



“Three Scenarios” Market Commentary – October 2024

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The third estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 3.0% in the second quarter of 2024. This is the same as the second estimate and stronger than 1.6% in 2024 Q1 (revised). On September 18, the Federal Reserve updated its economic projections that were last released in June. It now sees GDP growth of 2.0% in 2024, 2.0% in 2025, 2.0% in 2026, and 1.8% in the “longer run” (beyond 2026). Other than lowering the 2024 projection from 2.1%, each of these values is the same as in March and June. What changed, however, were the estimates for unemployment and inflation. The Fed sees unemployment at 4.4% in 2024, 4.4% in 2025, and 4.3% in 2026 (versus 4.0%, 4.2%, and 4.1% in June). It expects inflation at 2.3% in 2024, 2.1% in 2025, and 2.0% in 2026 (versus 2.6%, 2.3%, and 2.0% in June). Overall, the Fed says unemployment is running higher and inflation is running lower than expected.

On September 18, the Federal Open Market Committee (FOMC) slashed the federal funds rate by 0.5% in its first cut since March 2020. The target federal funds rate is now 4.75% to 5.0% and likely headed much lower. Based on the FOMC’s own projections, the median “dot plot” shows the federal funds rate at 4.4% by the end of 2024, 3.4% by 2025, 2.9% by 2026, and 2.9% in the “longer run”. Overall, the Fed is telegraphing another 2.0% in overall cuts. The Fed’s balance sheet had \$7.080 trillion in assets on September 25, down \$43 billion from August 28 (less than the Fed’s reduction commitment of \$60 billion per month). The next FOMC announcement on monetary policy is scheduled for November 7.

Technical factors of the market are bullish (more demand than supply), while fundamentals are fairly priced – therefore, we are mildly bullish on the market. The Standard & Poor’s forecast for S&P 500 operating earnings per share (EPS) through September 30, 2025 is \$266.74, which implies a price-to-earnings (P/E) ratio of 21.6 with the S&P 500 at 5,762. The earnings yield (E/P) of 4.63% represents fair value relative to the 10-year U.S. Treasury note yield of 3.81%. The yield spread is 0.82%. Seven of the eight largest companies in the S&P 500 make up \$16.0 trillion of the \$51.0 trillion index market capitalization with a weighted P/E of 33.0. If 31.5% of the index has a P/E of 33.0, then 68.5% of the index has a P/E of 16.4 for the overall P/E to be 21.6. A P/E of 16.4 is an E/P of 6.10%, which is attractively priced compared to the 10-year Treasury note yield of 3.81% (a yield spread of 2.29%).

The S&P 500 showed resilience as it muscled its way to an all-time high in September. After opening September at 5,648, the S&P 500 quickly dropped to the month’s low print of 5,408. Just as it looked like the bears were in control, the index then rallied past resistance around 5,650 to close at a new high of 5,762 on September 30. The pattern of higher lows was followed with a higher high – an all-time high to boot! While the uptrend is confirmed, volume has been lighter than the July correction (a bearish observation).

Equity investors should consider having a plan for three market scenarios: rising prices, falling prices, and sideways prices (trading range). One of the most bullish factors today is that the Fed has begun an easing campaign which will likely be quick and aggressive. As the Fed cuts rates further, cash sitting in money market funds will see yields shrink. Lower yields on cash may coax some investors to put money back into riskier assets like stocks. On the other hand, the mega-cap technology stocks are very pricey. Investors who select individual stocks can minimize exposure to them and focus on undervalued stocks. Index investors, however, are caught up in the bubble. Meanwhile, we are facing a general election on November 5. This political season has been particularly volatile, including a second assassination attempt on President Trump on September 15. There will undoubtedly be no shortage of news in the coming months, with perhaps a black swan event lurking. What is an investor to do? We maintain that a balance of stocks and cash helps plan for all three scenarios. Owning stocks helps investors in the realm of rising prices, while owning cash buffers downside risk with falling prices. Meanwhile, dividends and interest are enjoyed in a sideways market. Since *predicting* the future is unrealistic, the next best thing is to *plan* for it.