COMMENTARY

The biggest financial headline of the third quarter was the much anticipated reduction of the Federal Funds Rate by the Federal Reserve. The Fed went with a 50 basis point cut, which was on the higher end of estimates, bringing the rate to 4.75% - 5.0%. Cutting 50 basis points rather than 25 is a boon to the highly interest rate sensitive real estate market and financial institutions who lent in excess of $2.5 trillion at low interest rates just a few years ago. The Fed is also attempting to slow the growth of US Treasury interest expense which is approximately $1.1 trillion annually. Interest expense accounts for approximately 16% of US Treasury expenses compared to 6% at the beginning of 2021. The longer-term U.S. Fed moves will be sequential based on multiple factors including the state of the economy and the inflation versus jobs outlook.

Inflation as measured by the consumer price index fell to 2.5% nearing the Federal Reserve’s target of 2%. Unemployment rose slightly over the quarter only to return to where it began at 4.1%. A stunning statistic which is inflating financial asset prices is the growth of the money supply or M2. Pre-covid M2 was approximately $15 trillion and is now above $21 trillion. In addition, the yield curve (interest rate versus time) has flattened and the level of interest rates is lower by 1.1% on the two year treasury note, and approximately 0.4%-0.5% lower on the 10, 20, and 30 year treasuries since the end of 2023.

The all-important corporate earnings have not disappointed. The S&P500 earnings growth is the highest in 3 years at 11.4% with about 80% of the companies beating their earnings estimates. Although we have seen a rotation away from big Tech into other sectors (e.g., health care, consumer staples) in third quarter equity returns, technology companies remain a market leader. Of the 10 largest companies in the S&P 500, 8 are technology mega-capitalization companies.

The European Central Bank lowered rates from 4.25% to 3.65% - a major rationale is that Germany, the bedrock of Europe, is currently growing less than 1% and there are indications of rapid economic decline across Europe. The Bank of England cut rates from 5.25% to 5.0% during the third quarter as well. The Bank of Japan bucked the trend by actually raising rates modestly to 0.25%.
Finally, the fourth quarter of 2024 will be highly influenced (behaviorally not fundamentally) by the U.S. Presidential election coupled with the prospect of a balance between the executive and legislative branches of government. The growing national debt ($35 trillion) which neither political party is addressing, the serious growing geopolitical instability across the world, and the elevated stock valuations based on lower interest rates and the dramatic increase in the money supply inflating financial assets are areas of concern to monitor.