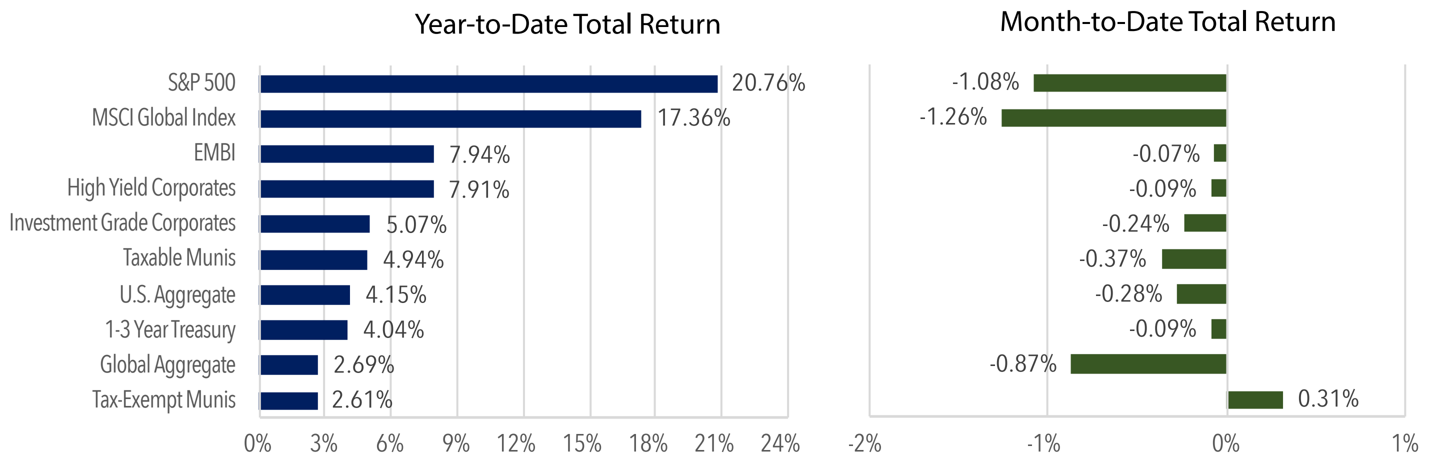
Week Ending: **October 4, 2024**

Melt Up

Economic Overview:

After hitting record highs, the equity market wobbled this week on geopolitical concerns. The economic data, however, continues to point toward a "soft landing," with inflation moderating and the economy gaining new jobs (+254k) at a pace fast enough to keep downward pressure on the unemployment rate. So, we asked ourselves, "What will happen to risk assets if the Fed continues to cut rates and we avoid a recession?" We look past the headlines and use history as a guide to answer this question. In the past 16 cutting cycles since 1954, we have seen ten easing cycles coinciding with a recession, as the Fed often reduces rates to support a waning economy. However, there have been periods where the Fed lowered rates without a recession. In these easing cycles, stocks dramatically outperform bonds on average, and small-cap stocks have slightly higher returns than large-cap stocks, albeit with significantly more volatility. If the Fed keeps cutting without a recession, markets could "melt up" from here instead of melting down. Risk on?

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: How will the Fed's rate-cutting cycle impact bank loans? Declining SOFR rates may reduce yields, but they also increase cash flows to bank loan issuers, which is positive for fundamentals. We expect the lower interest expense to reduce forward-looking default rates at the margin. Nonetheless, active management remains critical.

Corporates: $15 billion was priced in the investment grade (IG) primary market this week, bringing the year-to-date (YTD) total to $1.29 trillion. Demand remains strong as almost all new issues are trading tighter post-issuance. IG corporate spreads continue to grind tighter, with the option-adjusted spread on the index now at 87, two basis points (bps) tighter on the week, and almost back to the YTD low of 85 bps.

Municipals: Municipal performance in September was positive. The Bloomberg Municipal Index recorded a total return of 1% last month. Additionally, the High Yield Muni Index posted a performance of 0.9%, and the US Aggregate Eligible Taxable Muni Index generated a total return of 1.5%. Year-to-date, the Investment Grade Index increased by 2.3%, the High Yield Index outperformed with 7.5% gains, and the Taxable Index was up 1.7%.

Equities: The U.S. equity market fell for the first time in four weeks on renewed geopolitical concerns in the Middle East despite stronger-than-expected economic data. Sector leadership was mixed, with real estate, materials, and consumer discretionary down by more than 2%. Energy gained over 6%, followed by communications and financials, which ended the week with small gains.

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