

Fed Rate Cuts Give Higher Probability of the Great Rotation Occurring

Major Indices Up in August Despite Volatility

Despite pullbacks and elevated volatility in the earlier days of the month, major equity indices were up in August amid easing inflation, a dovish change in monetary policy, and increased probabilities of a soft landing. The S&P 500 gained 2.4% for the month while the Dow Jones Industrial Average was up 2.0%, posting a new all-time high, and the Nasdaq Composite followed with an increase of 0.7%. US value stocks (+3.0%) were among the best performers, followed by international developed equities (+2.9%) and US large-caps (+2.3%). Bonds fared well as investment grade corporates rose 1.8%, high yield credits gained 1.6%, and the US Aggregate Bond Index increased 1.5%. Aside from gold (+2.1%), commodities struggled as crude oil was down 4.4%, broad-based commodities declined 0.2%, and silver fell 0.2%.

Exhibit 1: Trailing Returns as of August 30, 2024

Index/ETF	1-Mo	3-Mo	YTD	1-Y	3-Y	5-Y
Equities						
US Value (SPYV)	3.00%	7.08%	13.99%	23.30%	11.37%	13.79%
International Developed Equities (SPDW)	2.88%	4.20%	11.18%	18.16%	2.93%	8.50%
US Large-Caps (SPY)	2.34%	7.23%	19.35%	26.68%	9.22%	15.84%
US Growth (SPYG)	2.16%	7.82%	24.49%	30.10%	6.78%	16.91%
Broad-based Emerging Markets (SPEM)	1.21%	4.70%	10.28%	14.18%	-0.66%	5.68%
US Mid-Caps (SPMD)	-0.17%	3.95%	12.11%	18.58%	5.46%	12.21%
US Small-Caps (SPSM)	-1.61%	6.62%	8.24%	17.01%	2.78%	10.70%
US Fixed Income						
Investment Grade Corporate Bonds (SPBO)	1.77%	4.79%	3.95%	9.88%	-1.99%	0.84%
High Yield Credit (JNK)	1.58%	4.36%	6.29%	11.97%	1.77%	3.34%
US Aggregate Bond Index (SPAB)	1.49%	4.77%	3.19%	7.50%	-2.18%	-0.11%
US Treasury 7-10 Year (IEF)	1.34%	5.55%	2.74%	6.09%	-3.87%	-1.32%
Treasury Inflation Protected Notes (SPIP)	0.78%	3.66%	4.03%	6.11%	-1.80%	1.83%
Municipal Bonds (MUB)	0.24%	2.60%	1.05%	5.21%	-0.41%	0.94%
Commodities						
Gold (GLD)	2.09%	7.43%	20.99%	28.20%	10.95%	9.97%
Silver (SLV)	-0.15%	-5.08%	20.98%	16.71%	5.78%	8.97%
Broad-based Commodities (BCI)	-0.20%	-5.56%	0.93%	-4.56%	2.88%	6.53%
Crude Oil (USO)	-4.37%	-0.64%	11.54%	0.92%	15.37%	-4.10%

Source: FactSet. Data as of August 30, 2024. 1Y, 3Y, and 5Y numbers are annualized.



Powell Signals Dovish Change in Fed Policy

At this year's annual Jackson Hole symposium, Federal Reserve Chairman Jerome Powell expressed a dovish stance. "The time has come for policy to adjust," he stated, all but confirming the Fed is ready to start cutting interest rates. As recent Consumer Price Index (CPI) and Personal Consumption Expenditure (PCE) reports continue to show disinflationary progress, Powell signaled he is more convinced that inflation is on a sustainable path back to the Fed's 2% target. "The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks," he said. The Chairman also drew attention to recent signs of weakening in employment indicators and communicated that the Fed will do everything it can to support a strong labor market. His speech also revealed officials aren't anticipating a large loss in jobs or a high probability of recession. As of September 2nd, a 100% chance for the first rate cut to occur in September is priced in per the CME FedWatch Tool, with the odds of a 25 bps cut and 50 bps cut standing at approximately 68% and 32%, respectively.

US Growth Remains Healthy

Per the second preliminary estimate, US GDP for Q2 grew at annual rate of 3.0%, up from the first preliminary reading of 2.8%, and well above 1.4% in Q1. The upward revision was largely attributed to increases in consumer spending, as well as gains in private inventory investment and nonresidential fixed investment. For Q3, the GDP outlook also remains healthy as the Atlanta Fed GDPNow model forecasts 2.5% growth as of August 30th.

Exhibit 2: US GDP Growth

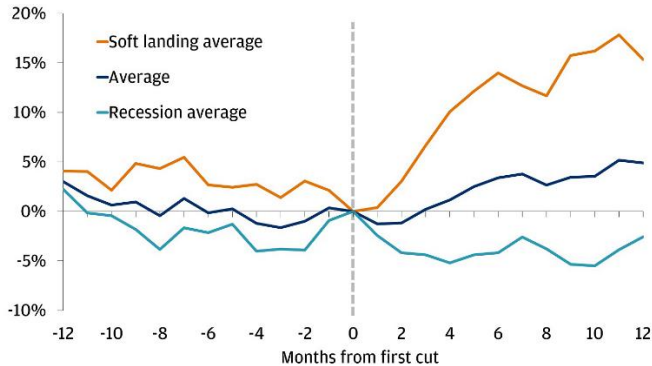


Source: Trading Economics, US Bureau of Economic Analysis. Data as of August 29, 2024.

How do Equities Perform in Cutting Cycles?

When analyzing the S&P 500's performance across all Fed rate cutting cycles going back to 1965, history suggests that on average, equities tend to perform well in the months after the initial cut given growth remains intact. However, if recessionary conditions follow, equity returns have historically struggled.

Exhibit 3: S&P 500 Performance During Fed Cutting Cycles

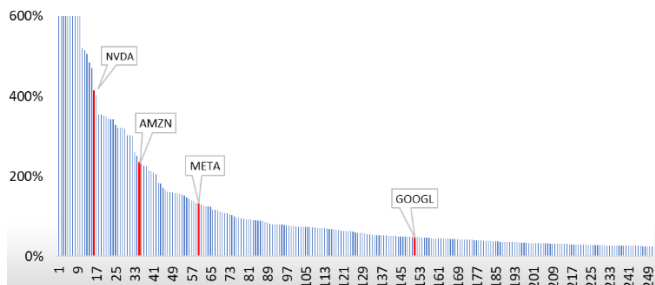


Source: J.P. Morgan, Federal Reserve, NBER, Bloomberg Finance L.P. Analysis as of December 11, 2023. Analysis incorporates cutting cycles that began in: Nov '66, Aug '69, June '74, May '81, Oct '84, Jun '89, Jul '95, Sep '98, Jan '01, Sep '07, Jul '19, and Mar '20. Recession is determined by an NBER-defined contraction that occurred within 12 months of the first cut, excluding the 2019 cycle preceding the COVID-19 pandemic. Past performance is no guarantee of future results. It is not possible to invest directly in an index.

Opportunities Outside of the Magnificent

Among the 900 constituents in the S&P 900 Index, which contains large and mid-cap stocks, 251 companies have seen earnings growth greater than 25% over the last twelve months. More notably, only four of the "Magnificent Seven" stocks make that list, with 15 constituents growing their earnings faster than NVDA, 35 outpacing that of AMZN, 60 expanding net profits more than META, and 151 increasing earnings beyond that of GOOGL. This suggests that there may be more attractive opportunities across other cheaply valued stocks with appealing growth potential.

Exhibit 4: S&P 900 Stocks with >25% 12M EPS Growth



Source: FactSet, Astoria Portfolio Advisors. Data as of August 29, 2024. Trailing EPS growth calculations use quarterly last twelve months reporting frequency.

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Do Not Lose Sight of the Big Picture. Fed Rate Cutting Cycles Have Historically Led to New Market Leadership. Rotate Portfolios Away From the Magnificent Seven

Data has been volatile from Q1 through today, which is historically common in this part of the cycle. However, several indicators have weakened or fell short of expectations more recently as lags from tight monetary policy have started to materialize:

- Declining inflation via CPI, PPI, PCE
- Slight loosening in the labor market evidenced by Initial/Continuing Claims, JOLTS Job Openings, ADP Payrolls, Nonfarm Payrolls
- Contractionary ISM Manufacturing and Markit Manufacturing PMIs

We acknowledge this initial weakening, but also note that the economy has not yet meaningfully deteriorated. Not all indicators have declined to severely low levels, and others still exhibit strength:

- Expansionary ISM Services and Markit Services PMIs
- Strong aggregate Q2 S&P earnings
- Healthy Q2 GDP, as well as Q3 GDP forecasts
- A consumer that remains strong via Retail Sales

However, we feel it is crucial to monitor for the rate of decline among future data at this point in the cycle.

Moreover, don't get myopic and lose sight of the big picture. We had a 10-year period where investor portfolios were dominated by mega-cap, US growth stocks. This tilt produced attractive risk-adjusted returns, but investing is about buying low and selling high. Maintaining an overweight towards a cohort that is expensive, over-owned, and where the upside is limited feels counterintuitive from an investing standpoint.

Capital is ultimately allocated in search of the best return per unit of risk. We think the mid-cap/smaller-cap space offers an attractive return per unit of risk on a forward-looking basis as the interest rate cycle begins to take effect. We are not saying that this factor will specifically work today, tomorrow, or next week. We simply argue that investor portfolios need to evolve in the next 1, 3, and 5 years, and this market segment looks attractively priced.