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One North Brentwood Boulevard, Suite 850
St. Louis, Missouri 63105
(855) 382-1600
www.benjaminfedwards.com
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Investment Insights Quarterly

From the Desk of Bill Hornbarger, Chief Investment Officer

October 2024

Sticking the Landing

As telegraphed and widely expected, the Federal Open Market Committee cut rates in September, the first reduction in the overnight rate in more than four years. The U.S. Federal Reserve (Fed) moved aggressively, lowering the benchmark rate by 50 basis points (bps), as policy focus shifted from reducing inflation to limiting the constraints of tight monetary policy to the broader economy in general—and the employment outlook in particular.

When changing rates, the Fed's goal is to engineer a soft landing. That term is widely used in the financial press, but many investors don't have a clear understanding of what it means. A soft landing is defined as a cyclical slowdown in economic growth that ends without a recession, usually by raising rates enough to stop overheating inflation but not enough to cause a severe downturn.

The Fed accomplished the first half of that equation (stop overheating and high inflation) by raising rates aggressively between March 2022 and July 2023 (a total of 5.25%). It is attempting to accomplish the second half (avoid a severe downturn) by embarking on an easing cycle to make monetary policy less restrictive. The Bloomberg consensus forecast of economists seems to support a successful soft-landing outlook. That group currently puts the odds of a recession at 30%.



	2023 (actual)	2024 est.	2025 est.	2026 est.
Real GDP (YoY%)	2.9%	2.6%	1.8%	2.0%
Core PCE (YoY%)	4.2%	2.7%	2.2%	2.1%
Unemployment	3.6%	4.1%	4.4%	4.3%
Fed Funds	5.50%	4.50%	3.30%	3.05%

As of October 14, 2024
Source: Bloomberg

One of the things we were concerned about entering this year was the market's optimism about interest-rate cuts. At the beginning of the year, market sentiment (as evidenced by the futures markets) was that the Fed would make six 0.25% rate cuts in 2024, which felt too aggressive based on the inflation outlook at the beginning of 2024. Conversely, we identified one of the risks as the Fed leaving rates too high for too long. The Fed's move to lower rates and rhetoric indicating that more rate reductions are likely gives us comfort that the Fed is highly attuned to the risks.

We do want to point out that in a soft-landing scenario, not all parts of the economy are moving to the same degree or even in the same direction. Based on our view, up to this point the Fed has seemingly managed to engineer an environment where a soft landing is the highest probability outcome. We see the positives and negatives as follows:

The Positives

- Inflation is declining and nearing the Fed's target zone (2% core personal consumption expenditures).
- Global central banks are cutting rates, including in the United Kingdom, Eurozone and United States.
- The economy continues to grow with the current Atlanta Fed GDPNow forecast for the third quarter at 3.4%.
- Earnings growth is expected to remain positive.
- The election will be behind us soon.
- Consumer balance sheets are strong, with stock and home prices at/near record high levels.

The Concerns

- Geopolitical concerns exist.
- Consumer sentiment is stagnant/declining.
- It has been a very contentious and divisive election cycle.
- The consumer savings rate is declining as consumer debt is rising.
- The unemployment rate is increasing (although it is still "low" historically).
- U.S. manufacturing is in recession.
- The U.S. yield curve and leading indicator index are signaling a recessionary environment.

We would suggest that, valuations aside, the environment remains relatively positive for the financial markets. This bull just turned two years old, which is relatively young as bull markets go. Inflation is falling, allowing the Fed to cut rates with stocks near all-time highs; historically, this has been followed by a positive 12 months in terms of equity returns, and we are headed into a seasonally strong part of the year. We believe that investors should focus on these factors as opposed to the headlines surrounding the election and stay at/near their strategic equity weightings.

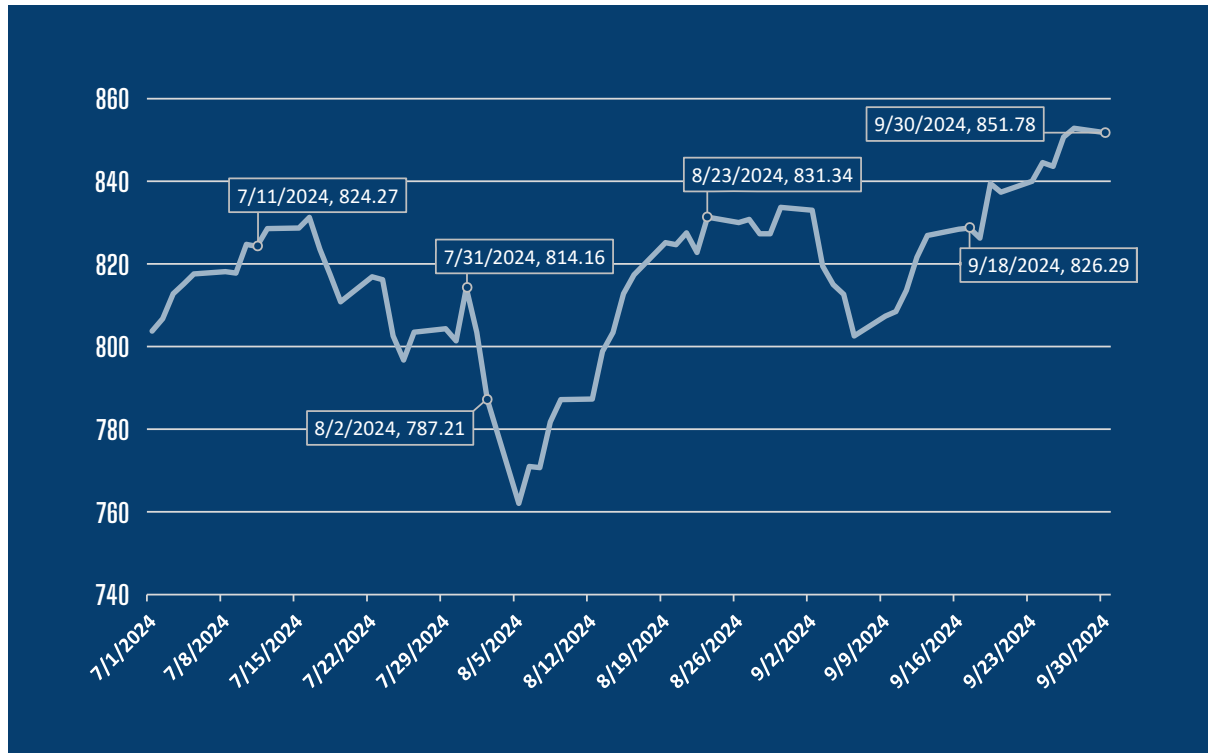


Third-Quarter (Q3) Key Dates

- July 11 – June CPI posted a positive surprise (softer inflation) at -0.1% overall and a year-over-year reading of 3%, with core CPI +0.1% and 3.3%, year over year.
- July 31 – The Central Bank of Japan surprised international markets by raising its interest rates to +0.25% from -0.10%, forcing an unwind in the USD/JPY carry trade and sending U.S. equities lower.
- August 2 – The unemployment rate increased to 4.3% from 4.1% in July, adding additional evidence of a slowing economy and triggering the Sahm Rule.
- August 23 – Jerome Powell delivered an overwhelmingly dovish speech at Jackson Hole, providing a timeframe (September) for the first cut.
- September 18 – The Fed cut rates for the first time in more than four years and decided on a larger (50 bps) cut.
- September 30 – The S&P 500 ended Q3 2024 at a record high closing level.

Global Stock Market

MSCI ACWI in USD



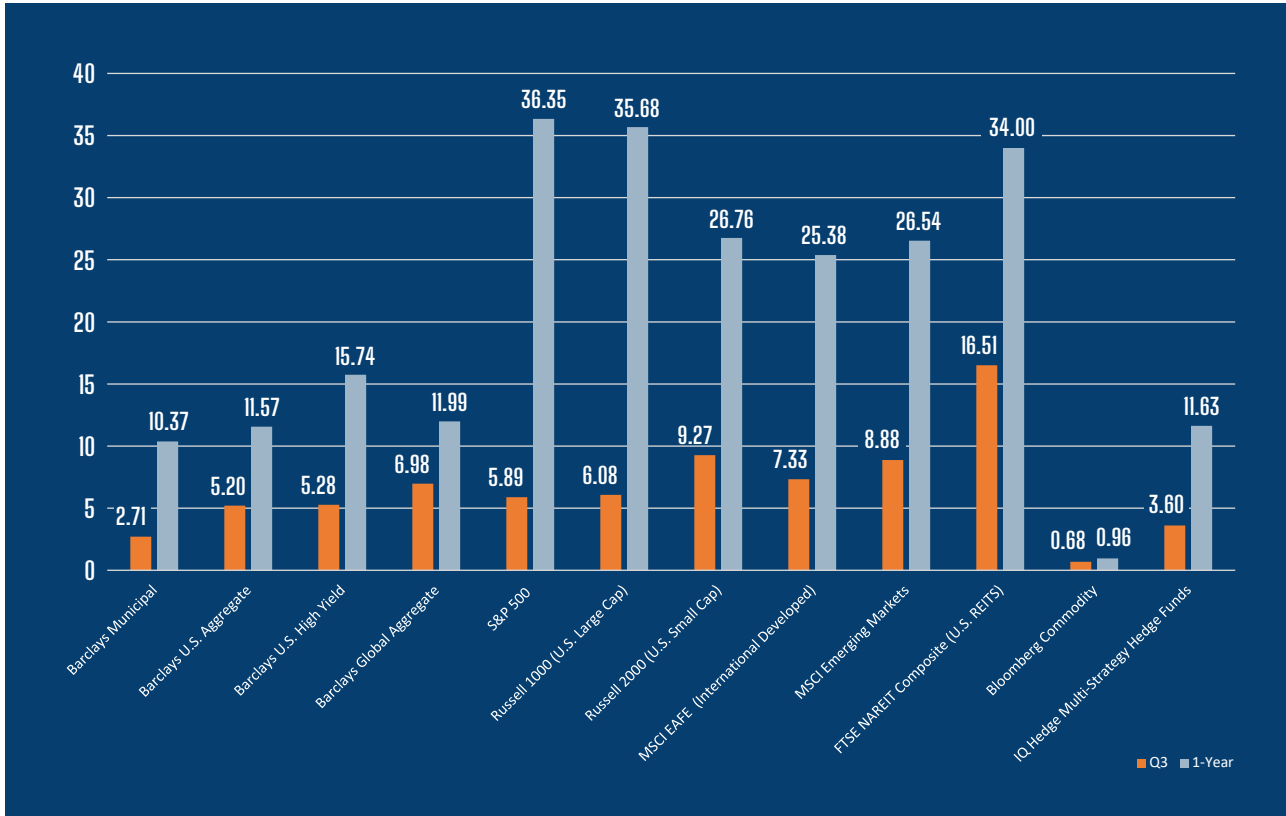
As of September 30, 2024
Source: Bloomberg

MARKET EVENTS



Asset-Class Returns

Q3 2024



As of September 30, 2024
Source: Conway

Fixed Income

- Treasury and other sovereign debt yields continued to fall in September, leading to strong gains in core fixed income and municipal bonds.
- Credit spreads were largely flat last month, but price appreciation and higher carry led to solid total returns.
- Bonds outside the United States benefited from U.S. dollar weakness that provided an added boost to returns.

Equities

- U.S. equities posted solid gains in September, led by large caps and growth stocks.
- Growth stocks beat value stocks last month and large caps outperformed small caps.
- Through the first nine months of 2024, the S&P 500 has gained 22.1% and the Russell 2000 has risen 11.2%.
- Developed markets outside the United States exhibited weakness last month in local terms, but posted positive returns due to the weak U.S. dollar.
- Within EAFE markets, value stocks outperformed growth stocks, and small caps handily beat large caps.
- Emerging markets were the star performers in September led by the surge in China at the end of the month.
- The weak U.S. dollar boosted EAFE returns by 131 bps and EM returns by 112 bps.

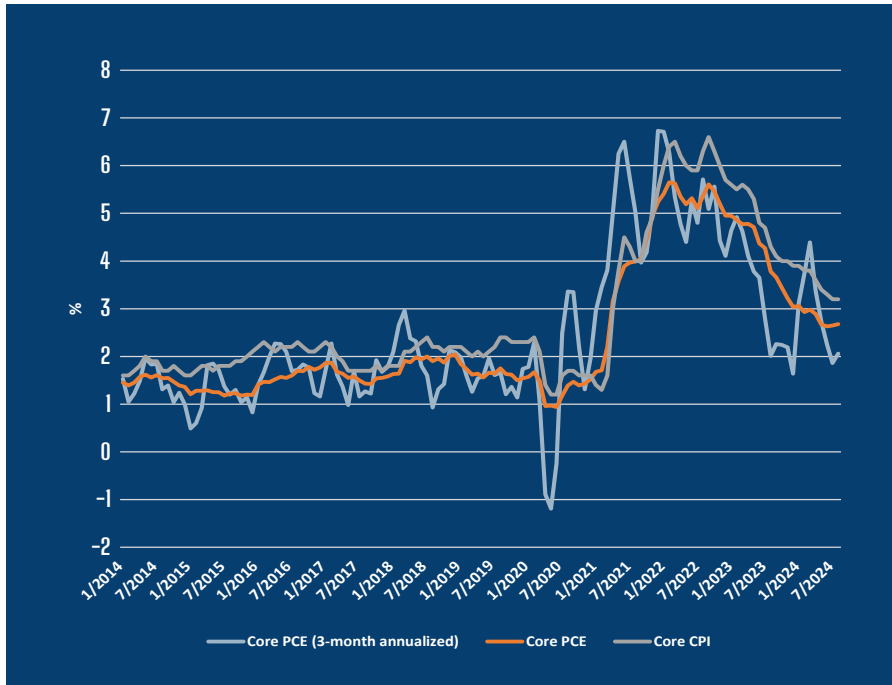
Real Assets

- Real estate had a very strong quarter, and trailing one-year returns are now 34%.
- Commodities were little changed for the quarter with gold hitting record highs and crude oil falling.



Inflation

Core Personal Consumption Expenditures vs. Core CPI

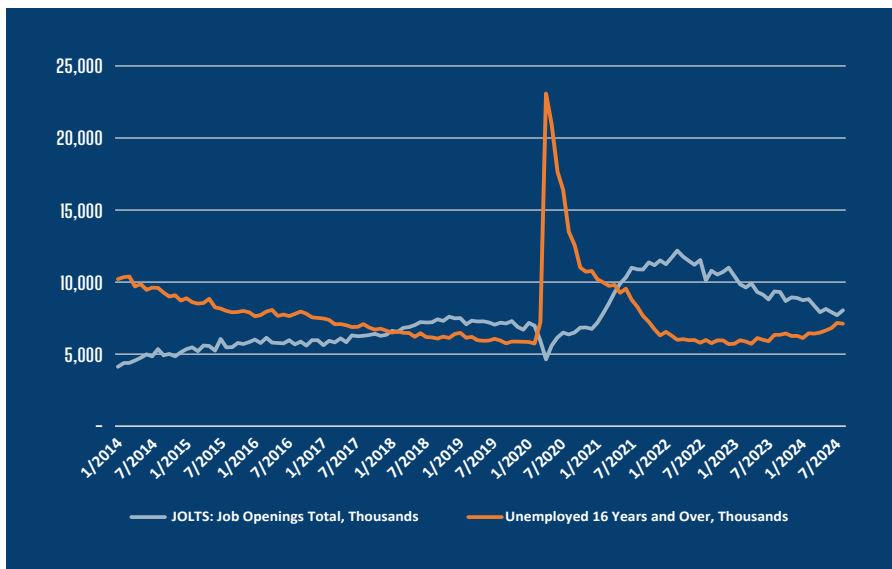


As of September 30, 2024
Source: Haver

- The Fed uses core personal consumption expenditures (PCE) as favored inflation measure and targets 2% over a cycle.
- PCE tends to be lower than the Consumer Price Index (CPI) due to the substitution component.
- Inflation by any measure has declined.
- While year-over-year core PCE remains above the 2% target, it is trending in the right direction.
- On a three-month annualized basis, core PCE has been at/near the 2% target.

Employment

Job Openings vs. Unemployed



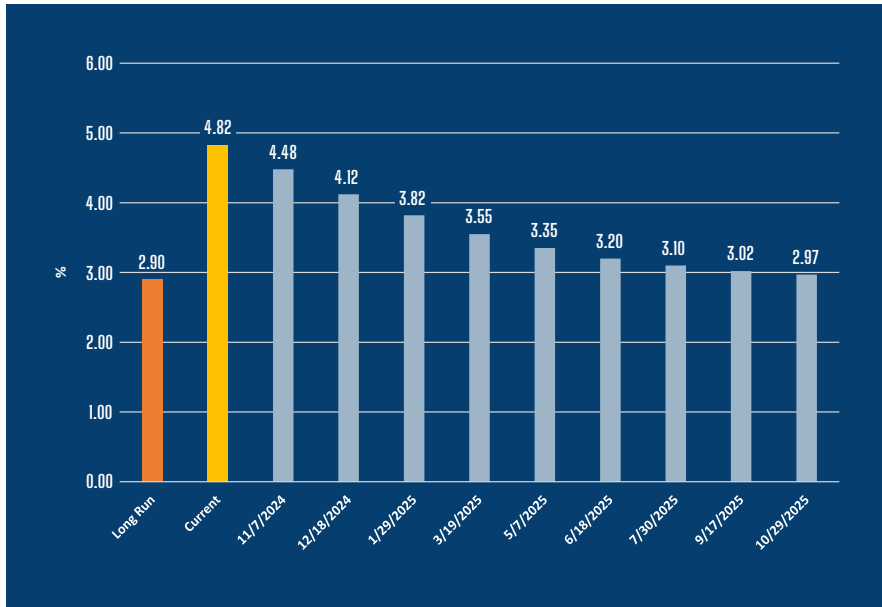
As of September 30, 2024
Source: Haver

- The Fed's focus has seemingly shifted from fighting inflation to employment.
- By almost any measure, employment has softened in recent months.
- The number of unemployed has increased at the same time that job openings have declined as firms are more careful about hiring.



Monetary Policy

Fed Funds Futures Implied Policy Rates

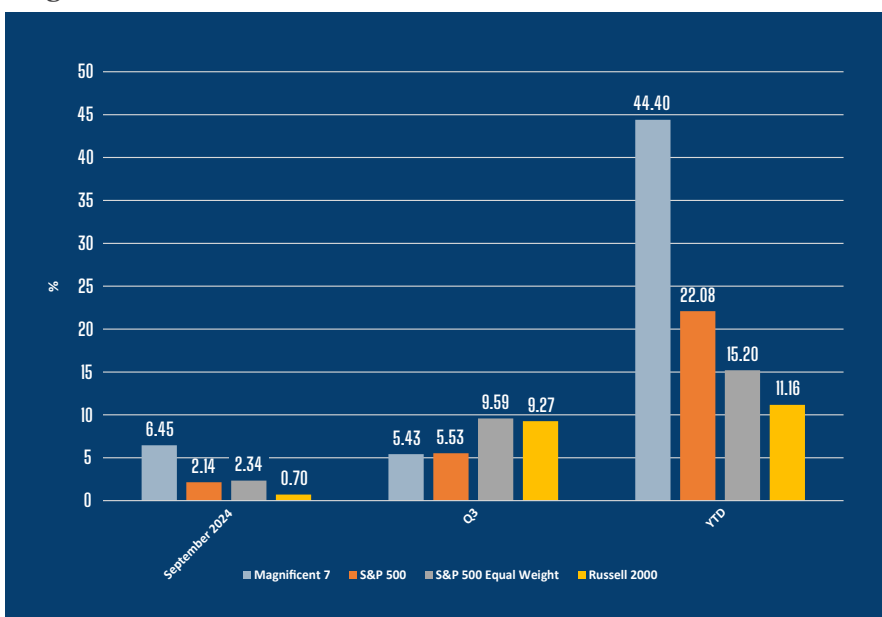


As of September 30, 2024
Source: Bloomberg

- The Fed cut rates by 50 bps in September; it was its first cut in four years.
- The markets were evenly split between 25 and 50 bps prior to the meeting.
- The Fed projection materials indicated a slightly higher long-term neutral rate, approximately 3%.

Market Breadth

Magnificent Seven vs. The Broader Market



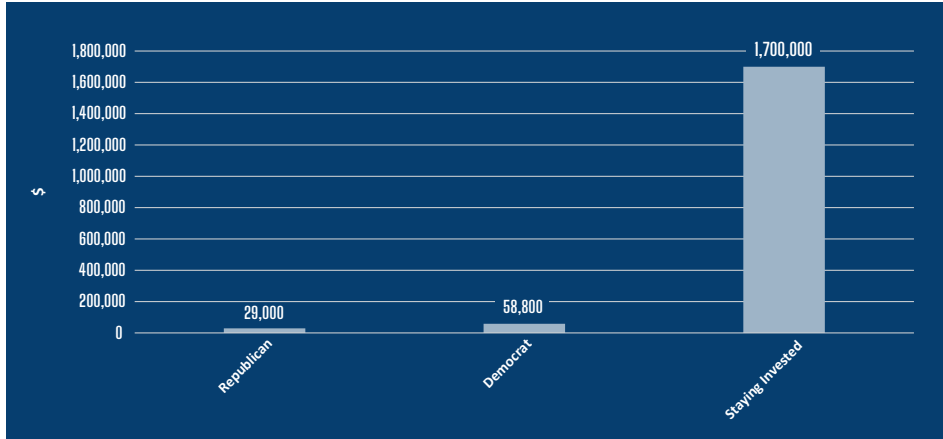
As of September 30, 2024
Source: Bloomberg

- Tech stocks underperformed in July as only two of the S&P 500's 11 sectors posted declines: communication services (-4.2%) and information technology (-2.1%).
- The market did broaden out in Q3 with the Russell 2000 (small cap) and S&P 500 equal weight indexes leading.
- Despite this relative strength, the Magnificent Seven (Tesla, Meta, Amazon, Alphabet, Apple, Microsoft, Nvidia) continues to lead the market and provide a strong tailwind for the capitalization-weighted S&P 500 benchmark.



The Election

The Value of \$1,000 Invested

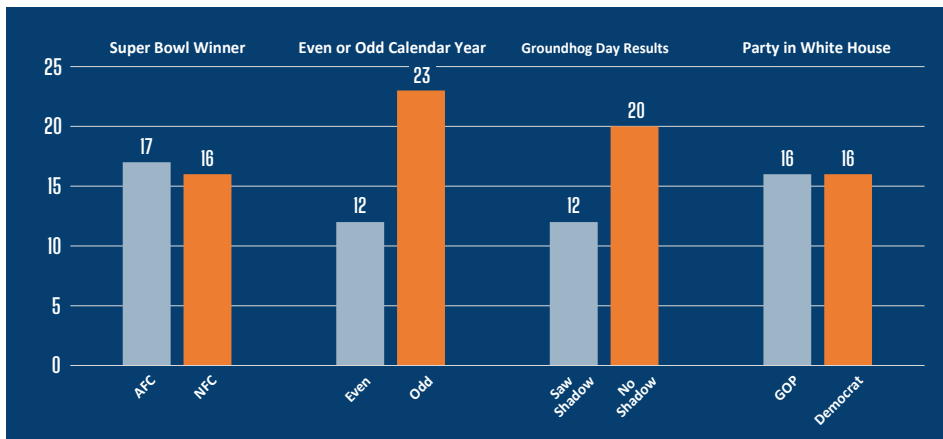


As of September 30, 2024
Source: Bespoke

- \$1,000 invested since the Eisenhower administration in 1953 under only Republican presidents would be worth \$29,000 today.
- \$1,000 invested under a Democratic president over the same period would be worth \$58,800.
- That same \$1,000 would be worth \$1.7 million, if one had remained fully invested.

The Election

Last 50 Years – Median Calendar-Year Returns Based On:



As of September 30, 2024
Source: Russell Investments

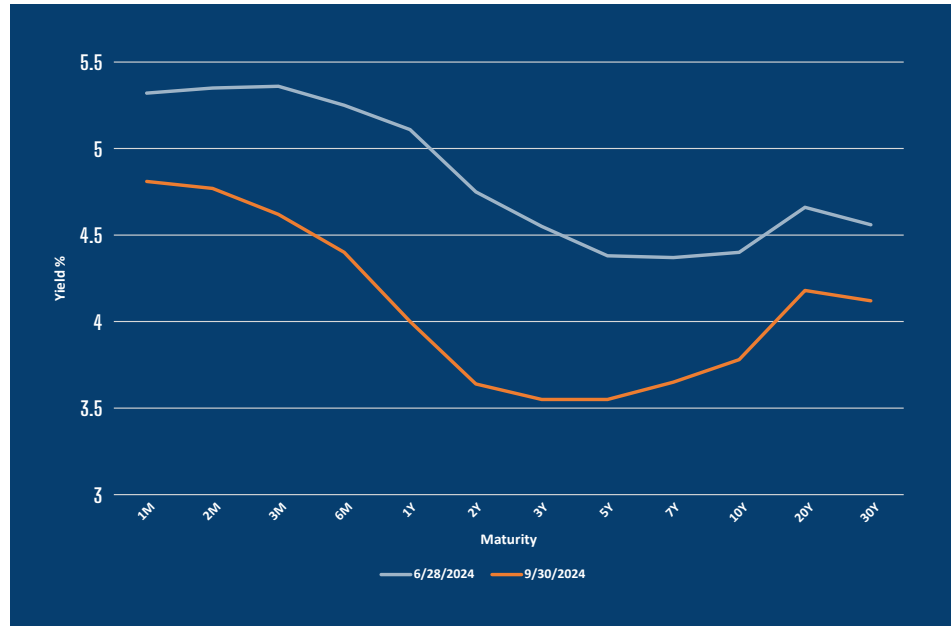
- Elections may influence investors to take action in their portfolios based on results.
- Endless comparisons can be made on what factors contribute to stock market returns.
- Historically, markets have produced positive returns, regardless of the party in office.



U.S. Treasury Curve

Yields fell sharply during the quarter, and the yield curve between two and 10 years moved to a positive slope as the Fed cut rates 50 bps at the September meeting.

U.S. Treasury Yield Curve



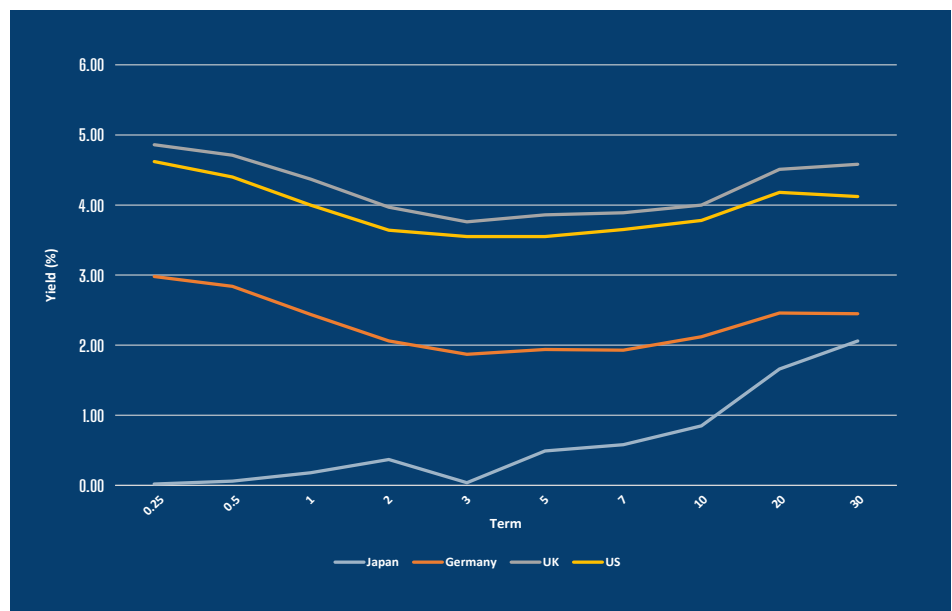
As of September 30, 2024
Source: Bloomberg

Government Bond Curves

Global bond yields reversed course and declined sharply during the quarter. Lower inflation and global central bank easing resulted in strong gains for the quarter for global bond benchmarks.

Global Government Bond Yield Curves

End of Q3 2024



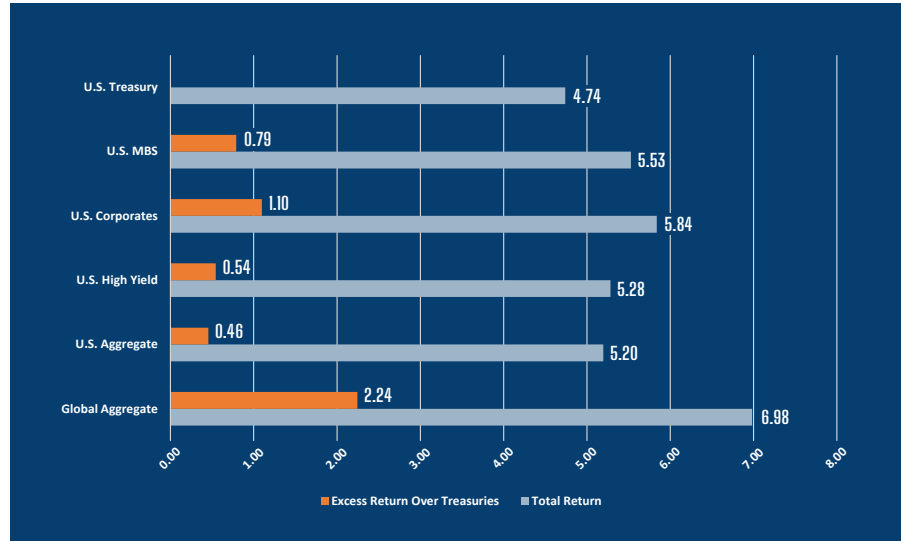
As of September 30, 2024
Source: Bloomberg



Fixed Income Performance (Q3)

Falling yields were a strong tailwind for all segments of the fixed-income markets. Strong equity markets were additional support for credit, and global central bank easing aided global bonds.

Fixed Income Performance Q3 2024

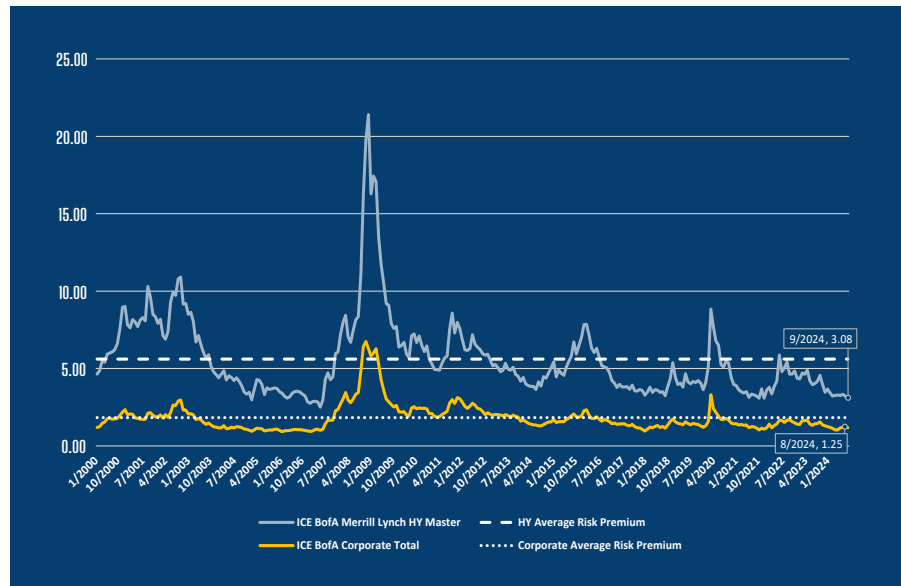


As of September 30, 2024
Source: Bloomberg

Credit

Credit spreads continued to narrow on the strength of higher equity markets and investor demand for yield.

Investment Grade and High Yield Credit Spreads



As of September 30, 2024
Source: Haver



Municipal Bonds

Municipal bonds continue to offer a yield advantage for high tax bracket investors. Longer maturity municipals (5+ years) cheapened during Q3 as municipal yields fell slower than Treasuries.

Term	AAA General Obligation	U.S. Treasury	Municipal % of Treasury
1	2.49	4.05	61.6%
2	2.37	3.61	65.6%
3	2.35	3.54	66.2%
4	2.35	3.55	66.1%
5	2.35	3.58	65.6%
7	2.45	3.67	66.7%
10	2.61	3.80	68.8%
15	2.84	3.98	71.4%
20	3.22	4.21	76.5%
25	3.42	4.26	80.3%
30	3.49	4.12	84.8%

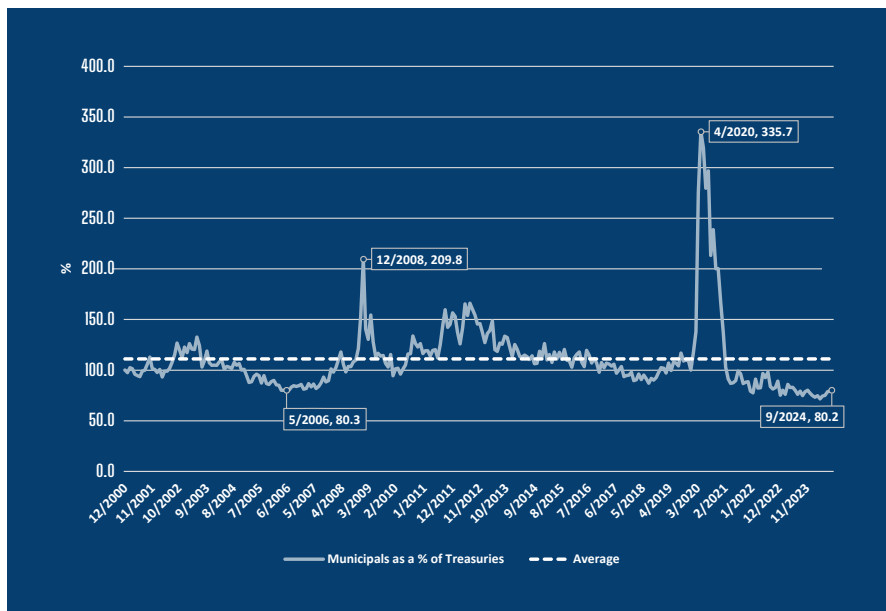
As of September 30, 2024
Source: Bloomberg

Municipal Bonds

Municipal bond credit quality remains strong, reflected in valuations relative to Treasuries. Municipals still make sense for higher tax bracket investors.

Municipal Yields as a Percentage of Treasury Yields

ICE/Bank of America Municipal Master/10-Year Treasury



As of September 30, 2024
Source: Haver

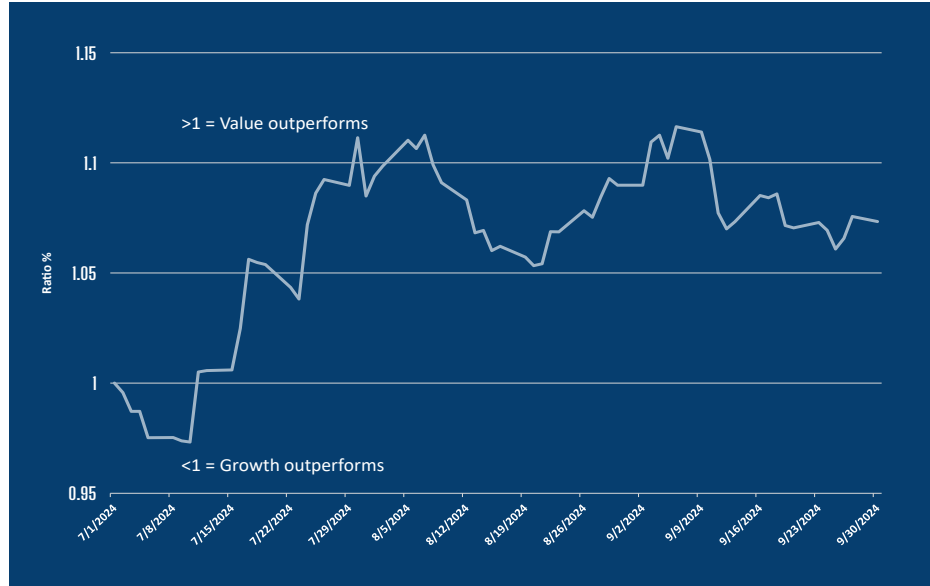


Equity – Value vs. Growth

Value outperformed growth across the size spectrum.

Large Cap Value/Large Cap Growth - Q3 2024

Russell 1000 Value/Russell 1000 Growth



As of September 30, 2024
Source: Bloomberg

Equity – Large vs. Small

Small cap outperformed large cap during Q3.

Large Cap/Small Cap - Q3 2024

S&P 500/Russell 2000



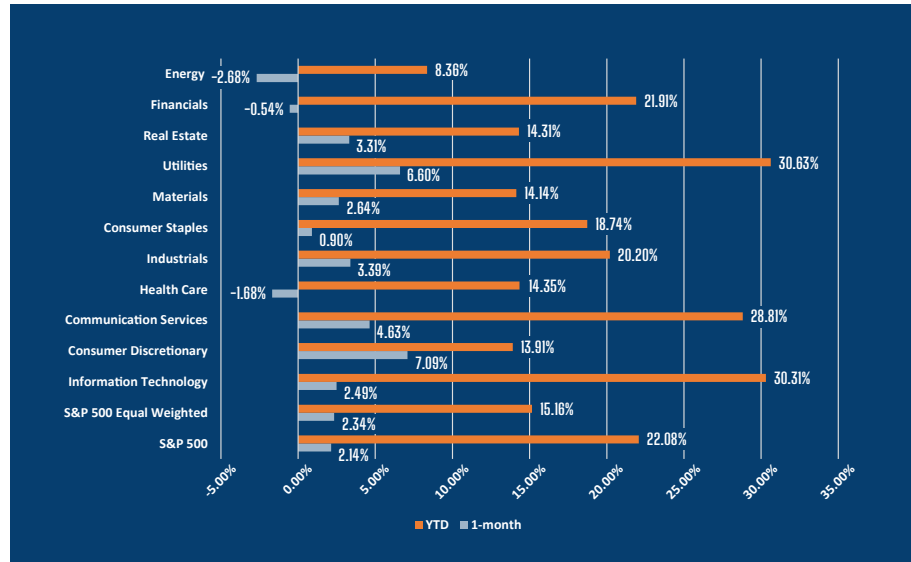
As of September 30, 2024
Source: Bloomberg



U.S. Equities – Return by Sector

The S&P 500 posted a solid gain and the markets broadened out during the quarter. Trailing one-year returns remain strong across all sectors.

S&P 500 Sector Returns Q3 2024

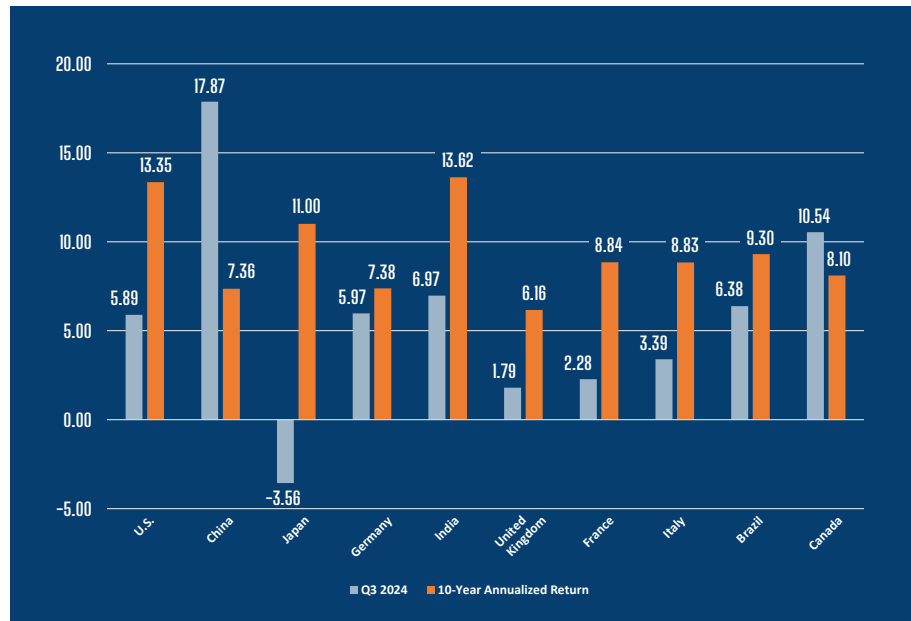


As of September 30, 2024
Source: Conway

Country Total Returns (%) – 10 Largest Economies

Global equities were higher in Q3 with the exception of Japan. China saw both a 52-week low as well as a 52-week high near the end of the quarter as news of economic stimulus resulted in a strong rally for Chinese stocks.

Country Total Equity Market Returns



As of September 30, 2024
Source: Bloomberg

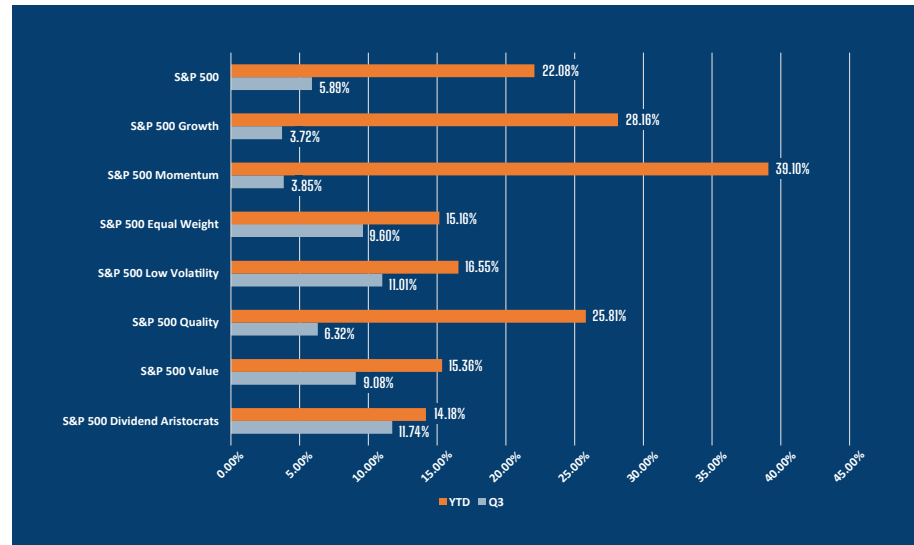


U.S. Equity Factors – Total Return

Declining bond yields aided higher dividend factors with value, dividend aristocrats, and low volatility leading growth and momentum during Q3.

Total Return: Core Factors

Q3 2024

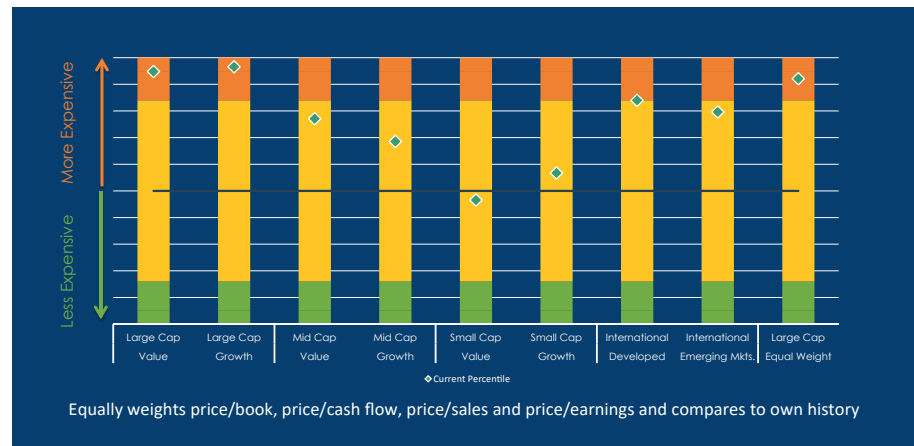


As of September 30, 2024
Source: S&P

Valuations

Large-cap stocks remain expensive relative to history while small-cap stocks are at historically inexpensive levels relative to their large-cap brethren.

Equity Asset Classes Value Rank to Own History



As of September 30, 2024
Source: BFE, Bloomberg

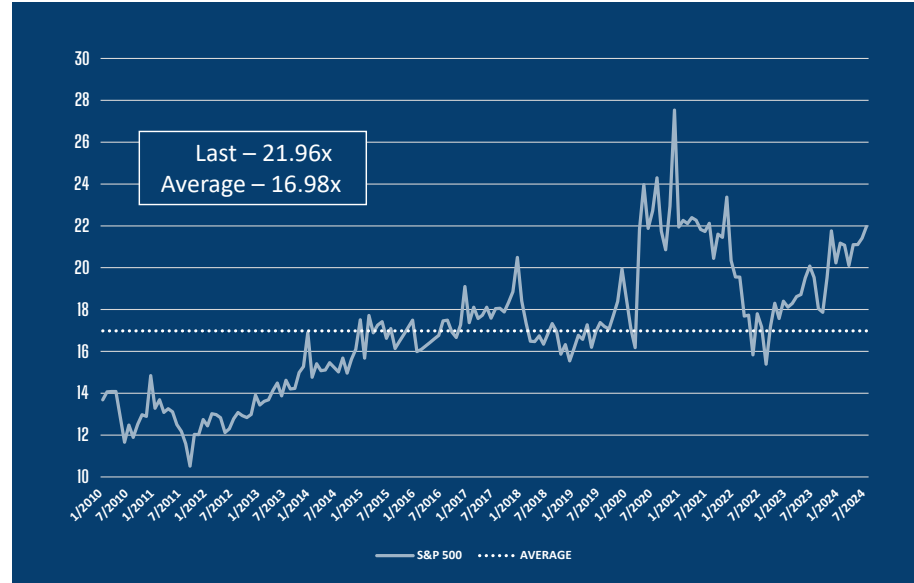


Valuation

U.S. large-cap stocks remain expensive relative to history. Growth stocks, particularly tech and communication services, are the most expensive segment of the market.

S&P 500 Composite: Forward Price/Earnings (P/E) Estimate

(Current + 3 Quarters)



As of September 30, 2024
Source: Haver

Equity Risk Premium

The equity risk premium is a valuation metric showing an “expected” return for stocks over bonds. As yields have risen, bond returns have become more attractive relative to stocks.

Equity Risk Premium

Earnings Yield (1/S&P 500 P/E ratio) less Real 10-year Yield (10-Year-Expected Inflation)



As of September 30, 2024
Source: Benjamin F. Edwards



2025 Prospects

S&P 500 earnings per share for 2025 are currently estimated to be approximately \$275/share.

S&P 500		S&P 500 Earnings Per Share					
		\$230.00	\$240.00	\$250.00	\$260.00	\$270.00	\$280.00
S&P 500 P/E Ratio	18.5	4,255	4,440	4,625	4,810	4,995	5,180
	19.0	4,370	4,560	4,750	4,940	5,130	5,320
	19.5	4,485	4,680	4,875	5,070	5,265	5,460
	20.0	4,600	4,800	5,000	5,200	5,400	5,600
	20.5	4,715	4,920	5,125	5,330	5,535	5,740
	21.0	4,830	5,040	5,250	5,460	5,670	5,880
	21.5	4,945	5,160	5,375	5,590	5,805	6,020
	22.0	5,060	5,280	5,500	5,720	5,940	6,160
	22.5	5,175	5,400	5,625	5,850	6,075	6,300
	23.0	5,290	5,520	5,750	5,980	6,210	6,440
	23.5	5,405	5,640	5,875	6,110	6,345	6,580
	24.0	5,520	5,760	6,000	6,240	6,480	6,720
	24.5	5,635	5,880	6,125	6,370	6,615	6,860
	25.0	5,750	6,000	6,250	6,500	6,750	7,000

As of September 30, 2024
Source: Benjamin F. Edwards

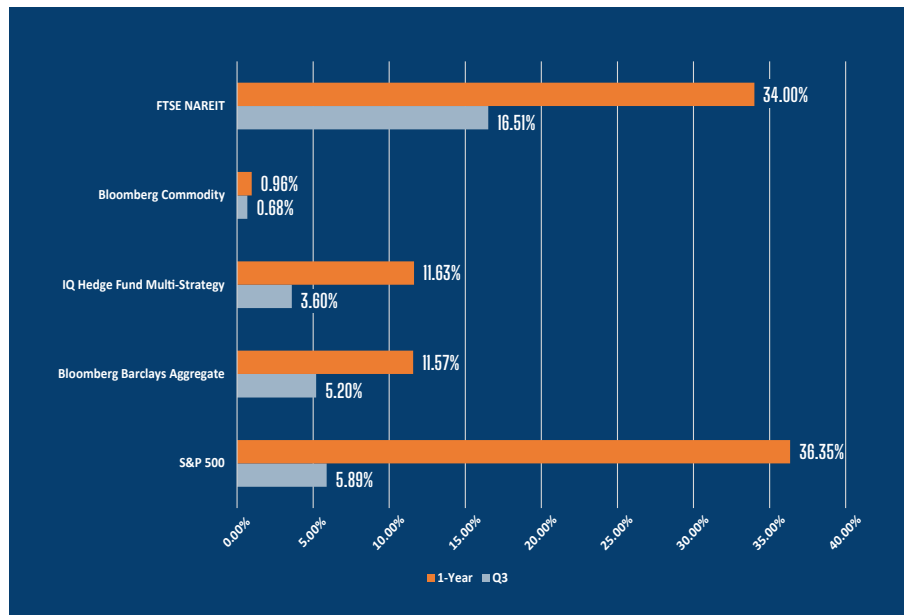


Alternative Returns

Alternative strategies and asset classes were generally positive in Q3 and for the trailing year. The commodity basket was virtually flat despite strong gold prices.

Alternative Returns

Q3 2024

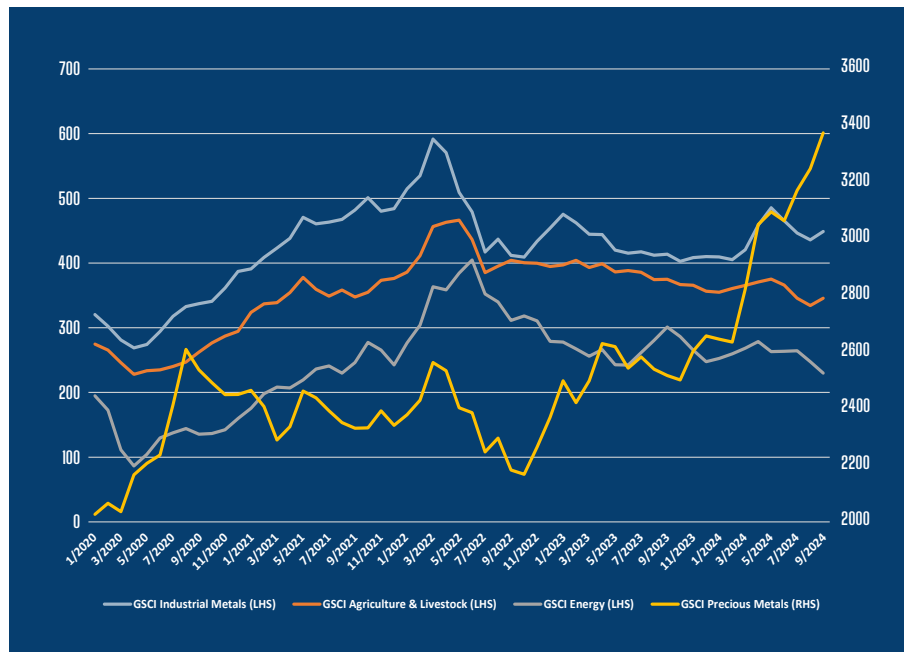


As of September 30, 2024
Source: Conway

Commodities

Commodity prices have mostly trended sideways with the exception of precious metals. Gold recently hit record highs, and silver is at the highest levels in more than a decade.

Goldman Sachs Commodity Indexes



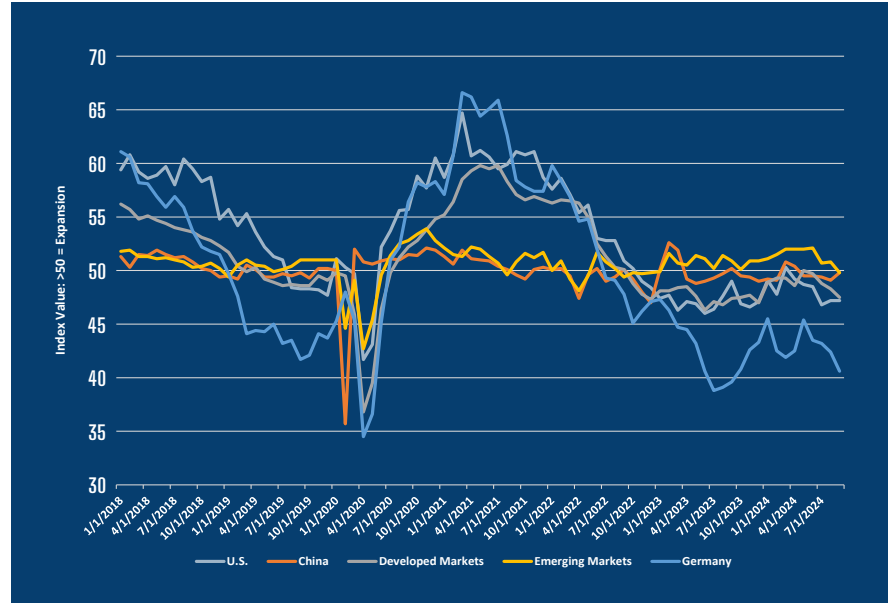
As of September 30, 2024
Source: Bloomberg



PMI Composites

The Purchasing Managers Index (PMI) is a survey-based measure of the prevailing direction of trends in the manufacturing sector. Readings >50 equal expansion and <50 contraction. By this measure, global growth appears to be slowing.

Global Manufacturing Surveys



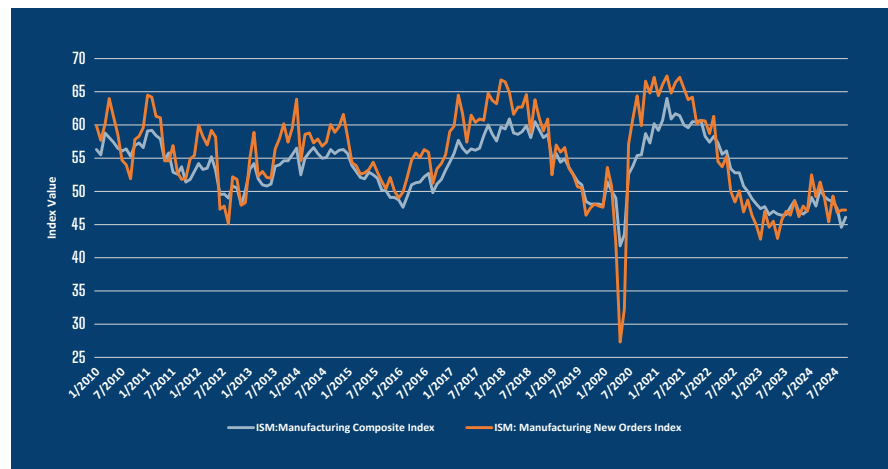
As of September 30, 2024
Source: Bloomberg, Haver

Manufacturing

Manufacturing remains weak relative to the overall economy.

Institute for Supply Management Manufacturing Composite Index

New Orders Index, >50=Expansion, <50=Contraction



As of September 30, 2024
Source: Haver

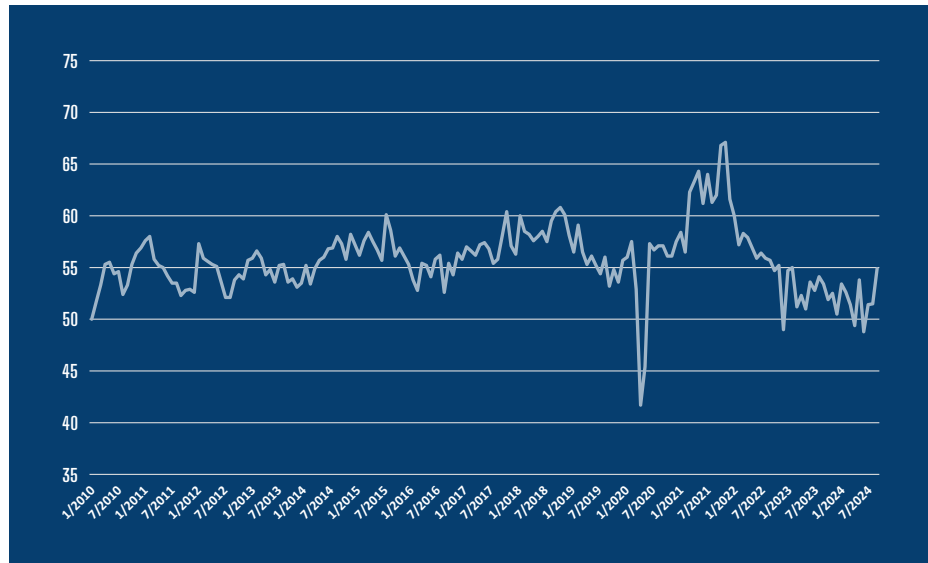


Services

Survey-based indicators show that the service side of the economy rebounded after a soft spring.

Institute for Supply Management Services Index

>50=Expansion, <50=Contraction

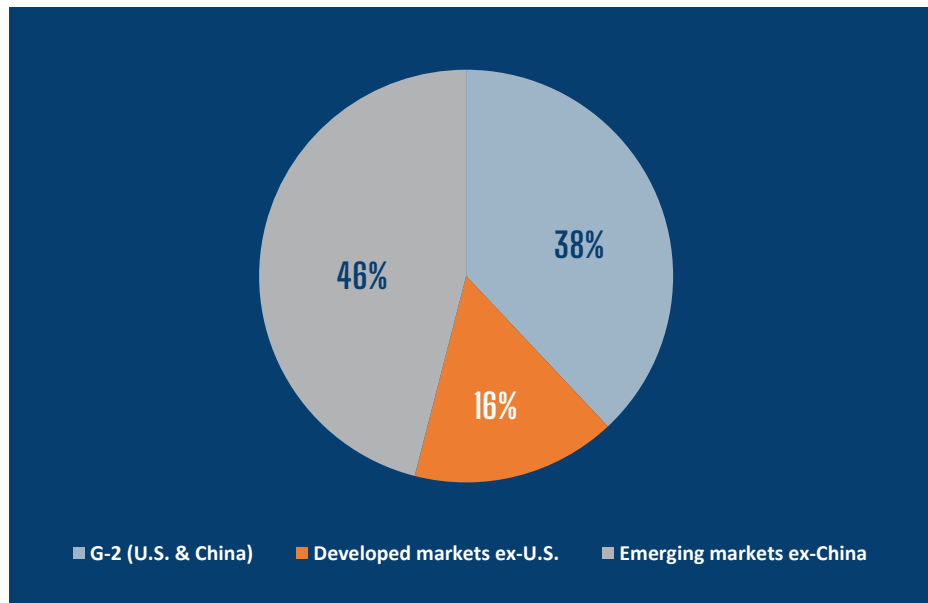


As of September 30, 2024
Source: Haver

Global Growth

Global growth is projected to be in line with the April 2024 World Economic Outlook (WEO) forecast, at 3.2% in 2024 and 3.3% in 2025.

Breakdown of 2024 Estimated GDP Growth



As of September 30, 2024
Source: NTAM

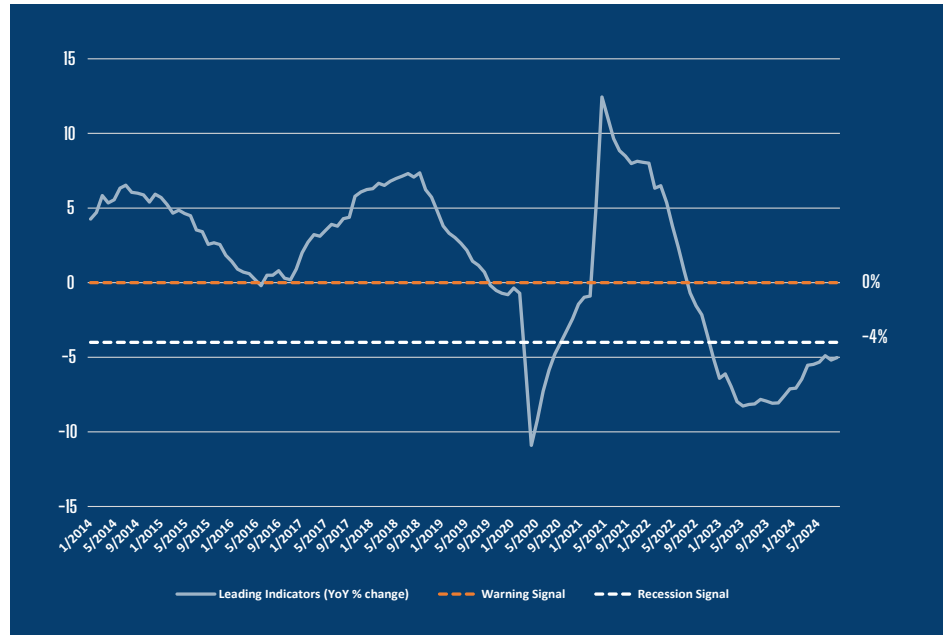


Leading Indicators

The index of leading indicators has been negative for 29 of the past 30 months, consistent with soft economic growth/recession.

Composite Index of 10 Leading Indicators

% Change Year over Year



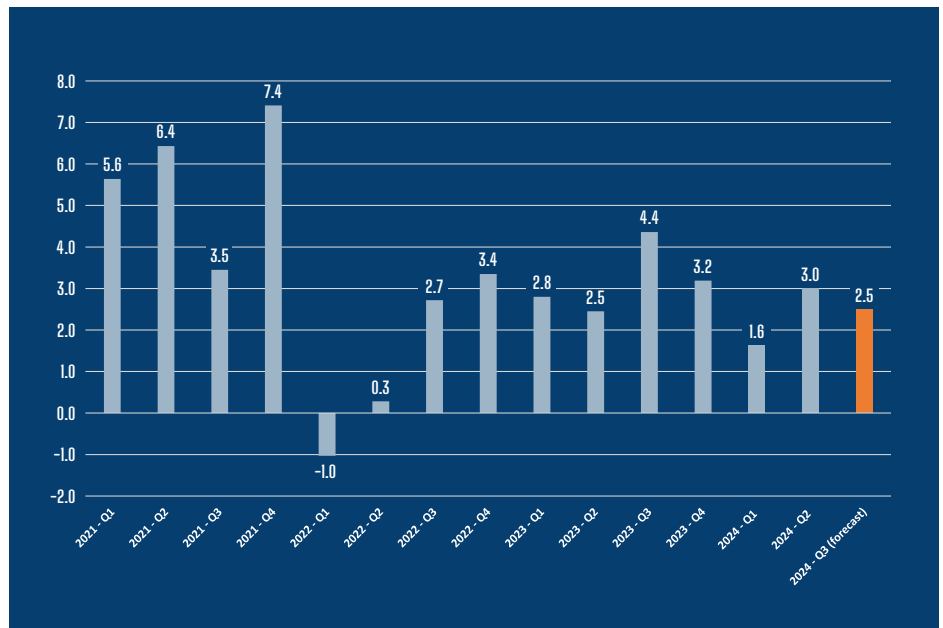
As of September 30, 2024
Source: Haver

Growth

Despite recessionary concerns, the economy continues to grow at a solid pace. The GDPNow forecast from the Atlanta Fed shows 2.5% for GDP for Q3.

Real Gross Domestic Product

% Change - Annual Rate



As of September 30, 2024
Source: Haver, Atlanta Fed



September 30, 2024	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Bloomberg U.S. Treasury Bill 1-3 Month	0.43%	1.36%	4.08%	5.52%	3.57%	2.33%	1.63%
Bloomberg Municipal	0.99%	2.71%	2.30%	10.37%	0.09%	1.39%	2.52%
Bloomberg US Govt/Credit Intermediate	0.83%	2.96%	4.38%	7.19%	1.50%	1.70%	1.64%
Bloomberg U.S. Aggregate	1.34%	5.20%	4.45%	11.57%	-1.39%	0.33%	1.84%
Bloomberg U.S. High Yield	1.62%	5.28%	8.00%	15.74%	3.10%	4.72%	5.04%
Bloomberg Global Aggregate	1.70%	6.98%	3.60%	11.99%	-3.06%	-0.83%	0.57%
U.S. Equity Indices							
DJ Industrial Average	1.96%	8.72%	13.93%	28.85%	9.97%	11.78%	12.03%
S&P 500	2.14%	5.89%	22.08%	36.35%	11.91%	15.98%	13.38%
NASDAQ Composite (Price)	2.68%	2.57%	21.17%	37.60%	7.98%	17.86%	15.01%
Russell 1000	2.14%	6.08%	21.18%	35.68%	10.83%	15.64%	13.10%
Russell 1000 Growth	2.83%	3.19%	24.55%	42.19%	12.02%	19.74%	16.52%
Russell 1000 Value	1.39%	9.43%	16.68%	27.76%	9.03%	10.69%	9.23%
Russell Mid Cap	2.23%	9.21%	14.63%	29.33%	5.75%	11.30%	10.19%
Russell 2500	1.49%	8.75%	11.30%	26.17%	3.47%	10.43%	9.50%
Russell 2000	0.70%	9.27%	11.17%	26.76%	1.84%	9.39%	8.78%
Russell 2000 Growth	1.33%	8.41%	13.22%	27.66%	-0.35%	8.82%	8.95%
Russell 2000 Value	0.06%	10.15%	9.22%	25.88%	3.77%	9.29%	8.22%
Non-U.S. Equity Indices							
MSCI World	1.87%	6.46%	19.28%	33.03%	9.61%	13.59%	10.65%
MSCI ACWI	2.36%	6.72%	19.08%	32.35%	8.60%	12.72%	9.94%
MSCI ACWI Ex-U.S.	2.74%	8.17%	14.70%	25.96%	4.67%	8.10%	5.72%
MSCI EAFE	0.97%	7.33%	13.50%	25.38%	6.02%	8.72%	6.22%
MSCI EAFE Growth	0.46%	5.72%	12.57%	26.93%	2.25%	8.08%	6.99%
MSCI EAFE Value	1.47%	8.98%	14.52%	24.00%	9.70%	8.97%	5.21%
MSCI Europe	0.40%	6.63%	13.41%	26.00%	7.33%	9.55%	6.22%
MSCI Japan	-0.44%	5.88%	12.71%	21.97%	3.05%	7.54%	6.75%
MSCI AC Asia	5.17%	8.88%	18.31%	26.74%	1.76%	7.08%	6.14%
MSCI EAFE Small Cap	2.62%	10.65%	11.59%	24.08%	0.12%	6.85%	6.63%
MSCI ACWI Ex-U.S. Small Cap	3.06%	9.03%	12.38%	23.84%	1.90%	8.69%	6.51%
MSCI Emerging Markets	6.72%	8.88%	17.24%	26.54%	0.82%	6.15%	4.41%
MSCI EM Asia	8.05%	9.63%	21.94%	30.19%	1.17%	7.60%	6.01%
MSCI China	23.93%	23.64%	29.60%	24.14%	-5.38%	1.00%	3.58%
MSCI EM Eastern Europe	-0.77%	-0.84%	8.24%	39.84%	-35.60%	-19.00%	-7.48%
MSCI EM Latin America	0.14%	3.86%	-12.21%	3.38%	7.78%	2.53%	1.03%
MSCI EM Small Cap	3.71%	5.64%	13.30%	23.55%	5.68%	12.73%	6.27%
MSCI Frontier Markets	0.61%	4.63%	11.15%	15.63%	-2.43%	3.72%	1.37%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	1.55%	3.60%	7.07%	11.63%	3.04%	3.74%	2.98%
Real Assets Indices							
FTSE NAREIT Composite	3.09%	16.51%	13.95%	34.00%	3.19%	4.76%	7.78%
Alerian MLP	-0.29%	0.72%	18.56%	24.46%	25.47%	13.50%	1.82%
Bloomberg Commodity	4.86%	0.68%	5.86%	0.96%	3.66%	7.79%	0.03%
S&P Global Infrastructure	3.82%	13.43%	18.02%	30.93%	9.58%	6.87%	6.32%
Other							
CBOE Market Volatility (VIX)	11.53%	34.49%	34.38%	-4.51%	-10.25%	0.60%	0.25%

Source: Morningstar



The information provided is based on internal and external sources that are considered reliable; however, the accuracy of this information is not guaranteed. This piece is intended to provide accurate information regarding the subject matter discussed. Investing involves risk including the potential loss of principal. No investment strategy, including asset allocation and diversification, can guarantee a profit or protect against loss in periods of declining values. Past performance is no guarantee of future results. Indexes are unmanaged and investors are not able to invest directly into any index. This information does not constitute a solicitation or an offer to buy or sell any security mentioned.

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The return of principal for bond funds and funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. Lower rated bonds are subject to greater fluctuations in value and risk of loss of income and principal than higher rated bonds. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value in your investment.

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