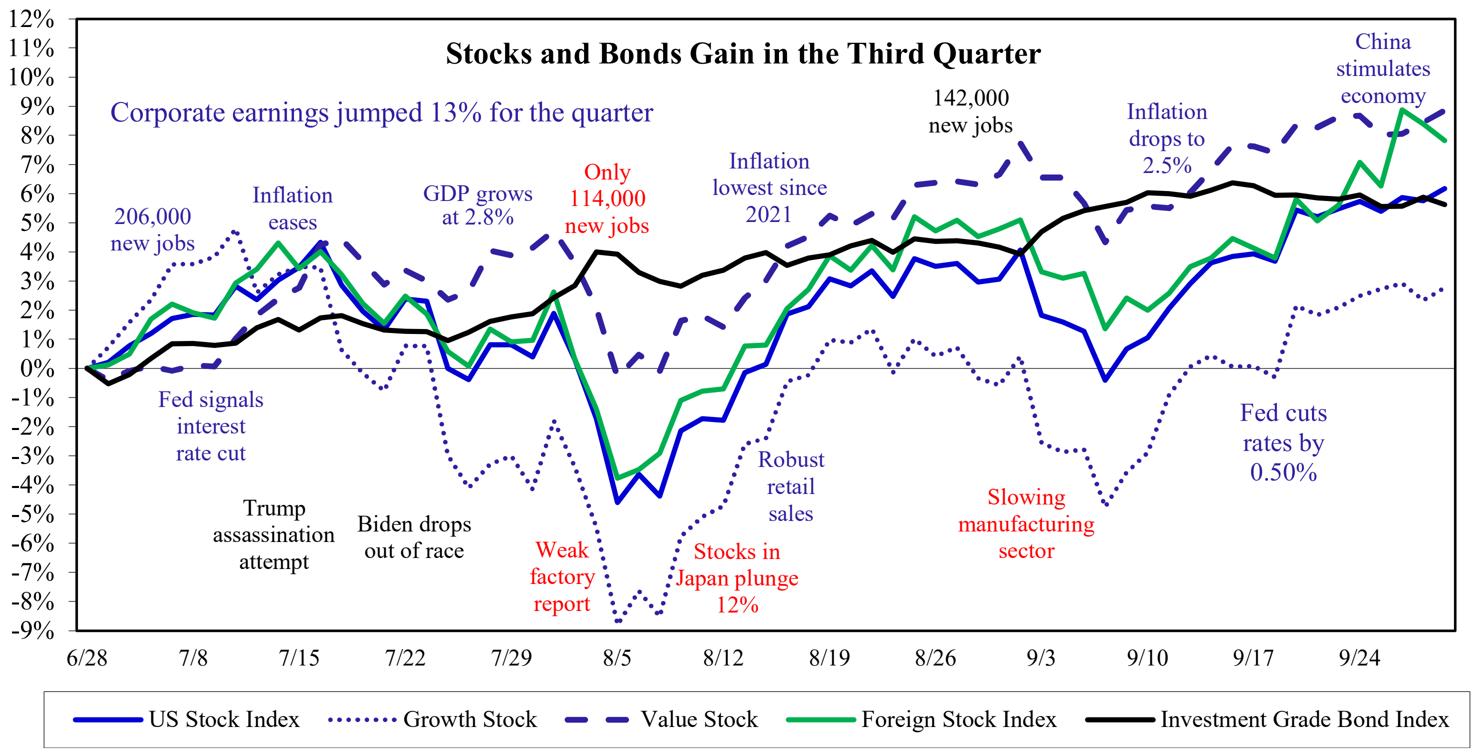
Economic and Financial Market Summary
Third Quarter 2024

Disciplined Investors LLC

Since the Federal Reserve began raising interest rates in 2022, people have wondered if they could achieve a "soft landing" for the economy. Could the Fed dampen inflation without causing a recession? While it is too early to declare "mission accomplished," inflation is moving close to the Fed's 2% target, so the focus has shifted to the labor market that has cooled. Unemployment has risen from 3.7% at the start of the year to 4.2%, and further weakness would be unwelcome news to the Fed, so they cut rates by 0.50% last month instead of 0.25%. If hiring slows more, that could push the Federal Reserve to lower rates by another half-percent in November.

The third quarter was favorable for both stocks and bonds due to the falling interest rates. Stocks also benefited from corporate earnings increasing 13%. New areas of the market took the lead. Foreign stocks jumped nearly 8% in the quarter outpacing the 6% gain for U.S. stocks. Small and mid-cap stocks beat large-caps by about 3% this period, and value stocks surged 6% more than growth stocks. The Artificial Intelligence mania lost momentum, and only three of the "Magnificent Seven" stocks (Apple, Microsoft, Nvidia, Amazon, Alphabet, Tesla, and Meta) managed gains for the quarter. Many market watchers think that the broader leadership is more healthy for the stock market, possibly indicating further gains to come.



Between now and the election, volatility could be sparked by politics and global conflicts. Stocks often rally after the election because uncertainty is removed (plus the strong seasonal period begins in November). A divided government is usually preferred by investors, and prediction markets indicate this is the most likely outcome. (There is only a 21% chance of a Democratic sweep and a 29% chance of a Republican sweep, according to Polymarket.) Unless there is an "October surprise," neither political party seems able to break away from the other.

Over the long term, the economy and corporate earnings determine investment performance much more than politics. When a recession is avoided after the Fed starts cutting interest rates, stocks have averaged a 10% gain over the next six months. If the economy falls into a recession after the Fed cuts rates, stocks drop 6% on average over the same time period. The Federal Reserve describes the economy as "strong overall". This soft landing scenario along with falling interest rates would typically boost stocks despite the high current valuations for U.S. large-cap and growth stocks.

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