OCTAVIA
WEALTH ADVISORS

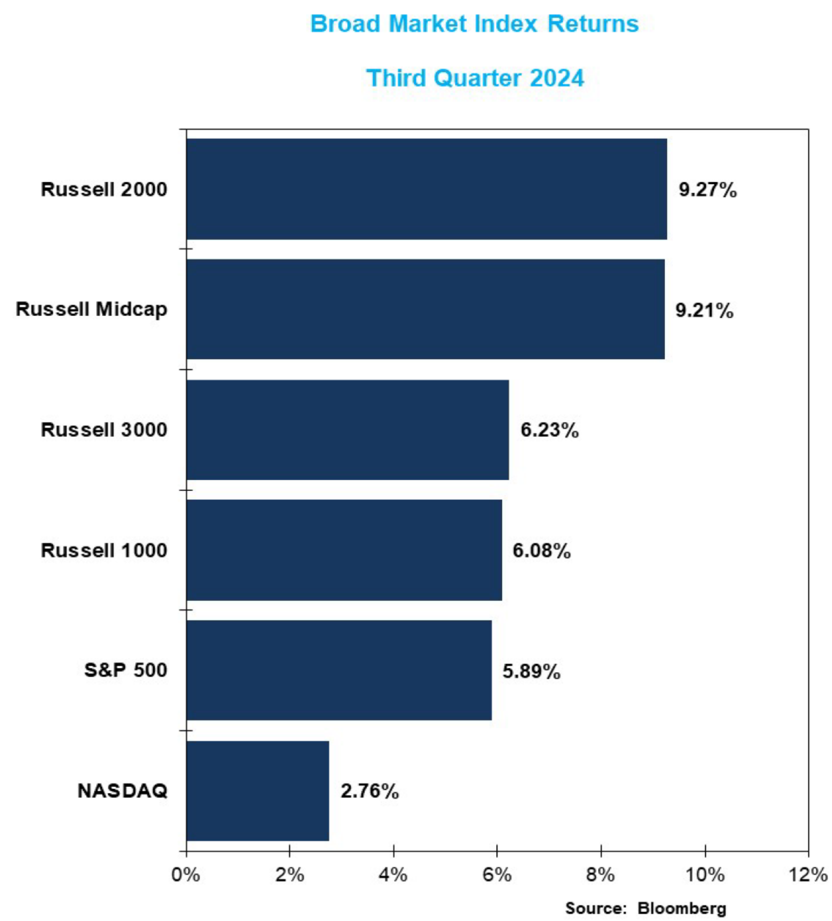
Economic and Market Overview

Third Quarter 2024

Building a Lifelong Partnership

The Economy

The U.S. economy continued to expand strongly in the second quarter, and early third quarter data has shown signs of continued expansion, but potentially at a slower pace. For the second quarter, the Bureau of Economic Analysis estimated that real GDP grew at a seasonally adjusted annualized rate of 3.0%, a sizable improvement from 1.6% in the first quarter. Early (unofficial) estimates for third quarter GDP growth are also around 3%. The labor market slowed during both the second and third quarters, but a strong September jobs report may point to resilient strength. The Federal Open Market Committee (FOMC) lowered its federal funds rate target by 50 basis points in September, to a range of 4.75% to 5.00%. And although recent inflation numbers have cooled, annual price increases are still above the Fed's 2% target.



Highlights and Perspectives

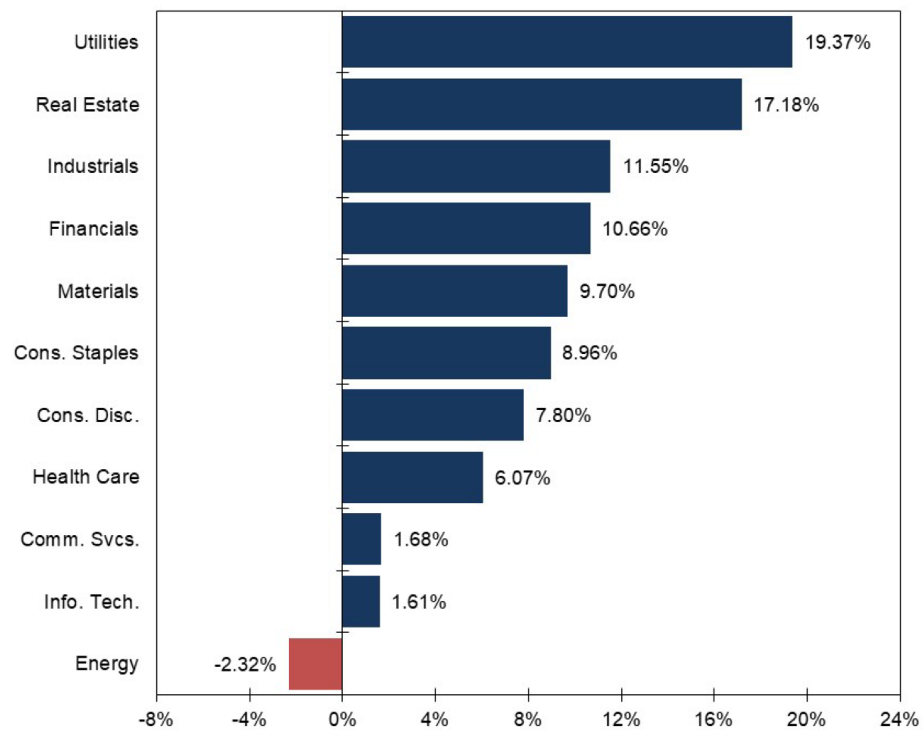
GROSS DOMESTIC PRODUCT (GDP)

In its most recently revised data, the Bureau of Economic Analysis estimated that real GDP grew at a 3.0% annualized rate in the second quarter, a noticeable improvement from 1.6% in the first quarter. Economists point to immigration-led job growth and productivity gains as key drivers of economic growth. Though job gains have slowed, unemployment levels remain reasonable. Consumer spending has continued to grow meaningfully, likely thanks to improving real incomes after several years of inflation eating away at spending power. Growth in business inventories and non-residential fixed investments were also meaningful contributors to GDP growth in the second quarter. Corporate profits rose by 3.6% (not annualized) after falling 1.7% in the first quarter of the year. GDP is expected to have grown solidly in the third quarter as well, but various other data points may foretell slowing growth in quarters to come.

HOUSING

Housing market activity has shown a few positive signs, but generally remains stuck at low levels due to the combination of high mortgage rates and high home prices. Sales of existing homes were significantly below their ten-year average throughout the third quarter, and leading indicators paint a mixed picture of activity to come. In the latest data, existing home sales fell 2.5% month-over-month in August to an annualized rate of 3.9 million units, 4.2% below its year-ago level. Housing inventory expanded throughout the quarter as homes sat on the market longer, with 4.2 months

U.S Equity Market Returns by Major Sector
(GICS Sectors in S&P 500, Third Quarter 3Q24)



Source: Bloomberg

of supply available at the end of August, up slightly from July. Existing home prices were 3.1% higher than a year ago. The NAHB housing market index improved slightly in the quarter but remains in negative territory, indicating that homebuilders perceive building conditions to be poor.

EMPLOYMENT

Job growth slowed at the end of the second quarter and into the third quarter, but September's payrolls report provided some optimism. Employers added 254,000 jobs in September, above expectations for around 150,000. Payroll numbers for July and August were revised upward by a combined 72,000 positions, though job growth in those two months was still somewhat muted at 144,000 and 159,000, respectively. Pending revisions to the September number, average monthly job growth in the third quarter was nearly 186,000, better than 147,000 in the second quarter but below the first quarter average of 267,000. Average hourly earnings were nearly 4% higher in September than a year ago, continuing to grow at rates faster than pre-pandemic averages. The unemployment rate ticked down to 4.1% while workforce participation was flat at 62.7% for the third consecutive month.

FEDERAL RESERVE POLICY

At its September meeting, the FOMC voted to lower the target for its primary policy rate, the federal funds rate, by 50 basis points, to a range of 4.75-5.00% from 5.25-5.50%. This marks the first rate cut by the FOMC since 2020 and a pivot in policy after the FOMC held rates steady for 18 months. In the weeks leading up to the meeting, market participants mostly expected a 25-bps cut, but expectations suddenly shifted to favoring a 50-bps cut a few days prior, and the FOMC met those expectations. Meeting minutes indicate that Fed participants were generally in agreement that both inflation and the labor market have weakened, but there was disagreement on the appropriate size of a rate cut. Those favoring a larger cut primarily noted concerns about the labor market, while those favoring a smaller cut pointed to inflation above 2% and potential volatility if markets perceived the cut as a panic move.

The committee also released an update to its Summary of Economic Projections (SEP). The median Fed member expects an additional 50 basis points of rate cuts in 2024 and another 100 bps of cuts in 2025, bringing the projected fed funds rate to a range of 3.25-3.50% by the end of next year. Those projections are more dovish than at the June FOMC meeting, when the median committee member expected 75 total basis points of rate cuts in 2024 and an additional 75 in 2025. The SEP also showed that the FOMC now expects 4.4% unemployment at the end of 2024, compared to 4.0% in their last projections, and 2.3% inflation, compared to 2.6% previously.

INTEREST RATES

Fixed income securities' prices were broadly and significantly higher for the quarter as yields declined. Several soft inflation readings and weaker jobs reports caused expectations for interest rate cuts to rise, pushing yields lower. The yield curve shifted significantly lower during the quarter and remained inverted, with yields for maturities shorter than one year remaining higher than yields beyond 10 years. However, a key segment of the curve—the spread between 2-year and 10-year yields—disinverted in September for the first time since July 2022. Treasury yields for maturities up to one year fell as much as 110 basis points during the quarter, while intermediate- and longer-term yields fell as much as 85 bps. 2-year Treasury yields ended the quarter at 3.64% compared to 4.75% at the start, while 10-year yields declined to 3.78% from 4.40%.

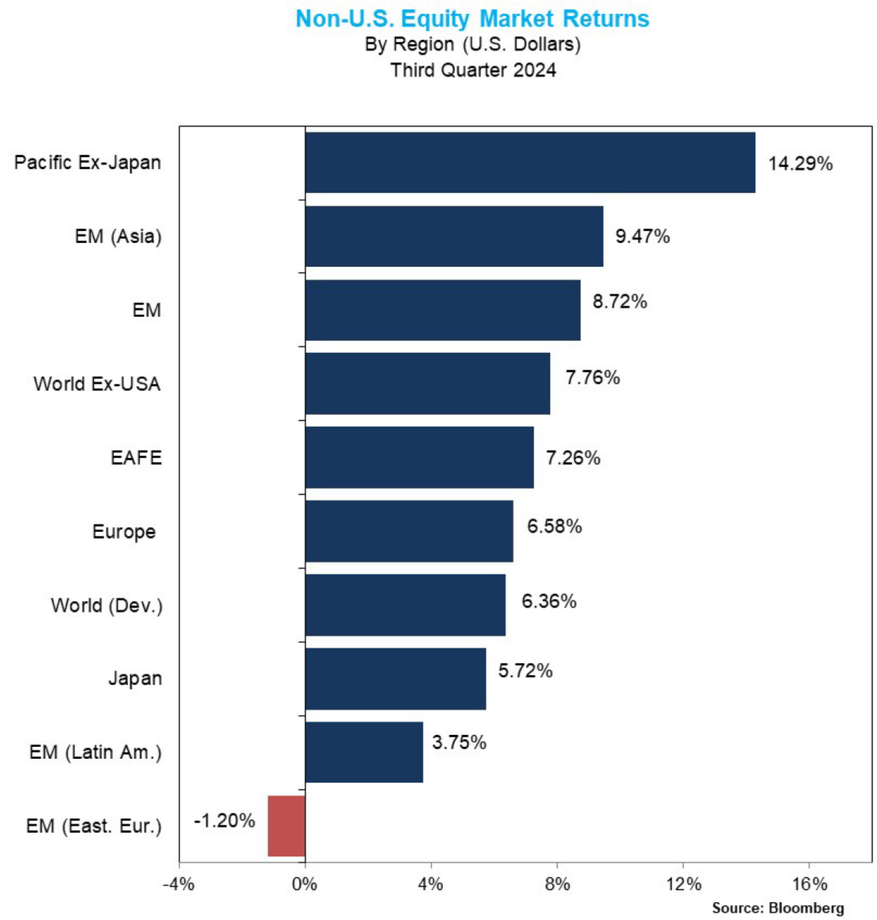
As a result of yields declining, total returns on fixed income securities were very strong. The Bloomberg U.S. Aggregate Bond index returned 5.2% for the quarter. High yield securities were also strong, rising 5.3%. Municipal bonds, as measured by the Bloomberg Municipal Bond Index, rose 2.7%. Non-U.S. bonds outperformed U.S., as the Bloomberg Global Aggregate ex-U.S. index rose 8.5%.

EQUITIES

Stock prices were higher for the fourth consecutive quarter, with gains broadly distributed. Headlines provided no reason to halt the ongoing market rally as corporate profits grew strongly, inflation weakened, the labor market weakened but continued to add jobs, and the FOMC delivered an interest rate cut. The quarter was not without incident, as a sudden bout of volatility rocked markets for a few days at the beginning of August. However, after shaking off that setback, the S&P 500 advanced 5.9% in the quarter.

Of the S&P 500's eleven underlying sectors, ten finished the quarter in the green. Utilities, Real Estate, and Industrials were the strongest performers, returning 19.4%, 17.2%, and 11.6%, respectively. The Energy sector was the quarter's only loser, falling 2.3%, while Information Technology and Communication Services were positive but weak, rising 1.6% and 1.7%, respectively. The Russell 1000 index of large cap stocks generated a 6.1% total return for the quarter, with growth stocks outperforming value. Small cap stocks, as represented by the Russell 2000, outperformed large caps with a 9.3% quarterly return, driven by an exceptional month of July where the index gained more than 10%.

International stocks also saw strong returns for the quarter. The MSCI ACWI ex-USA index, which measures all markets outside the U.S., rose 8.1%. The MSCI EAFE index of developed markets rose 7.3%, while MSCI Emerging Markets rose 8.7%.



Outlook

The U.S. economy has so far avoided recession, but various signs of weakening appeared during the third quarter, creating an uncertain path forward. To be sure, slower economic activity may be good for inflation, which has trended downward to about 2.5% from 9% at its peak in 2022. However, slower economic activity generally coincides with a weaker labor market, which has developed according to various reports throughout the third quarter. In response, the Fed has pivoted its attention from fighting inflation to supporting the economy, delivering a 50-bps interest rate cut in September and projecting multiple additional cuts over the next 18 months. Additional contributors to uncertainty include ongoing conflicts in Ukraine and the Middle East, trade tensions with China, and the upcoming presidential election, which will affect the outlook for taxation, government spending, and regulation.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

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