



**Global Strategic**  
**NextGen OCIO**

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# **3Q 2024 COMMENTARY**

**FED EASING CYCLE  
BEGINS, EQUITY  
MARKETS ROTATION,  
INTEREST RATES  
VOLATILE**

# Top 4 Takeaways

## 1. Q3 2024: INVESTORS ROTATE FROM TECH TO VALUE AND NON-U.S. EQUITIES | BONDS RALLY AMID RATE CUT EXPECTATIONS

**Global stocks gained 6.7% and the U.S. Bond market rose 5.2%.** There was a noticeable shift in equity markets from growth/tech stocks toward value-oriented and defensive sectors like real estate, financials, industrials and utilities. This rotation was driven by profit-taking in tech, concerns over high valuations, and expectations of rate cuts. International stocks outperformed the U.S., led by China **+23.6%**. The U.S. dollar weakened by **-4.9%**. The bond market benefited from expectations of Fed monetary easing, softening employment data, Yen carry trade and economic uncertainties.

## 2. FEDERAL RESERVE MONETARY POLICY SHIFT

In July, the Fed held rates steady after prior hikes but remained cautious about future increases due to inflation concerns. By August, as inflation cooled and labor market data softened, speculation grew that the Fed would move towards rate cuts. **In mid-September, the Fed made its first rate cut since 2020, reducing rates by 50 basis points** in response to signs of economic slowdown and easing inflation. The Effective Fed Funds Rate is now 4.83%.

## 3. VALUATIONS

U.S. stock market valuations remain elevated particularly in large-cap and tech sectors as price appreciation has outpaced earnings growth. Per Factset, the S&P 500 forward P/E ratio is 21.6 versus the 5-year average of 19.5 and 10-year of 18.0. Recently, there has been a rotation toward undervalued sectors. Value and small-cap stocks offer more attractive discounts compared to growth stocks. Non-U.S. equity valuations remain at a notable discount compared to U.S. equities despite ongoing challenges and can continue to benefit from a weakening U.S. dollar.

## 4. SEMI-LIQUID PRIVATE MARKETS

Semi-liquid private market investment returns continue to provide strong risk-adjusted returns and diversification to public allocations. All three asset classes produced positive returns, resulting in **+2.7%** for the basket of investments (Returns are lagged, GSIS Model Weights).

# 1. Investors Rotate from Tech to Value and Non-U.S. Equities | Bonds Rally Amid Rate Cut Expectations

3rd Best Start to a Presidential Election Year for U.S. Stocks Since 1928

## STOCKS

Global equities returned **6.6%** in Q3 led by Emerging Markets **+8.7%**, which was fueled by strong returns from China (stimulus) and a weaker U.S. dollar. International Developed Markets also had a strong quarter, gaining **+7.3%**. U.S. equities gained **+5.9%**, led by value stocks **+9.4%**.

## BONDS

The bond market benefited from expectations and realization of monetary easing and economic uncertainties. The Barclays Aggregate Bond Index returned **+5.2%**, led by corporate bonds **+5.8%** and municipal bonds returned **+2.7%**.

## PRIVATE MARKETS (GSIS MODEL WEIGHTS)

Private Equity was the best private markets asset class during the quarter. Private Markets, priced on fundamentals, tend to lag strong public market rallies.

## Market Returns (Period Ending 9/30/2024)

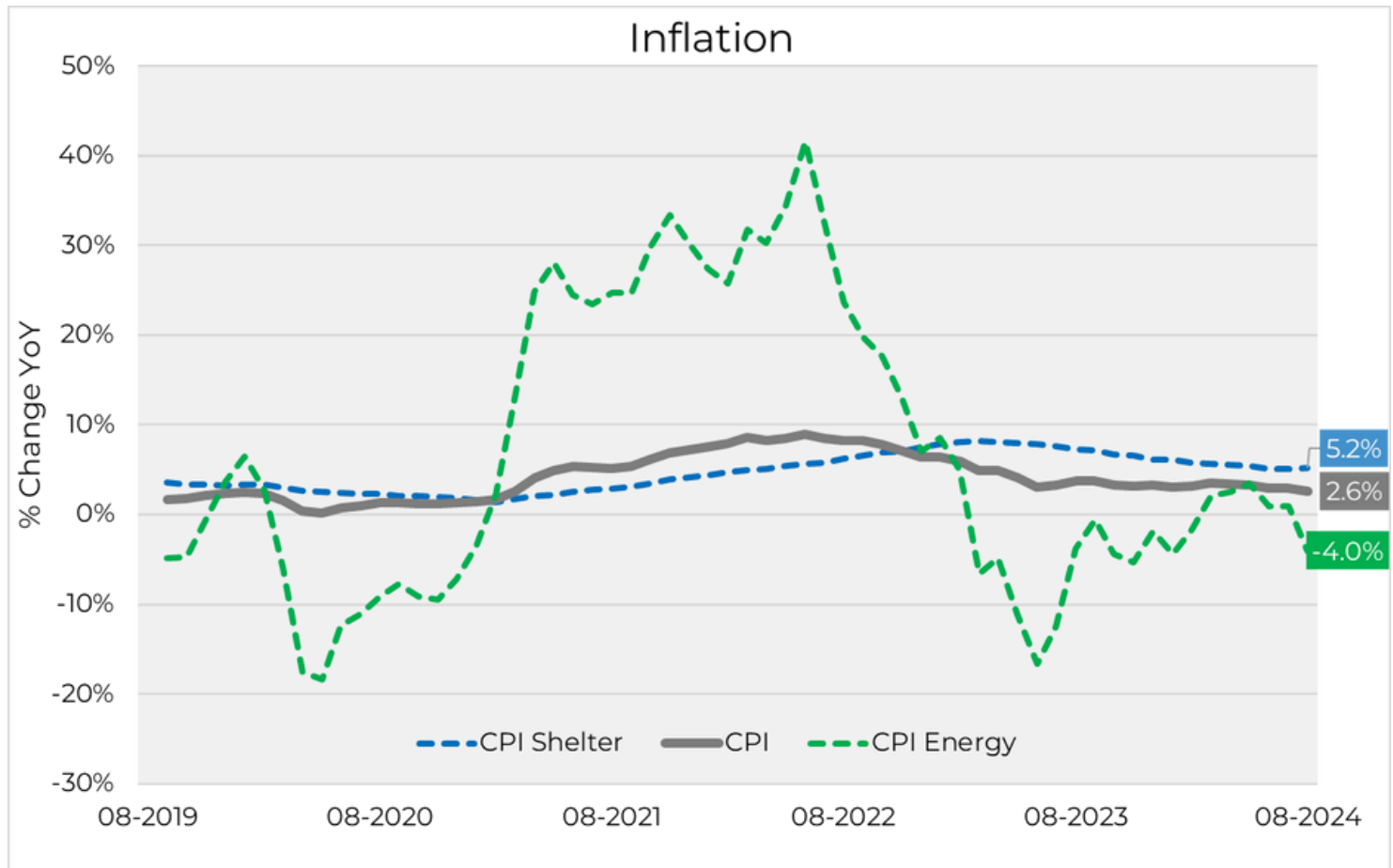
Asset Class	Index	QTD	YTD	1 Year	3 years	5 Years
Global Equity	MSCI ACWI	6.6%	18.7%	31.8%	8.1%	12.2%
US Large Cap	S&P 500	5.9%	22.1%	36.4%	11.9%	16.0%
US Large Cap Growth	Russell 1000 Growth	3.2%	24.5%	42.2%	12.0%	19.7%
US Large Cap Value	Russell 1000 Value	9.4%	16.7%	27.8%	9.0%	10.7%
US Small Cap	Russell 2000	9.3%	11.2%	26.8%	1.8%	9.4%
International	MSCI EAFE	7.3%	13.0%	24.8%	5.5%	8.2%
Emerging Markets	MSCI Emerging	8.7%	16.9%	26.1%	0.4%	5.7%
Commodities	S&P Global Natural Resources	3.3%	3.5%	7.1%	8.1%	9.9%
Real Estate	CRSP US REIT	17.3%	13.5%	34.2%	2.5%	4.7%
Muni Bonds	Bloomberg Municipal Bond	2.7%	2.3%	10.4%	0.1%	1.4%
Taxable Bonds	Bloomberg Aggregate Bond	5.2%	4.4%	11.6%	-1.4%	0.3%
High Yield Bonds	Bloomberg High Yield Bond	5.3%	8.0%	15.7%	3.1%	4.7%

## 2. Federal Reserve Monetary Policy

In Q3, the Fed lowered the Fed Funds rate by 0.5%, which marked a pivot toward a more accommodative stance to prevent further economic weakening. In addition, the market expects another 75 basis points reduction by the end of 2024. The Fed's decision was driven by a combination of cooling inflation, concerns about a softening labor market and the negative impact of high financing costs for businesses.

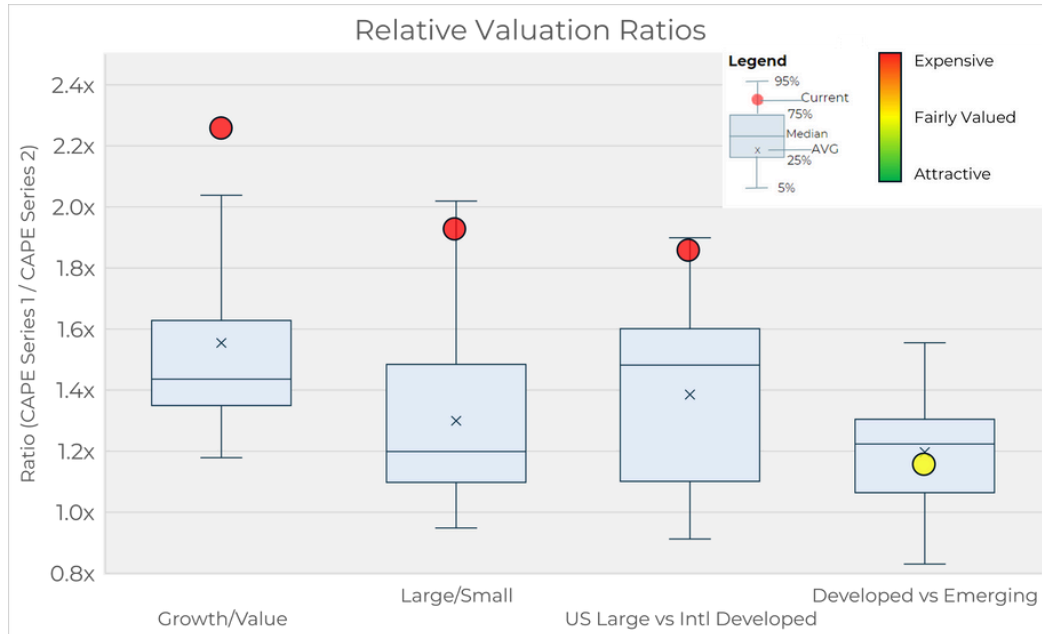
### Fed Funds Rate Policy & Inflation

U.S. inflation showed a consistent cooling trend during 3Q24. In July, the Consumer Price Index (CPI) rose by 2.9% year-over-year, its lowest increase since early 2021. By August, annual inflation had further declined to 2.6%, driven by significant drops in energy prices, which fell 4% over the past year, and a 10.3% decrease in gasoline prices. However, core inflation (excluding food and energy) remained higher at 3.2%, reflecting ongoing cost pressures in services such as shelter, which rose by 5.2%.



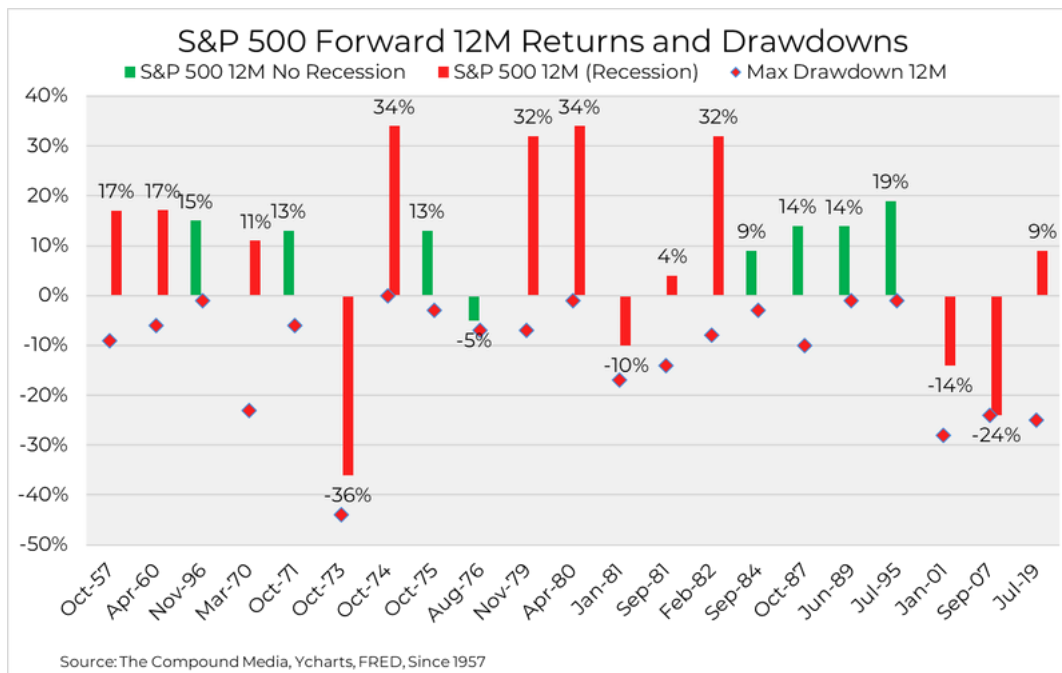
### 3. Valuations

U.S. Large Cap, specifically AI driven U.S. Large Cap Growth, continues to be the only major equity asset class that is significantly overvalued.

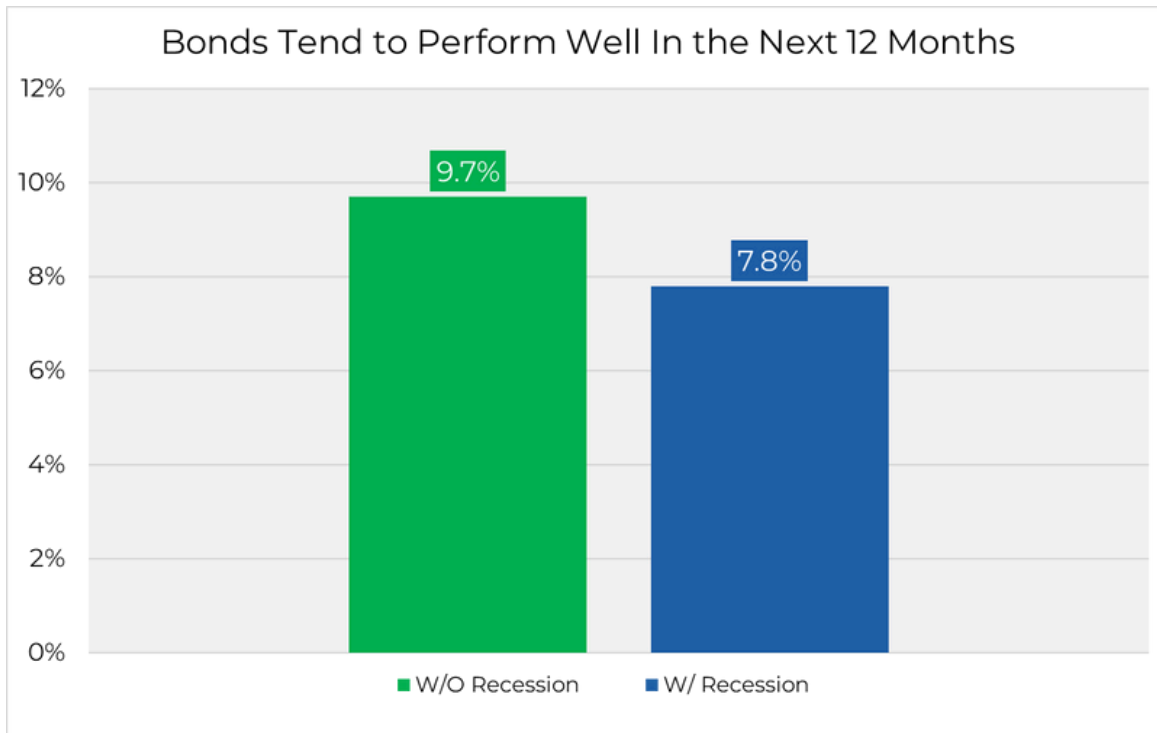


#### S&P 500: AFTER THE FED CUTS RATES

The S&P 500 has generated positive returns in 16 of the 21 occurrences following the first rate cut. The stock market has returned on average 11% over the next 12 months when the economy did not have a recession and an 8% return when accompanied by a recession.



After the first Fed funds rate cut, bond prices typically rise, and yields fall as lower borrowing costs make existing bonds with higher yields more attractive. Investor concerns regarding the growing deficit could keep intermediate and long-term interest rates higher. Changes in inflation expectations could impact long-term bond yields.



## 4. Semi-Liquid Private Markets

- **Private Credit** continues to produce consistent returns **+2.7%**. The asset class total return has more recently benefitted from the higher interest rate environment. As rates fall, forward total return expectations should decrease but maintain a meaningful spread above public bonds.
- **Private Equity (PE)** returns were strong in Q3 2024 **+3.4%**. Lower interest rates should be a tailwind for PE because it makes financing cheaper, boosts valuations, supports M&A activity and increases investor interest in PE.
- **Private Real Assets** produced positive returns during the quarter **+2.1%**, led by infrastructure. Lower interest rates generally have a positive impact on real assets because they reduce the cost of financing, lower cap rates and increase the attractiveness of these assets relative to fixed-income investments.

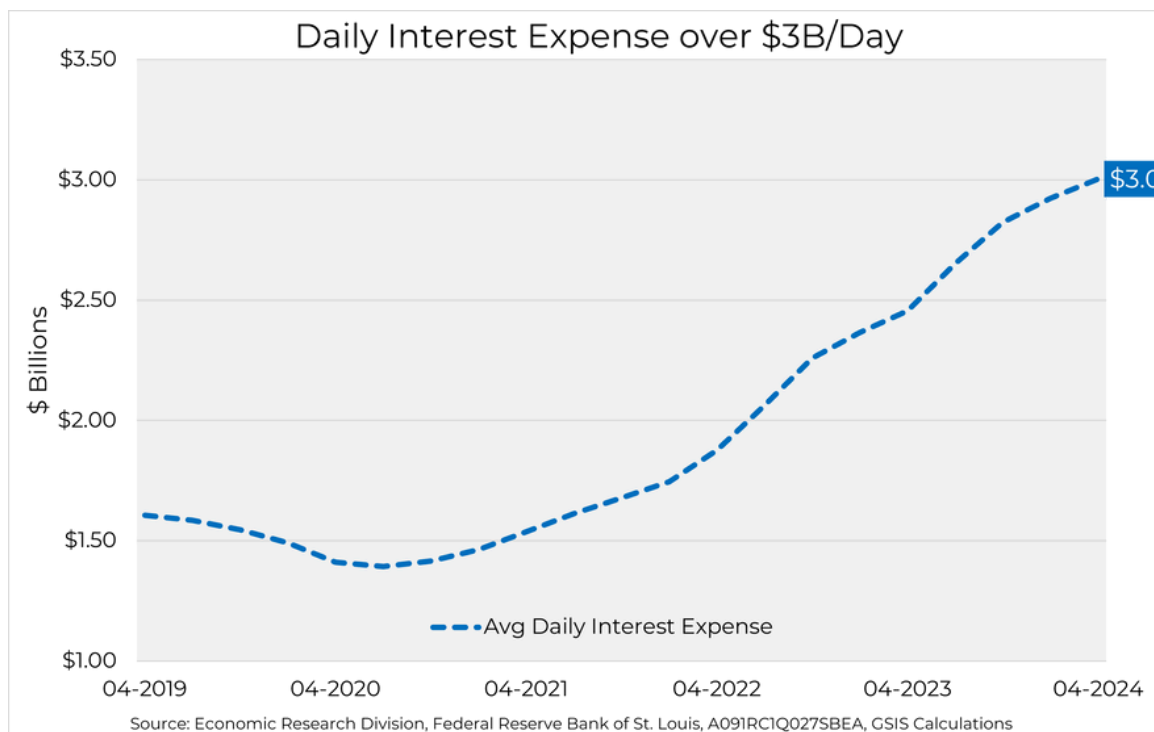
# Looking Ahead

The main market drivers should continue to be the changes in inflation and the pace of the Federal Reserve policy response. An aggressive rate cut plan could reaccelerate inflation pressures. Consumers, who are borrowers, tend to do well after an initial cut.

## FED FUNDS RATE CUTS PACE

Rate cuts can influence inflation expectations. If the market anticipates that the Fed's action will lead to higher inflation in the future, yields on longer-term bonds may increase slightly to reflect the expectation of higher inflation, even as short-term yields decline.

Lowering the Fed Funds rate significantly impacts the U.S. Government interest expense. If the Fed cuts interest rates by 1% and the entire yield curve declines by an identical amount, then daily interest expense will decline from \$3 billion per day to \$2.5 billion per day.



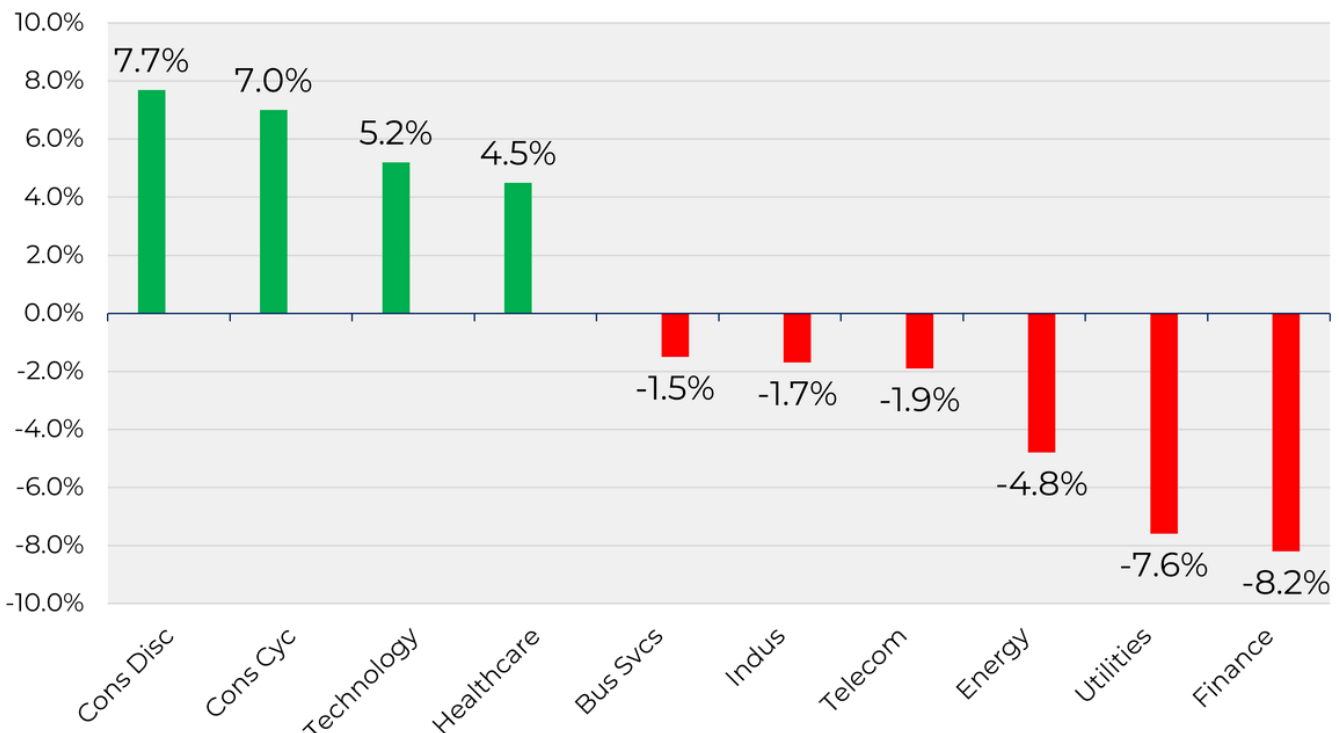
**\$3B**

U.S. Gov't  
Per Day  
Interest  
Expense

## US EQUITIES: FIRST RATE CUT PERFORMANCE

Overall, a Fed rate cut generally supports equity valuations by reducing the discount rate applied to future earnings, but its impact varies across sectors depending on their interest rate exposure, capital intensity and economic sensitivity. Interest rate-sensitive sectors like financials (banks and insurance companies) may initially face pressure, as lower rates can compress their net interest margins and profitability. Consumer discretionary and technology sectors tend to react positively, as lower borrowing costs can boost consumer spending and corporate investment, supporting growth prospects for these industries.

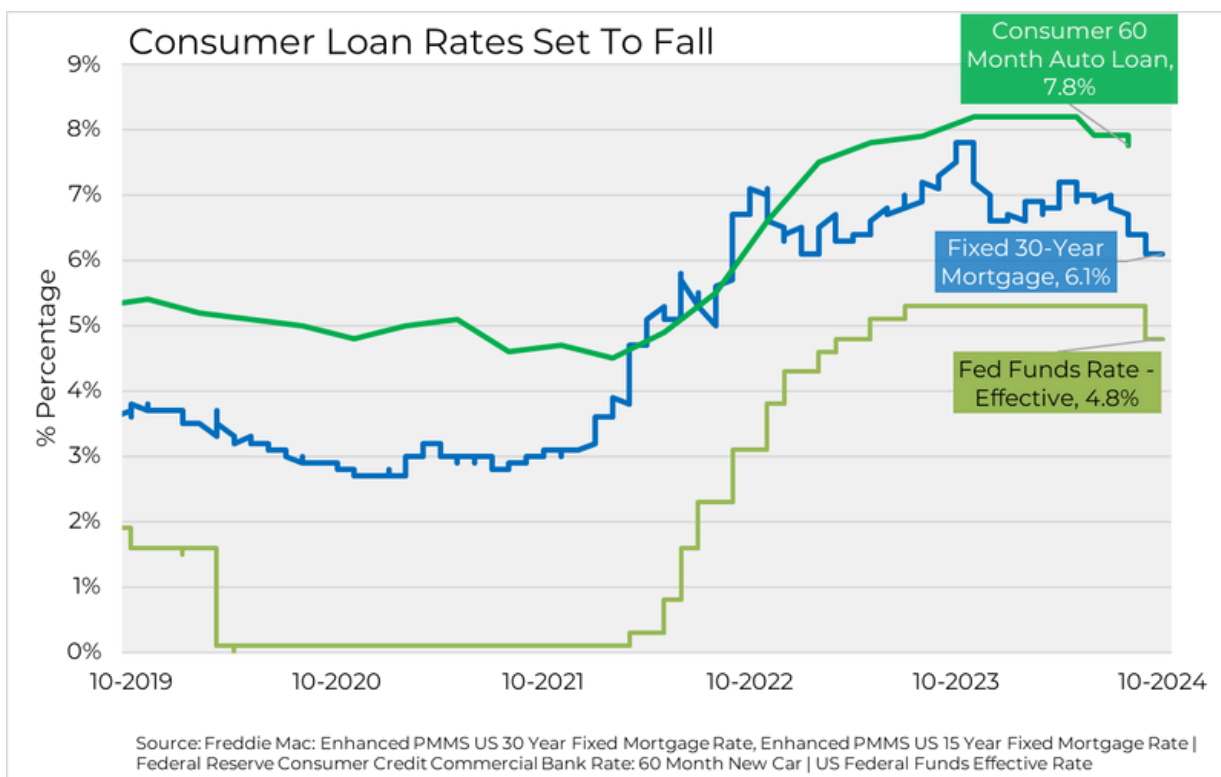
Sector Performance After First Rate Cut



Source: Visual Capitalist, PinPoint Macro Analytics, GSIS Calculations. Rate Cuts Cycle Data: 1973-2024.

## CONSUMERS

After an initial Fed funds rate cut, consumers generally benefit through several channels. Lower interest rates reduce borrowing costs, making loans such as mortgages, auto loans, and personal loans more affordable. This can boost consumer spending on big-ticket items like homes and cars, as well as refinancing activity, which frees up disposable income for other expenditures. Additionally, lower rates can support employment and wage growth by stimulating business investment and economic activity, which further boosts consumer confidence and spending. However, savers may see reduced returns on interest-bearing accounts. **Overall the benefits are more pronounced for borrowers than for savers.**



## Summary

The current market environment presents a unique blend of opportunities and risks.

**Reasons for Optimism:** A favorable interest rate outlook, stable economic indicators and technological advancements create a supportive backdrop for sustainable growth and positive returns.

**Reasons for Caution:** Potential for volatility amid elevated valuations, increasing global debt levels, work stoppages, geopolitical conflicts and potential for reaccelerating inflationary pressures calls for a balanced approach.

As always, we recommend maintaining a diversified portfolio and focusing on long-term goals to capitalize on opportunities while managing potential downside risks.

## Thank you for your Trust and Confidence.



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