ACKERMAN
CAPITAL MANAGEMENT

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ACM QUARTERLY MARKET COMMENTARY – THIRD QUARTER 2024

Capital Markets

The third quarter was good to investors, as stocks added to their strong gains from the first half of the year, and bonds posted one of their best quarters in recent decades. Importantly, the Federal Reserve also reduced the target Fed Funds rate by 50 basis points in September, its first rate cut since the 2020 pandemic. This move bodes well for the capital markets as it confirms the Fed's belief that inflation is back under control while increasing the odds of avoiding a recession in 2025.

Global stocks were volatile in the third quarter, with an 8% correction in mid-July and a 4% correction in the first week of September. Despite this downside volatility, global stocks still posted a solid quarterly gain of 6.4%, bringing the year-to-date return to an impressive 18.6%, its best January to September performance since 2009. Notably, the third quarter advance was very healthy in terms of its breadth, which was a critical development after the disturbingly narrow gains in the second quarter that were concentrated in a handful of large U.S. growth stocks. Value, small-cap, international, and emerging market stocks all posted robust gains, outperforming large U.S. growth stocks in the most recent quarter.

Bonds also enjoyed a strong quarter, as U.S. Aggregate Bonds returned 5.3%, putting it back to positive on the year with a 4.5% gain. To put this quarter in some context, the more than 5% return for Aggregate Bonds represents its third-best quarter over the past thirty years. Municipal bonds were less stunning, but still returned 2.7% in the quarter, bringing the year-to-date return to 2.2%. Long-term bonds were the top performer in the quarter, unsurprising given the decline in interest rates, but emerging market bonds were also notably strong.

Inflation-sensitive assets were mixed during the quarter. The Bloomberg Commodities Index was flat, but gold, our only remaining holding in this asset category, was up 13% in the quarter, bringing its year-to-date return to 27.3%. REITs also had a good quarter after a difficult first half of the year, while Energy Stocks were down, after a better start to their year. Finally, our modest exposure to alternative and absolute return strategies in tax-advantaged portfolios is up on the year, led by a more than 9% return in a multi-strategy fund and a more than 5% return in a merger arbitrage fund, partially offset by a 4% loss in a managed futures fund.

The Economy

The U.S. economy remains fundamentally strong. The weight of the evidence suggests that

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policymakers have managed to rein in inflation by aggressively raising interest rates without pushing the economy into recession. Final second quarter real GDP growth was 3.0%, a slight improvement over the initial estimate of 2.8% and well above the initial 2.0% forecast. The CPI continues to fall, with September at 2.4%, its lowest reading since February 2021. Meanwhile, the PCE Price Index fell to 2.6% in July, its lowest reading in years, but has ticked up slightly in the past two months. The improvement in these inflation readings gave the Fed confidence to make a larger-than-expected 50 basis point rate cut in September. This represents the first rate cut since the Fed began raising interest rates in the spring of 2022, and should lead to additional rate cuts in the months ahead to support continued economic expansion. Globally, growth slowed after a strong first half of the year. Even so, the Global Purchasing Manager Index remains well above levels that would indicate any recession risks. In addition, growth will benefit from the fact that more than 70% of the world's central banks are now easing interest rates, including China, which recently announced its most aggressive stimulus package since the pandemic.

Portfolio Management

In tax-managed accounts, we stayed the course in the third quarter. We remain modestly overweight stocks with an emphasis on Large U.S. Growth stocks. However, in our tax-advantaged accounts, we made several adjustments in September. In those accounts, we took some profits in equities, given the overly bullish investor sentiment heading into a seasonally weak part of the year. In addition, we reduced our emphasis on Large U.S. Growth Stocks in these accounts, given the improving relative performance from value and low volatility stocks, where valuations and long-term expected returns are better. Also, given narrow credit spreads and a slowing economy, we swapped our Long-Term Government/Corporate exposure for Long-Term Treasuries only on the fixed income side of these accounts. Finally, our international bond exposure is longer USD-hedged in anticipation of a weaker dollar over the next year or so as the Fed continues to cut interest rates.

Looking Forward

The market developments in the third quarter are very encouraging, given the improved breadth of the stock market and the strong bond performance. Three historical analogs were triggered that solidly point to above-average returns for balanced portfolios over the next year. First, September marked the fifth consecutive month in which global stock prices were up. This feat alone is a bullish sign. Using the S&P 500 as an example, from 1950 to 2023, it recorded a five-month winning streak just 27 times, and the S&P 500 was higher one year later in all but one instance with an average gain of 13%. Secondly, the breadth improvement in the third quarter helped the equal-weighted S&P 500 make a new high, after failing to do so since the first quarter. As a result of this price strength, this index's one-year rate of change also rose above 25%. Since

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1960, reaching this level of price momentum in a recovery from a prior 15% twelve-month loss (October 2022) has occurred only 11 times. In every instance, the index was higher one year later, with a median gain of more than 15%. This record bodes well for the broader market, especially value and small-cap stocks. Finally, we were curious what such a strong quarter for bonds might portend for the capital markets going forward. Going back to 1990, we identified all three-month periods (not just calendar quarters) with a gain of 5% or more for Aggregate Bonds and found sixteen instances with an encouraging message. The S&P 500 was higher one year later after all but one of these signals with a gain of 18.6%, and the bond market was higher one year later in every case with a return of 9.1%. Both of these returns represent about a 175% improvement over their average annualized returns over that entire period.

Despite these positive historical analogs, our self-aware, contrarian mindset does make us a little nervous in the short-term. As great as the past twelve months have been, simply put, investing in the public markets is not meant to be this profitable and peaceful. In fact, going back to 2008, the current one-year profitability to volatility ratio of a 60/40 balanced portfolio is about as good as it gets, meaning returns have been excellent with relatively low volatility. "Mr. Market" has a way of poking investors in the eye at times like this, just when everyone is starting to feel really good about their investment portfolios. The only comparable times over the past fifteen years occurred at the end of 2017 and 2019. In the first instance, the next quarter was difficult, with weak bond returns, a 10% stock market correction, and a massive spike in implied volatility. The second instance was, of course, followed by the pandemic and a four-week market panic unlike any before. The 2017/2018 instance is the better historical analog, and in that case, balanced account losses in the first quarter of 2018 never exceeded 5%, and by the end of the third quarter, they had recovered to a 10% year-to-date gain (only to be wiped out and then some in a terrible fourth quarter.) So, while we are optimistic about the prospects for stocks and bonds over the next twelve months, it is unlikely be as smooth of a ride as we have enjoyed lately.

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