Research Review

October 2024

Significant reversals were observed in October, as the U.S. presidential election betting odds shifted to an outcome that ultimately materialized as Donald Trump was elected as U.S. President in the November 5 general election. Concerns for a second inflationary wave mounted during the month on the back of macroeconomic forces such as Federal Reserve (Fed) easing, loose financial conditions, ongoing Treasury budget deficits, and heightened instability in the Middle East, as well as a fresh inflationary tailwind prompted by President-elect Trump's campaign promise of significant tariffs imposed on imported goods. Bond market volatility spiked during the month as asset allocators acknowledged the pro-inflationary pressures that may result from the election, which in turn helped drive a 50 basis-point (bp) rise in the 10-Year Treasury Note yield, the sharpest monthly increase since September 2022. This led the rate-sensitive bond sectors to underperform the credit-oriented corners of the bond market, while in real assets, the monthly spike in interest rates helped drive a sell-off across real estate investment trusts (REITs).

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CERTUITY

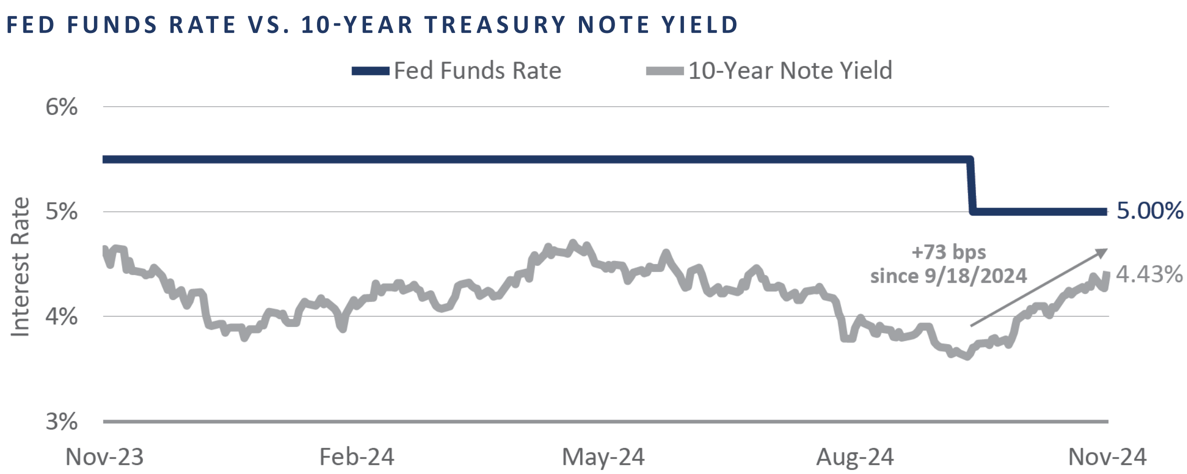
Economic Update

Treasury Rates and the U.S. Dollar Spike as Market Participants Digest the Presidential Election Results

"Fears of a Fed policy error with their mid-September 50 basis point rate cut before inflation has returned to their 2% target have sparked concerns of a second inflationary wave." – Mike O'Conner, CFA

With all eyes on the November U.S. presidential election, October presented investors with meaningful reversals across the financial markets, particularly as it relates to relative geographic performance across global equities—favoring domestic—and a sharp increase in Treasury rates.

As the election approached, a notable uptrend across both Treasury interest rates and the global exchange rate value of the U.S. dollar began to take hold. Relatedly, the bond market's discounted path for further Fed rate cuts narrowed, with Fed funds futures essentially removing a 25 bp cut by year-end 2024 and nearly 70 bps of implied easing throughout calendar year 2025 versus the discounted path observed at the beginning of the month.



Data sources: Bloomberg, L.P., NBER; Data as of November 6, 2024

Several factors contributed to October's rise in Treasury rates, including concerns of steep tariffs on imported goods under a Trump regime—particularly on Chinese imports, continued solid economic performance from the U.S. economy, and a general lack of clarity regarding returning the U.S. fiscal situation to a more sustainable trajectory. Concerns over a Fed policy error from their mid-September 50 bp rate cut, before inflation reached the 2% target, have fueled fears of a second inflationary wave, with Treasury rates rising over 70 bps since the cut.

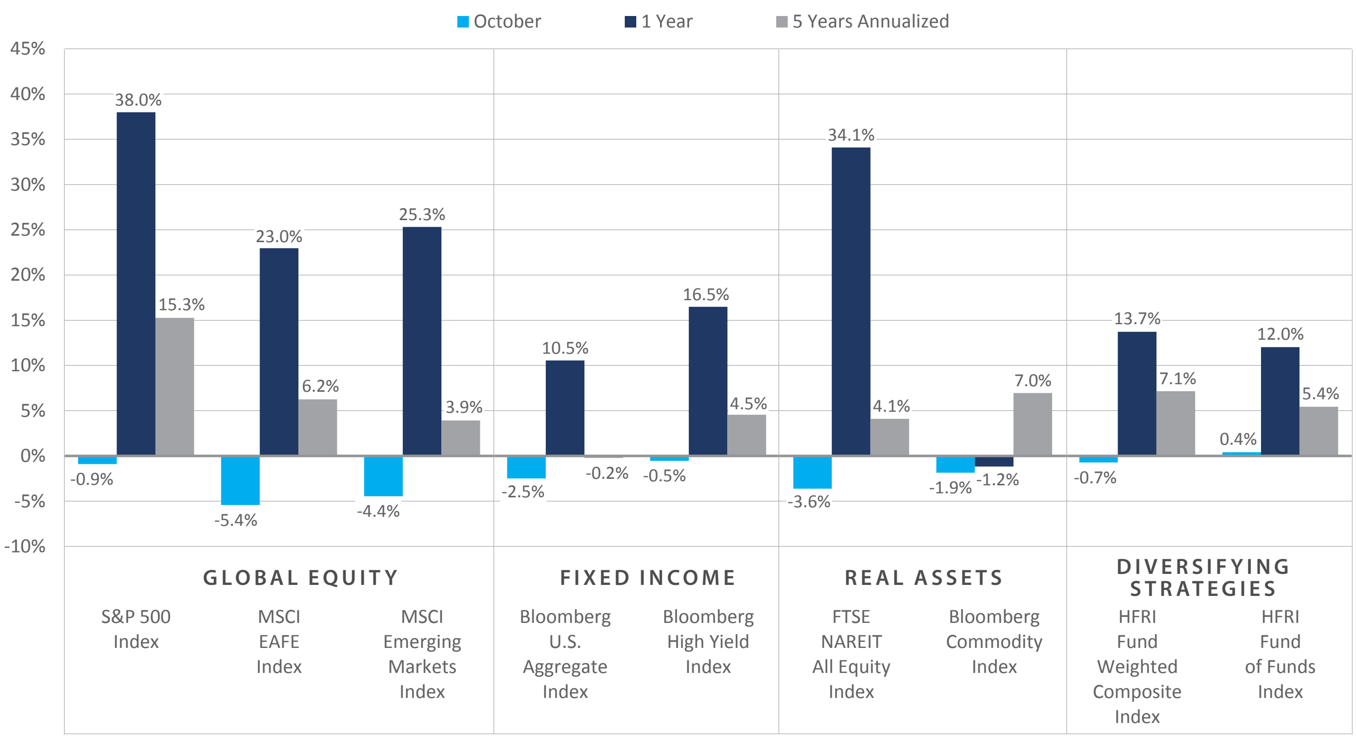
The market reaction to the presidential election results was a pleasant surprise for those allocators underwhelmed by smaller cap equity performance versus large cap in recent years, as both small and microcap equities strongly outperformed large cap on November 6, likely reflecting the sentiment that President-elect Trump's "America First" policies could support small businesses and foster a more business-friendly environment.

With the uncertainty of the presidential outcome in the rearview, ascertaining the likely path of the new administration's fiscal and monetary policy in the coming quarters and years and the cascading effects on the financial markets will be important to asset allocators. This is especially true given the current record high stock prices, elevated valuations, and the continued tense geopolitical backdrop.

In summary, financial market volatility increased in October as investors braced for the looming November U.S. presidential election. Amid stubbornly high inflation and renewed upward pressure on the U.S. dollar and Treasury interest rates, meaningful market reversals were witnessed during the month, including notably weak performance from international equities and rate-sensitive fixed income sectors.

Market Summary

October 2024



Data sources: Lipper, HedgeFund Research

Global Equity

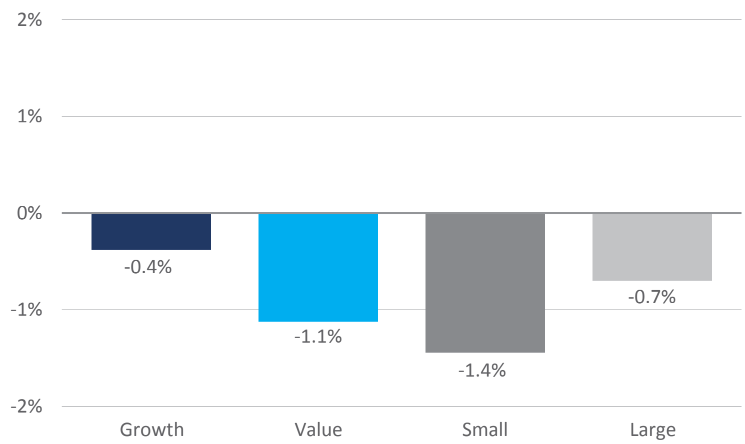
October was a challenging month for global equity markets, characterized by significant volatility and widespread declines across major equity indices. Volatility drivers included mixed corporate earnings, concerns over prolonged inflation, and rising bond yields. Despite these headwinds, sectors like financials and energy showed resilience, and a few economies showed signs of potential soft landings. Overall, global equities fell during October, reflecting investor caution and a complex interplay of economic and political factors.

U.S. equity markets outperformed their international counterparts but finished about flat on the month. Late-month tech losses and rising U.S. Treasury yields contributed to the drawdown in the final week of October. After betting big on cloud infrastructure in the late 2010's, big tech companies have reaped the benefits through significant increases in revenues. These companies are once again making considerable investments, only this time to support artificial intelligence (AI) infrastructure. Skepticism around the ultimate long-term revenue benefits of AI amid these large capital expenditures pressured prices of some of the U.S. equity markets' largest stocks, such as Microsoft and Apple. On a more positive note, the financials sector performed well due to an uptick in investment banking fees and trading revenue.

Japanese equities declined in October when measured in U.S. dollars, due to the strengthening of the currency, but performed positively in local terms. The market was influenced by rising long-term yields in both the U.S. and Japan, which benefited financial stocks—or more specifically, banks. As net exporters, large cap Japanese companies took advantage of the weakening yen, benefitting sectors like machinery and information technology. The Bank of Japan's decision to adjust its yield curve control policy and allow the 10-Year JGB yield to rise above 1% also impacted

INVESTORS FIND REFUGE IN GROWTH STOCKS ONCE AGAIN

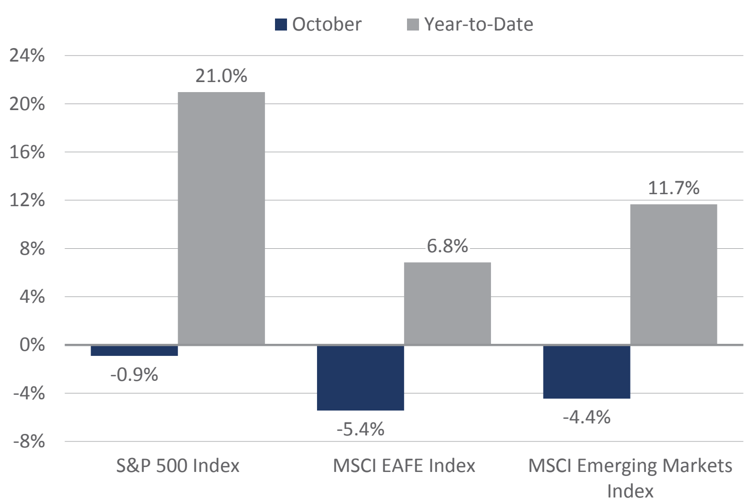
U.S. Equity Markets Style Returns



Data source: FTSE Russell

U.S. EQUITY MARKETS DECLINE MONTH-OVER-MONTH FOR THE FIRST TIME SINCE APRIL

Equity Indices Performance Returns (U.S. Dollars)



Data sources: S&P, MSCI

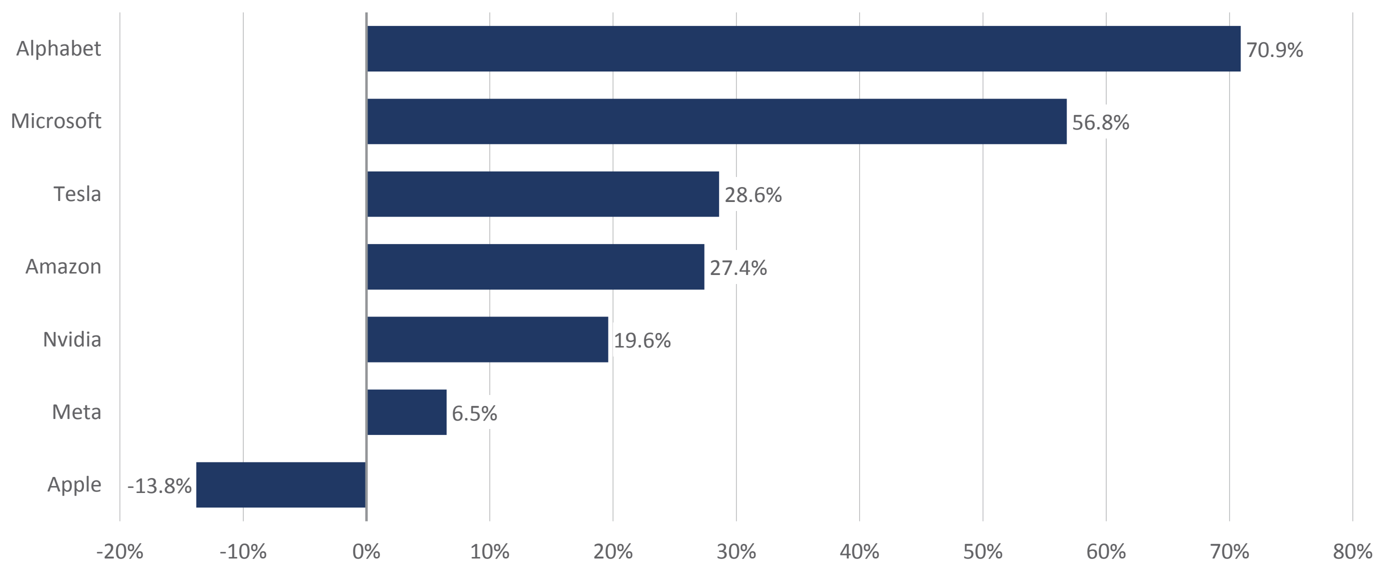
investor sentiment. Growth stocks, especially small caps, struggled due to resilient inflation and higher CPI forecasts.

International developed equities continue to underperform the U.S. as well as their emerging markets counterparts, largely headlined by consumer pressures and concerns of a higher-for-longer interest rate environment. In the euro zone, the European Central Bank (ECB) once again cut rates, signaling a more positive environment for equity growth than other regions globally. However, many of the larger companies in the MSCI EAFE Index continue to face headwinds, specifically automobile manufacturers and luxury goods companies. UK equities fell over the month, with no sectors posting positive returns in USD terms. The consumer services subsector held up well, but any sectors or industries exposed to global industrial end markets underperformed. Supply chain disruptions were prominent, as many healthcare equipment companies were forced to lower earnings guidance.

Emerging markets were hit hard in October, with equities declining over 4%. The downturn was led by a strong U.S. dollar, profit taking in India, and poor investor sentiment in China. After one of its best-performing quarters in over a decade, China's equity markets pulled back as the government's stimulus measures were seen as insufficient to boost consumer confidence. Additionally, the potential implementation of high tariffs imposed against China by U.S. President-elect Trump added to market pressures. The semiconductor subsector seemed to be the only bright spot for emerging markets as equity investors continue to price in substantial growth.

TECHNOLOGY MARKET LEADERS BETTING BIG ON AI

LTM Capex Growth for Major Technology Companies



Data sources: FactSet; LTM data is September 2023-September 2024, Nvidia is July 2023-July 2024

Fixed Income

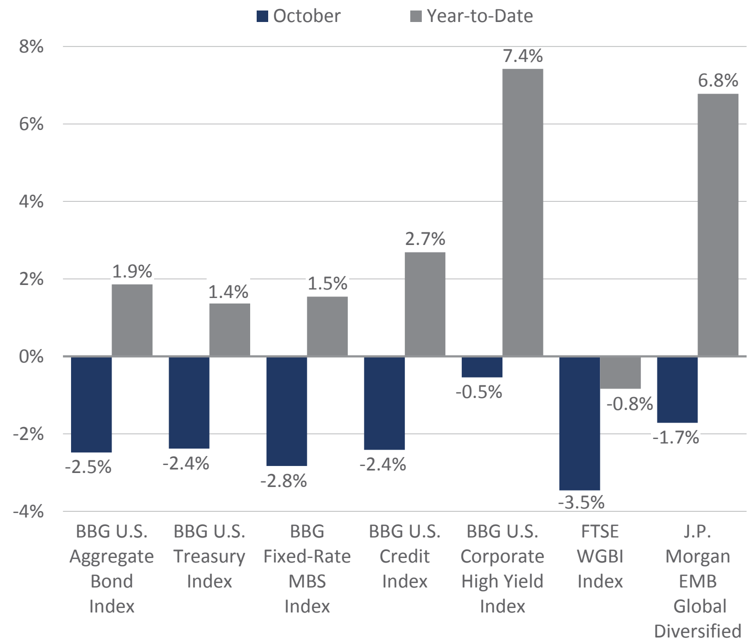
In October, a sell-off in Treasuries across the yield curve, coupled with strong economic data and rising inflation expectations, intensified market concerns. The U.S. unemployment rate exceeded the forecasted amount by 0.1% while quarter-over-quarter GDP growth remained healthy at 2.8%. Importantly, year-over-year CPI core inflation printed 20 bps hotter than expected at 3.3%. The market began pricing in inflation and growth expectations that run contrary to the Fed's 50 bps cut the month prior.

The Bloomberg U.S. Aggregate Bond Index (Agg) fell 2.5% for the month, reversing much of the third quarter's positive performance. High yield managed to evade the bulk of the losses as credit spreads remained tight throughout the sell-off. Additionally, the high yield (HY) market's quality remains strong given both company fundamentals and investor demand for yield. Both investment grade (IG) and HY spreads approached lows for the year at 0.9% and 3.0%, respectively.

M2 supply continued to climb in October and its growth rate surpassed inflation, even as the Fed continued its restrictive policies. The Fed's rate cuts and the end of quantitative tightening could potentially bring further inflationary pressures. Bank loans and bond issuance has been relatively muted despite overall strong economic conditions. Bank loan activity has primarily been a result of repricing rather than refinancing or new issuance. New home sales have also remained muted, likely due to the rate sell-off, inhibiting refinancings and home transactions.

FIXED INCOME ROLLERCOASTER: YEAR-TO-DATE GAINS AMID OCTOBER DIPS

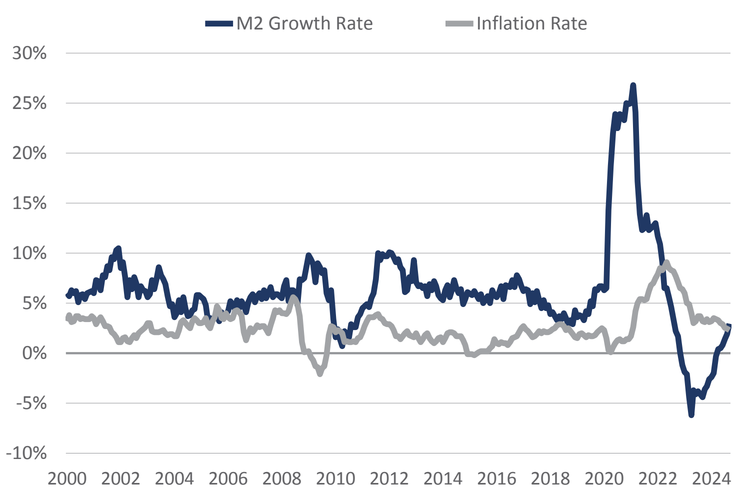
Fixed Income Index Returns



Data source: Lipper

UPWARD PRESSURE ON INFLATION

M2 Money Supply Growth vs. Inflation



Data source: FRED

Real Assets

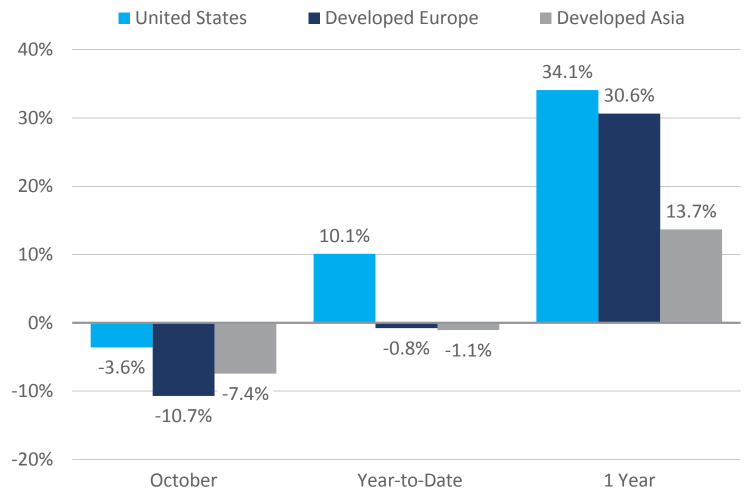
Real Estate

In October, U.S. REITs fell 3.6%, as measured by the performance of the FTSE Nareit All Equity REITs Index. Global REITs declined 5.1%, driven by underperformance in developed Europe and Asia, as measured by the FTSE EPRA/Nareit Developed Index.

The data center property sector led month-to-date and year-to-date performance, supported by big tech's investment in data infrastructure, which has led to lower vacancy rates and higher rents in primary markets. Surprisingly, the office sector was the second-best performer, with the index up 25.2% year-to-date in 2024. This recovery could signal early signs of partial stabilization for the office market.

EUROPE AND ASIA WEIGH ON GLOBAL REITs

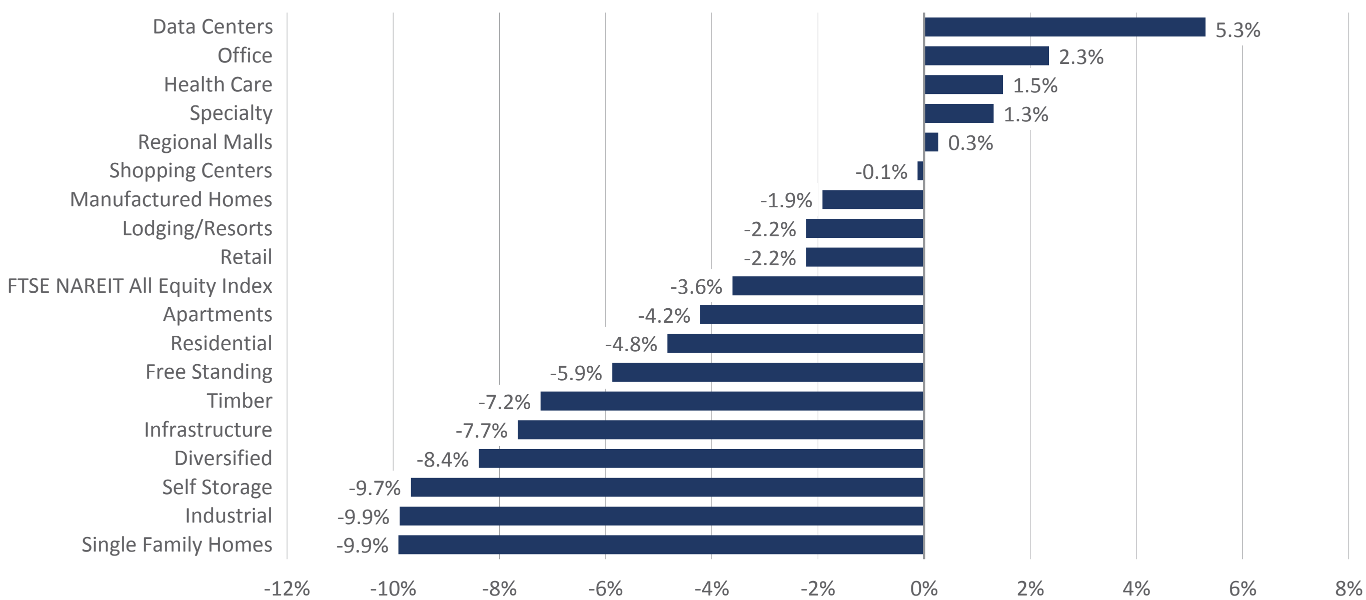
Trailing REIT Performance by Geography



Data source: FactSet

DATA CENTER FUNDAMENTALS REMAIN ROBUST

REIT Trailing Performance by Property Type



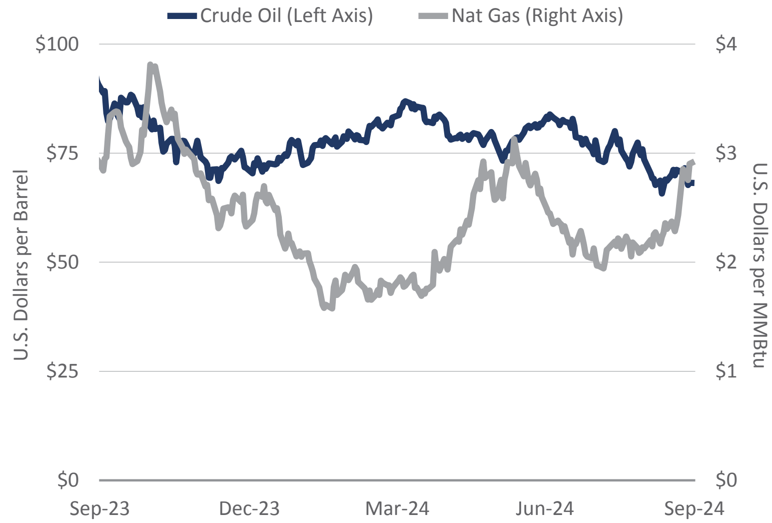
Data source: FactSet

Natural Resources

In October, the price of crude hovered around $70 per barrel, as measured by the West Texas Intermediate (WTI) Continuous contract. OPEC+'s spare capacity balanced the risk of significant disruptions in the global oil market due to potential escalations in conflicts between Israel and Iran. Natural gas prices declined 7.4% as measured by the Henry Hub continuous contract, driven by continued storage increases that have led to storage levels above the five-year average.

CRUDE OIL AND NATURAL GAS MOVE IN OPPOSITE PATHS IN SEPTEMBER

Price of WTI Crude and U.S. Natural Gas



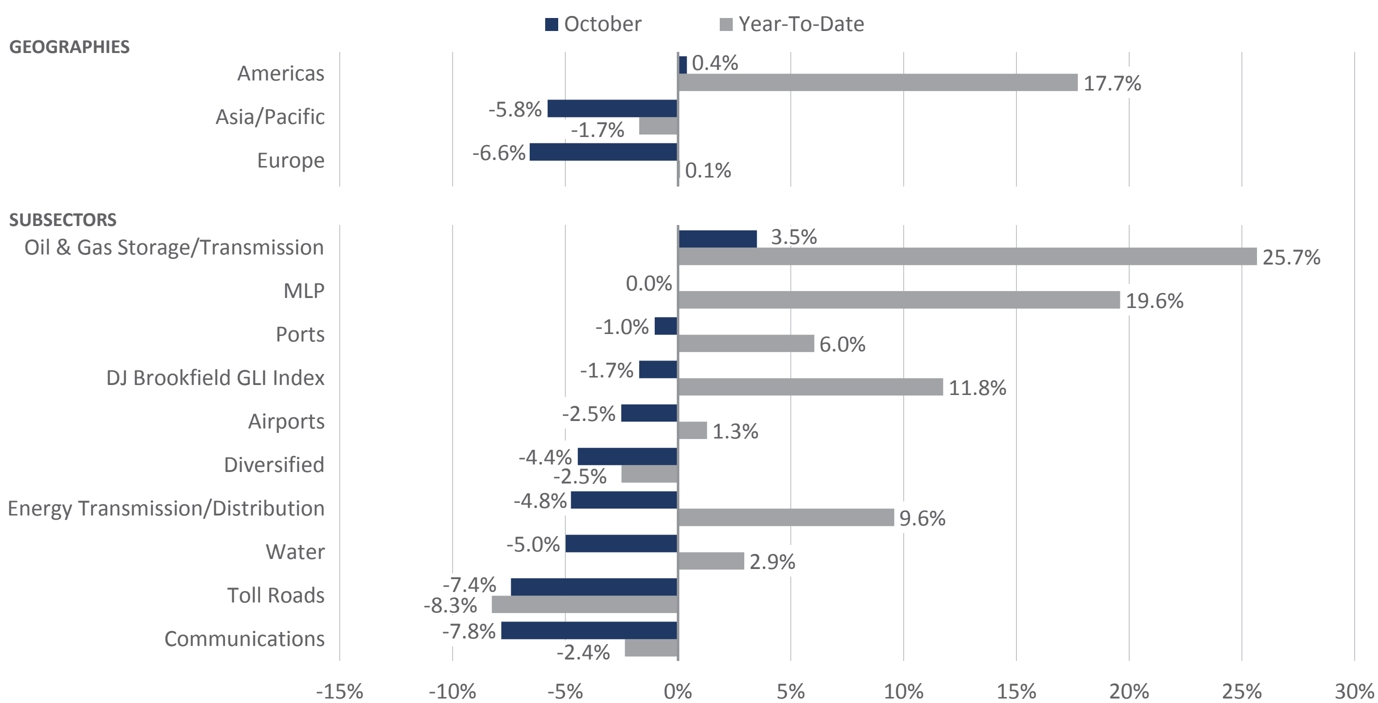
Data source: FactSet

Infrastructure

In October, global listed infrastructure stocks fell 1.7%, according to the Dow Jones Brookfield Global Infrastructure Index, retracing some of the gains made in the third quarter. Oil and gas storage and transmission emerged as the only positive performing subsector, with energy infrastructure maintaining momentum due to healthy balance sheets and strong earnings.

INFRASTRUCTURE STOCKS GIVE BACK FOLLOWING STRONG THIRD QUARTER

Listed Infrastructure Trailing Returns



Data source: FactSet

Diversifying Strategies

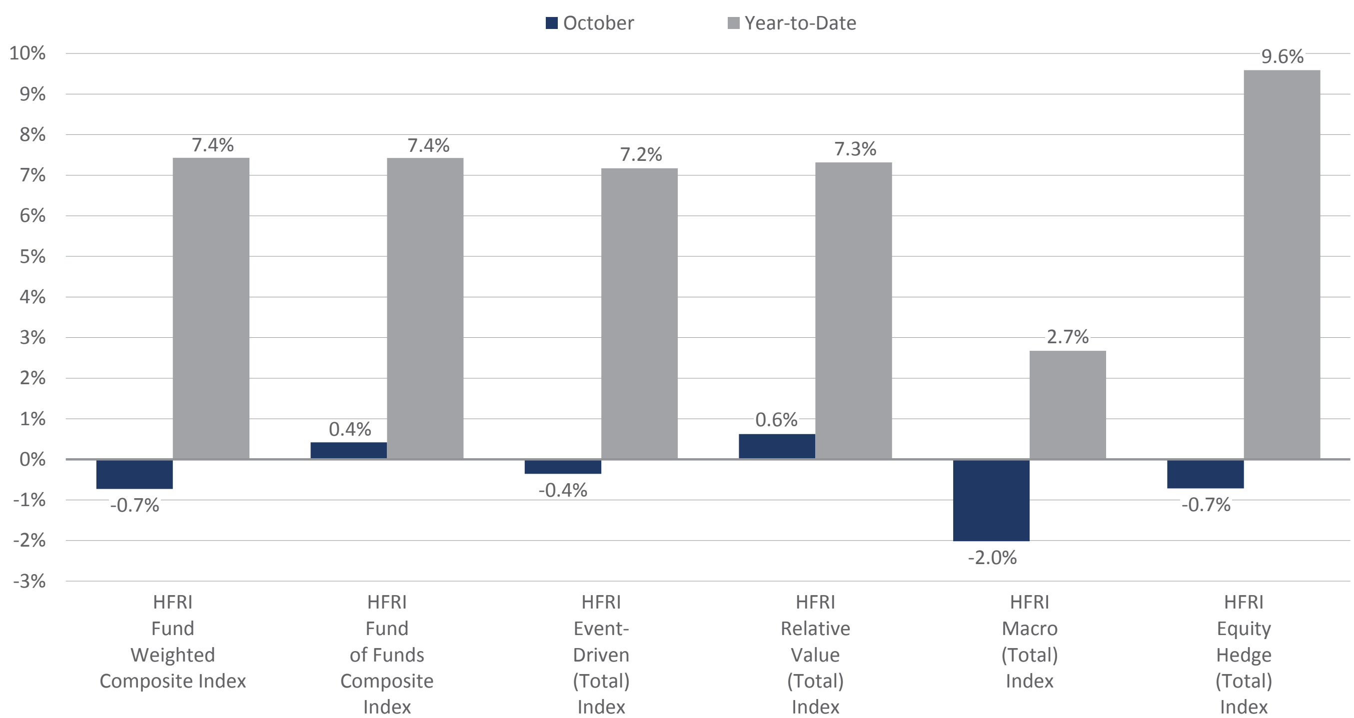
Hedge funds produced mixed returns during October, with relative value strategies the sole generator of positive returns. Returns of the other major strategies were all negative and global macro was the largest underperformer.

While the major strategies struggled, the underlying sub-strategies had some bright spots. Equity market neutral, credit arbitrage, and sector-focused equity strategies were all positive performers. Managers were profitable in trading energy and technology, particularly within long/short equity.

Systematic trend-following strategies faced headwinds during October as long-term models were unable to react quickly enough to shifting trends. The biggest detractors were fixed income, equities, and currencies. Losses stemmed from long positions across bonds and interest rates while also being short the U.S. dollar. Long positions in equities were another key detractor as markets flipped mid-month, catching managers off guard.

HEDGE FUNDS FACED CHALLENGES IN OCTOBER

HFRI Indices Performance Returns (U.S. Dollars)



Data source: HedgeFund Research

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All data is as of October 31, 2024 unless otherwise noted.

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