U.S. since the start of the third quarter. We are watching the impact of China's recent announcements on the economy and market performance closely to gauge whether the outperformance will continue and for how long.

If you have any questions regarding this commentary or your investment strategy, please let us know and we would be happy to schedule a time to review.

Best regards,

Steve Giacobbe, CFA, CFP®