

Forget ‘T-Bill and Chill.’ The Economic Backdrop Ahead is Supportive and the 493 Look Attractive



Markets Struggle in October

Amid underwhelming Big Tech earnings, concerns regarding the path for Fed interest rate cuts, election uncertainty, and geopolitical conflict, equities were down in October as the S&P 500 Index and Nasdaq 100 Index fell 0.9% and 0.8%, respectively. International developed equities (-5.0%) were among the worst performers, followed by US small-caps (-2.6%) and emerging market equities (-2.6%). Bonds also struggled as 7-10 year US Treasuries decreased 3.4%, the US Aggregate Bond Index declined 2.6%, and investment grade corporates were down 2.5%. Aside from broad-based commodities (-1.3%), silver, crude oil, and gold all produced positive returns, gaining 4.9%, 4.5%, and 4.3%, respectively.

Exhibit 1: Trailing Returns as of October 31, 2024

Index/ETF	1-Mo	3-Mo	YTD	1-Y	3-Y	5-Y
Equities						
US Growth (SPYG)	-0.69%	4.38%	27.19%	43.41%	6.65%	16.93%
US Mid-Caps (SPMD)	-0.73%	0.29%	12.62%	32.75%	5.13%	11.31%
US Large-Caps (SPY)	-0.89%	3.55%	20.77%	37.73%	8.96%	15.17%
US Value (SPYV)	-1.21%	2.85%	13.83%	31.51%	10.91%	12.30%
Broad-based Emerging Markets (SPEM)	-2.59%	5.46%	14.91%	27.23%	0.89%	5.42%
US Small-Caps (SPSM)	-2.59%	-3.23%	6.46%	30.01%	1.90%	9.34%
International Developed Equities (SPDW)	-5.01%	-1.22%	6.76%	22.58%	1.61%	6.28%
US Fixed Income						
High Yield Credit (JNK)	-0.99%	2.14%	6.87%	15.74%	2.14%	3.38%
Municipal Bonds (MUB)	-1.22%	0.14%	0.95%	9.10%	-0.18%	1.02%
Treasury Inflation Protected Notes (SPIP)	-1.76%	0.53%	3.76%	8.61%	-1.87%	2.03%
Investment Grade Corporate Bonds (SPBO)	-2.52%	0.90%	3.06%	13.84%	-1.94%	0.73%
US Aggregate Bond Index (SPAB)	-2.57%	0.20%	1.87%	10.39%	-2.24%	-0.29%
US Treasury 7-10 Year (IEF)	-3.39%	-0.74%	0.63%	9.15%	-3.81%	-1.53%
Commodities						
Silver (SLV)	4.93%	12.96%	36.87%	41.99%	10.48%	11.99%
Crude Oil (USO)	4.52%	-5.99%	9.65%	-2.58%	8.52%	-4.16%
Gold (GLD)	4.30%	11.90%	32.61%	37.62%	14.98%	12.22%
Broad-based Commodities (BCI)	-1.32%	3.01%	4.18%	-1.07%	1.59%	6.52%

Source: FactSet. Data as of October 31, 2024. 1Y, 3Y, and 5Y numbers are annualized.

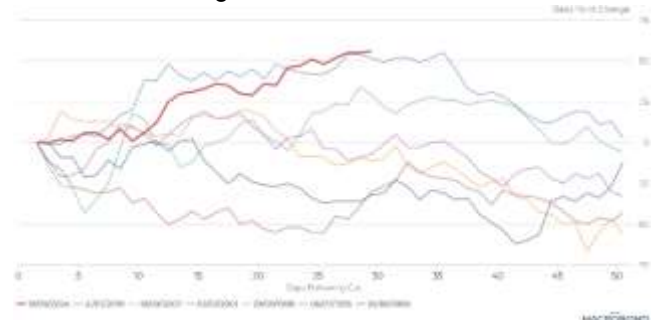
Fed Anticipated to Continue Cutting Rates

At the upcoming November FOMC meeting, the Federal Reserve is widely expected to decrease interest rates by 25 bps, dropping the fed funds rate to the 4.50–4.75% range. The move will mark the second consecutive meeting in which the Fed eases monetary policy, following the initial 50 bps cut at the September meeting. Recent Nonfarm Payrolls and JOLTS Job Openings reports suggest the labor market continues to somewhat loosen, though part of their weakness can be attributed to recent hurricanes and strikes. Moreover, inflation has decelerated, but it remains above the Fed’s 2% target as core annualized Consumer Price Index (CPI) and Personal Consumption Expenditure (PCE) readings for September registered 3.3% and 2.7%, respectively. Nonetheless, the FOMC minutes stressed that both the Fed’s price stability and maximum employment mandates have come more into balance, and officials see another 25 bps cut to occur at the December FOMC meeting.

10-Year Yield Rises Following Rate Cuts?

Historically, Fed interest rate cuts have often been followed by weakness in the labor market, a slowdown in GDP growth, lower inflation expectations, and ultimately lower longer-dated yields. The opposite has happened in this cycle with the 10-year Treasury yield increasing approximately 50 bps since the initial rate reduction given the economic backdrop remains strong, uncertainty regarding the election and fiscal policy persists, and deficit concerns loom.

Exhibit 2: US 10-Year Yield Response to Initial Fed Rate Cuts – 1989 through 2024

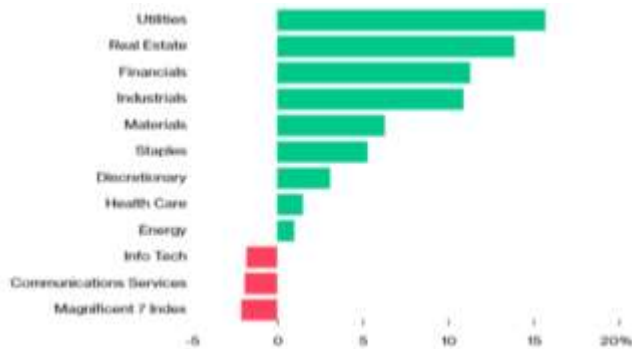


Source: Macrobond

Big Tech Stocks Lag the Broader Market

Mega-cap technology stocks via the Bloomberg Magnificent 7 Index have led the market over the past two years given their ability to grow profits. From the beginning of the year through July 10th, they've rallied 22%. However, this marked their 2024 peak as their earnings growth has slowed, and investors have started to question their willingness to pay higher multiples for such profits. From that peak through October 25th, the Magnificent 7 have fallen 2%, while all other sectors have outperformed, led by utilities, real estate, and financials, which all gained over 10%.

Exhibit 3: Performance of Sectors and Bloomberg Magnificent 7 Index – July 10 through October 25

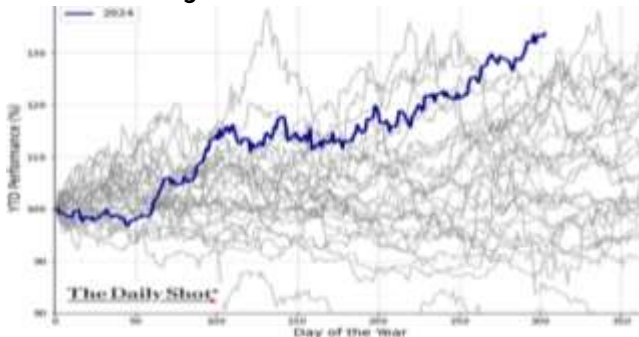


Source: Bloomberg. Data from July 10, 2024, through October 25, 2024.

Gold Hits New All-Time High

Amid geopolitical conflict, political uncertainty, continued support from central bank purchasing, varying paces of global economic recovery, and more interest rate cuts expected ahead, gold hit an all time high of just over \$2,790 per ounce on Wednesday, October 30th. YTD through October, the yellow metal is up 32.6%, notching its best year so far in decades.

Exhibit 4: Rolling YTD Performance of Gold Since 1995



Source: The Daily Shot

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Since the start of 2024, we've been vocal about how we're the most constructive we've been on equities in years. Why? The earnings recession ended in 2023, valuations are not significantly expensive for the 493 stocks, and now, the Fed has started to cut interest rates. Additionally, the big picture remains healthy as:

- The unemployment rate lies at 4.1%
- The first preliminary estimate of Q3 GDP came in at 2.8%
- The ISM Services PMI remains in expansionary territory
- Both initial and continuing claims have retreated from recent highs
- Credit spreads remain tight
- Businesses and consumers have low debt-servicing costs given they were able to lock in low rates
- Consumer expenditures as well as spending on AI and the energy transition remain robust

Although the S&P 500 Index is up 21% YTD through October, the S&P 500 Equal Weight Index has gained 13% over the same period, suggesting the average stock has had a decent year. Moreover, the 493 continue to look attractive as their earnings growth is projected to increase while that of the Magnificent 7 is declining, and monetary policy is expected to become less restrictive.

With rates where they were, many investors found 'T-Bill and Chill' to be attractive. However, equities meaningfully outperformed as the S&P 500 Index rose 52% cumulatively in the past two years, and with the more supportive economic backdrop likely to materialize ahead, we advocate increasing one's equity exposure.

Though inflation has declined, economists and Fed policymakers don't see interest rates heading back down to just above zero. For this reason, we continue to own real assets which trade at cheap valuations and are likely to benefit from deglobalization and a higher interest rate world.