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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **September 5, 2024**

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Last week's S&P 500 Index: +0.2%

Waiting game

Key takeaways

- Investors won't have to wait long for the Fed's decision, which will be released on September 18.
- Friday's August employment report and next week's August CPI inflation report are the two key pieces of the decision-making puzzle.

The Labor Day weekend has come and gone. The kids are back in school. Summer is over. Now what? Well, quite a bit actually. The Federal Reserve (Fed) is about to kick off what is likely to be a series of rate cuts later this month, and the United States will elect a new president on November 5. Mixed in along with those two events are a plethora of important economic reports that will help guide the Fed's monetary decisions this month and at the remaining (post-election) policy meetings in November and December. And don't discount incoming U.S. economic data and its possible influence on voters as we approach election day. As one well-known political pundit noted decades ago, "It's the economy, stupid!" And, as most of us know, there are greatly varying opinions on the current state of the U.S. economy.

Investors won't have to wait long for the Fed's decision, which will be released at the close of this month's monetary policy meeting on September 18. The financial media are spending an inordinate amount of time (our view) trying to drum up interest in whether or not our central bankers will cut 25 or 50 basis points (bps; 100 bps equal 1.00%) at this month's meeting. While we are in the 50 bps camp, we do not think investors should get hung up on the magnitude of this first cut. The more important point to focus on is that the Fed is ready to cut rates, likely by a meaningful amount over the balance of this year and in 2025. To be more precise, we are looking for 100 bps of cuts over the balance of this year and then another 75 bps of cuts next year. That would take the federal funds target rate down close to what we would consider to be the "neutral rate." The neutral rate, theoretically, is the interest-rate level that neither stimulates nor creates headwinds for the economy.

Our recent portfolio adjustments have been in anticipation of the onset of the Fed's rate-cutting cycle, which we believe will lead to an improved economy as we move through next year. Specifically, after a robust rally in bonds and a correction in stocks, we reallocated from short-term fixed income into large-cap equities. In addition, a portion of the reallocation went toward bringing our small-cap domestic equity weighting up to a neutral (in line with strategic long-term allocations) after nearly two years of being underweight. While we are sticking with our quality preference for now, small caps are typically beneficiaries of a rate-cutting cycle. We also moved some long-term fixed income into intermediate-term (roughly three- to seven-year maturity) fixed-income securities, partially as a hedge against potential fluctuations in bond prices.

This Friday's August employment report and next week's August Consumer Price Index (CPI) inflation report are two pieces of the decision-making puzzle the Fed and markets will analyze for not only rate-cut implications but also insight into which candidate might benefit come the November election.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates.

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