Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK
Insights from Multi-Asset Solutions' Portfolio Managers

Quarter ending
SEPTEMBER | 2024

On the Radar Screen

1. **Labor markets are a critical gauge of the health of the economy.** As always, we monitor new unemployment insurance claims for sign of deterioration. We are currently quite some distance from a worrisome level.
2. **Inflation appears largely vanquished for now, but that could change.** Looser monetary policy, higher personal incomes and government spending could potentially induce a second wave.
3. **China rolled out powerful policy support programs late in the quarter.** Watch to see the impact in China itself, knock-on effects to the global economy, and whether or not officials are willing to introduce additional measures if the anticipated expansion fails to materialize or property prices continue to slide.
4. **Rapid improvements in AI technology** have fueled the stellar performance of several technology companies, making them a critical pillar for the broader market. Earnings expectations are ambitious. We eagerly await release of 3Q results to see if they can satisfy those lofty expectations and keep the party going!

"The best kept secret in the investing world: Almost nothing turns out as expected." – Harry Browne

It's go time! In a startling turn of events, financial markets have been jolted by a series of significant policy moves that in combination are likely to reshape the global economic landscape for months to come. The Federal Open Market Committee (FOMC) opened the barrage, catching investors off-guard with a more aggressive-than-anticipated 0.5% reduction in the federal funds rate in what promises to be a prolonged rate-cut campaign. In his press conference, Federal Reserve Chair Powell reaffirmed its conviction that inflation is returning to target and testified to its desire to relax policy settings before meaningful deterioration in labor markets sets in. This bold move was followed shortly thereafter by a pair of what can only be described as "shock-and-awe" monetary and fiscal policy actions from the Chinese government in its effort to escape the malaise that has plagued the Chinese economy of late.

These developments, coming in rapid succession, are poised to inject a significant boost into global growth prospects. The unexpectedly aggressive easing of monetary policy in the world's largest economy, coupled with equally ambitious measures from the second-largest, create a potent cocktail. We anticipate this one-two punch will reverberate through global markets, potentially catalyzing increased business investment, consumer spending and overall economic activity.

However, as is ever the case, incoming data are mixed. While these actions absolutely provide cause for optimism, there is also reason to temper our enthusiasm with a measure of caution. Several key risks are present that warrant our attention:

- Despite the recent cut, interest rates remain in restrictive territory, continuing to exert pressure on borrowing costs for businesses and consumers alike. It will be a year or more before we find ourselves in a truly neutral policy environment.

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- Senior loan officers within the banking sector continue to exhibit some reluctance in their willingness to lend to either consumers or businesses, constricting credit growth and potentially impeding the transmission of monetary policy to the real economy.

- Certain indicators of labor market health are showing signs of weakness (quits rate, payroll growth, hiring of temporary workers), suggesting that the impact of higher rates is taking a toll—rate cuts may be coming too late to save many jobs.

Furthermore, current market valuations give us pause. Elevated price-to-earnings ratios in the stock market and tight credit spreads in the bond market suggest that much of the good news may already be priced in. These rich valuations are likely to act as a ceiling, limiting potential upside from here.

All that being said, we see no immediate catalyst on the horizon that would trigger a significant market correction or reset. The absence of clear downside risks, combined with newfound policy support, create a backdrop that is conducive to steady, if unspectacular, gains.

"A statistical regularity is what I'd call it." – Jerome Powell, FOMC Chair. The Sahm rule, developed by economist Claudia Sahm, is a recession indicator that triggers when the three-month moving average of the national unemployment rate rises by 0.5 percentage points or more relative to its lowest point in the previous 12 months. This rule has historically been an exceptionally reliable predictor of recessions in the United States.

That threshold was recently violated, hoisting a large red flag, but its importance at present has been dismissed by many observers including its creator, Ms. Sahm, herself. Chair Powell likewise questioned its applicability. Why? Some of the more persuasive arguments against its relevance today include:

1. Immigration. The observed rise in the unemployment rate is at least partly a result of an expansion in the pool of available labor rather than current jobholders losing their employment, as is more typically the case.

2. Changing labor market dynamics. The rise of gig economy work, remote work and shifting employment preferences post-pandemic may affect unemployment measurements in ways not accounted for by the rule.

3. Unprecedented pandemic effects. The COVID-19 pandemic caused extreme and rapid changes in employment that don't follow typical economic patterns, potentially skewing the rule's effectiveness.

Economics is a soft science in which rules are not always binding, unlike physical sciences. Their significance is nuanced, and this is an instance in which healthy skepticism is merited. The Sahm rule notwithstanding, the labor market still appears quite healthy to us.

"I'd rather be an optimist and a fool than a pessimist and right." – Albert Einstein. We're fond of saying that nothing in this business is certain, and too often we are reminded of just how true that is—we've earned our fair share of humility over the years. But while it is something of a tautology to say than nothing is certain, there are absolutely tendencies that generally prove true over time—statistical regularities, to borrow from the quote above. An obvious such tendency is for stocks to rise more often than not, or so 250+ years of U.S. history has taught us. Foolish optimism has had an uncanny way of paying off for patient investors over time. In contrast, the cards are stacked against the pessimist—being right is both essential and very difficult. We keep this truism front of mind in the management of the portfolios for which we are responsible. Our default position is to lean into stocks slightly when there is relatively little clarity as to where things are headed (our current stance). In periods during which we have a firm belief that conditions are favorable, we tilt more aggressively into stocks, going meaningfully overweight. And when we find conditions to be more concerning, we are likely to pull exposure back into alignment with our benchmark or possibly even go mildly underweight, but we are very resistant to the idea of making a bold move in that direction. There is definitely an asymmetry to our active positioning favoring "risk-on" over "risk-off" as it pertains to equities. The same is true for credit exposure within a fixed-income portfolio.

Being too aggressive can come at a cost, but so too can being too conservative, and with greater frequency. Investors would be wise to heed the admonition of legendary investor Peter Lynch: "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." Optimism pays.

About Risk

All investments are subject to market risk, including possible loss of principal.
Stocks and bonds can decline due to adverse issuer, market, regulatory, or economic developments. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. A bond's prices are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise.

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