Market Review and Outlook

- The economy has so far remained incredibly resilient against Fed rate increases as a result of the tight labor market. The Fed's well-timed pivot toward policy easing will help underwrite a soft landing, which at the moment remains the base-case scenario.

- Presidential elections often create significant economic uncertainty, and the policy proposals from the current contenders are disparate enough to result in near-term market volatility; in addition, the Democrats' shift from Joe Biden to Kamala Harris has contributed to changing polling numbers for both parties in various swing states.

- Structural growth issues in China will not be resolved by near-term monetary policy support measures. Meanwhile, European growth is still being muted by a combination of energy independence and innovation-led growth in the U.S. Former European Central Bank President Mario Draghi's plans for structural growth reform should be taken seriously.

This past quarter was yet again further proof that politics, the economy, and financial markets have not lost their power to surprise, and a lot can happen in the span of three short months.

Democrats Switch Candidates Midstream

Unquestionably, the most notable development this past quarter was the Democrats' decision to change presidential candidates midstream, following challenging polling numbers and a difficult debate performance June 27 from President Joe Biden. The switch from President Biden to Vice President Harris was likely anticipated by many, with the only surprise being the delay in activating the change, given election season. President Biden's official announcement was July 21st, following comments from staunch allies such as Nancy Pelosi (*"he has to make a decision!"*) and the redoubtable democrat George Clooney with his op-ed in the *New York Times*.

After a rocky start, and initially coming across as very policy-light, Vice President Harris seems to have quickly gathered momentum and performed well in her first—and so far only—debate with President Trump. According to many election measuring resources, she is now neck and neck in the polls with former President Trump. She also has the benefit of a substantial campaign war chest nearing $1 billion, compared with Trump's $692 million, much of which is being deployed on the good people in America's seven major swing states, in particular the highly contentious state of Pennsylvania.

The past quarter also witnessed two attempted assassination plots on President Trump's life, an unparalleled and haunting reality of the current political tension; yet, despite some iconic imagery, neither attempt seems to have resulted in much of a lasting impact in the polls. This reality highlights the deeply entrenched views of Americans on their political parties and candidates. It also perhaps foretells that whoever is elected will have a very difficult task in leading the incredibly divided nation.

From a financial market perspective, we should expect heightened equity market volatility in the coming months, as is normally the case as elections draw near without certainty of a landslide victory by either party. A look at past market performance around elections shows that while the White House occupant matters in the very near term, over the longer term, structural growth in the economy tends to matter much more. During President Trump's first term in office, the two worst-performing economic sectors were real estate and energy—both sectors that were at the very heart of the "Trump trade" at the start of his presidency. Similarly, the best-performing sector during Biden's term in office have been the energy sector—again completely at odds with his rhetoric on energy sustainability.

The fact that neither candidate seems to show much concern about debt sustainability is a concern in itself. While we do not believe that the economy is near any kind of tipping point on debt sustainability, increased longer-term debt issuance is likely to result in more volatility in longer-term interest rates.

U.S. Economic Resiliency Continues

The economy's performance, up to now, has been consistent with the Fed's much-desired soft landing. After an uncomfortable bump up in inflation during the first quarter—causing many to scale back their expectations for further progress on inflation and the ability of the Federal Reserve to lower interest rates going forward—the Consumer Price Index

Market Review and Outlook

through the third quarter resumed its downward trend, falling from 3.3% in May (reported mid-June) to the current 2.5% (for August). The Fed's preferred measure, the PCE deflator, fell from 2.6% to just 2.2%, hence effectively at the Fed's target 2% rate (which, remember, is an average not a ceiling).

The employment situation has also been incredibly resilient. While the unemployment rate over the quarter ticked up from an April low of 3.4% to 4.3% in July (before falling back to 4.1% in September), triggering the Sahm rule (which states that whenever the 3-month average of the unemployment rate has risen more than 50 basis points above the 12-month low, the economy has been in recession), about half of this increase has been the result of an increase in supply, with workers going back into the labor force as a result of high demand (i.e., new entrants or reentrants), as opposed to a reduction in demand, where more workers are moving from employment to unemployment. This is a higher share than during past cycles and has been aided by the large increase in net migration into the U.S., a factor that has also played a role in subduing both wages and aggregate inflation.

Growth Fears Spark Equity Market Volatility Early in the Quarter

Early August put investors on edge about the economy's prospects for stability and growth. The release of a lower-than-expected increase in employment for July (released August 2nd) was the catalyst for a sharp spike in market volatility. This volatility was heightened by fears that the market was experiencing a massive "yen carry-trade unwind." With the Bank of Japan raising rates and the Fed about to lower them, a key source of market liquidity over the past few years started to become unstuck. Investors for years have been profitably borrowing in yen, investing the proceeds in higher-yielding assets elsewhere (e.g., Treasury bills), before converting back and capitalizing on a depreciated exchange rate.

Pivots by central banks are often precarious; specifically following the employment report and fears about a reduction in liquidity, investors panicked that the Fed had raised rates too high, had missed the opportunity to start lowering them in July, and was now behind the curve. A recession seemed virtually guaranteed without an emergency intermeeting rate cut, as evidenced by the VIX index, a gauge of investor anxiety, jumping to a near-term high of 38.6, well above the historical average.

Surprise! The Fed Cuts by 50 Basis Points in September, Market Breadth Returns

The Fed managed to sooth tensions by doing virtually nothing at all, and the market was soon accelerating to all-time highs, a surprise to most forecasters.

The Fed started to lower rates in September with a surprise cut of 50 basis points. This cut was fortunately not in response to any stress related events unfolding in the banking system or the financial markets; rather, the Fed knows that the prevailing rate of 5.25%-5.5% was set to balance the much higher inflation rates, and with inflation now effectively back to target, the risks of weaker employment growth starting to turn, it was time to pivot back toward a more neutral setting. The Fed's latest estimate of the neutral rate is 2.9%, or roughly 250 basis points lower than the September peak in the fed funds rate, although many believe the real rate is much higher than stated.

The stock market has taken this as a good sign. The S&P 500 in the first three quarters of this year increased by 20.8%, the fastest three-quarter start to the year since the 27.9% increase over the first three quarters of 1997. More encouraging for most investors, is that the S&P 500 has finally seen a tangible increase in market breadth over the last quarter, following two years fully dominated by the Magnificent 7 stocks. The aggregate S&P 500 index increased by 5.5% this past quarter, against a much larger 9.1% jump in the equally weighted index. The Mag 7 names increased 5.4%, but given their size, have acted as a significant drag on aggregate index.

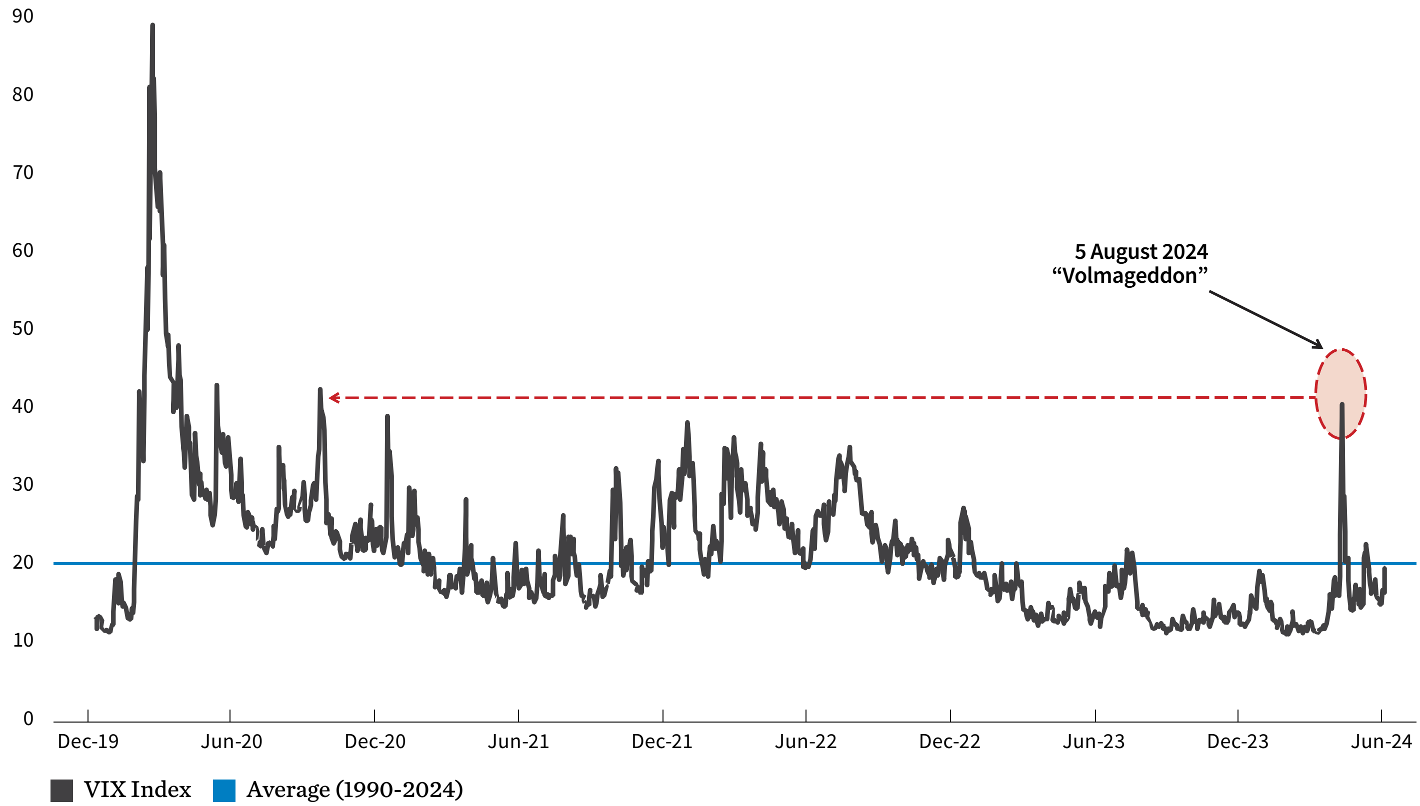
During the Fed tightening cycle there has also been continuing strength in the corporate debt market. High-yield credit spreads have remained exceptionally compressed, despite pain in other areas of the financial markets. The Fed's hope in lowering rates today, will once again help ensure a soft landing, i.e., with an expected decline in rates over the next two years coinciding with longer-duration corporate debt starting to approach maturity walls.

Private market deal cadence through three quarters of 2024 was tracking at an improved pace versus 2023. Corporate M&A activity has ticked up to a greater degree than private equity activity. Small-cap public market equities have also trailed larger-cap stocks over a multiyear period, which has been a headwind for private deal activity. Conditions have been uneven for different private asset classes. "*Particularly in times of increased volatility and macroeconomic uncertainty, M&A*

EXHIBIT 1

VIX Volatility Index

(Index of the price of 30-day put options - call options on S&P 500)



Sources: Bloomberg, William Blair Equity Research

activity provides smaller private companies the opportunity to become part of larger, more stable companies that can provide financial support and strategic synergies." (Source: WB Research Private Markets Pulse). Several dynamics including changing tides within traditional financing channels and anticipated increasing demand from investors are contributing to the expectation of further growth in private markets solutions across the asset management landscape.

Foreign Growth Woes Continue

China's deflating property bubble prompted the government to unleash what the popular press has referred to as *taking out the policy bazooka*, or a series of monetary policy measures to help ease the country's woes. While the moves caused the equity market to surge in the short term, the changes do not address the fundamental structural issue the economy faces—one where growth is still being driven by exports and investment, as opposed to consumer spending. Without measures to empower the Chinese consumer, the economy will continue to suffer from overproduction and downward pressure on asset prices, in turn forcing greater pressure on foreign economies to absorb the slack. This is something the U.S. is countering with tariff protection but the EU is struggling to address.

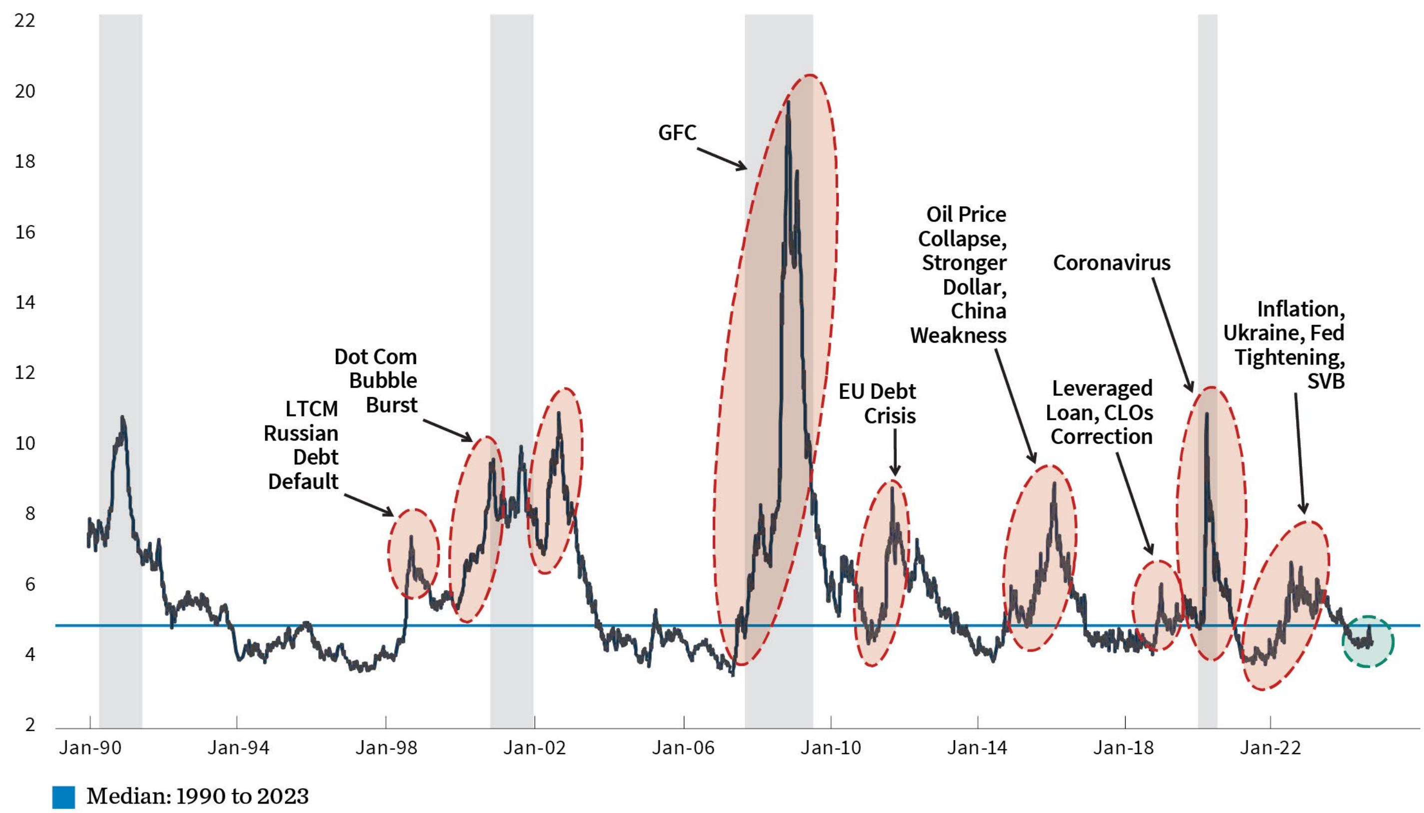
The structural difficulties facing the EU were highlighted in former ECB President Mario Draghi's plan for European structural reform—an $800 billion strategy to reinvigorate growth through a series of initiatives, including deregulation, increased infrastructure spending on both green initiatives and a sustainable energy policy, closing the gap between China and the U.S. on technology, and using the EU weight to extract better trade deals with foreign economies. At present, the euro area's

Market Review and Outlook

EXHIBIT 2

High Yield Credit Spread

BofA High Yield Corporate Bond Yield Minus 10-Year U.S. T-Note Yield, %



Sources: Bloomberg, Bank of America Merrill Lynch US High Yield Bond Index, William Blair Equity Research

growth strategy is seemingly nonexistent. It is sandwiched in the middle of a trade war the U.S. is waging with China (and possibly against itself in the event of a Trump victory), and as a result it is being forced to absorb more of China's excess capacity. In addition, an ongoing hot war in Russia-Ukraine has impacted energy supplies, and it is facing stiff competition from an innovation, industrial policy, and energy independent-led U.S.

PWM Investment Tip:

Clients with substantial wealth who may benefit from the services of a family office or those who are navigating the complex needs of a company and its executives or its corporate retirement plans turn to William Blair professionals for guidance and strategic solutions. Did you know that our firm's capabilities include *family office solutions*, *corporate & executive services*, and *corporate retirement services*?

Market Review and Outlook

Index		YTD	Q3	1Y
S&P 500	US Large Cap	22.08	5.89	36.35
DJIA	US Large Cap	13.93	8.72	28.85
Russell 3000	US All Cap	20.63	6.23	35.19
Russell 2000	US Small Cap	11.17	9.27	26.76
MSCI EAFE	Developed International	12.99	7.26	24.77
MSCI EM	Emerging Markets	16.86	8.72	26.05
Bloomberg US HY	US High Yield	8.01	5.28	15.74
Bloomberg US Agg	US Core Bond	4.45	5.20	11.57
Bloomberg Muni	US Muni Bond	2.30	2.71	10.37
MSCI US REIT GR	US Real Estate	15.84	16.12	34.38

Total Returns

Source: Factset, William Blair