Q3 2024 Investment Update and Outlook

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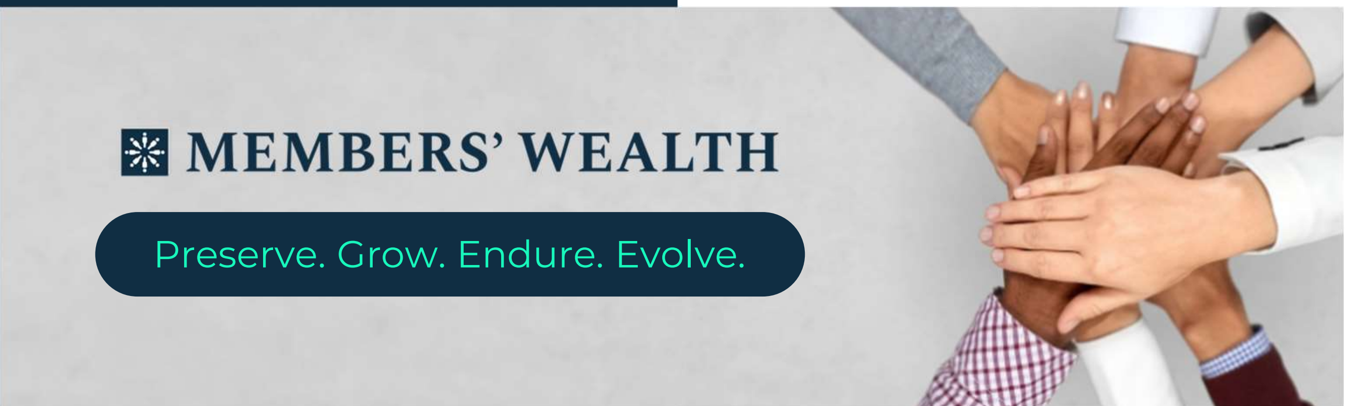


Step aside Fed, Time for the US Consumer Bailout

As we head into the final quarter of 2024, the economic landscape remains dynamic, shaped by a combination of factors that continue to impact global markets. The stock market has reached all-time highs, reflecting both investor optimism and resilience despite ongoing geopolitical tensions, including the war in the Middle East, and uncertainties surrounding the upcoming U.S. presidential election. At the same time, the Federal Reserve's decision to cut interest rates for the first time in years marks a pivotal shift in monetary policy, aimed at addressing slowing economic growth and inflation concerns. As always, navigating this complex environment requires a thoughtful and balanced approach to both risk and opportunity. See Table 1 for returns through the end of the third quarter.

Table 1 - YTD Thru 9.30.2024 Results

Symbol	Name	QTD	YTD	1 Yr	3 Yr (ann)	5 Yr Ann	10 Yr Ann
^SPX	S&P 500	5.89%	22.08%	36.35%	11.91%	15.98%	13.38%
^RUTTR	Russell 2000 Total Return	9.27%	11.17%	26.76%	1.84%	9.39%	8.78%
^DJUSRET	Dow Jones US Real Estate Index Total Return	17.08%	13.71%	34.17%	3.05%	4.85%	7.74%
^BCTR	Bloomberg Commodity Index Total Return	0.68%	5.86%	0.96%	3.66%	7.79%	0.03%
^BBUSATR	Bloomberg US Aggregate	5.20%	4.45%	11.57%	-1.39%	0.33%	1.84%
^BBMBTR	Bloomberg Municipal Bond	2.71%	2.30%	10.37%	0.09%	1.39%	2.52%
JNK	SPDR Blmbg High Yield Bd ETF	5.48%	7.94%	15.67%	2.37%	3.58%	3.69%
IEMG	iShares Core MSCI Emerging Markets ETF	7.25%	14.60%	24.24%	0.48%	6.11%	4.05%
IEFA	iShares Core MSCI EAFE ETF	7.45%	12.93%	25.20%	4.99%	8.12%	5.97%

Collectively, How are we faring?

In the US, consumer spending drives approximately 70% of the American economy, making it a crucial factor in the nation's economic growth and stability. Thus, the health of the consumer is paramount. Where does the consumer stand? Figure 1 – Health of the Consumer[i] shows household debt service ratio and balance sheets look good. However, the bottom right-hand portion of the chart shows a pickup in delinquency in auto and credit loans which is worth watching.

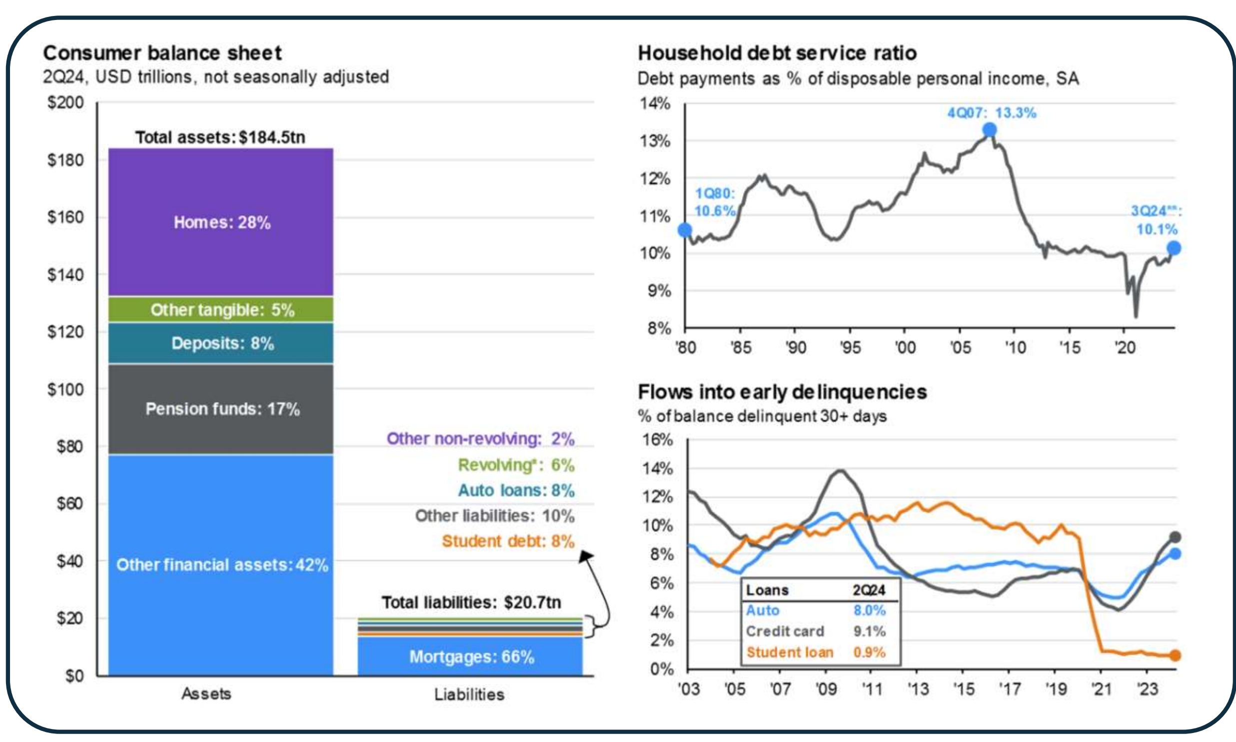


Figure 1 Health of the Consumer

Another way to assess the consumer is through the consumer sentiment index, which measures the overall confidence and economic outlook of consumers, based on their views of current and future financial conditions. Figure 2 – Consumer Sentiment Index[ii] shows the index below average which historically portends positive future 12 month returns for the S&P 500.

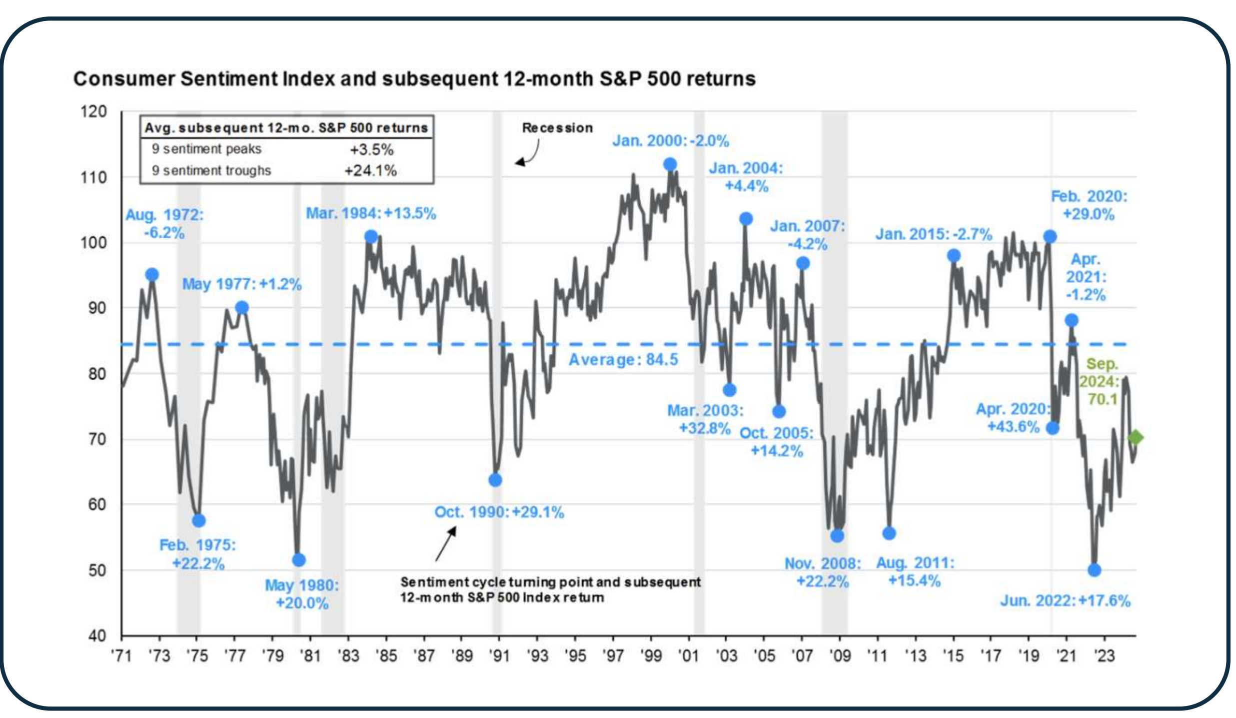
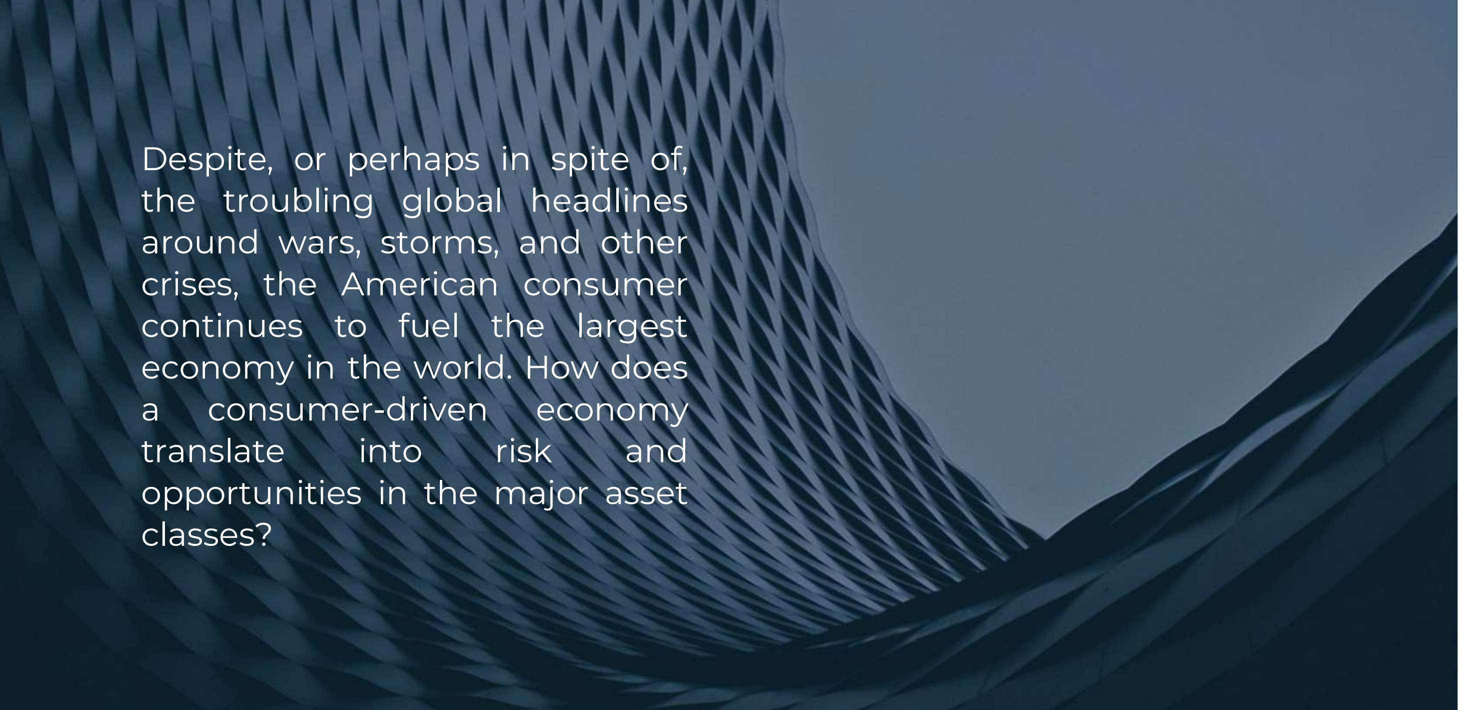


Figure 2 - Consumer Sentiment Index



Despite, or perhaps in spite of, the troubling global headlines around wars, storms, and other crises, the American consumer continues to fuel the largest economy in the world. How does a consumer-driven economy translate into risk and opportunities in the major asset classes?

Asset Class Risk and Opportunities

Cash and Short-Term Bonds

Following the Fed's decision to cut rates for the first time in years, we've seen a notable impact on cash yields, particularly in money markets, CDs, and short-term bonds. While yields have come down from their recent peaks, they remain attractive, providing a compelling option for conservative investors seeking liquidity and stability in an uncertain environment. The Fed's move signals a shift in policy aimed at supporting the economy amid slowing growth, and while lower rates typically reduce yields on cash instruments, they continue to offer competitive returns compared to historical norms. However, the risk in cash and short-term bonds lies in the possibility of further rate cuts, which could compress yields further, eroding the income potential from these traditionally safer vehicles. As we navigate this post-rate-cut environment, it's important to balance cash allocations with broader market opportunities to manage potential downside risks while maintaining liquidity. Figure 3 – Investment Opportunities outside of CDs[iii] demonstrates how CDs fared relative to other major asset classes in previous rate cut cycles signaling to investors to not get too comfortable with cash, money markets and CDs.

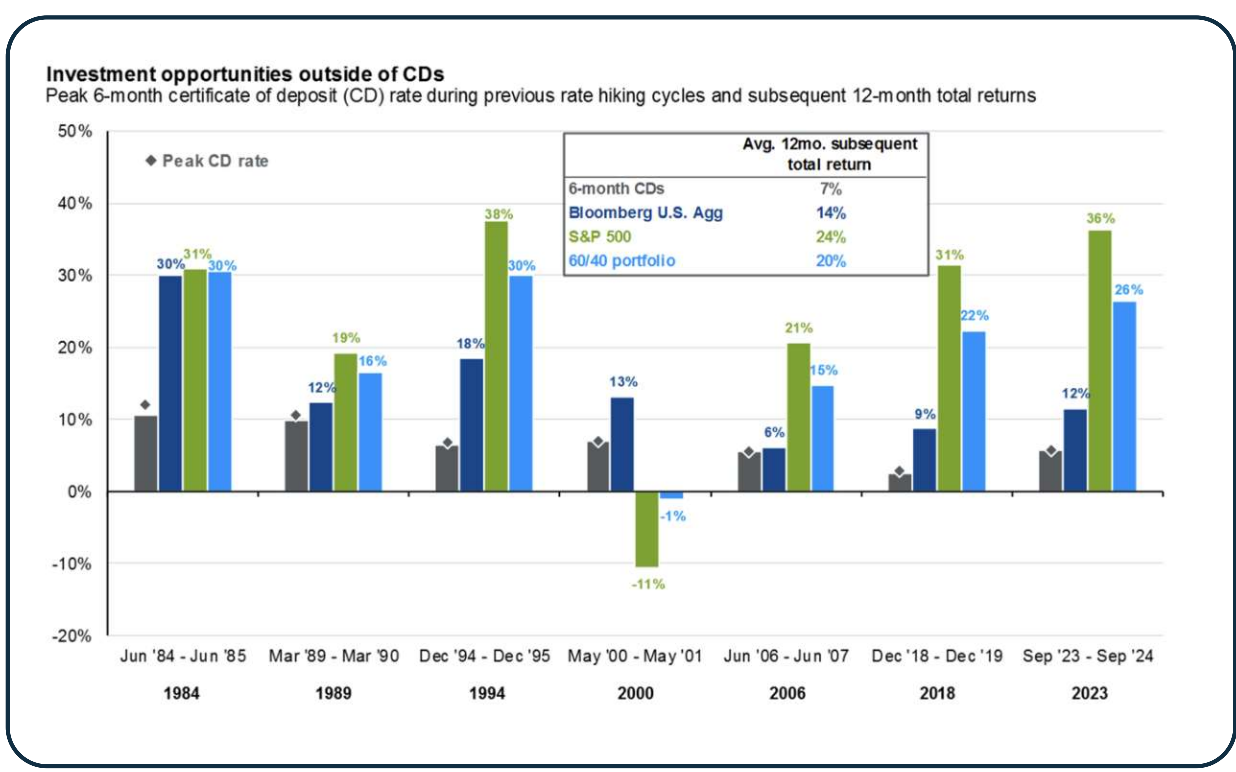


Figure 3 - Investment Opportunities outside of CDs

Bonds

The intermediate bond market has faced mixed signals as the Fed's rate cut created ripples along the yield curve. (Figure 4 – U.S. Treasury Yield Curve[iv])

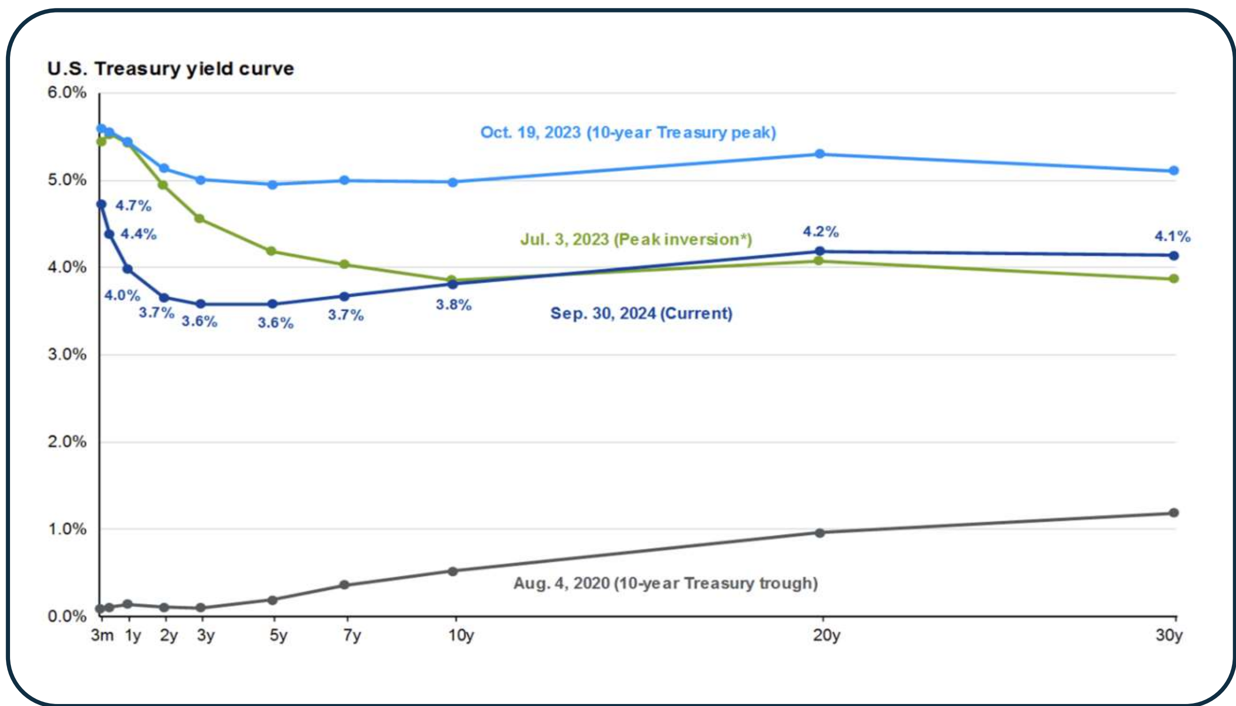


Figure 4 U.S. Treasury Yield Curve

While short-term rates have declined in response to the Fed's actions, the longer end of the curve has seen more muted movement, reflecting ongoing uncertainty in both inflation expectations and economic growth prospects. The yield curve remains relatively flat, signaling caution among investors about the future trajectory of rates and the economy. Extending duration in this environment poses a unique risk: if rates continue to rise unexpectedly due to inflation or other shocks, bond prices could fall, leading to potential losses for those holding longer-term bonds.

However, the risk of not extending duration is equally significant—if rates continue to drop, as the Fed signals further cuts or economic conditions worsen, those holding shorter-term bonds may miss out on the price appreciation and higher yields that come with locking in longer-term rates. Striking the right balance between capturing yield and managing interest rate risk will be critical for investors navigating these shifting conditions.

Looking at Figure 5 Duration and yield of the Bloomberg U.S. Aggregate[v] shows a huge gap that widened since the 2008 financial crisis. Yield had historically been higher than duration. Since 2008, that has not be the case. What this means to us is that we are no longer getting paid a strong enough yield for taking duration risk. So rather than speculating on rate movements, we have a strong preference in client portfolios to laddered bond portfolios and short duration high yield bonds to adjust client bond portfolios back to a yield-to-duration ratio that is more attractive than just holding the Aggregate Bond Index. We fully understand this is some daunting technical jargon but wanted to point it out to spark conversation at your next client meeting.

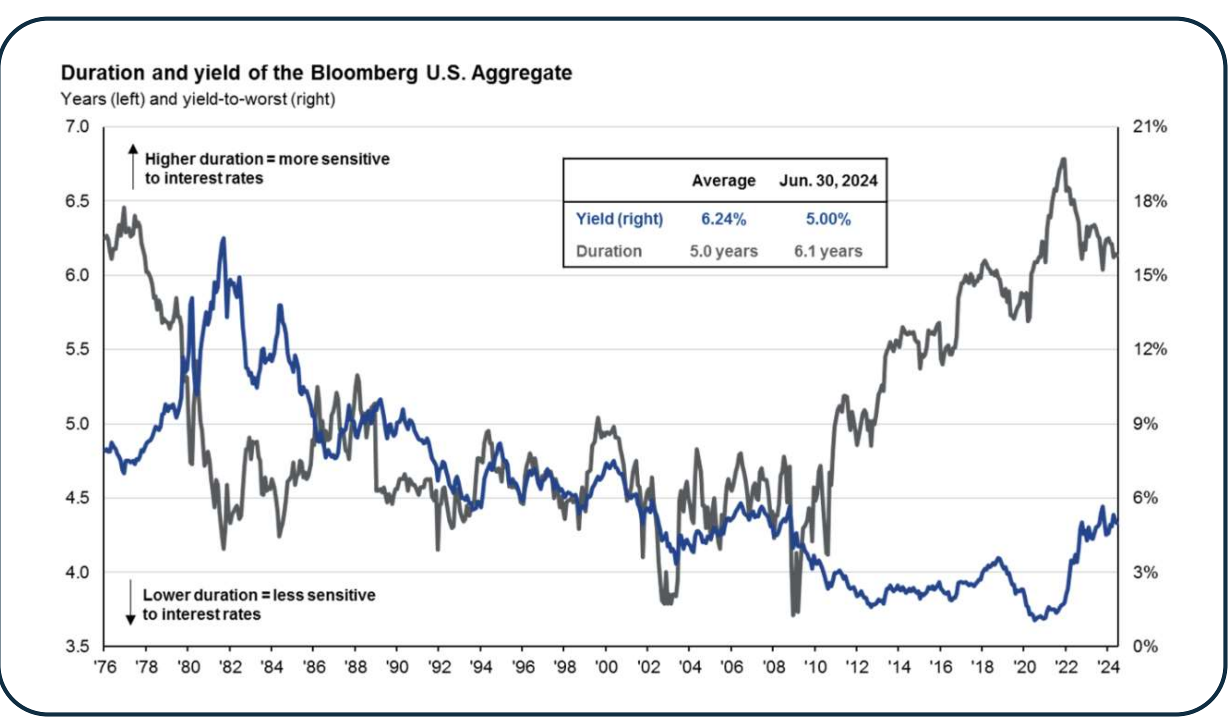


Figure 5 - Duration and yield of the Bloomberg U.S. Aggregate

Now as to where rates go from here, we guess that is anyone's guess! Seems the FOMC points lower for Fed Funds rate (Figure 6 – Federal funds rate expectations[vi]) (think cash and CDs and short-term Treasuries for investors). Which just has us reiterate, do not get to comfortable in cash and money markets.

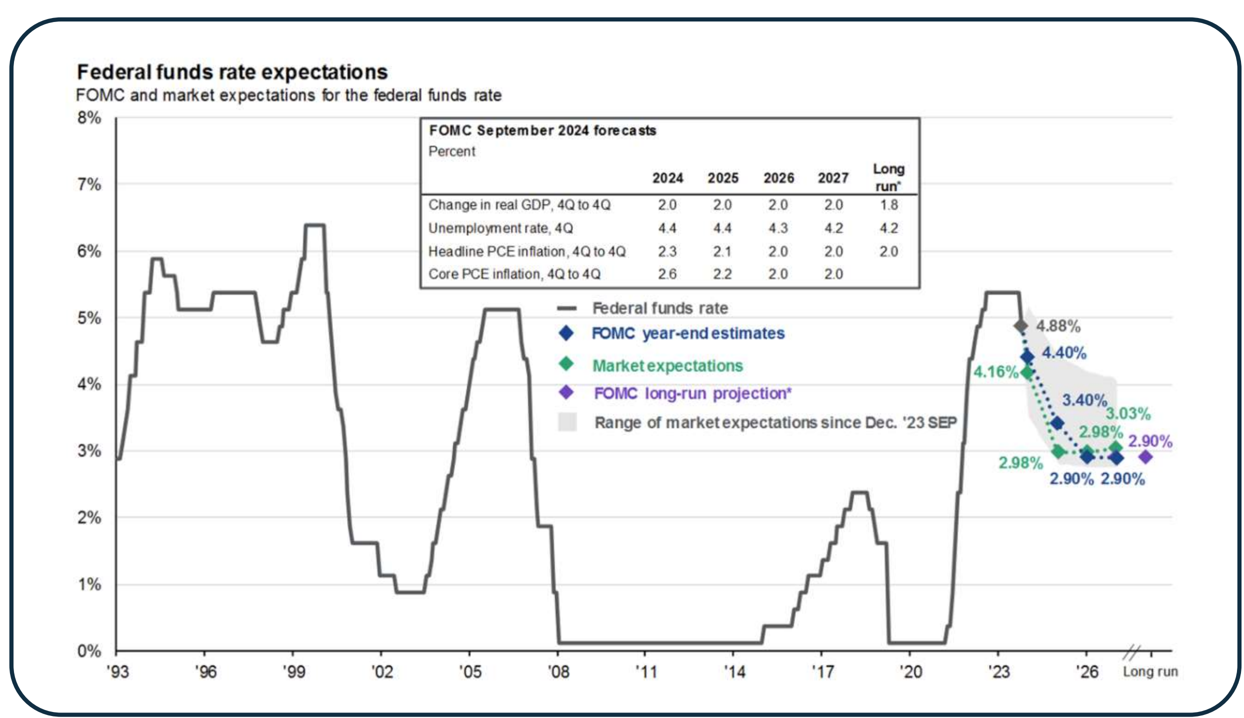


Figure 6 - Federal funds rate expectations

High Yield Bonds

High-yield bonds, which carry more risk due to lower credit quality, have shown resilience this quarter despite the Fed's rate cut. Credit spreads (Figure 7 – Corporate Bond Spreads[vii]), which measure the difference between high-yield bonds and safer government bonds, initially tightened following the Fed's action, reflecting a temporary boost in investor confidence. However, they remain sensitive to broader market uncertainties, including geopolitical tensions and slower economic growth.

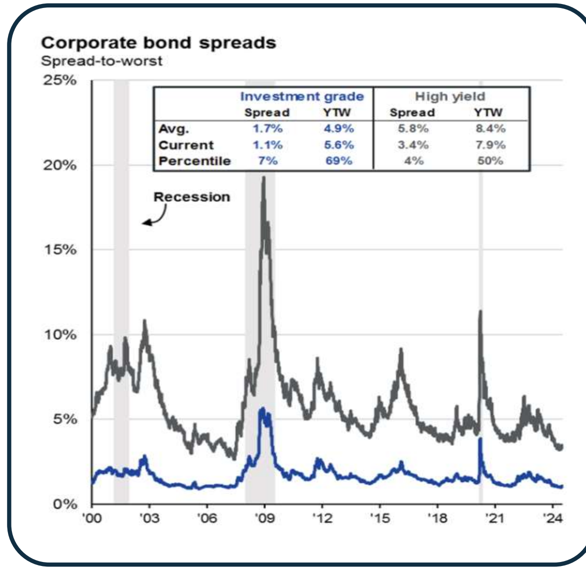


Figure 7 - Corporate Bond Spreads

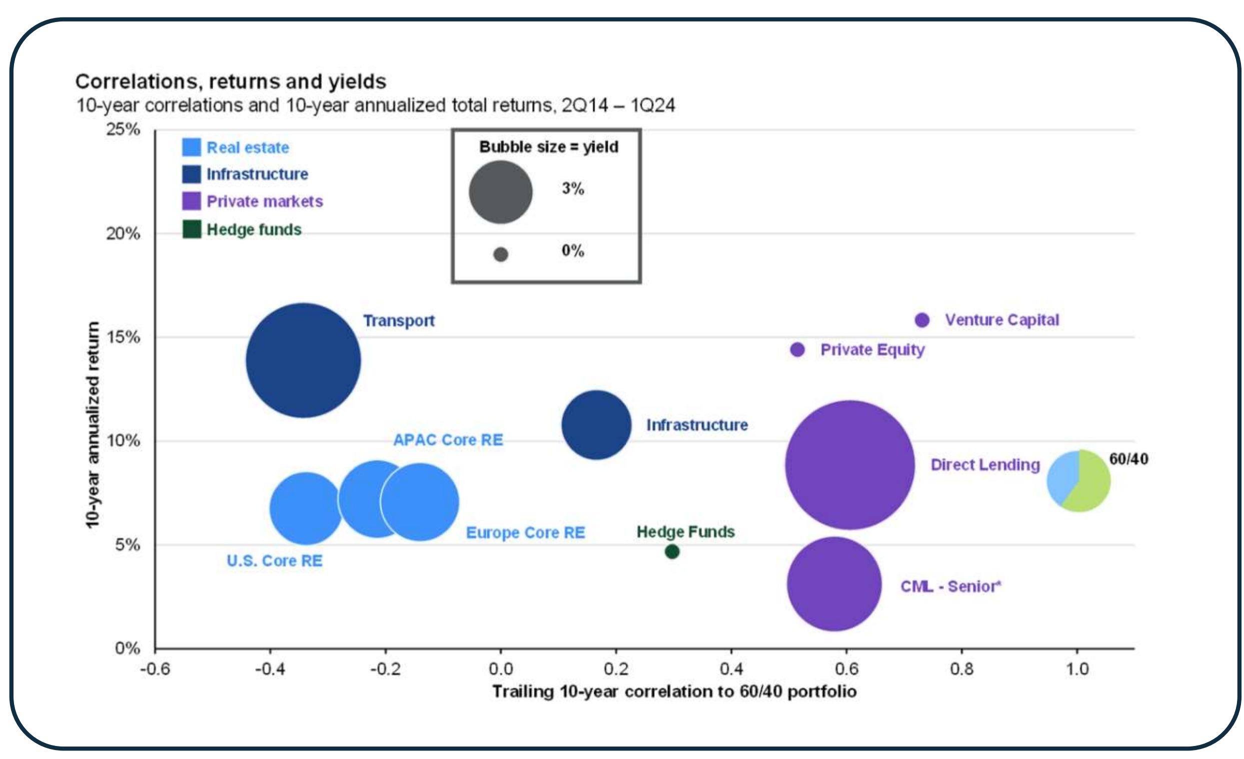
While the Fed's lower rates create a more favorable borrowing environment, they can also mask underlying risks in the high-yield space. Companies with weaker balance sheets may be more vulnerable in a volatile economy, and if credit conditions deteriorate, we could see spreads widen again, leading to potential price declines.

Given these factors, we are more cautious than usual when approaching high-yield bonds in this environment. There may be selective opportunities for those willing to take on additional risk, particularly in sectors or issuers with strong fundamentals. However, the broader risk of credit defaults or further spread widening makes it essential to approach high-yield investments with a clear understanding of both the upside and the potential volatility.

Alternatives[viii]

At Members' Wealth, when we discuss alternatives, we refer to investments beyond the traditional scope of stocks, bonds, and cash—assets that offer diversification and potentially uncorrelated returns in uncertain times. Figure 8 – Correlations, returns and yields[ix] examines the correlations and returns of real estate, infrastructure, private markets, hedge funds, and other strategies relative to the more traditional 60/40 stock and bond portfolio. Generally, from a diversification perspective, it is good to look for assets that offer low to negative correlation relative to your current portfolio while also offering positive return expectations. However, it's important to recognize the inherent risks when considering these assets. At Members' Wealth, where appropriate, we may incorporate alternatives into a balanced, diversified strategy aimed at protecting against the unexpected while enhancing long-term returns. Like many investments, alternatives are not for everyone. Speak with your advisor at the next quarterly meeting if you would like to learn more.

Figure 8 - Correlations, returns and yields



Equity

The stock market, particularly large-cap equities like the S&P 500, has reached new highs this quarter, largely driven by strong corporate earnings, resilient consumer demand, and an optimistic outlook on future interest rate cuts. Large-cap stocks have outperformed smaller counterparts, reflecting investor preference for established, stable companies in a period of heightened uncertainty. Meanwhile, small-cap stocks have struggled, primarily due to their sensitivity to rising borrowing costs and slower economic growth. These companies tend to be more reliant on credit, and the recent rate cut, while offering some relief, has not yet translated into strong performance. However, small-cap stocks could see upside potential if rates continue to drop and economic conditions stabilize, offering a more attractive risk-reward balance moving forward.

So, the Fed cut rates, so now what? This might be our most popular question these last few weeks. Figure 9 - So, the Fed cut rates, so now what shows in the left chart the build up to the first cut is generally weak for the equity markets, while the next 12-24 months is a mixed bag with notable tough years in 2001 and 2007. However, the right chart reminds us that long-term investors have been fine with positive returns in all periods. We are not sure we can make much of the left chart for portfolio positioning in the short run. So, we are being mindful of too much exposure to equity for investors that are more sensitive to short term fluctuations.

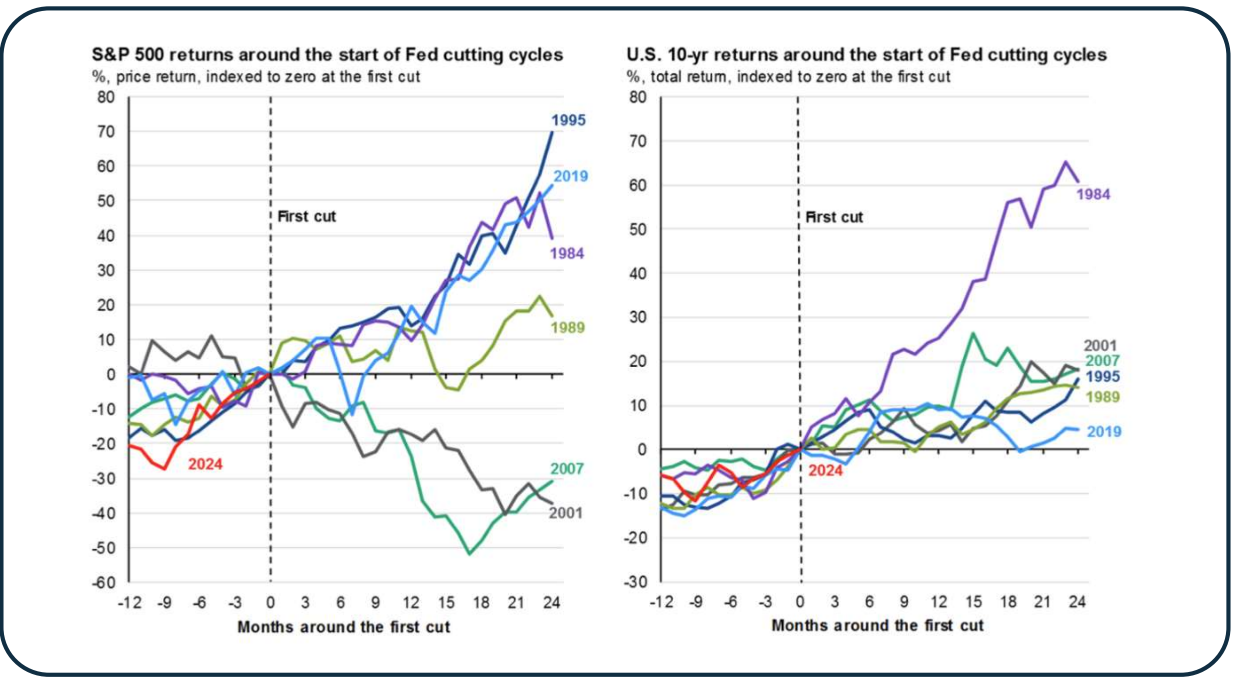


Figure 8 - Correlations, returns and yields

The second most popular question is about the stock market continuing to hit all-time highs and whether it can keep going up. The answer is yes. It can keep going up. Not that it has to in the short term but Figure 10 – Average cumulative S&P 500 total returns when investing at a new high[xi] shows that outside of the 3-month period, new highs beget new highs, on average, in periods 6 months or longer. Again, this is an average and not all the time. But investors should be aware that what goes up can keep going up. So be careful of market timing.

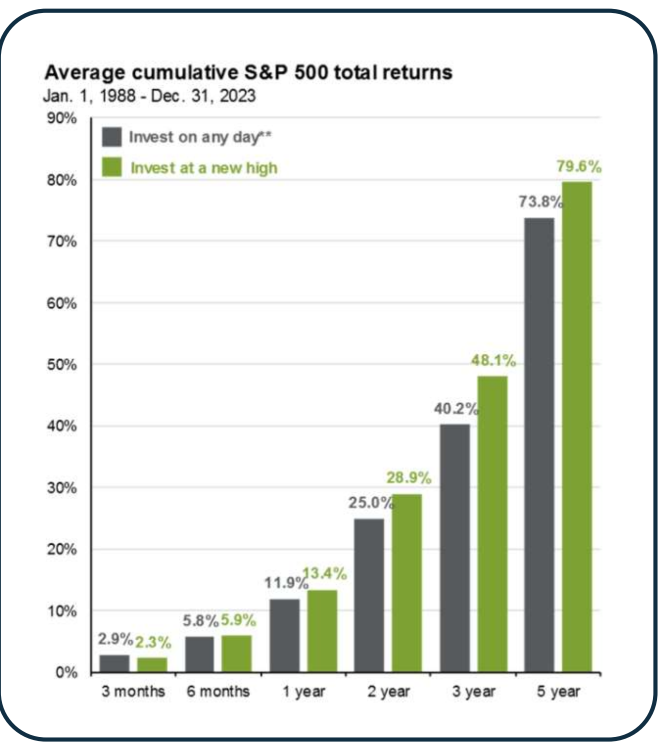


Figure 10 - Average cumulative S&P 500 total returns when investing at a new high

The U.S. stock market continues to take the spotlight, but it's important to highlight the attractive valuations of international stocks. Historically, international stocks have traded at a discount relative to U.S. stocks, but the current price-to-earnings ratio of international stocks is nearly 50% lower than that of U.S. stocks. (Figure 11 – International Stock Price to Earnings Dividend Yields[xii] Additionally, dividend yields on international stocks are more than double those of U.S. stocks. With both yield and valuation advantages in place, increasing exposure to international markets could be a strategic move for the future.

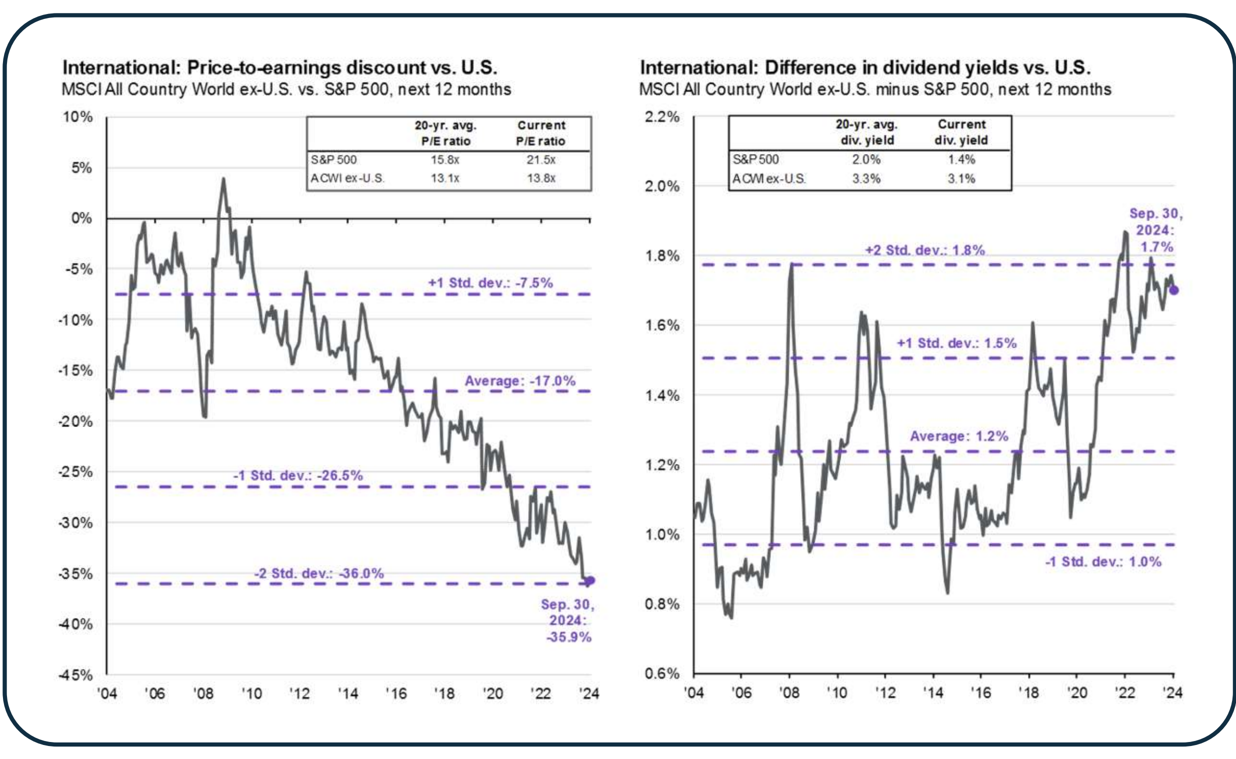


Figure 11 - International Stock Price to Earnings Dividend Yields

Despite the U.S. market's dominance, there’s still a case for holding international equities. Geographic diversification can offer protection against localized risks and provide exposure to regions with different growth dynamics. Emerging markets, while volatile, have the potential for long-term growth. At Members’ Wealth, where appropriate, we recommend risk mitigative thoughtful approach, considering both the strength of U.S. equities and the diversification benefits of international exposure, tailored to each client’s risk tolerance and long-term goals.

Outlook

At Members' Wealth, our outlook for the market remains cautiously optimistic as we head into the final quarter of 2024. While we've seen large positive moves in equities, particularly in large-cap stocks, it's important to stay disciplined. These gains may present opportunities to trim winners and rebalance portfolios, ensuring alignment with long-term objectives and risk tolerance. We are ever mindful of tax considerations, especially with the year-end approaching, and we are taking a case-by-case approach for each portfolio to determine the best strategy moving forward.

In the fourth quarter, we will diligently scour portfolios for tax loss harvesting opportunities, seeking to offset gains where appropriate and position clients for the new year. This approach allows us to manage tax efficiency while maintaining balance in client portfolios, regardless of the outcome of the upcoming presidential election. Any potential market volatility surrounding the election or geopolitical developments will be viewed as an opportunity rather than a threat. We remain focused on our clients' long-term goals and believe that a disciplined approach will allow us to navigate whatever challenges or opportunities arise, ensuring a strong finish to 2024 and a solid foundation for 2025.

Year-End 2024 Tax and Estate Planning Strategies

As we approach the end of 2024, it's an important time to review and fine-tune financial plans with a focus on maximizing tax efficiency and preparing for the future. Year-end planning is a valuable opportunity to optimize portfolios, ensure retirement contributions are on track, and revisit estate plans. At Members' Wealth, we are taking a proactive approach to ensure that each client's plan is tailored to their specific needs and goals. Below are some of the key strategies we are discussing with our clients this quarter:

1. *Tax Loss Harvesting*: With the volatility seen in the market this year, tax loss harvesting is a timely strategy to consider. By selling underperforming assets to realize losses, clients can offset gains from winners in their portfolio, reducing their taxable income. This is an excellent way to manage tax liability without compromising long-term investment objectives.
2. *Maximizing Retirement Contributions*: We encourage all clients to review their retirement account contributions. Maximizing contributions to 401(k)s, IRAs, or Roth IRAs can reduce taxable income while securing tax-deferred or tax-free growth. For high-income earners, we are exploring "backdoor" Roth IRA conversions, which offer a strategic path to benefit from tax-free withdrawals in retirement.
3. *Gifting and Charitable Contributions*: The annual gift tax exclusion allows individuals to gift up to $18,000 per recipient without triggering any gift tax. This is an effective tool for reducing taxable estates, especially for clients with a long-term wealth transfer plan. For those charitably inclined, donating appreciated stock or contributing to a donor-advised fund offers the dual benefit of reducing taxable income while supporting causes that matter most to them.
4. *Roth Conversions*: For clients anticipating higher future tax rates or those experiencing a lower-income year, Roth conversions can be an effective strategy. Converting traditional IRA assets to a Roth IRA at lower tax rates now can provide tax-free growth and withdrawals in the future, making this a valuable tool for both retirement and estate planning. This is especially relevant for those looking to leave assets to heirs.

5. *Reviewing Estate Plans and Trusts*: Given the potential for changes in tax laws, it's essential to review estate plans regularly. Now is the perfect time to ensure trusts are structured optimally to manage wealth transfer and protect assets. We also recommend reviewing beneficiary designations on retirement accounts and insurance policies to ensure alignment with clients' current wishes.

As 2024 draws to a close, these strategies are central to our year-end planning discussions. We remind investors that our approach is personalized and focused on adjusting each client's financial plan for near-term tax efficiency, long-term growth, and wealth preservation. Regardless of future changes—whether in tax laws or economic shifts—being prepared and adjusting now will help preserve and grow wealth, ensuring success in the years to come.

As we navigate the final months of 2024, the economic landscape presents both opportunities and risks. Market highs, fueled by investor optimism, stand against a backdrop of geopolitical tensions and economic uncertainty. The Fed's recent rate cuts highlight the importance of careful planning. At Members' Wealth, we view market volatility as an opportunity and remain committed to helping clients manage risk, rebalance portfolios, and evolve their strategies. By staying disciplined and focusing on enduring long-term goals, we are well-positioned to finish the year strong and lay the foundation for continued success in 2025.

i U.S. 4Q 2024 JP Morgan Guide to the Markets

ii U.S. 4Q 2024 JP Morgan Guide to the Markets

iii U.S. 4Q 2024 JP Morgan Guide to the Markets

iv U.S. 4Q 2024 JP Morgan Guide to the Markets

v U.S. 4Q 2024 JP Morgan Guide to the Markets

vi U.S. 4Q 2024 JP Morgan Guide to the Markets

vii U.S. 4Q 2024 JP Morgan Guide to the Markets

viii Each quarter we like to highlight an alternative strategy or investment or speak to the category as a whole. Part update, part education. What is an alternative? At Members' Wealth, an alternative is something that is not traditional. (Traditional being an investor owning with the expectation of income and/or price appreciation from bonds, stocks, and cash). Alternatives can include but are not limited to Real Estate, Private investments, long/short, market neutral, event-driven, convertible bonds, merger arbitrage, trend-following strategies, managed futures, commodities, and the list goes on.

ix U.S. 4Q 2024 JP Morgan Guide to the Markets

xi U.S. 4Q 2024 JP Morgan Guide to the Markets

xii U.S. 4Q 2024 JP Morgan Guide to the Markets

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The Dow Jones Industrial Average (DJIA) is a stock market index of 30 prominent companies listed on stock exchanges in the United States. The S&P 500 index is designed to be a broad based unmanaged leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe or representative of the equity market in general. The National Association of Securities Dealers Automated Quotations (NASDAQ) is an American stock market that handles electronic securities trading around the world. The Russell 2000 index is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States. The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The Bloomberg US Aggregate Bond Index, is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States.

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