



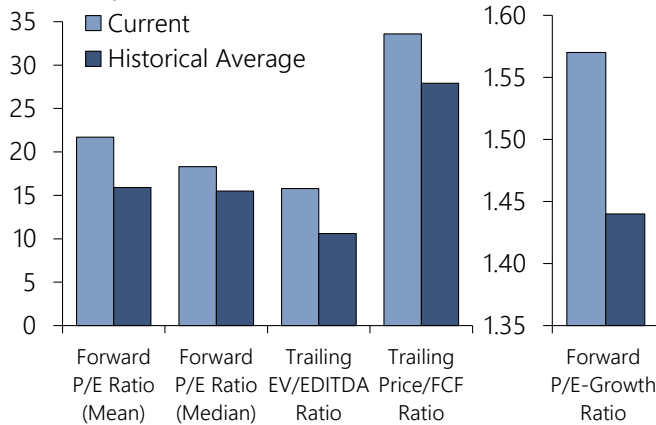
Key Points

- U.S. Soft(ish) Landing Base Case as Fed Kicks Off Monetary Easing Cycle
- China's Promised Stimulus Bazooka Could Boost GDP Growth Into 2025
- Euro Area's Economic Momentum Failing to Reach Escape Velocity
- Fed Will Steadily Recalibrate Fed Funds Rate to 3.5 Percent by Mid-2025
- Income Will Underpin Tax-Exempt Bond Returns Going Forward
- Improving Earnings and Fed Easing Will Support Stock Market Broadening

In Focus: Structural Changes Underpin Higher U.S. Stock Valuations

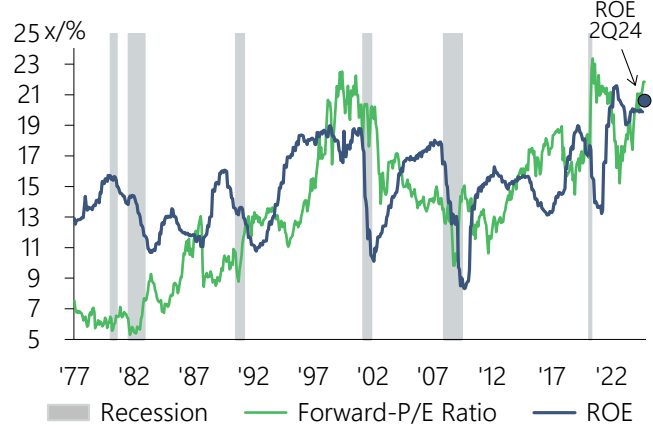
1 U.S. Equity Valuations Historically High

U.S. Equity Market Valuations



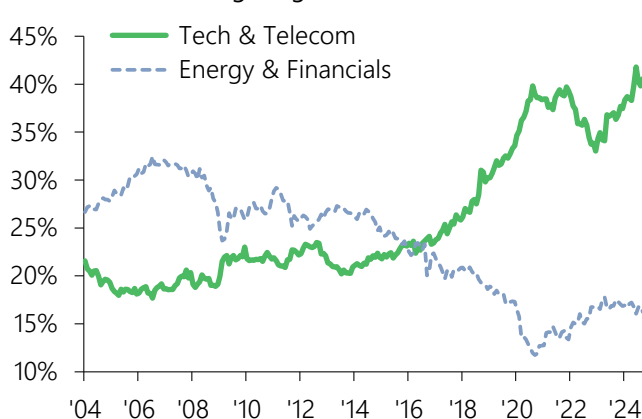
2 Rising Profitability Buys Valuation Uptick

S&P 500 Index Forward P/E and ROE Ratios



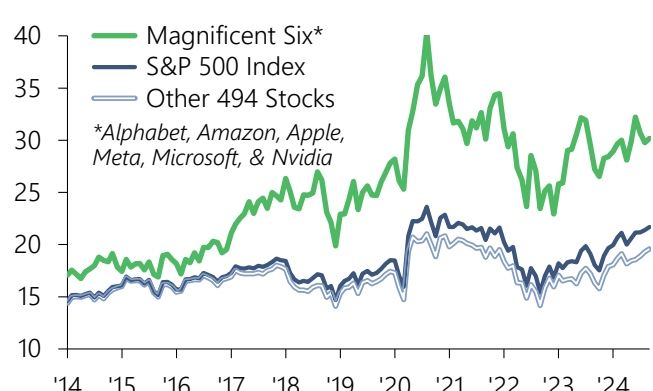
3 Significant Sector Shifts Tell Much of Story

S&P 500 Sector Weightings Over Time



4 "Mag Six" Distorting Market Valuations

S&P 500 Index Price-to-Earnings Ratio Next Twelve Months



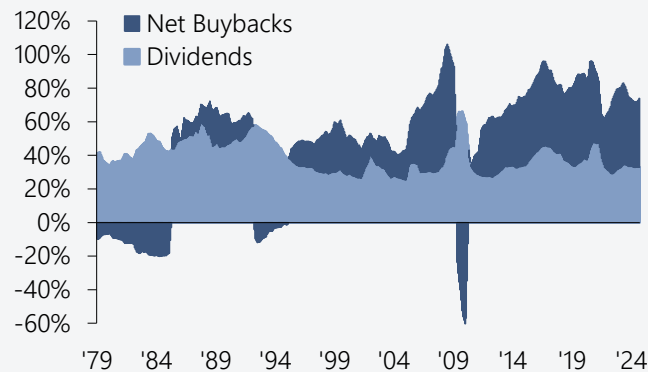
Sources: BofA Research, Empirical Research, FactSet, 9/30/24

Higher Stock Valuations Justified, But Now Earnings Growth Needs to Come Through

The surge in the U.S. stock market has understandably raised investor concerns that high valuations may cap return potential in the near term. While valuations are unquestionably elevated relative to long-term historical averages, several factors contribute to this situation. It is often dangerous to assert that “this time is different,” but there are important considerations that complicate historical comparisons. As shown in the cover chart, the increase in U.S. stock valuations has coincided with significant corporate profitability and cash flow growth that has also propelled overall capital returns, including dividends and share repurchases, to record highs.

Capital Returns Have Surged in Recent Years

S&P 500 Index Combined Dividend & Net Buyback Ratio



Source: Empirical Research, 9/30/24

The technology sector has been a major driver of rising corporate profitability and, buoyed by robust earnings growth, has progressively become a significant weight in broad stock market indices over the years. While one could argue that technology is susceptible to economic trends, several secular trends lessen its cyclicality. The trends include rising spending on artificial intelligence, cloud and edge computing, cybersecurity, automation, digital transformation, e-commerce, digital payments, and growing chip content in an ever-increasing range of products. The diversity of drivers within technology suggests strong growth prospects relative to the overall market, which is not a new development.

Technology firms often possess faster revenue growth, better profit margins, and more robust balance sheets, causing investors to assign premium valuations to their stocks. In contrast to technology, industries with lower multiples, such as financials and energy, have generally declined in stock index weightings. Notably, the stellar performance of the so-called “Magnificent Six” (Mag 6) stocks has had a sizeable influence on technology sector profits and index weightings. However, even excluding these high-flying stocks, valuations for the “other 494” are somewhat elevated compared to historical norms.

Beyond index composition, it is vital to consider other factors influencing valuations, including interest rates, inflation, and overall economic and corporate earnings conditions. The Federal Reserve’s recent shift to easing has improved investment sentiment, with short-term rates likely to decline further. However, we see limited potential for declines in longer-term maturities, barring a severe economic downturn that we currently do not anticipate. The earnings yield to bond yield differential remains at historically low levels, implying minimal if any, support from bonds for stock valuations.

Bond Yields Not Supportive of Stock Valuations

S&P 500 NTM Earnings Yield vs. 10-Year Treasury Yield Spread, Basis Points

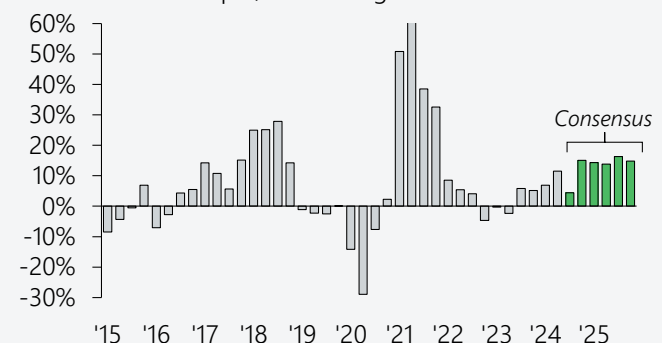


Source: FactSet, 9/30/24

In summary, there are valid reasons for a structural increase in U.S. stock valuations. However, the overall market is currently at levels that make further multiple expansion unlikely, putting the onus on EPS growth to drive future returns. Historically, stock valuations tend to increase ahead of improved earnings outlooks, and the recent uptick is partly due to optimism fueled by a more accommodating Fed, as well as easing measures in China. Encouragingly, S&P 500 Index earnings are trending upward, and stimulative policies should begin to take hold into 2025. We expect equity returns from here to depend primarily on the strength of the current earnings cycle.

S&P 500 Index Earnings Growth Improving

S&P 500 Bottom-Up Y/Y% Earnings Growth

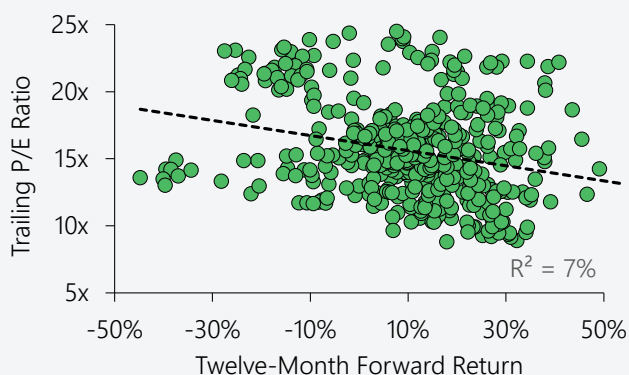


Source: FactSet, 9/30/24

U.S. large-cap stocks are currently “fairly valued.” Still, this does not necessarily limit their potential for further upside in the near term. A recent Piper Sandler study highlighted that the statistical correlation between P/E ratios and one-year forward returns is effectively zero. We sense, however, that many investors are exploring other areas within the equity market where valuations appear more attractive. International stocks and U.S. small-cap valuations appear attractive, especially when compared to large-cap U.S. stocks.

P/Es Not Predictive of Short-Term Returns

S&P 500 Trailing P/E vs. Twelve-Month Forward Return



Source: Piper Sandler, 10/7/24

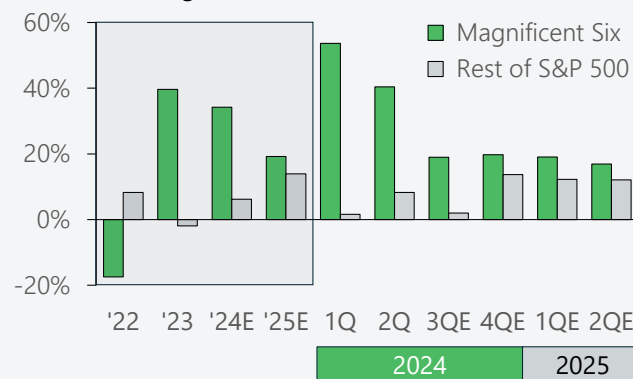
Nonetheless, when adjusting for factors like Big Tech’s influence on large-capitalization indices, the valuation disparities are not quite as pronounced as they may seem initially. Even so, we expect that an improving earnings outlook will lift returns for both small-cap and international stocks, and these asset classes historically perform well in response to monetary easing.

Much like our viewpoint that the overall equity market is fairly valued, we do not observe significant valuation dislocations across sectors, market capitalization sizes, or geographies. In this context, it truly is a market for stock pickers. In the past quarter, equity markets have broadened beyond just Big Tech, and we expect this trend to continue. While we remain optimistic about the outlook for large-cap tech fundamentals, we believe relative earnings momentum may attract investors to other sectors.

The financial sector should profit from stabilizing credit conditions and improving capital markets, with many well-capitalized firms returning significant capital to shareholders. The transport and industrial sectors will also likely realize improving fundamentals as loosening monetary policy fuels optimism for 2025. Additionally, sentiment for consumer cyclical groups (such as retail, auto, and housing) should improve after facing challenges amid higher interest rates and inflation.

Earnings Trends Support Broadening Market

S&P 500 Earnings Growth, Y/Y%



Source: FactSet, 9/30/24

As for U.S. small-cap stocks, we continue to emphasize quality – specifically, firms with strong free cash flow and visible growth – especially since nearly 35 percent of Russell 2000 Index listings have negative earnings. Internationally, we find South Korea, Brazil, and India attractively valued with regard to their near- and long-term earnings growth prospects.

While we do not anticipate any immediate shifts in the current valuation landscape, monitoring factors that could alter the status quo is crucial. First, the tech sector’s earnings and profitability drivers must stay strong. Second, any resurgence in inflation may weigh on valuations and potentially lead to a reversal in Fed policy. Third, investors have been accustomed to significant fiscal and monetary stimulus during times of market turmoil, particularly since the global financial crisis (i.e. the Fed Put), which has undoubtedly buoyed valuations. However, it is feasible that constraints may limit a future policy response as U.S. fiscal challenges intensify or if inflation concerns curb monetary easing. As such, any doubts about the efficacy of policy support will depress stock valuations as investors discount the downside risks.

We do not view any of the above factors as imminent concerns for equity valuations. However, they require constant evaluation, given the complexity of the market and economic landscape. Our research efforts remain focused on the “bottom up,” identifying stocks with attractive valuations relative to their near-term and long-term earnings growth potential.



Global Macro Developments

U.S. Soft(ish) Landing Base Case as Fed Kicks Off Monetary Easing Cycle

Given monetary policy tends to affect economic activity with “long and variable lags,” only time will tell if the die is already cast for a recession following the Federal Reserve’s most aggressive tightening in decades. However, the economic winds look to be at the central bank’s back, and while the economy will slow, the Federal Reserve (Fed) might actually pull off a soft or soft-ish landing. An earlier spate of weaker-than-expected economic data, including further signs the labor market is cooling, may have spooked the Fed and likely factored heavily into its decision to slash interest rates by 50 basis points instead of 25 in September. But the jury is still out on whether it can successfully stem burgeoning unemployment. Payroll growth continues to trend downward, and the Beveridge Curve implies unemployment will accelerate (Exhibits 1 and 2). As we highlighted last quarter, the overall labor market usually responds slowly to policy shifts. And it does not help that the Fed often bases policy actions on coincident and lagging indicators (e.g., inflation, payrolls, GDP growth). Big upward revisions to corporate profits and personal incomes show both are in better shape than reported previously, giving us more confidence the expansion can endure. Even so, the economy is vulnerable to shocks, such as an escalation in regional conflicts, a dockworkers’ strike, mass deportations, or a reenergized trade war.

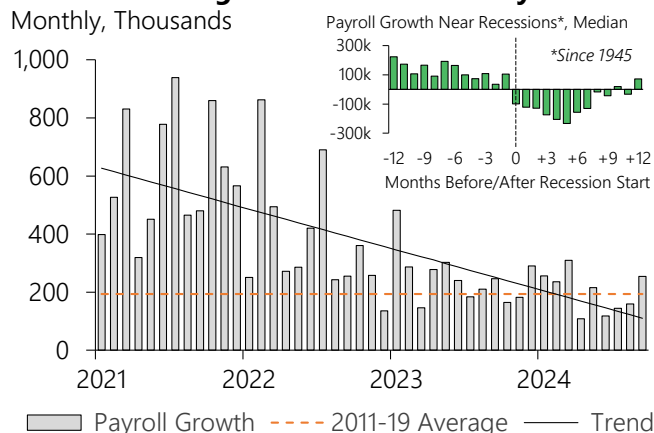
Massive Upward Data Revisions Help Explain U.S. Consumer Spending Resiliency

Before the recent annual update, government data showed annualized real GDP growth of +2.8 percent over the last two years versus real GDI growth of +1.1 percent, telling two very different stories about the U.S. economy’s health. In theory, the two economic measures should be about equal. While GDP is more widely cited, GDI has generally been the more accurate gauge. Thus, GDP has historically been revised toward GDI. However, a massive \$838 billion (annualized) upward revision to real GDI erased much of the prior discrepancy (Exhibit 3). The government also upped its estimate for disposable personal income by \$598 billion (Exhibit 4). So, where it had before looked like spending growth outstripped disposable income growth, the new data indicates that incomes are actually rising faster. Consequently, consumers had \$447 billion in added savings at the end of the second quarter, and the savings rate went to 5.2 percent from 3.3 percent. An upward revision of \$368 billion to still-rising corporate profits may also reduce the urgency to cut staff if economic growth begins to ebb. Small businesses are a different story – their profits are under pressure, at least in aggregate. If pink slips start to fly, small firms will lead the way, especially since those with <250 workers constitute 73 percent of private payrolls.

Chinese Policymakers Deliver More Stimulus as Deflationary Pressures Persist

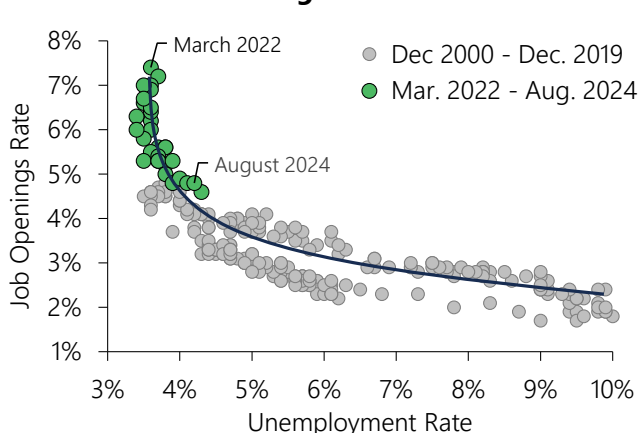
China’s economy has slowed appreciably since it posted an upside surprise for the March 2024 quarter. The government’s gradual countermeasures have failed to steady the property sector, with new and existing home prices falling -5.7 and -8.6 percent year over year, respectively, in

Exhibit 1: Change in U.S. Nonfarm Payrolls



Source: Bureau of Labor Statistics, 10/4/24

Exhibit 2: U.S. Beveridge Curve



Source: Bureau of Labor Statistics, 10/1/24



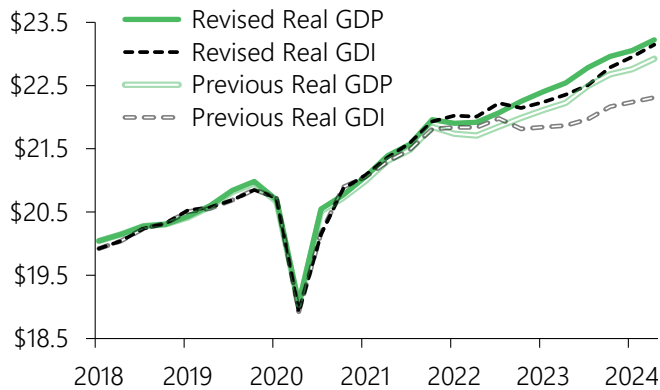
August. A negative wealth effect, decelerating income growth, and deteriorating job prospects have also foiled efforts to spur consumer spending. Retail sales of consumer goods have slowed to a crawl and were -11 percent below the pre-pandemic trend in August (Exhibit 5). Similarly, the pace of growth in manufacturing and infrastructure fixed investment has softened recently, likely reflecting the slow transmission of earlier fiscal stimulus. Sluggish domestic demand has pushed the economy into a deflationary rut, with the GDP deflator (an inflation gauge) negative year over year for six out of the last seven quarters. And external demand, a vital GDP growth driver this year, appears poised to ebb and may exert additional downward pressure on prices. Ever more fretful the economy will undershoot the government’s 2024 growth target of “about five percent” and slip further into a deflationary spiral, policymakers revealed added monetary and financial support measures on September 24. Without offering details, the Politburo also pledged more forceful fiscal support days later, especially for the beleaguered property sector.

China Risks Getting Stuck in Liquidity Trap as Crisis of Confidence Endures

China is suffering from a self-inflicted crisis of confidence that has discouraged consumers from spending and businesses from hiring and investing. Beijing’s previous reluctance or, worse, its inability to backstop the property crisis, borne out of its attempt to rein in excessive debt, shook Chinese citizens’ broad-based belief that the government is the “savior of last resort.” Barclays Research estimates that the property market slump has slashed household net wealth by about \$18 trillion since 2021, or \$60,000 per family. To make things worse, consumers’ employment expectations have sunk to a record low (Exhibit 6). As a result, precautionary savings continue to surge, with household deposits rising to 147 trillion yuan, or \$21 trillion, in August. Against this backdrop, monetary easing has been ineffective, given what economists call a liquidity trap

Exhibit 3: U.S. Real GDP vs. Real GDI Revisions

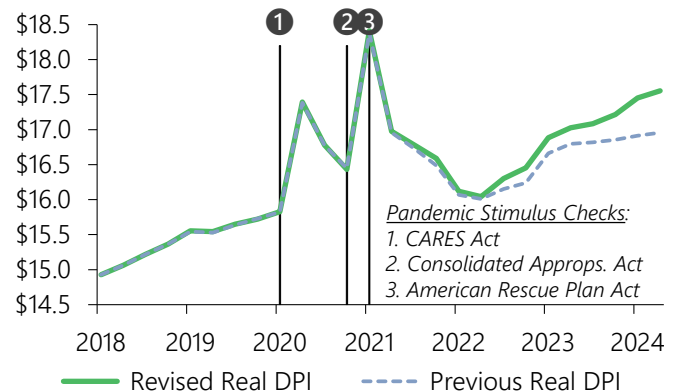
SAAR, Trillions



Source: Bureau of Economic Analysis, 9/26/24

Exhibit 4: U.S. Real Personal Income Revisions

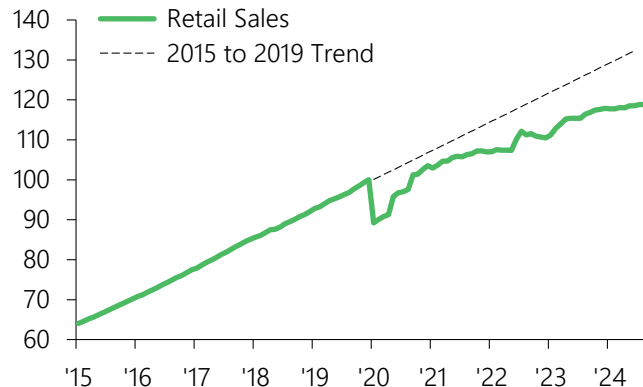
Disposable, SAAR, Trillions



Source: Bureau of Economic Analysis, Pandemic Oversight, 9/26/24

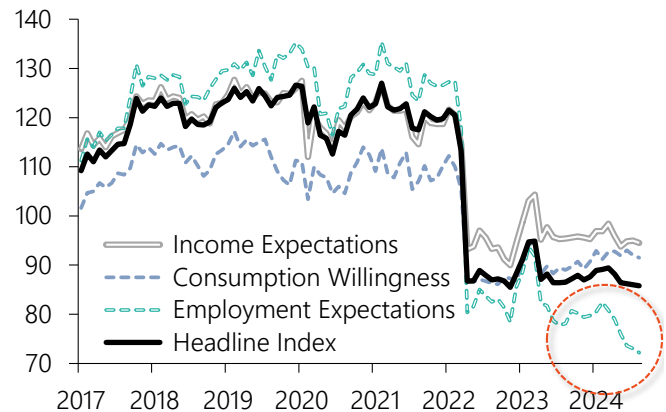
Exhibit 5: China Retail Sales of Consumer Goods

Seasonally-Adjusted, Rebased Index, 12/31/2019 = 100



Source: National Bureau of Statistics, 9/15/24

Exhibit 6: China Consumer Confidence Index



Source: National Bureau of Statistics, 9/30/24



– fearful consumers (and businesses) hoard cash and are disinclined to invest or assume added debt. Beijing has also turned to its stale investment-led playbook of stimulating infrastructure and manufacturing to lift economic growth, contributing to excess capacity and deflation. Over the last 15+ years, the Chinese economy has become highly reliant on government intervention for growth. If Beijing cannot spark a virtuous cycle of (domestic) consumer-led growth, it may be in a quandary similar to the one it is in now once the effects of the latest stimulus abate.

China’s Promised Stimulus Bazooka Should Boost Economic Growth Into 2025

Potential and existing easing measures, a summary of which is shown in Exhibit 7, should help stabilize the property market and calm anxious consumers. Still, as of now, policymakers only have the concept of a more aggressive “counter-cyclical adjustment.” Deutsche Bank estimates the total size of fiscal and monetary stimulus could reach 7.5 trillion yuan, or 6 percent of 2024 GDP, to become the largest in its history in nominal terms. Nevertheless, it remains to be seen whether the Politburo’s recent policy statement will be its “whatever it takes” moment. Rather than an all-at-once stimulus bazooka, there is a real chance that policymakers will continue to

Exhibit 7: China’s Economic Stimulus Measures: Past, Present, and Future

Officially announced, and already delivered (effective)

- Monetary * 1-year MLF rate cut by 30 basis points, effective from September 25
- * RRR cut by 50 basis points, 7-day reverse repo rate cut by 20 basis points, effective from September 27
- Housing * Increase PBoC’s contribution from 60% to 100% for the Affordable Housing Relending Scheme
- * PBoC announced two housing supportive measures that expire Y/E 2024 will be extended to Y/E 2026

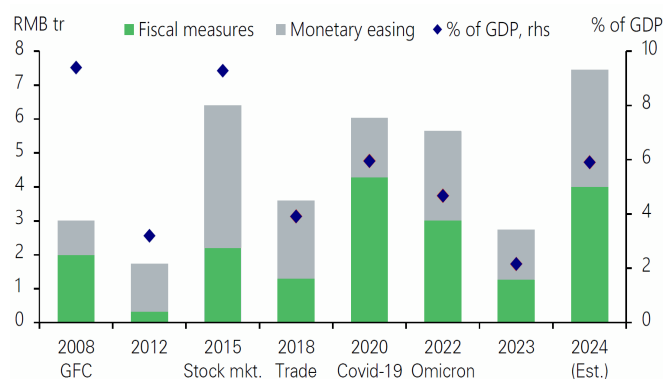
Officially announced, but not effective or implemented yet

- Monetary * Loan prime rate (LPR) and deposit rate cut by 20-25 basis points
- Housing * Minimum downpayment requirement for second home mortgage lowered to 15%
- * Rate reduction for existing mortgages (average 50bps, 150 billion yuan interest saving per annum)
- * Politburo: relax home purchase restrictions, increase lending to white-list projects, stop housing’s decline
- Equity * PBoC 500 billion yuan swap facility, allowing securities firms, funds, and insurers to borrow for stock purchases
- * PBoC 300 billion yuan re-lending facility to fund buybacks at a 2.25% annual interest rate for listed companies and their major shareholders
- Fiscal * Ministry of Civil Affairs and Ministry of Finance announced to offer a one-time cash allowance to extremely poor people (nearly 5 million) before October 1
- Bank * NFRA announced it will inject 1 trillion yuan of new capital into big six banks

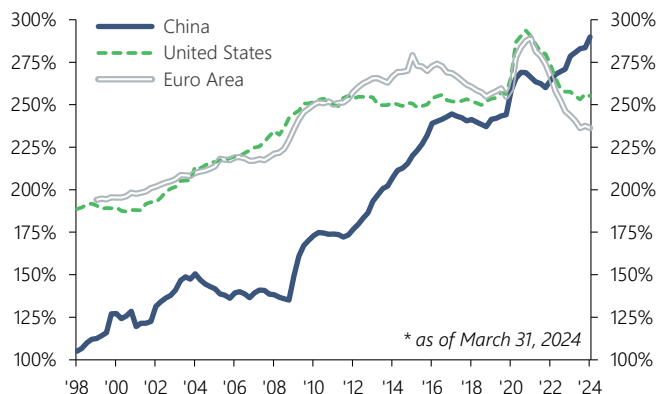
No official announcement yet, news reports only

- Fiscal * Reuters reported that China to issue 1) 1 trillion yuan of special bonds mainly to stimulate consumption (including monthly allowance of ~800 yuan per child to households with 2+ children, excluding the first child); 2) another 1 trillion yuan via special bonds to help local government tackle debt problems; and 3) subsidy and tax reduction for SMEs

China’s economic stimulus packages over time



Total credit to the non-financial sector, % of GDP*



Source: JP Morgan (table), Deutsche Bank (bar chart), Bank for International Settlements (line chart), 9/30/24



roll out support measures gradually. Furthermore, while government intervention may steady the property market, reviving demand and prices will likely be more difficult – this goes for the broader economy as well. China’s investment-led, credit-fueled economic growth model has long reached the end of its effectiveness. And while the country has huge opportunities if it can successfully transition to consumer-led growth, that may still be years away (and curbed by demographic headwinds). Meanwhile, easing measures will boost economic growth into 2025, and likely 2026, and hopefully get consumers feeling more optimistic and willing to spend.

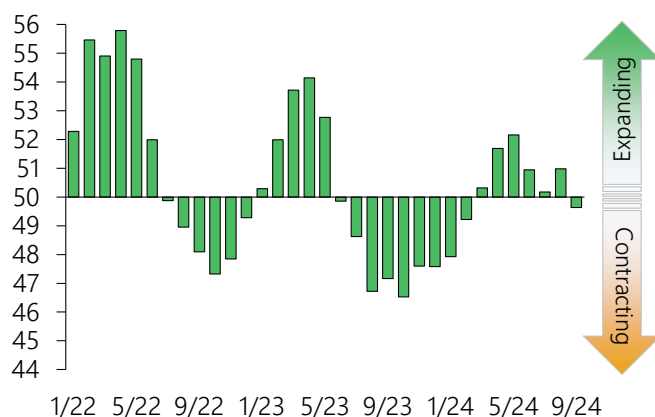
Euro Area’s Economic Momentum Failing to Reach Escape Velocity

The Euro Area economy has struggled to escape its post-pandemic funk. It has been a bit like Michael Corleone in *The Godfather Part III*: “Just when I thought I was out, they pull me back in!” Bouts of economic weakness have followed bouts of strength, keeping annualized real GDP growth to a measly +0.3 percent over the past two years. Notably, the Manufacturing PMI has contracted for 27 consecutive months, the longest stretch on record (the series began in 1997). Yet, services demand (albeit volatile), government spending, and, more recently, export growth have helped the economy keep its head above water or at least near the surface. The Composite PMI’s rebound earlier in 2024 once again proved short-lived, with the gauge dipping back into contraction in September (Exhibit 8). Hence, the Euro Area could stay in economic stagnation (or worse) through year-end as the fiscal impulse tightens and exports wane. But not all is lost. Given the still-tight job market, improving real wage growth, and plentiful savings, consumers are well-placed to drive an economic recovery. Monetary loosening will also provide a tailwind. Although sticky services inflation is a potential obstacle, falling business confidence and cooling employment prospects (and a possible Trump presidency) will likely lead the European Central Bank to err on the side of easing, cutting rates another 100-150 basis points by year-end 2025.

Bank of Japan’s Hiking Cycle Proceeds as Consumer Spending and Wages Perk Up

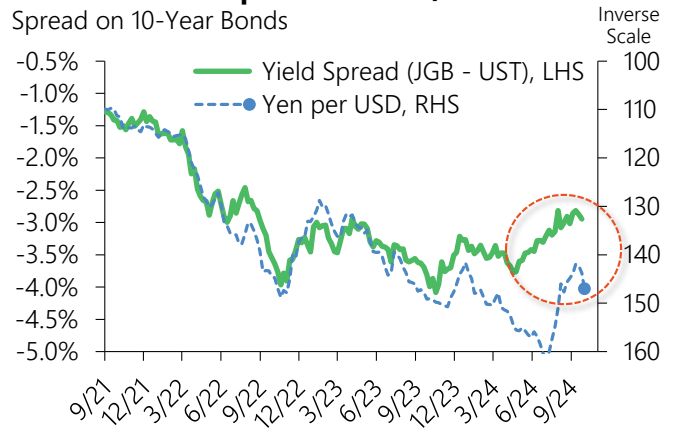
Japan’s economy regained its footing during 2024’s second quarter, growing at a +2.9 percent annualized rate. Recent Composite PMI readings imply continued, albeit more modest, growth through the third quarter. However, we still expect negligible real GDP growth for the full year after a weak first quarter. Wage growth improved and broadened after favorable spring labor union negotiations, lifting consumer confidence and spending. Still-low unemployment, solid inbound tourism, and elevated corporate sentiment suggest that wage and spending gains will persist. Likewise, core consumer inflation accelerated modestly to a six-month annualized rate of +2.3 percent in August versus the Bank of Japan’s +2.0 percent target. With evidence of a budding cycle of higher wages and prices mounting, the Bank of Japan increased interest rates again in July and is intent on tightening gradually. However, there is a risk the economy may backslide into deflation without ongoing monetary support. Weaker external demand is a significant risk and has kept a lid on Japan’s manufacturing sector. Additional uncertainties include limited clarity on the fiscal policy under newly appointed Prime Minister Shigeru Ishiba and continued currency volatility amid diverging global central bank policy actions (Exhibit 9).

Exhibit 8: Euro Area Composite PMI



Source: S&P Global, 10/3/24

Exhibit 9: Yield Spreads vs. JPY/USD FX Rates



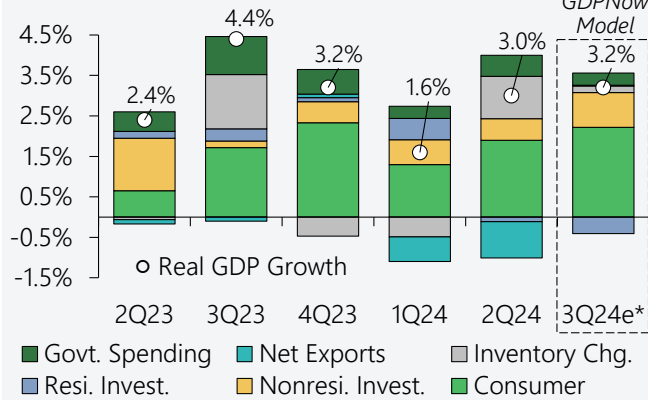
Source: Tullett Prebon, Federal Reserve, 9/30/24

United States: Other Notable Data Points

Resilient Consumer Spending Supports Growth

U.S. Real GDP

Contribution to SAAR Q/Q% Change

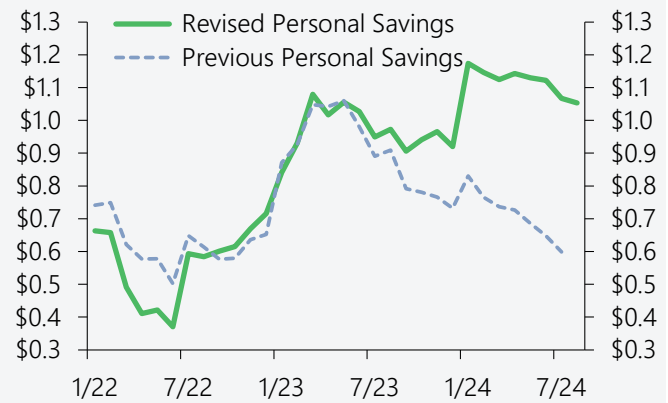


Source: Bureau of Economic Analysis, Atlanta Fed, 10/8/24

Reassuring Revisions to U.S. Personal Savings

U.S. Personal Savings

SAAR, Trillions

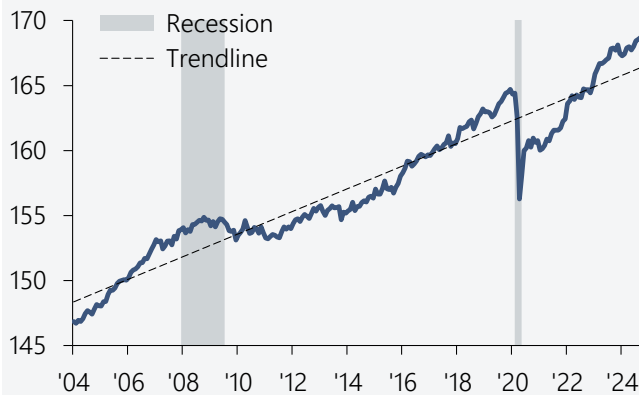


Source: Bureau of Economic Analysis, 9/26/24

U.S. Civilian Labor Force Well Above Trendline

U.S. Civilian Labor Force

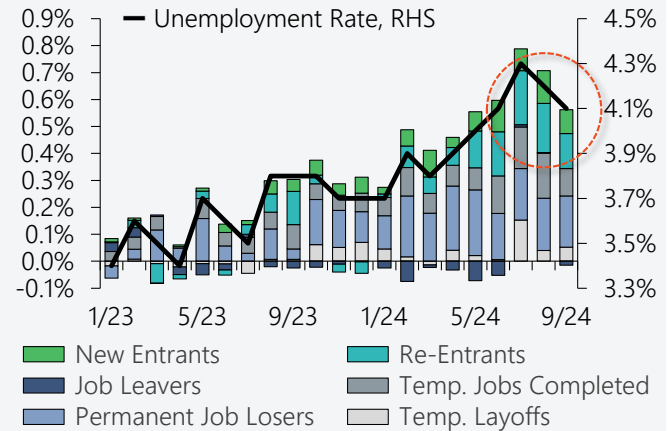
Seasonally-Adjusted, Millions



Source: Bureau of Labor Statistics, 10/4/24

Joblessness Up Partly on New and Re-Entrants

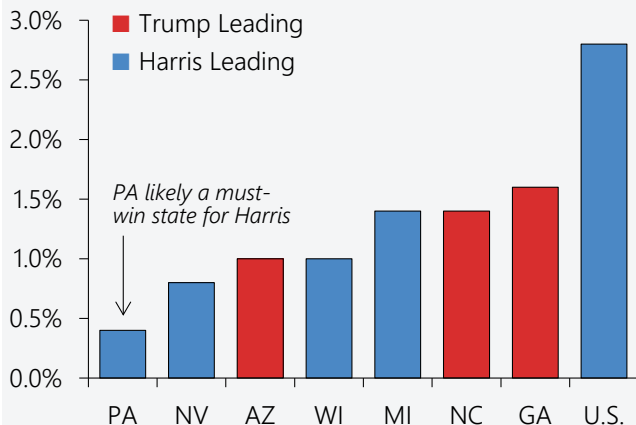
Cumulative Contribution to U.S. Unemployment Rate



Source: Bureau of Labor Statistics, 10/4/24

U.S. Presidential Election Way Too Close to Call

2024 Presidential Election Poll Differentials

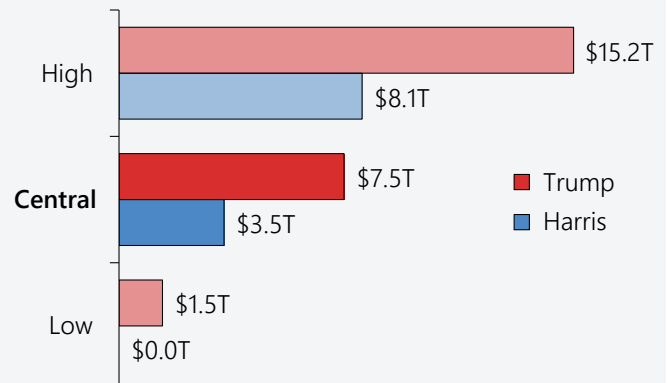


Source: 270 to Win (Average of Recent Polls), 10/8/24

Both Candidates Projected to Increase Deficit

Fiscal Impact of Harris and Trump Campaign Plans

Trillions, 2026-2035

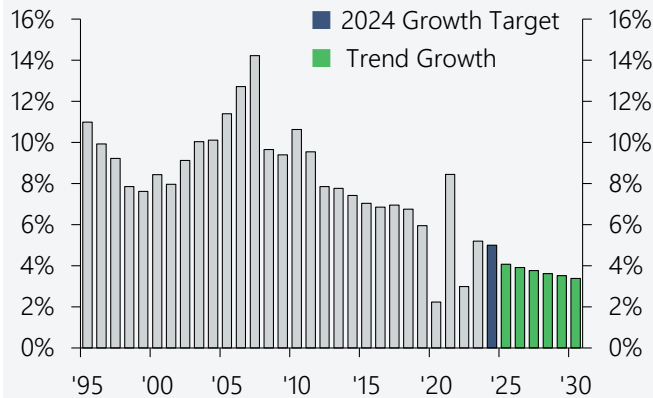


Source: Committee for a Responsible Federal Budget, 10/7/24

China: Other Notable Data Points

Trend Implies ≈3% GDP Growth by Decade-End

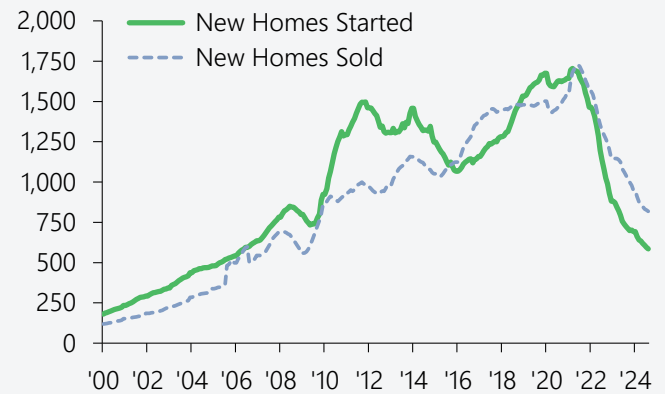
China Real GDP Growth
Y/Y Percent



Source: National Bureau of Statistics, 9/30/24

China's Property Market Continues to Tumble

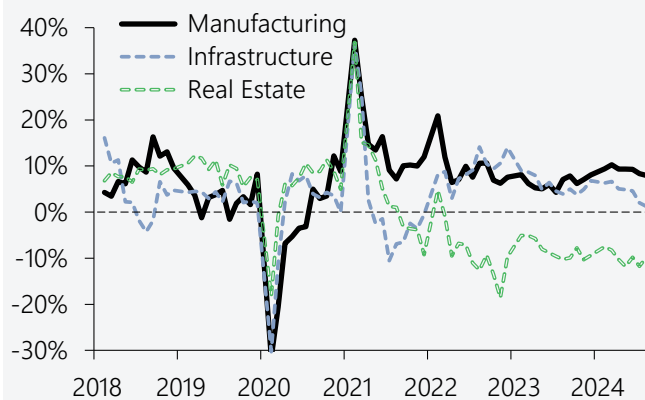
China Floor Space of Residential Buildings
Rolling 12-Month Sum, Millions of Square Meters



Source: National Bureau of Statistics, 9/15/24

China's Investment-Led Policies Aiding Growth

China Fixed Asset Investment
Monthly, Y/Y Percent



Source: National Bureau of Statistics, 9/15/24

... But Are Also Contributing to Deflation

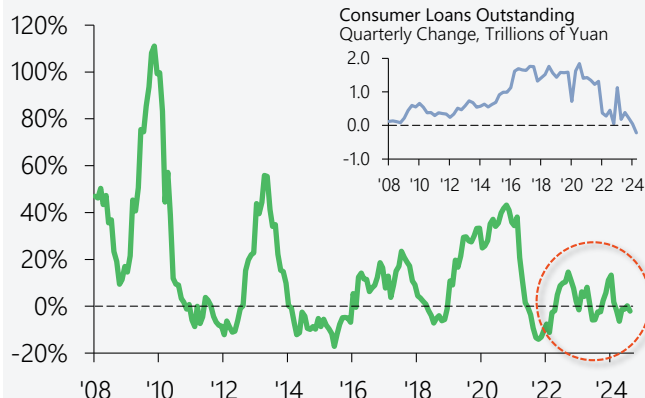
China GDP Deflator
Y/Y Percent



Source: Oxford Economics, 9/30/24

Standstill in Total Social Financing Growth

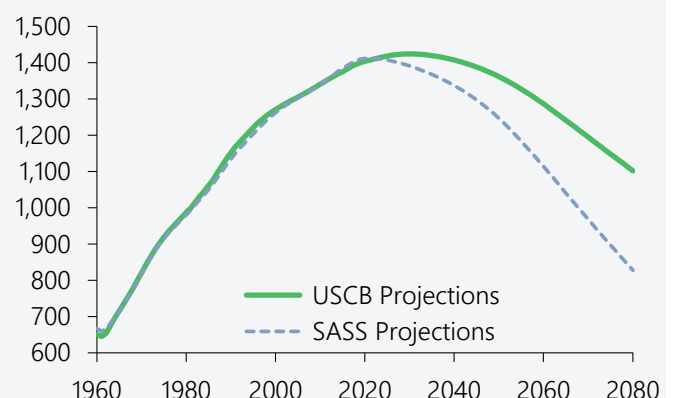
China Total Social Financing
Twelve-Month Moving Sum, Y/Y Percent



Source: People's Bank of China, 9/14/24

China Facing Weighty Demographic Headwinds

China's Population, Historical & Projected
Millions



Source: Census Bureau, Shanghai Academy of Social Sciences, 9/30/24



Federal Reserve Recalibrating Fed Funds Rate Toward Neutral

U.S. Treasury yields fell significantly in the third quarter of 2024 as the Federal Reserve (Fed) implemented a 50 basis point fed funds rate cut, marking its first step toward a neutral policy stance. The yield curve also steepened, with the 2-year Treasury yielding less than the 10-year for the first time since 2022. The Fed's decision to slash rates by 50 basis points instead of 25 reflects its increasing concern about deteriorating job conditions. Labor markets often weaken more rapidly than central banks can respond to with interest rate cuts, prompting Chair Powell to emphasize the importance of remaining ahead of the curve. Consequently, the Fed signaled an additional 50 basis point cut before year-end and a further 100 basis points of reductions in 2025. We believe that the economy will avoid a recession and that the Fed will reduce the fed funds rate to around 3.5 percent by mid-2025, bringing monetary policy closer to neutral (i.e., neither stimulates nor restricts economic growth). The neutral rate, sometimes called R^* (star), is dynamic and changes with varying economic conditions. As Chair Powell noted during the press conference, estimates of the neutral rate come with considerable uncertainty. Instead of relying solely on empirical or model-based estimates, he reiterated that the Fed will recognize the neutral policy rate by its effects on the economy.

Calm Corporate Spreads; Mortgage Spreads Remain Attractive

Reflecting the stable earnings environment, corporate bond spreads narrowed modestly in the third quarter. By sector, communications and utilities outperformed during the quarter (lower economic sensitivity), tech gave back some of its recent gains, and energy underperformed on declining commodity prices. Given the tight spreads, we remain underweight corporate bonds but anticipate more attractive investment opportunities to emerge as the economy softens. We have been selective when adding to our corporate exposure, recently purchasing bonds issued by SBA Tower Trust and secured by its cell phone towers. Given the stability of revenues owing to users' reliance on mobile communications, the collateral is of high quality. We also acquired bonds from Johnsonville Aeroderivative Combustion Turbine Generation LLC, backed by the Tennessee Valley Authority (TVA). TVA is using this structure to finance the construction of ten high-efficiency natural gas power plants for fast response to peak energy demand. Whereas corporate spreads remain narrow, concerns about elevated prepayments have kept spreads on high-coupon mortgages relatively wide. As a result, we have raised our allocation to mortgage-related securities and taxable municipal bonds with prepayment protections, which offer more attractive valuations than corporate bonds currently.

Taxable Fixed Income Strategy

We are maintaining an overweight position in the middle of the yield curve, where appropriate, to capitalize on the shift toward lower rates and a steeper curve. Portfolios remain underweight longer maturity bonds, as we expect a soft landing to constrain significant yield movements on the long end of the curve. Additionally, we continue to reduce exposure to lower-quality assets, where appropriate, as we do not expect investors to chase lower rates by buying credit-sensitive bonds for the currently attractive yields, which would likely widen spreads. On the other hand, portfolios have significant exposure to specific bank and finance companies where spreads are attractive relative to the credit risks. Portfolios are also overweight bonds backed by cell phone tower leases, as discussed above, and favor high-quality bonds issued by utilities with minimal wildfire risk exposure, midstream firms, and stranded cost assets. Finally, portfolios continue to benefit from an income advantage as spreads in mortgage-related sectors remain historically wide. We anticipate mortgage spreads to narrow closer to normalized ranges as interest rates decline and expect this income advantage to be the key driver of outperformance over time.



High-Grade Tax-Exempt Yield Curve Steepens

The tax-exempt yield curve steepened during the third quarter of 2024 as short-term yields fell much more than long-term yields. Specifically, the two-year Municipal Market Data (MMD) AAA General Obligation (GO) yield plummeted by over 80 basis points to +2.30 percent. In comparison, the 30-year MMD AAA GO yield only fell by twenty basis points to +3.52 percent during the quarter. In general, credit spreads were relatively stable during the quarter.

Strong Third Quarter Tax-Exempt Bond Performance

Third-quarter tax-exempt municipal bond performance was strong (Exhibit 10). Intermediate bonds in the five-to-seven-year range performed best, but all duration tenors did well. Credit quality was not a large differentiator, as returns were relatively similar across quality ranges. Performance across revenue bond sectors was also strong; notably, housing bonds produced among the best returns during the quarter.

Market Absorbs Record New Issue Volume

Municipal bond issuance remains strong and totaled \$380 billion for the first nine months of 2024, already reaching last year's total. Issuance is on track to achieve a record this year, exceeding the previous high of nearly \$485 billion in 2020. Flows into tax-exempt mutual and exchange-traded funds were positive during the third quarter. Third quarter secondary trading volume was the lightest quarter since rates increased rapidly in early 2022. As a result, the market easily absorbed the heavy supply.

Tax-Exempt Fixed Income Outlook

As anticipated, the Federal Reserve has started to shift from a restrictive to a neutral policy by cutting the fed funds rate in September. This action has moved the question from when and if the Fed will cut rates to how often and by how much will the Fed continue to cut rates. All eyes remain on the economy and whether inflation accelerates or employment weakens. It seems we may achieve a relatively soft landing, which sets the stage for a favorable backdrop for fixed income in general and tax-exempt bonds in particular. However, we are within a month of a presidential election, which remains too close to call. Also, tensions in the Middle East are intensifying, and tax-exempt yield ratios relative to comparable maturity Treasury yields remain rich. While investor demand for tax-exempt income remains strong, short-term volatility may occur if economic or political results differ from market participant expectations or if geopolitical events lead to a flight to quality.

Tax-Exempt Fixed Income Strategy

We continue to emphasize revenue bonds over general obligation bonds in client portfolios. Moreover, many of our recent purchases have been single-family housing bonds and airport revenue bonds, which possess relative value compared to other tax-exempt bonds. Given the likely trajectory of rates, we have become more discerning in the types of short-call bonds we purchase for client portfolios. Still, we have been able to find sufficient opportunities for client portfolios. In terms of duration, we have positioned most portfolios with longer than benchmark duration. Portfolios also possess significant yield advantages over their benchmarks. We think client portfolios are positioned well for the current environment.

Exhibit 10: Bloomberg Municipal Bond Index Percent Returns

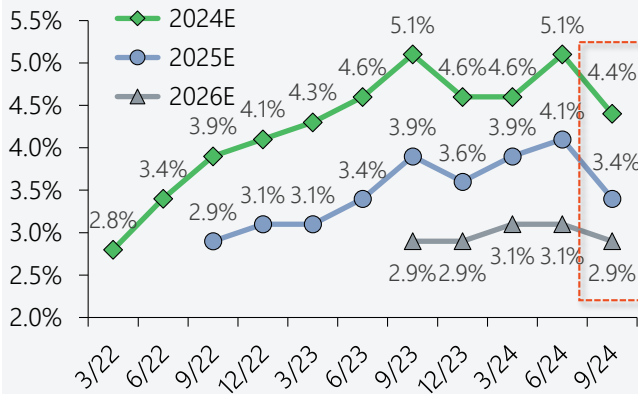
	3Q24		2024			3Q24		2024			3Q24		2024	
Muni Bond Index	2.71	2.30	AAA	2.79	1.67	GO Bond Index	2.77	1.75						
3-Year	2.39	2.47	AA	2.69	1.99	Revenue Bond Index	2.70	2.50	Education	2.64	2.05			
5-Year	3.04	2.23	A	2.67	3.01	Electric	2.56	2.06	Water & Sewer	2.62	1.91			
7-Year	3.20	1.83	BBB	2.91	4.24	Hospital	2.61	3.23	Resource Recovery	3.28	1.42			
10-Year	2.64	1.02				Housing	3.13	3.25	Leasing	2.82	2.02			
Long	3.03	3.11				IDR/PCR	3.23	4.48	Special Tax	2.58	1.81			
						Transportation	2.62	2.51	Tobacco Index	1.98	2.95			

Source: Bloomberg, 9/30/24

Fixed Income: Other Notable Data Points

FOMC Projections Reinforce Further Easing

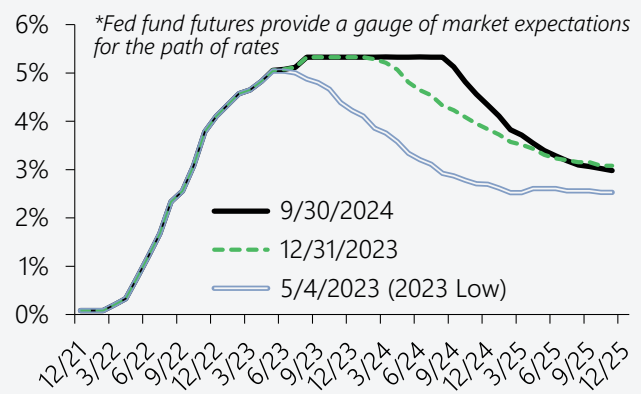
FOMC Median Fed Funds Rate Projections
Year End, Percent



Source: Federal Reserve, 9/18/24

Markets Pricing in Added Rate Cuts for 2025

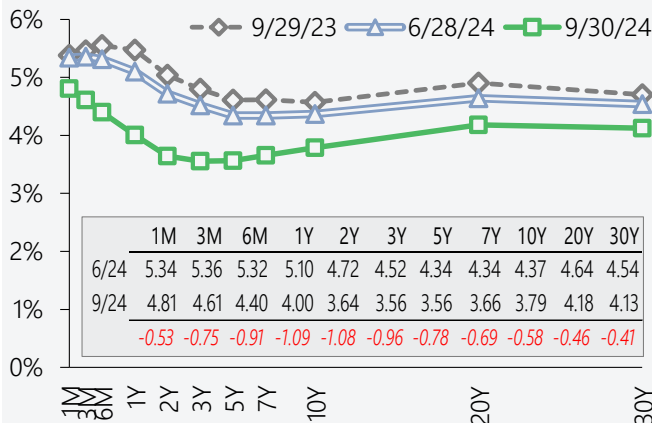
Fed Funds Futures Curve*
Implied Fed Funds Rate



Source: CME Group, 9/30/24

Treasury Yield Curve Will Continue to Steepen

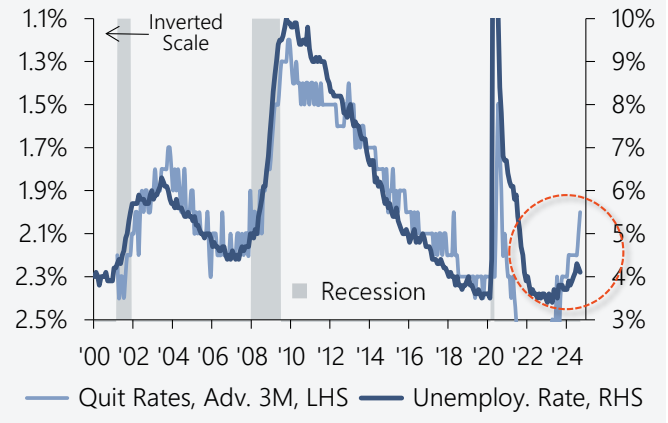
U.S. Treasury Yield Curve



Source: FactSet, 9/30/24

Fed Focused on Labor Market Deterioration

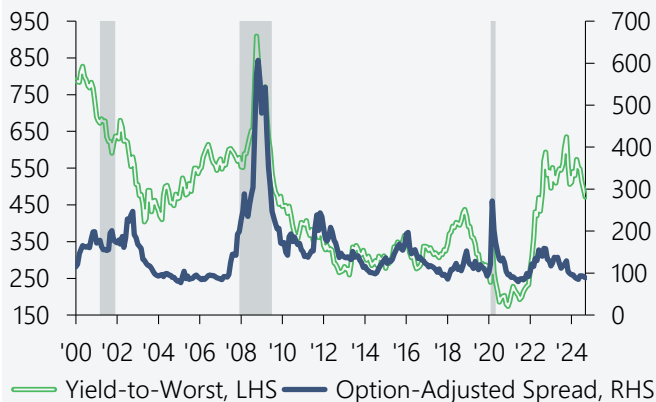
U.S. Quit Rate vs. Unemployment Rate



Source: Bureau of Labor Statistics, NBER, 10/4/24

Corporate Spreads Remain Historically Tight

Bloomberg U.S. Aggregate Corporate IG
Basis Points



Source: Bloomberg, 9/30/24

Mortgage Spreads Remain Highly Attractive

Average MBS Yield vs. 5-10-Year Treasury Yield
Spread, Basis Points



Source: Bloomberg, 9/30/24



Global Equities: Environment and Strategy

U.S. Stock Market Broadened Considerably in September Quarter

The S&P 500 Index gained +5.9 percent in 2024's third quarter to bring the year-to-date return to +22.1 percent. Nonetheless, the robust returns mask the considerable swings in the equity market and investors' risk appetite during the quarter. Broad large-cap equity indices marched higher through the first half of July but slumped in the second as investors, driven by the rising odds for interest rate cuts, rotated from crowded mega-cap artificial intelligence plays into bond proxies and small-cap stocks. Stocks across the market cap size and investment style spectrum then sold off in the first few trading days of August due to renewed U.S. recession fears and an unwind in the yen carry trade. Stocks regained their footing, but investors shifted decidedly to risk-off in August from July's risk-on rotation into small-cap stocks, with large-cap defensive sectors outperforming for the month. While September has historically been a weak month for stocks, the S&P 500 returned +2.1 percent to become the best September since 2013. Interest rate-sensitive sectors such as consumer discretionary, utilities, and telecom led the Index to a new high. Notably, as we predicted, participation in market gains broadened considerably, with 66 percent of S&P 500 constituents outperforming the overall Index in the September quarter versus 25 percent in the June quarter and 35 percent in the March quarter (Exhibit 11).

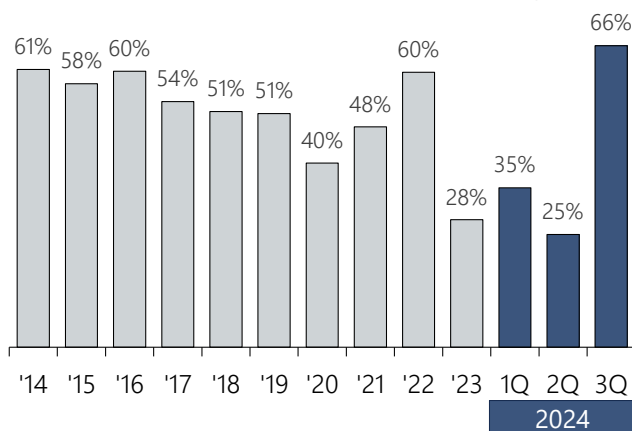
Strong Flows Into U.S. Equity Funds Helping Trigger Cautionary Technical Signals

Improving U.S. corporate earnings growth, declining interest rates, the fear of missing out (do not fight the Fed), and the vast amount of legacy liquidity sloshing around the financial system continue to underpin positive U.S. equity fund flows. Over \$120 billion flowed into U.S. equity mutual funds and ETFs, taking the twelve-month cumulative sum to \$361 billion (Exhibit 12). In addition, nearly \$1.8 trillion has flowed into equity mutual funds and ETFs worldwide since the beginning of 2021, with 74 percent of that going into U.S. equity funds or global funds with U.S. exposure. As per the NAAIM Exposure Index, active portfolio managers ended September with elevated, but not stretched, risk exposures, implying there is room for incremental equity buying. However, the 14-month relative strength index is in overbought territory for both the market-cap and equal-weighted S&P 500. Then again, while the S&P 500 has rarely remained oversold for long, it has been overbought for lengthy periods in the past. Citi's Levkovich Index (formerly called the Panic-Euphoria Model) has receded somewhat from its recent highs (i.e., investors are too euphoric), but it, too, continues to send cautionary signals. Goldman Sachs' U.S. Bear Market Indicator has also risen into the danger zone. As a result, earnings likely need to surprise to the upside for the broader market to move meaningfully higher from here.

Global Equity Strategy

For most of 2024, equity investors have generally expected monetary easing and a soft landing. As a result, stock valuations have already discounted much of this increasingly likely outcome. We suspect very limited, if any, multiple expansion in the near- to intermediate-term, requiring

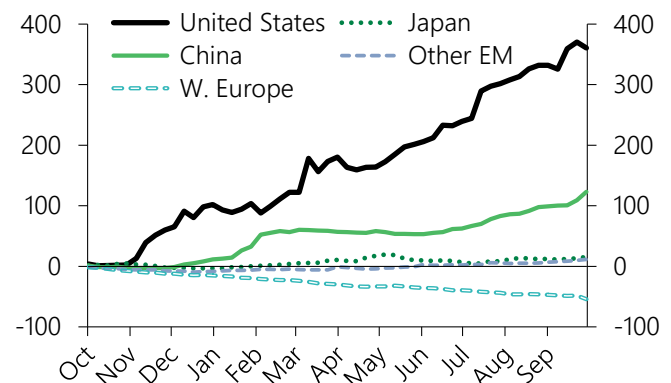
Exhibit 11: % of S&P 500 Stocks Beating Index



Source: FactSet, 9/30/24

Exhibit 12: Global Equity Fund Flows, LTM

\$ Billions, Cumulative



Source: EPFR, 10/2/24



earnings growth to drive prospective equity returns. Importantly, earnings growth is showing nascent signs of acceleration (partly due to easy comparisons) just as monetary loosening and significant Chinese stimulus are set to add further support, especially in 2025. In this regard, we suspect stock gains will continue to broaden as investors anticipate cyclical improvements in the global economy, favoring a broad group of industries, including technology, industrials, financials, transports, and beleaguered consumer cyclicals. However, given our expectation for a relatively muted economic rebound in 2025, our efforts are focused on identifying firms that can demonstrate operating leverage to drive outsized earnings gains even if revenues accelerate only modestly. Moreover, we believe dividend-paying stocks will return to favor as bond yields become less competitive – our focus remains on investing in high-quality companies that can grow dividends at an above-market pace through earnings growth and higher payout ratios.

Although we expect stock market returns to broaden, we do not see material weakness in the “artificial intelligence (AI) trade,” given powerful underlying fundamentals that are broadening into adjacent industries. For example, U.S. power demand appears set for a growth inflection as AI ambitions fuel a significant buildout in power-intensive data centers and broader electrification efforts continue nationwide. The combination of meaningful capital deployment to pursue AI’s open-ended potential, the outsized power needs of specialized AI chips, and an inadequate power grid after two decades of stagnant demand point to power generation as a bottleneck. We anticipate a multi-year investment cycle in power infrastructure and an “all-of-the-above” approach to power generation sources, as there are (1) no quick solutions owing to long build cycles, (2) reliability issues with renewable power sources, and (3) permitting and regulatory challenges. We expect natural gas, which accounts for around 40 percent of U.S. electricity generation, to be critical in meeting power demand growth. Thus, we favor related companies such as natural gas pipeline operators and gas-fired power plant service providers.

We like China, South Korea, Singapore, and India equities for the international portfolios. We maintain an overweight position in China because of its attractive valuation, which we believe reflects excessive investor pessimism and our expectation that China’s stimulus measures may turn out to be more positive than expected. The MSCI China Index fell -15.4 percent from May 20 to September 9 amid weak macro data. Yet, we saw a significant shift in the market sentiment following the Federal Reserve’s rate cut and China’s latest stimulus efforts. As a result, the Index surged over +27.0 percent from its September low through month-end. While near-term liquidity-driven momentum remains strong, whether it sustains depends on follow-up policies and how those policies would shape the growth outlook. The MSCI China Index is currently trading at about 10.8x forward earnings, which remains cheap from both a historical perspective and relative to global counterparts. We maintain a balanced portfolio in sectors with positive secular trends, such as internet, insurance, consumer, and utilities. We also like companies with stable fundamentals and high dividend yields.

In Mexico, as expected, leftwing nationalist President Andres Manuel Lopez Obrador’s Judicial reform was approved by Congress. As a result, all of Mexico’s more than 1,700 federal judges and magistrates, including Supreme Court justices, will face nationwide elections in 2025 and 2027. The reform would end judicial independence and violate the 2020 U.S.-Mexico-Canada Agreement that replaced NAFTA. Accordingly, we are more cautious about Mexican equities, as the measure undermines the rule of law, weakens the judicial system, and imperils trade and investment. On the other hand, we like India for its strong economic growth and South Korea for its Corporate Value-Up Index program. Our preferred sectors in emerging markets include financials, e-commerce, consumer staples, industrials, renewable energy, technology, and basic materials.

Global Equities: Other Notable Data Points

U.S. Small-Cap & International Did Well in 3Q

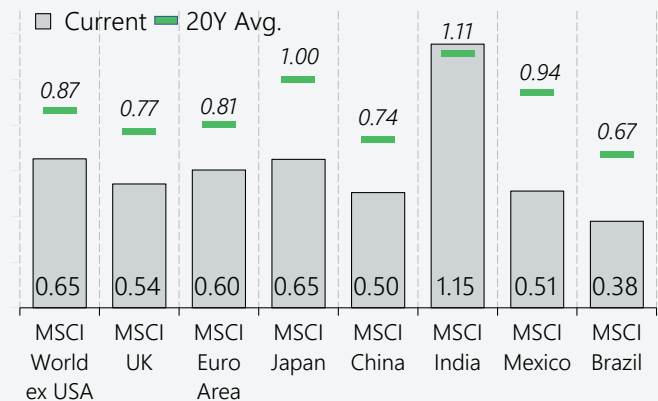
Total Returns, in U.S. Dollars
Percent, as of 9/30/24

	Annualized				
	3Q	YTD	1 Yrs.	3 Yrs.	5 Yrs.
Russell 1000® Gr.	3.2	24.5	42.2	12.0	19.7
S&P 500®	5.9	22.1	36.4	11.9	16.0
MSCI AC Asia Pac	9.2	17.8	27.3	2.4	7.3
MSCI EM	8.9	17.2	26.5	0.8	6.1
MSCI World (ex. U.S.)	7.8	13.6	25.6	6.2	8.9
MSCI EAFE	7.3	13.5	25.4	6.0	8.7
Russell 2000® Gr.	8.4	13.2	27.7	-0.4	8.8
Russell MidCap® Gr.	6.5	12.9	29.3	2.3	11.5
Russell 2000®	9.3	11.2	26.8	1.8	9.4

Source: FactSet, 9/30/24

International Stocks Attractive Relative to U.S.

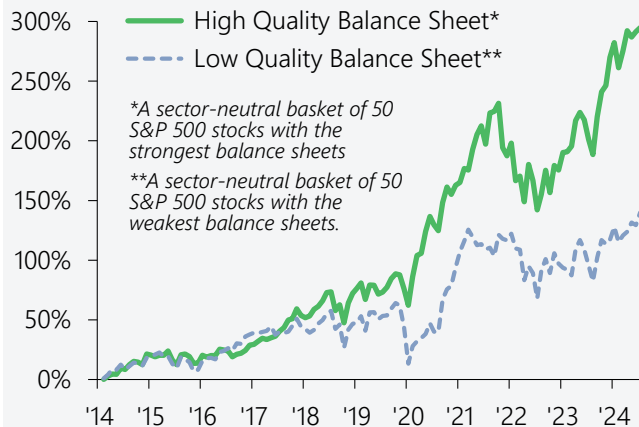
NTM Relative PE Multiples, by MSCI Region/Country
Relative to MSCI USA Index



Source: FactSet, 9/30/24

Quality Has Considerable Performance Lead

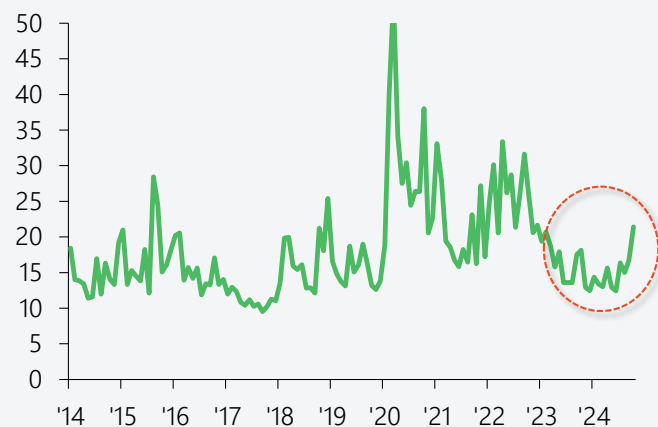
Cumulative Return



Source: Goldman Sachs, Bloomberg, 9/30/24

Stock Market Volatility Rising Into U.S. Election

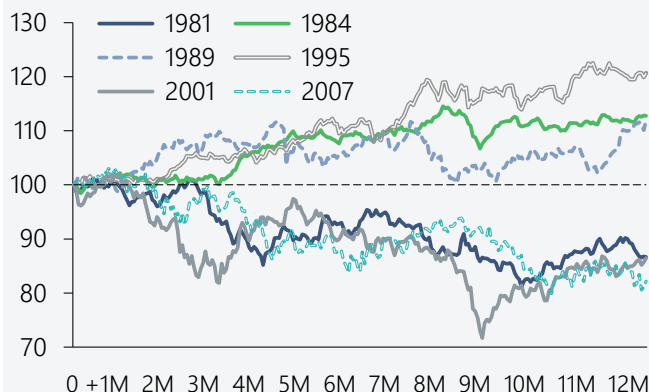
CBOE Volatility Index (VIX)



Source: FactSet, 10/8/24

Economy Dictates Stock Returns After First Cut

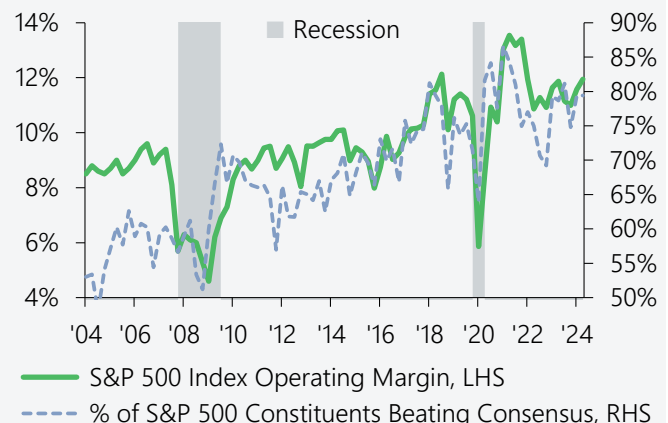
Avg. S&P 500 Performance After First Rate Cut of Cycle
Rate Cut Date = 100



Source: FactSet, 9/30/24

Profitability and Earnings Beats Trending Higher

S&P 500 Index Margins vs. Earnings Beat Percentage



Source: S&P Global, FactSet, 9/30/24

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