ACADEMY ASSET MANAGEMENT

Market Update

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The U.S. economy continues to demonstrate resilience, with second-quarter 2024 GDP growth reaching 3.0%. However, recent data presents a nuanced picture. Consumer sentiment has shown significant volatility, with the Conference Board's Consumer Confidence Index falling sharply in September to 98.7, from 105.6 in August, nearing levels typically associated with recessionary concerns. As we enter the final quarter of 2024, market participants will closely monitor these developments and their potential impacts on asset prices and the economic trajectory.

Inflation is steadily moving closer to central bank targets, with the core Personal Consumption Expenditures (PCE) index—the Federal Reserve's preferred inflation measure—standing at 2.7% as of August 2024. This progress prompted the Federal Open Market Committee (FOMC) to implement a 50 basis point rate cut in September. Typically, a cut of this size is reserved for periods of significant economic distress, but Fed Chair Jerome Powell tempered concerns by charactering it as a proactive risk management strategy aimed at mitigating the risk of further economic deterioration.

The Fed's Summary of Economic Projections (SEP) suggests further rate cuts are likely, with the federal funds rate projected to decrease to 3.5% by the end of 2025. The SEP also forecasts core PCE inflation to decrease to 2.3% at the end of 2024, approaching the Fed's 2% target, while the unemployment rate is projected to rise slightly, reaching 4.4% in 2024, and staying stable in 2025.

The U.S. labor market remains crucial for future policy decisions. The latest employment report eased concerns about job market slowdown: nonfarm payrolls expanded by 254k, exceeding the 150k expectation. Net revisions were 72k higher; and the unemployment rate decreased to 4.1%.

China recently announced comprehensive fiscal and monetary stimulus measures, marking its most significant intervention since the early days of the COVID-19 pandemic. These measures may help mitigate risks of a broader global economic slowdown.

Given current economic data, we believe the FOMC should pause its rate-cutting cycle. However, the critical question is what they are likely to do. Following the aggressive cut in September, a pause in November might signal that the previous decision was an error. If incoming data remains consistent with recent trends, the Fed is likely to implement a 25 basis point cut in November, followed by a pause in December. This approach would allow the FOMC to maintain a cautious stance while supporting economic growth.

The interplay between consumer confidence and labor market dynamics will be critical in shaping both policy decisions and broader economic outcomes in the coming months.

FOMC Summary of Economic Projections

Percent

Variable	Median					Central Tendency				
	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run
Change in real GDP	2.0	2.0	2.0	2.0	1.8	1.9–2.1	1.8–2.2	1.9–2.3	1.8–2.1	1.7–2.0
June projection	2.1	2.0	2.0		1.8	1.9–2.3	1.8–2.2	1.8–2.1		1.7–2.0
Unemployment rate	4.4	4.4	4.3	4.2	4.2	4.3–4.4	4.2–4.5	4.0–4.4	4.0–4.4	3.9–4.3
June projection	4.0	4.2	4.1		4.2	4.0–4.1	3.9–4.2	3.9–4.3		3.9–4.3
PCE inflation	2.3	2.1	2.0	2.0	2.0	2.2–2.4	2.1–2.2	2.0	2.0	2.0
June projection	2.6	2.3	2.0		2.0	2.5–2.9	2.2–2.4	2.0–2.1		2.0
Core PCE inflation	2.6	2.2	2.0	2.0		2.6–2.7	2.1–2.3	2.0	2.0	
June projection	2.8	2.3	2.0			2.8–3.0	2.3–2.4	2.0–2.1		
Memo: Projected appropriate policy path										
Federal funds rate	4.4	3.4	2.9	2.9	2.9	4.4–4.6	3.1–3.6	2.6–3.6	2.6–3.6	2.5–3.5
June projection	5.1	4.1	3.1		2.8	4.9–5.4	3.9–4.4	2.9–3.6		2.5–3.5

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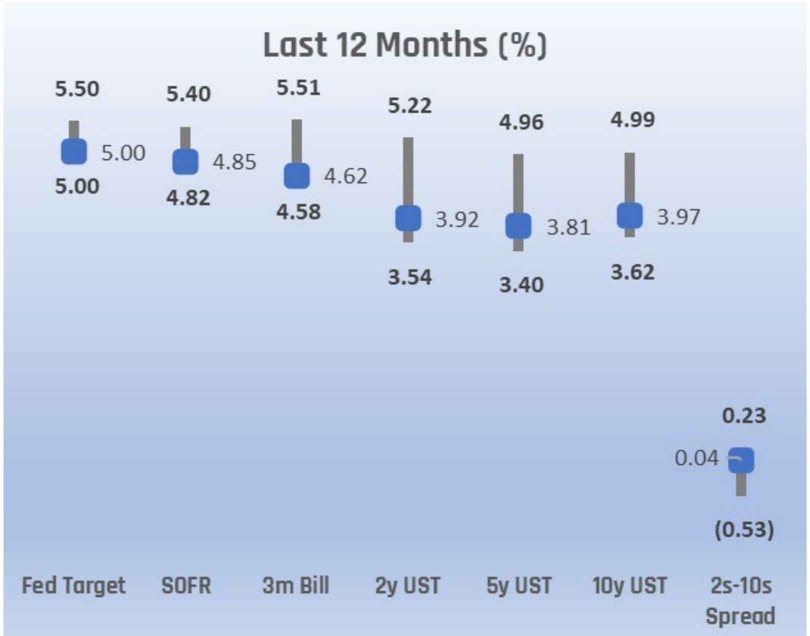
Product Views

Rates: Following the strong employment report, the 10-year Treasury yield rose to 3.97%, while the 2s10s yield curve spread narrowed to 4 basis points, as Fed rate cuts were priced out of the market. As mentioned previously, we believe markets are pricing in more rate cuts than are likely, barring a significant unforeseen event. Currently, about 150 basis points of additional easing are expected by the end of 2025.

We favor the belly of the curve, which, at current levels, provides some cushion if further rate cuts are removed from market pricing. We maintain a neutral stance on duration at both the front and back ends of the curve. We anticipate greater clarity in the coming months but remain prepared to take advantage of potential dislocations if opportunities arise.

Credit: Issuers sold over $600 billion globally, marking the busiest September on record. Despite this, investment-grade (IG) credit spreads remain only a few basis points away from their historical lows. We see limited upside in the form of spread tightening, even if we continue with a risk-on environment. We maintain a cautious stance, as the current spread levels have skewed the potential outcomes toward greater downside risks. Our focus is on identifying issuers with strong cash flow generation, which offer more resilience in a potential recession.



Securitized: Agency MBS spreads are near their tightest levels over the past 12 months, but still appear somewhat attractive when viewed over the last decade. Our focus remains on identifying specific collateral stories with strong potential for outperformance. With the yield curve now flat, buying spread products remains one of the few ways to generate attractive income.