IDB BANK
GLOBAL WEALTH MANAGEMENT

VIEWPOINTS

OCTOBER 2024

S&P 500 Earnings Breadth Broadens

After a few volatile weeks, global equities ended up about 2.6% in August. Following a 15% plus decline in the first three days of August, Japanese equities ended the month up 1.8%. In the U.S., defensive equities performed better than the more cyclical areas and mega cap stocks. Fixed income returns have benefited from recent declines in interest rates. The 2s10s curve (yield curve) has un- inverted. The 2-year Treasury yield declined as the market began anticipating interest rate cuts over the next 12 months. Credit spreads widened somewhat, but it mostly reflected heightened volatility in the rates market and less about the health of the corporate sector.

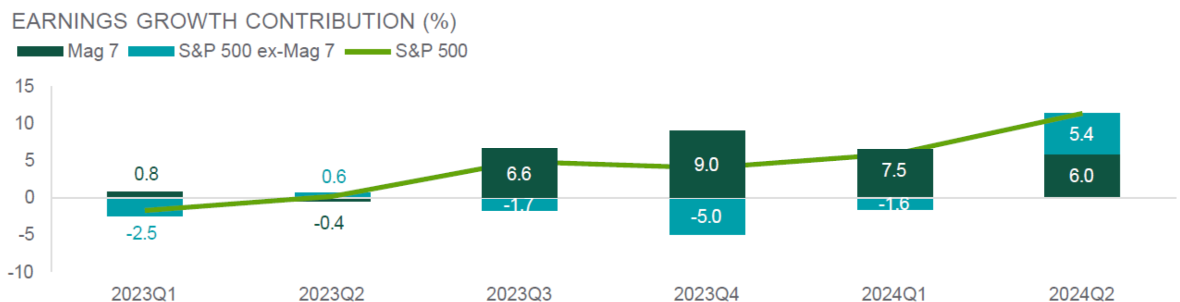
U.S. economic activity is likely to cool from its brisk pace in the first half, but we don't expect a contraction in the near term. The recent payrolls report and revisions released last month show that the job market is cooling from its earlier hot pace with no evidence of a downturn. Recent data has been broadly consistent with our soft landing base case and if anything, probabilities have coalesced even more around the base case.

Inflation is decelerating to more normal levels. With a cooling labor market, we would expect more progress on services inflation. The Fed has communicated that the "time has come" to begin cutting interest rates in response to falling inflation and slowing growth. The June 1SEP had the Fed Funds rate at 4.1% by the end of 2025, while the market expects an additional 125 basis points (bps) of cuts. Potential unwinding of rate cut expectations could be a source of volatility. Despite recent moderation, the U.S. growth outlook is much more constructive relative to Europe and China where slowing continues.

The S&P 500 saw 11% year-over-year earnings growth in the second quarter, of which nearly half came from stocks outside of the Magnificent 7. This is a change from the prior 2-3 quarters when their contribution was negative. We see a similar picture in the bond market where credit spreads have remained contained. The High Yield (HY) picture remains constructive with low default rates.

S&P 500 Breadth Broadened

S&P 500 ex-Magnificent 7 contributed 5.4% to 2Q S&P 500 earnings growth, the highest level since early 2023.



Source: Northern Trust Asset Management, Bloomberg, FactSet. Data as of 8/31/2024.
Magnificent 7 = Mag 7. 1SEP = Summary of Economic Projections.

Interest Rates

The shape of the yield curve (as measured by the difference between 2-year and 10-year Treasury yields), historically a closely watched indicator of economic recession, was inverted (it's normally upward sloping) for more than two years. This is the longest such stretch in over 40 years. Recently, however, with all signs pointing to a rate cut at the September 1 FOMC meeting, the yield curve has shifted to be upward sloping again.

While some are viewing this normalization as still a sign of imminent recession, we aren't seeing such a scenario as very likely when looking at the totality of economic data recently. Indeed inflection points in the economic cycle are often confusing and difficult to predict, but we would caution against reading too much into signals from a single indicator like the shape of the yield curve. In fact, some other, less frequently watched, measures of yield curve shape like 2-year/5-year remain inverted as markets continue to wrestle with their outlook for the economy and monetary policy. While we'll continue to monitor the yield curve, we suspect we won't be writing about yield curve inversion (again) or recession any time soon.

INVERTED NO LONGER

The 2-year Treasury yield has fallen on rate cut expectations.

Source: Northern Trust Asset Management, Bloomberg. 10-Year / 2-Year spread = 10-Year Treasury yield minus 2-Year Treasury yield. BPS = basis points. Data from 9/10/2021 through 9/13/2024. 1FOMC = Federal Open Market Committee.

- The yield curve has begun to normalize after being inverted for over two years.
- Inflection points in the economic cycle are often difficult to predict.
- We would caution against reading too much into any one indicator like curve shape.

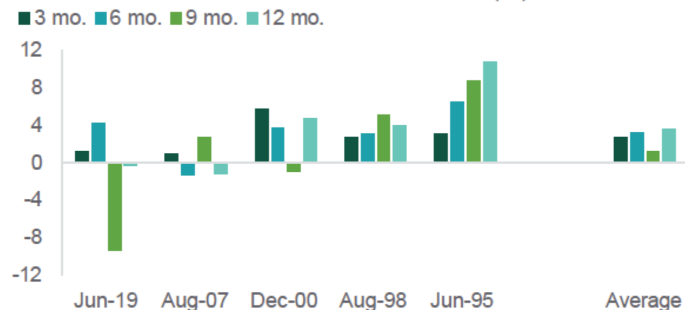
Credit Markets

High yield saw another strong month of performance, despite the uptick in volatility. Volatility increased significantly at the beginning of August, as markets encountered a "growth scare" from an unexpectedly weak employment report early in the month. High yield recovered quickly alongside equity markets as the month progressed, with additional economic data giving investors comfort that the economy was still broadly on solid footing.

High yield bonds have historically performed well following the first Fed rate cut. In the past, all five examples of rate cuts were accompanied by positive returns over the following three months for high yield bonds. Historically, higher quality credits typically outperform lower quality credits during a Fed easing cycle due to two primary factors. One is higher quality credits tend to have longer durations hence higher sensitivity to a decrease in rates, and the other being the Fed easing cycle has historically coincided with a steadily weakening economy leading to outperformance in higher quality companies. Given the high yield index is of higher credit quality versus prior Fed cutting cycles, this could be an additional tailwind for the asset class.

HY TENDS TO OUTPERFORM POST RATE CUTS

High yield bonds have historically performed well following the first Fed cut.



Source: Northern Trust Asset Management, Bloomberg, JP Morgan Research. HY = High Yield; proxied by the JP Morgan High Yield Index. Data as of 9/11/2024. Historical trends are not predictive of future outcomes.

- In the past, all five examples of rate cuts were accompanied by positive returns over the following three months for high yield bonds.
- Higher quality credits typically outperform lower quality credits during a Fed easing cycle.
- Given the high yield index is of higher credit quality versus prior Fed cutting cycles, this could be an additional tailwind for the asset class.

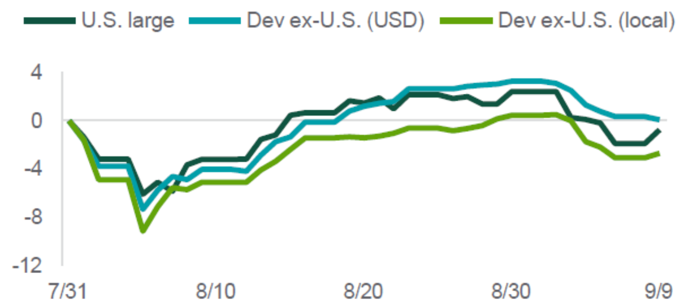
Equities

In August, U.S. large cap stocks were down 6.1% over the first three trading days before rallying 9.1% to finish the month 2.4% higher, as concerns about the yen carry trade and U.S. growth dissipated. Defensive stocks performed well, while value modestly outperformed growth. Developed ex- U.S. equities were up 3.3% getting a significant boost from dollar weakness. Volatility roared loudly before hastily retreating, although it has picked up again in September. Increased volatility is not unusual in a run up to the start of a Fed rate cut cycle. September, historically the weakest performing month, has lived up to its reputation thus far with semiconductors once again leading the way down and defensive stocks outperforming.

Recent data and market events have not altered our constructive fundamental views of a soft landing and solid corporate profits – second quarter earnings season wrapped up with 11.3% earnings growth, broad sector participation, and a strong outlook for the next 12 months. We reaffirmed our overweight equity positioning in the U.S. and emerging markets, but removed our overweight to developed ex-U.S. equities given a less-favorable economic growth outlook in Europe.

IN LIKE A LION, OUT LIKE A LAMB

Global Equities finished a volatile August on a high note



Source: Northern Trust Asset Management, Bloomberg. Total return data from 7/31/2024 through 9/10/2024. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

- August was a volatile month for global equities, but finished on a high note. Developed ex-U.S. equities received a significant boost from a weaker dollar.
- Increased volatility heading into a rate cut cycle is not unusual as investors debate economic outcomes.
- We reaffirm our constructive view on equities, but removed our overweight to developed ex-U.S. equities given a less-favorable economic growth outlook in Europe.

Base Case Expectations

Sticking the Landing

Global growth will move below trend but remain positive, supported by ongoing U.S. economic strength and labor market/consumer resilience. Inflation will remain above target but continue to proceed toward 2%.

Central Bank Transitions

Major central banks have started to cut policy rates and we expect more to follow suit as the year progresses. Economic growth may afford policymakers more time to confirm that inflation progress is sustainable.

Risk Case Scenarios

Stubborn Inflation

Inflation does not move lower due to economic re-surgence, tight labor markets, U.S. election induced pressures related to tariff or immigration policies, and/or disruptions from conflict in the Middle East..

Lagged Impacts

A soft landing is taken off the table as easing economic growth evolves into a traditional demand-led recession. In this scenario, a shallow recession is more likely than a deep contraction.

Indexes Used and Definitions:

MSCI ACWI: A free-float weighted equity index that includes both emerging and developed world markets.

S&P 500 Index: Widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

S&P Global Infrastructure Index: The S&P Global Infrastructure Index includes exposure to 75 companies from around the world tha represent the listed infrastructure universe.

INVESTMENT PROCESS

The asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic returns are developed using five-year risk, return and correlation projections to generate the highest expected return for a given level of risk. The objective of the tactical recommendations is to highlight investment opportunities during the next 12 months where the Investment Policy Committee sees either increased opportunity or risk.

The asset allocation recommendations are developed through the Tactical Asset Allocation, Capital Markets Assumptions and Investment Policy Committees.

Past performance is no guarantee of future results. Returns of the indexes also do not typically reflect the deduction of investment management fees, trading costs or other expenses. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved. This newsletter is provided for informational purposes only and does not constitute an offer or solicitation to purchase or sell any security or commodity. Any opinions expressed herein are subject to change at any time without notice. Information has been obtained from sources believed to be reliable, but its accuracy and interpretation are not guaranteed.

Northern Trust Asset Management comprises Northern Trust Investments, Inc., Northern Trust Global Investments Limited, Northern Trust Global Investments Japan, K.K., NT Global Advisors, Inc. and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

This commentary is for our clients' general information. It does not take into account the particular investment objectives, financial situation, or needs of individual clients and does not contain investment recommendations. It is not an offer or solicitation to buy or sell any securities or to adopt any investment strategy. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by the Bank to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. Investment involves risks. International investing involves additional risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. Index performance is shown for illustrative purposes only. The opinions are those of the Bank's Global Wealth Management division and are made as of the date of this commentary, and are subject to change without notice. There is no guarantee these opinions will come to pass. Other affiliates and Bank divisions may have opinions that are different from and/or inconsistent with the views expressed herein.

ViewPoints reflects data as of 9/18/24.

Investment Products:

<table>
<tr><td>Are Not FDIC Insured</td><td>Are Not Bank Deposits</td><td>Are Not Bank Guaranteed</td></tr>
<tr><td colspan="2">Are Not Insured by Any Federal Government Agency</td><td>May Lose Value</td></tr>
</table>

Powered by

IDB Bank® is a registered service mark of Israel Discount Bank of New York. Member FDIC.

© 2024. All Rights Reserved.