JOURNEY

Journey Wealth

Quarterly Market Commentary

Q4 September 2024

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Journey Wealth Investment Team

Pete Franz, CFA, CFP – Chief Investment Officer

As the CIO of Journey Wealth, Pete is responsible for establishing, managing, and articulating the firm's investment platform and approach. He collaborates with the firm's investment partners, monitors markets, and conducts portfolio analysis to construct portfolios that align with client objectives.

As the Head of Investments, Jack divides his time between developing solutions for clients and assisting with the curation of the firm's investment portfolios. Jack supports Pete in all facets of developing and monitoring the Journey Wealth investment platform, including working with key asset managers, our advisory team, and conducting ongoing research.

Jack LaLiberte, CFA, CPA - Manager, Investments

Market Recap

Market Recap

While equity markets have continued their steady, although slightly bumpier, march higher in the third quarter, fixed income has performed remarkably well. In the lead-up to a widely telegraphed Fed easing cycle, investors prudently shifted from cash and money market funds towards core fixed income. This has driven performance in bonds comparable to that of equities over the past quarter*. While there have been some cracks around the edges, the global consumer has remained stable, although the impact of the COVID-era stimulus appears to be dwindling.

Looking Ahead

After years of prognostication, rate cuts are finally here. While the pace and depth of cuts remains uncertain, the yields in cash and near-cash instruments are likely to continue to decline. Fixed income has historically performed well during cutting cycles. However, the correlation between short-term rates and longer-term fixed income performance is far from perfect. Other factors, including the shape of the yield curve and issuance dynamics, also influence fixed income performance. The equity picture is murkier. Valuations remain above long-term averages, particularly in the large cap US segment. Lower rates and a weaker Dollar could act as catalysts for small-cap and international equity performance, respectively. Although domestic GDP growth is unlikely to maintain the strong pace of the past few years, a gradual slow-down appears more likely than a severe recession.

Asset Allocation

The typical investor allows the ubiquitous noise of the marketplace to drive investment decisions. At Journey Wealth, we take a distinctly different approach. We let our clients' financial plans and unique needs drive their allocation of capital. Between geopolitical instability, election uncertainty and shifting interest rate expectations, the rest of the year is likely to be a volatile time for financial markets. While volatility can be disconcerting, we encourage proactive risk management by ensuring that your investment allocation lines up with your risk tolerance and financial plan. Please don't hesitate to reach out to your advisor to schedule time to discuss your financial plan, including your goals and planning assumptions. Letting planning drive the investment approach helps ensure that your portfolio remains aligned with your vision for the future.

*As measured by the S&P 500 Index compared to the Bloomberg Aggregate Bond Index..

**See disclosures on final page of this document

Leading Topics

Equity Markets

For the past two years, domestic equity markets have marched upwards without significant bumps in the road. Since October of 2022, the S&P 500 has returned over 50% and the PE ratio of the index has increased by over 40%. In 2023, performance was confined to a narrow segment of growth-oriented tech companies. In 2024, performance broadened considerably as the gap between US and international performance has narrowed, as well as the gap between large US tech companies and the rest of the domestic equity universe. It's impossible to tell where equity markets will go from here. While recent performance has been impressive and valuations appear rich, lower interest rates may spur continued upside potential. Small-cap equities are typically more sensitive to interest rates than their larger counterparts, who tend to have minimal exposure to floating rate debt. With the elevated levels of concentration in the S&P 500, diversification remains critical. Exposure to small-cap and international equities provides a key component of risk mitigation.

Federal Reserve/Fixed Income

The Fed began the much-anticipated easing process with their first rate cut last month. The market's response was largely muted. While one rate cut is not overly significant, the shift in direction is. Fixed income typically outperforms cash and other short-term instruments in easing cycles. While it's generally better to extend duration before the Fed begins easing, as seen during the recent summer bond rally, there's still time to reduce reinvestment risk by adding duration. Long-term yields remain at attractive levels. The Fed's projections indicate the possibility of another 50 bps of additional cuts this year.

Macroeconomic Outlook

Over the past year, we've seen some economic softening but nothing that indicates that a recession is imminent. Unemployment has ticked up but remains below historical averages. The US consumer has weakened over the past few years, although the consumer started from a very strong position fueled by stimulus. A weaker consumer alongside a strained government budget poses a growth risk for the economy. Those two segments represent approximately 85% of US GDP. Ultimately a government that spends about 60% of its revenue on interest payments and entitlements is unlikely to be able to make substantial investments in areas that spur long-term growth. A weaker consumer with lower levels of savings also points to a slower path of growth going forward.

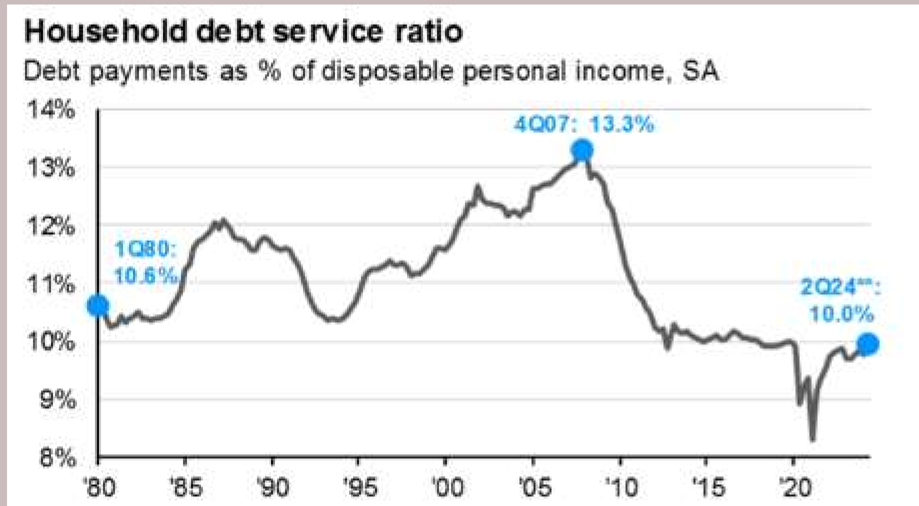
International Opportunities

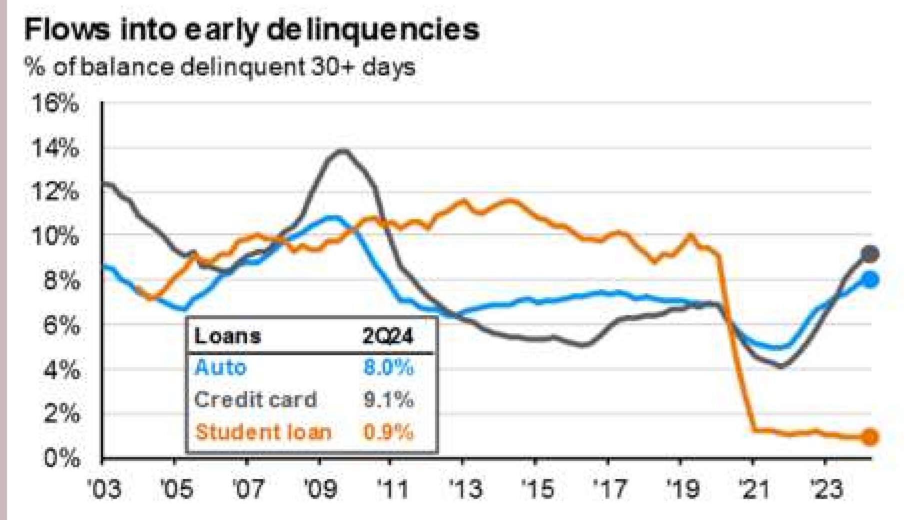
While US GDP growth is likely to slow in the near term, there are tailwinds for emerging market equities. Not only do these provide a broader opportunity set for growth, but they also reduce concentration risk for portfolios with significant US equity exposure. As additional rate cuts occur in the US, the dollar is likely to weaken. Historically, a weaker Dollar has provided a tailwind for international equities. The other factor is the impact of demographics on growth. While the US population is aging and birth rates decline, many emerging market economies feature expanding workforces and young populations, particularly in Mexico and India. Measured exposure to international equities could provide investors with a broader growth opportunity set as well as added diversification.

Slower Growth or Recession?

Three years ago, the US consumer was bulletproof. Unemployment was rapidly dropping, consumers were flush with stimulus, interest rates were near historic lows and the wealth effect was in full swing. So, what's changed in the interim? The labor market has loosened but unemployment remains well below the 10-year average. Equity markets and housing values remain near all time highs. The factors weighing on the health of the consumer today are a lack of excess savings and larger debt service obligations. Consumer savings levels have returned to pre-COVID levels, as have debt service ratios. However, auto and credit card delinquencies have risen to levels not seen since the wake of the financial crisis.

Consumer spending represents nearly 70% of US GDP. The divergence in delinquencies and overall debt service levels points to stress at the lower end of the consumer segment. The ratio of credit card debt to monthly income is between 60-80% for the lowest 30% of households by income. While consumer health has worsened and weakness at the lower end of the income spectrum should be monitored, nothing points to an imminent recession risk, barring some unforeseen economic shock.



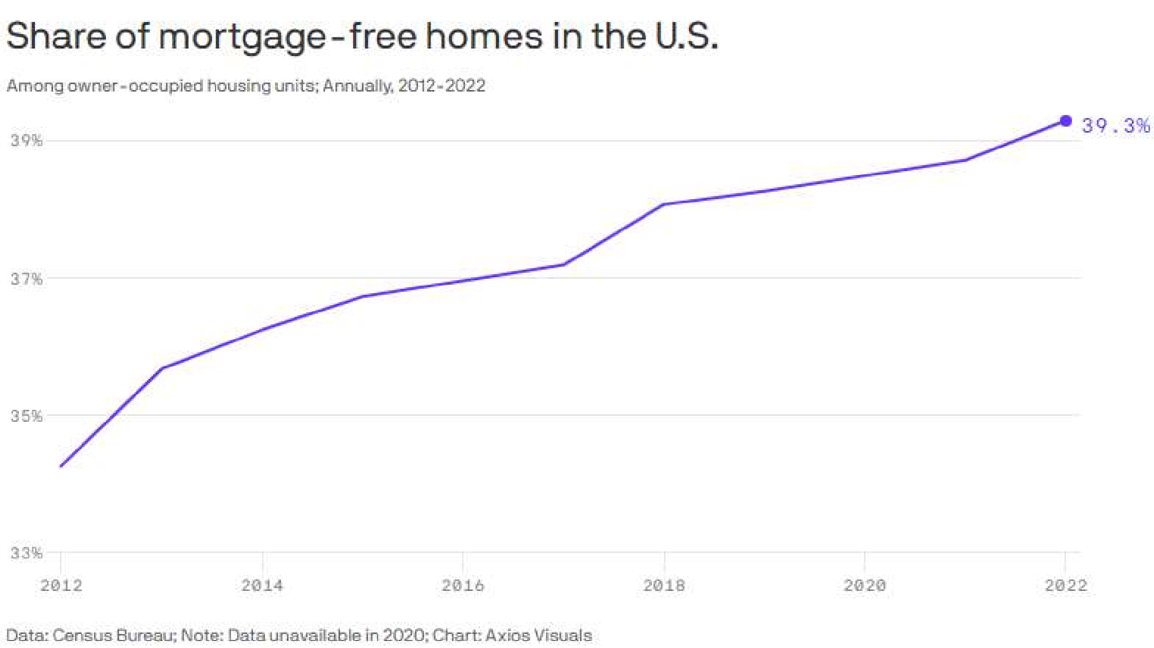


Source: JP Morgan

Housing: Will Rate Cuts Unlock Supply?

Many commentators have posited that once the Fed cuts rates, supply will return to the housing market. While that may be true to a degree, the impact of rate cuts on housing supply is likely exaggerated. Adjusting for seasonality, housing starts have steadily declined since their 2022 peak, likely due to concerns over affordability and interest rates. As far as existing supply goes, approximately 40% of US homeowners own their homes outright. Of those with mortgages, the average rate is about 4%.

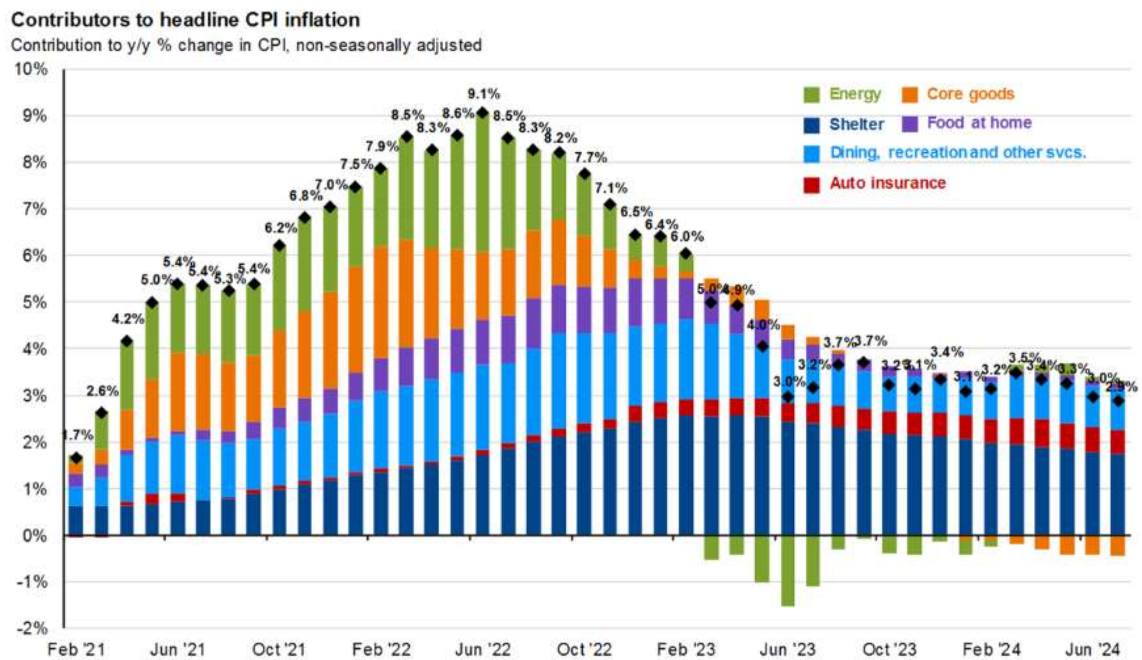
Mortgage rates have declined substantially over the past year, after peaking near 8% in the Fall of 2023. 30-year rates now sit around 6%. As such, the rate trade-off for sellers has already shrunk considerably and home sales rates remain at nearly the same levels as at the end of 2023. Ultimately, while rate cuts are likely to unlock some supply and spur some homebuilders to increase new housing starts, the quantity of housing available may not drastically increase. Nationally, home affordability remains near record lows. Interest rate cuts are helpful, but the correlation between the Fed Funds Rate and mortgage rates is far from perfect.



Inflation: A Lagging Indicator

The past year has seen slow but gradual improvement in inflation. While goods inflation has improved drastically, services and shelter costs have remained stubborn. The decline in inflation has been accomplished without a significant increase to unemployment or a dramatic slowdown in economic growth, at least not that we've seen thus far. While the pace of inflation remains above the Fed's 2% target, the largest component of inflation is measured using a lagged methodology.

The shelter component of CPI represents nearly two thirds of the current inflation figure. It's important to note that the shelter component of CPI is measured based on leases signed over the past 12 months. The Zillow Rent Index is a more current measurement that uses new leases signed. The Zillow Rent Index has increased 3.36% YoY as of August while the CPI shelter component currently sits at 5.21% YoY. As the shelter component of CPI catches up to current conditions, it's likely to place additional downward pressure on headline inflation. This was likely a consideration in the Fed's decision to cut rates in September.

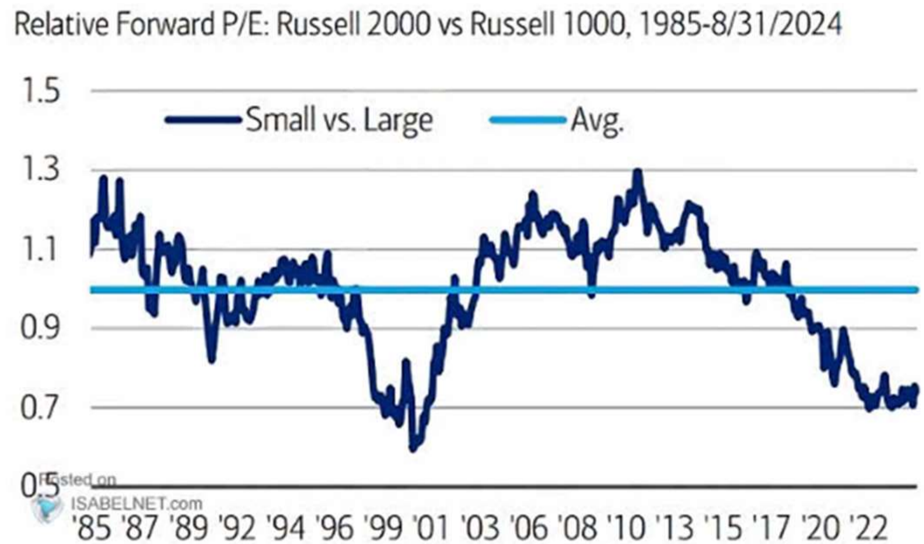


Source: JP Morgan

Federal Reserve & Equity Outlook

Last month, the Fed executed their widely telegraphed rate cut, reducing the Fed Funds rate by 50 bps. Policymakers anticipate another 50 bps of cuts this year and approximately 100 bps next year, although their projections are notoriously unreliable. Historically, cutting cycles that begin during non-recessionary periods have been favorable for equities. Prior to the current easing cycle, non-recessionary easing has occurred four times in the past 50 years. In those cycles, the S&P 500 realized an average return of just over 17% in the 12 months following the first rate cut. Contrary to conventional wisdom, small caps haven't fared as well in these cycles, with an average return of just under 6% over the same time frame. Small cap equities typically have more exposure to floating rate debt than their larger counterparts. A differentiating aspect of the current equity landscape is the magnitude of the valuation gap between large and small cap equities.

Small-cap US equities sport compelling valuations relative to large caps. The sector composition of the indices also differ. The small-cap focused Russell 2000 is tilted more towards the financial sector whereas large cap indices have more exposure to Tech. Both sectors stand to potentially benefit from additional rate cuts. A steeper yield curve benefits financial institutions as the gap between short and long-term rates is a significant determinant of net interest margin. Tech firms typically fall into the "growth" style of the equity universe. For these growthier companies, investors typically forecast a steep trajectory of earnings growth. Having a larger proportion of earnings forecast further out in time makes these equities more sensitive to interest rate assumptions than those where steadier earnings growth is expected. Although the granular picture is more nuanced, the takeaway is that historically non-recessionary easing cycles have been a tailwind for equities. While large cap equities have outperformed in past cycles, the present valuation dynamic could present opportunities for relative small-cap outperformance.



Source: BofA US Equity & Quant Strategy, FactSet

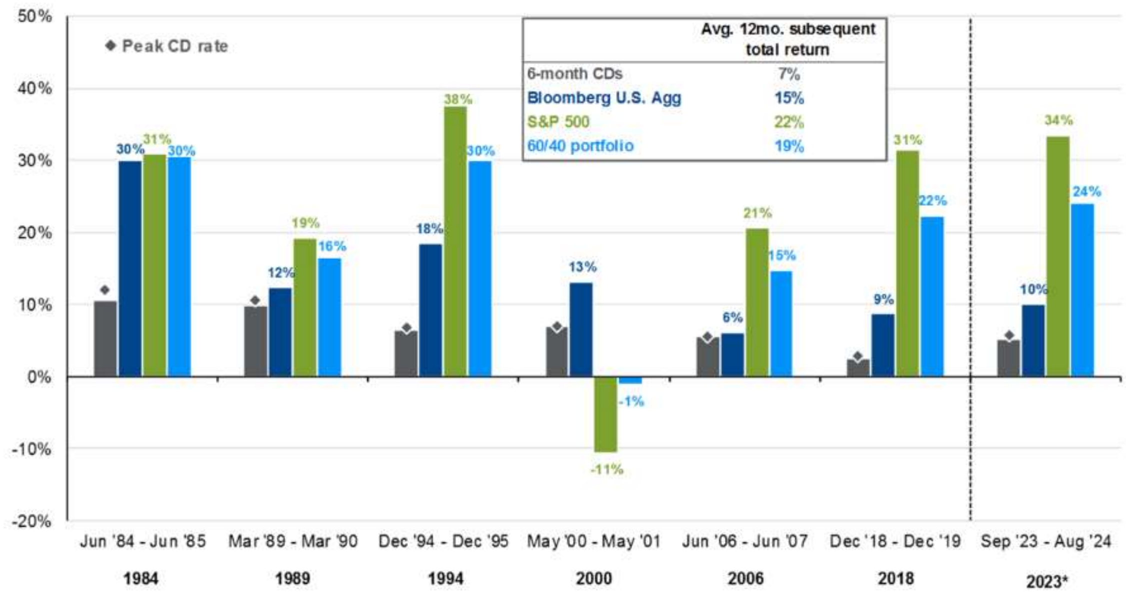
Fixed Income

One of the critical aspects of fixed income portfolio management, particularly during periods of interest rate volatility, is the balancing of reinvestment and interest rate risk. We've been advocates of duration extension for some time as the risk pendulum has swung from interest rate to reinvestment risk over the past two years. Investors who were able to look past the enticing but fickle yields available in cash and extend duration prior to the Fed's first cut were rewarded with a substantial summer bond rally. While impressive equity performance has diverted attention away from fixed income, over the past three months US bond returns (as measured by the Bloomberg US Aggregate Bond Index) have kept pace with the S&P 500. That's a rare occurrence when the S&P 500 is hitting fresh record highs. While some of the upside has already occurred, yields in fixed income remain attractive relative to the past decade. The yield trade-off between money market funds and core fixed income has diminished to nearly zero. The difference is that cash yields have nowhere to go but down in the near term. Over the past six Fed easing cycles, fixed income has healthily outperformed cash, with the Bloomberg US Aggregate Bond Index averaging a 15% return in the 12 months following the first cut. Given recent yield compression at the longer end of the curve, we'd caution against over-extending duration but still feel that core fixed income offers a better risk adjusted opportunity set than cash.

While interest rate volatility is likely to continue as the Fed's actions and political uncertainty buffet the yield curve, the opportunities available in fixed income appear attractive on a risk-adjusted basis. Although yields on cash equivalents are enticing, those rates can decline at the Fed's discretion, exposing investors to reinvestment risk. We frame our investment process in terms of our clients' financial planning needs and the hurdle rates necessary for clients to achieve their financial goals. Locking in yields in the 5% range for the long term can go a long way towards achieving those goals.

Investment opportunities outside of CDs

Peak 6-month certificate of deposit (CD) rate during previous rate hiking cycles and subsequent 12-month total returns



Source: JP Morgan

International Equities

International equity valuations look attractive relative to US equities, particularly those in the large cap growth category. As US equities have sustained their strong performance this year, the valuation gap has continued to expand. However, the appeal of international equities is broader than just favorable valuations.

In an environment where the S&P 500 is arguably more concentrated than ever before, international equities offer diversification. At the end of September, ten stocks comprised over one third of the weight of the S&P 500. Seven of those are concentrated in the Communications and Technology sectors. By contrast, the ACWI ex. US Index is far less concentrated, both on an individual name and sector basis. The top ten companies only made up about 12.5% of the index at the end of September and those companies are diversified across a variety of sectors.

Another piece of the international thesis is the currency movements associated with the present easing cycle. The US Dollar has weakened since the spring as markets built in the prospect of lower domestic rates. As the gap between domestic rates and those of other developed countries shrinks, the potential exists for additional weakening. A weaker Dollar could be a tailwind for international equities as well as fixed income.

International: Price-to-earnings discount vs. U.S.
MSCI All Country World ex-U.S. vs. S&P 500, next 12 months

Source: JPMorgan Asset Management

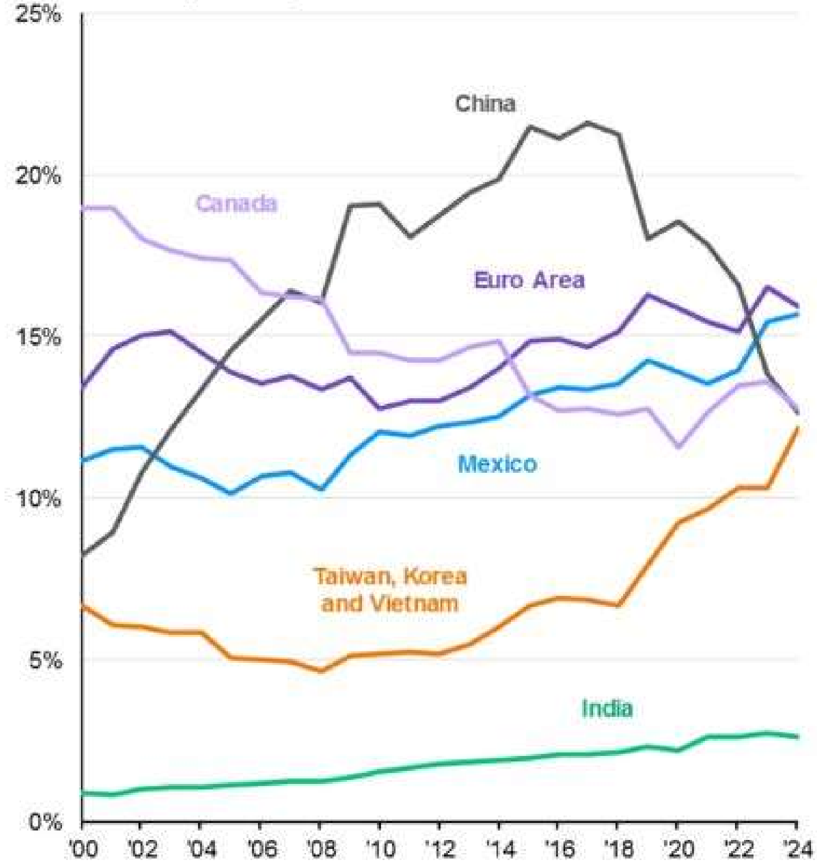
Emerging Opportunities

While some market participants simply break investable markets into domestic and international categories, we take a more nuanced approach. We further subdivide the international universe into two segments: developed and developing markets. The growth opportunity set appears more convincing for emerging economies. The IMF's projections forecast real GDP growth for emerging market economies is more than double that of developed economies. China captures a lot of attention in the discussion of emerging market economies. However, China's weight in the ACWI Emerging Markets Index has shrunk dramatically over the past few years, currently sitting around 25%. Since the trade disruptions surrounding COVID, global supply chains have shifted dramatically. Developing economies outside of China have benefitted from these supply chain shifts. Mexico and various emerging Asian economies have picked up additional US demand that has shifted away from China.

Demographics are another factor driving the opportunity set in developing economies. Many developed economies, including the US, Europe and Japan, face the demographic quandary of aging populations and falling birth rates. Developing countries, largely concentrated in Asia, Africa and South America aren't facing these headwinds. In 2024 alone, World Data Lab estimates that about 113 million people will join the middle class globally. Over half of those new consumers are expected to originate in India and China. While we don't advocate market timing or making outsized bets, we believe that maintaining meaningful exposure to emerging market equities is likely to provide a valuable engine for returns in the coming decades as well as an element of diversification.

U.S. goods imports by country

% of total U.S. goods imports, annual and YTD 2024



Source: JP Morgan

Behavioral Finance

Recency bias is a cognitive predisposition in which humans tend to over-emphasize recent events. This is remarkably applicable to investing. Investors tend to chase recent outperformers even though that has proven to be a poor strategy over the long term. That's one of the reasons that we believe so strongly in designing investment allocations that align with client goals. Thereafter, we manage risk by rebalancing regularly. In addition to maintaining acceptable risk levels, rebalancing to established targets removes the temptation to tweak and adjust allocations based on valuations, feelings or headlines. The purpose of rebalancing is to earn better risk-adjusted returns as well as to "buy low" and "sell high" in a systematic way. In the current environment, recency bias tempts investors to concentrate in large cap equities. Over the past few years, domestic large cap equities have generated an outsized proportion of total equity returns. While it's enticing to chase yesterday's winners, there's a great deal of variability from year to year in which asset classes provide the best returns. As such, we recommend a more systematic approach of matching your target allocation with your financial plan and regularly rebalancing towards that target.

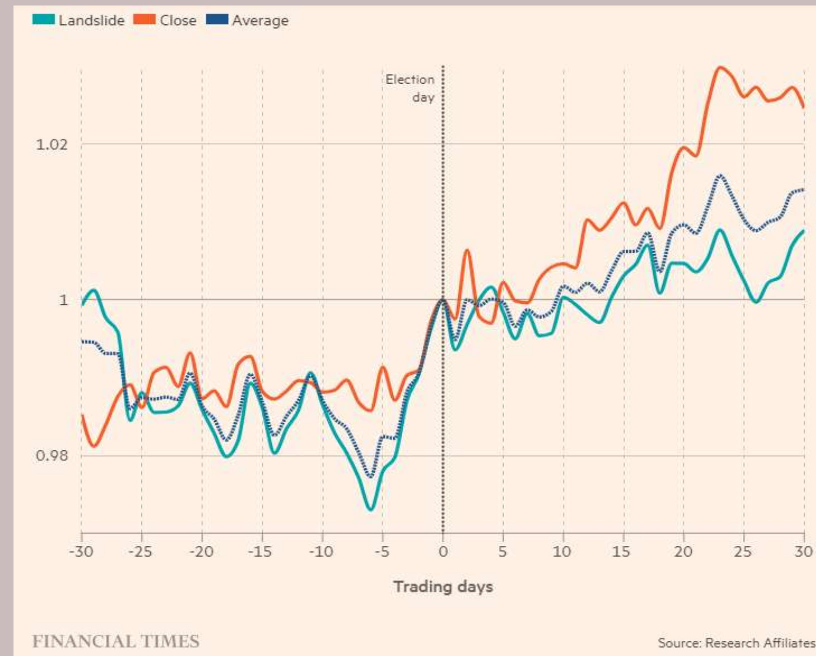
2009-2023																	
Ann.	Vol.	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD
Large Cap 14.0%	Small Cap 21.9%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%	Comdty. 16.1%	Large Cap 26.3%	Large Cap 19.5%
Small Cap 11.3%	REITs 21.2%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%	Cash 1.5%	DM Equity 18.9%	DM Equity 12.4%
REITs 10.9%	EM Equity 20.3%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%	High Yield -12.7%	Small Cap 16.9%	REITs 10.7%
High Yield 8.6%	DM Equity 18.4%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%	Fixed Income -13.0%	Asset Alloc. 14.1%	Small Cap 10.4%
Asset Alloc. 8.1%	Comdty. 16.6%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.5%	Asset Alloc. -13.9%	High Yield 14.0%	Asset Alloc. 10.2%
DM Equity 7.4%	Large Cap 16.1%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%	DM Equity -14.0%	REITs 11.4%	EM Equity 9.9%
EM Equity 6.9%	High Yield 11.5%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%	Large Cap -18.1%	EM Equity 10.3%	High Yield 7.5%
Fixed Income 2.7%	Asset Alloc. 11.5%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%	EM Equity -19.7%	Fixed Income 5.5%	Cash 3.6%
Cash 0.8%	Fixed Income 4.5%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%	Small Cap -20.4%	Cash 5.1%	Fixed Income 3.1%
Comdty. -0.2%	Cash 0.7%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%	REITs -24.9%	Comdty. -7.9%	Comdty. 0.9%

Source: JPMorgan Asset Management

The Election & Markets

Elections can generate volatility, which can make otherwise rational market participants question their exposures. In a study of elections since 1928, the S&P 500 tends to decline in the immediate run-up to elections. However, equities tend to rally in the month following elections, regardless of which party won. The effect is more pronounced when elections are close. While the election outcome is unlikely to have a profound economic impact, particularly in the event of a divided government, markets tend to rally simply due to the reduction in uncertainty. A similar phenomenon occurred around the recent Fed rate cut. Although the decision was widely anticipated, the reduction in the uncertainty premium boosted markets.

Historically, long-term equity performance (the only kind that matters if you're a long-term investor) has been far more correlated with employment, inflation and GDP growth trends than with which political party is in power. We don't make asset allocation or investment timing decisions based on elections. Historically, attempting to time investments around elections has proven to be a poor strategy.



What's It All Mean

Economic Outlook

The US consumer isn't as well insulated from economic weakness as during the COVID stimulus era. While the labor market has loosened, the employment picture is far from contractionary levels. The uptick in consumer debt delinquencies is concerning. However, the risk of a recession in the near term appears low, barring an economic shock.

Housing: Rates & Supply

While many consider rate cuts to be a prerequisite for unlocking housing supply, mortgage rates have already fallen considerably over the past year. Declines in the Fed Funds rate are not likely to be perfectly reflected by mortgage rates. Many US homeowners don't have a mortgage at all. As such, the notion that lower rates will rapidly unlock supply is an oversimplification. While rate cuts are likely to loosen up some supply and encourage builders to increase housing starts, an increase in supply will take time.

Inflation: The Lagged Effect

Housing makes up about 2/3 of the total CPI figure. Shelter costs are likely to be the key to the inflation equation going forward. The measurement methodology for the shelter component of CPI is susceptible to lagging present market conditions. More current metrics indicate that shelter inflation is markedly lower. Headline CPI is likely to decline as the measurement catches up to market conditions.

Lower Rates & Equities

The Fed began their easing cycle with a 50 bp rate cut last month. Policymakers anticipate approximately 50 bps of additional cuts this year and another 100 bps next year. Non-recessionary easing cycles have historically been favorable for equity performance. Small-cap equities are typically more sensitive to interest rates relative to their larger counterparts.

What's It All Mean

Global Opportunities

US growth equities have driven markets over the past decade, but we believe there are opportunities outside of this narrow neighborhood. In addition to more favorable valuations and demographic trends, international equities offer greater diversification than their more concentrated US counterparts.

Behavioral Finance

Historically, attempting to time markets has proven to be a poor investment strategy. Devising an investment allocation that fits with your unique financial plan reduces the temptation to do so. Regular rebalancing helps maintain target risk levels and allows investors to “buy low, sell high” in an unemotional, systematic manner. Elections tend to increase uncertainty. Historically, equities generally decline slightly in the month leading up to elections and experience positive performance in the 30 days following elections, regardless of which party wins. Longer-term, there's very little correlation between which party is in power and market returns. As such, it's critical to have a long-term allocation target and to stick with it. We believe that your planning needs should dictate your investment allocation choices rather than short-term uncertainty.

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Relevant Disclosures

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