MARKET
INSIGHTS

PACIFIC LIFE

PACIFIC LIFE FUND ADVISORS | OCTOBER 2024

Market Review and Outlook

Third Quarter 2024

Equity markets continued to climb higher during the third quarter of 2024. The S&P 500® index rose 5.89% for the period, although markets rotated in terms of style. While large-cap growth stocks outpaced others throughout the first half of 2024, value and small-cap stocks led the pace in the third quarter of 2024. During the quarter, the U.S. economy continued to exhibit soft-landing conditions, which revived some risk-taking sentiment. Additionally, support for value stocks grew as the market anticipated multiple rate cuts from the Federal Reserve (Fed). Coinciding with the rotation theme, developed international equities outperformed domestic stocks, as emerging markets fared better than developed markets.

Samuel Park
Director of Fundamental Research

Edward Sheng, PhD, CFA®, CAIA
Head of Asset Allocation

Emily Dai, CFA®
Director of Fundamental Research

Within fixed income, long-duration bonds outperformed their shorter-duration counterparts due to a falling 10-year Treasury yield. Among credit-spread sectors, emerging markets debt and high-yield bonds outperformed core bonds.

Outlook

The Fed surprised many by opting for a rate cut of 50 basis points instead of 25 basis points. Market participants will continue to observe the economy and Fed officials' statements for clues to gauge the magnitude of future interest-rate cuts. More importantly, determining the true motive behind the size of these cuts could help us appropriately prioritize areas of concern.

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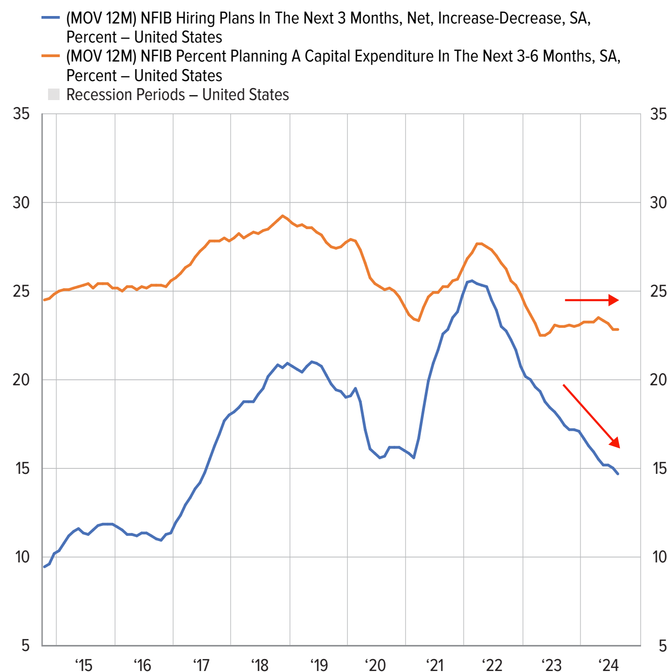
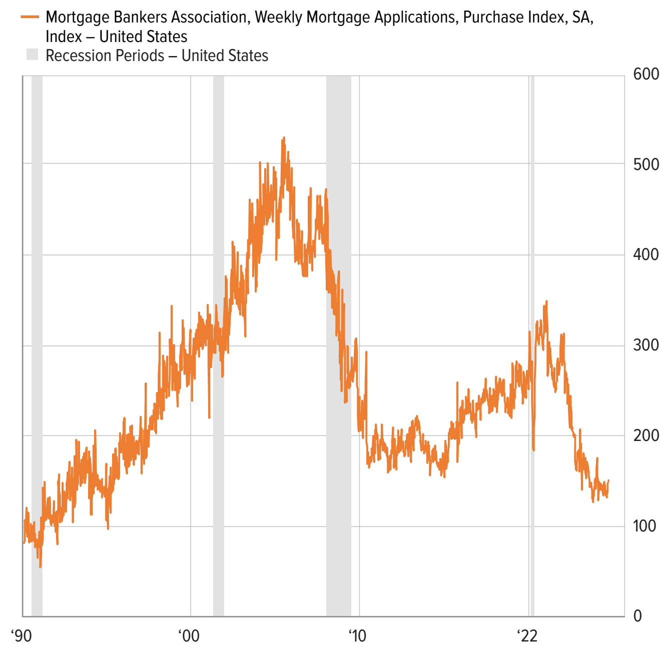
Complicating the economic outlook, Presidential and congressional elections will occur during the fourth quarter of this year. At the time of publication, all elections (i.e., presidential, U.S. Senate, and U.S. House of Representatives) remain extremely tight, considering the margin of error. From the market's perspective, a mixed result between Democrats and Republicans would be preferable, as that would likely keep policies relatively unchanged. Several studies suggest the S&P 500 index has generally performed well under a Democratic president and a divided U.S. Congress, although Republican presidents and with a divided Congress also have yielded positive market gains. While politicians may be frustrated by the difficulty of passing bills and new policies, markets prefer more certainty and maintenance of the status quo.

The tight election races, uncertainty about policy outlook, and elevated interest rates may have caused companies to slow or stall capital expenditure and hiring plans until election results are certain and the Fed helps lower borrowing costs. This is observed in the following chart, which illustrates the lack of expansionary business plans.



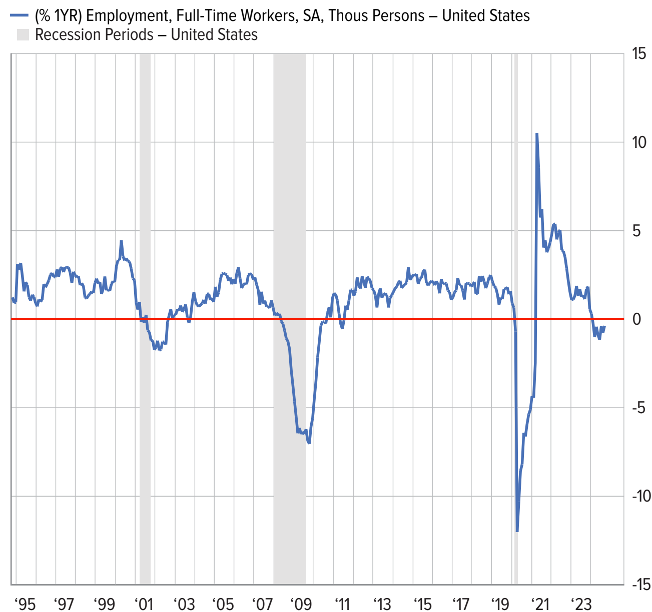
Source: FactSet

The Fed initiated its monetary easing policy during its September meeting. The market currently expects at least two more cuts or an additional 50 basis-points cut by the end of the year, which would lower the effective federal funds rate to a range of 4.25–4.75%. This should provide some relief for corporations and homebuyers. If the U.S. economy avoids a hard landing and companies refrain from pursuing mass layoffs, mortgage applications for home purchases should bounce back, as demand was likely suppressed due to high mortgage rates.



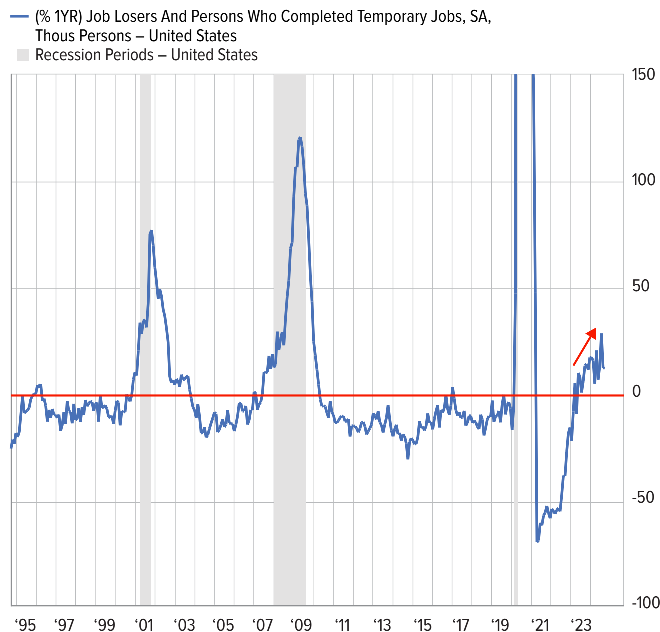
Source: FactSet

If the Fed remains very accommodative (as they did in September), conditions for a soft-landing outcome may remain salvageable despite some early signs of weakness in the labor market. For instance, the U.S. economy has experienced negative growth in full-time jobs since early 2024.



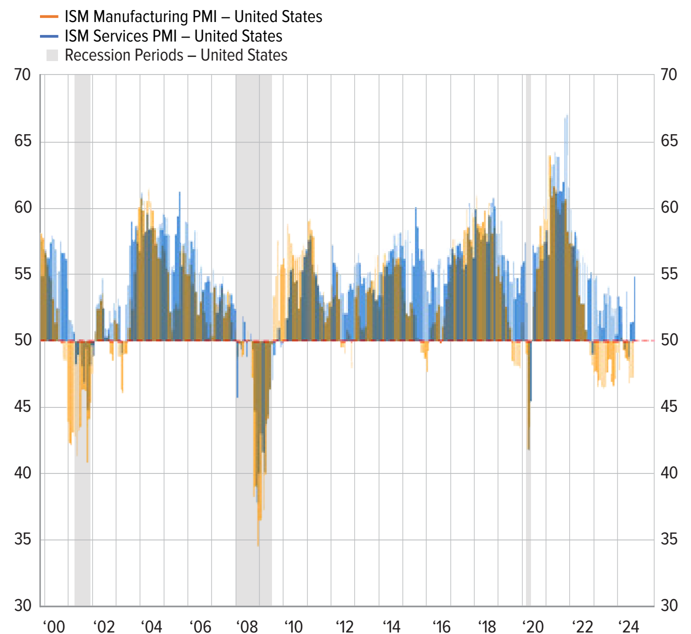
Source: FactSet

During the last few decades, prolonged negative growth in full-time jobs had corresponded to recessionary periods. Nonetheless, some of the job cuts this year likely reflect unwinding from over-hiring in 2021 as the economy recovered from the COVID-19 pandemic. On the other hand, the steady rise in temporary jobs since early 2023 was enough to persuade the Fed to opt for a 50 basis-points cut during its September meeting.



Source: FactSet

Whether or not the latest rate cut was preemptive or reactive, the U.S. economy (excluding manufacturing) appears to remain relatively solid. Historically, recessions occurred when both the manufacturing and services sectors had contracted for several months.



Source: FactSet

Although the S&P 500 index hit new highs soon after the Fed's surprise rate cut, we should not assume that the Fed will continue to aggressively cut rates. It is likely that the Fed sees pockets of weakness in the U.S. economy but also recognizes lingering inflation. The Fed recognizes that rejuvenating the housing market by lowering rates could also reignite inflation, especially given that high shelter costs had kept inflation elevated and sticky on its way down.

We recognize that a sustained rotation among asset classes (e.g., growth-to-value, large-to-small, etc.) could become a longer-term theme. However, this shift will likely depend on the success of the Fed's monetary policy as well as the outcome of the U.S. presidential and Congressional elections. The looseness or tightness of the monetary policy combined with the strength of the economy will likely influence how the markets evolve. We will continue to monitor these changing environments and adjust our allocations accordingly.

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