“What Comes Next…”

Alex Thompson

Lance Hollingsworth

John Laughlin

Sarah Haizlip

Leslie Drummond

Dear Clients and Friends: October 15, 2024

The AI fever in the stock market may have finally broken. Maybe. In the first half of 2024, investors’ passion for artificial intelligence drove the stock prices of a few companies skyward. While U.S. large cap indices benefited greatly from these moves, most stocks muddled through the uncertainty of a slowing economy and stubbornly high inflation. Outside the AI boom, concerns fueled fears the Federal Reserve would stay too high for too long, inviting a recession.

The third quarter brought a new order. Investors began to look beyond big tech. They took heart in a series of tamer inflation readings that gave the Fed confidence it could finally start to lower rates. Many, seeing signs of economic strength, grew confident that the central bank had managed to control price pressures and orchestrate an economic soft landing. It was a recipe for the broadening of a rally that many investors worried had grown precariously reliant on a limited theme.

Broad swaths of the market, from utilities to industrials to financials, bested the technology sector. Value stocks beat growth stocks. International stocks rallied. Even small cap stocks emerged from their hibernation. That being said, the S&P 500 was still up +5.5% for the quarter, pushing year-to-date gains to +21%. Small caps, as represented by the S&P 600, posted a +10% quarter, pulling it from a negative first half to a +9% on the year. Similarly, international stocks gained another +7% in the quarter, +13% for the year. Still, plenty of room to catch up.

With the Federal Reserve finally relenting and reversing their course on interest rates, the bond market rallied as well. Yields on the 10-year Treasury, peaking at 4.65% earlier this year, fell to 3.75% by the end of the quarter. This rally in yields produced a +5% quarterly gain in the Bloomberg Aggregate Bond Index and +4.5% total return for the year. It was a good quarter across the board.

Looking to the Future

Even though we have three solid quarters now on the books, we must look forward. And staring directly back at us is November 5th, the Presidential Election. This will be Summit Asset Management’s 9th presidential election to go through. During past elections, we have tried to be non-partisan and focus on economic and corporate data. We have written countless letters stressing the bad recipe of mixing politics with investing. We will do the same this year!

However, we need to set some expectations. Many Americans have fond memories of the previous administration’s economy. Inflation, interest rates, and gasoline prices were relatively low. The stock market did well, and pre-COVID job and economic growth were solid. These issues still top the list of voter concerns in 2024.

Regardless of who wins the election, no one should expect a quick return to the Goldilocks pre-COVID economy. From 2016 - 2020, the U.S. benefited from the benign economic trends dating back to the Great Recession (2008) and the slow and steady recovery that followed. Post-COVID, the economy is a different animal. Stronger inflationary pressures, more protectionism, costlier energy, and more global

Summit Asset Management LLC ~ 5100 Wheelis, Suite 107, Memphis, Tennessee 38117
Phone 901.729-8100 ~ Fax 901.729-8101 ~ www.summitassetmanagement.com

instability will dominate the economy during the next four years, no matter who is the U.S. president or which party controls Congress.

Many voters blame or credit the president for whatever happens on their watch. However, market forces drive the economy, and presidents normally have only a marginal effect. In fact, four key indicators – inflation, interest rates, gas prices, and GDP growth – historically show that trends under one president are largely the same as those under their predecessor. The COVID disruptions that began in 2020 changed the trajectory of all four of these metrics. The next president will be operating under a different environment.

Inflation

A surge in prices since 2021 has been Biden's biggest economic vulnerability. Except for occasional spikes in energy prices, the U.S. experienced no meaningful inflation between 1990 and 2021. "Deflation" was actually a major concern for the Federal Reserve during most of the 2000s. In fact, overall price levels went negative under Obama in 2015. Subsequent low inflation was just the continuation of a well-established existing trend.

A major factor in keeping inflation contained for much of the last 30 years was globalization and the surge and availability of cheap imports. Tariffs targeting Chinese imports enacted under Trump, and ratcheted up under Biden, began to close that door. Today, both political parties are promising an even tougher stance on China going forward. "Globalization" is now a dirty word. We expect more policies promoting onshoring and boosting domestic manufacturing, but likely resulting in continued elevated inflation. While making things in the U.S. creates jobs, it is almost always more expensive.

Interest Rates

At the height of the Great Recession, the Fed slashed rates to zero, attempting to shock the economy back to life amid a financial panic and near depression. As things normalized, they increased rates from 2015 through 2019, but the lack of inflation allowed the Fed to move slowly. When COVID hit in 2020, they quickly went back to zero. The super-low interest rates that consumers got used to between 2009 and 2021 were an anomaly. From 1990 to 2008, the Fed Funds Rate averaged 4.25%. From 2009 to 2021, the average was 0.50%. Absent another global collapse, we're likely not going back to zero.

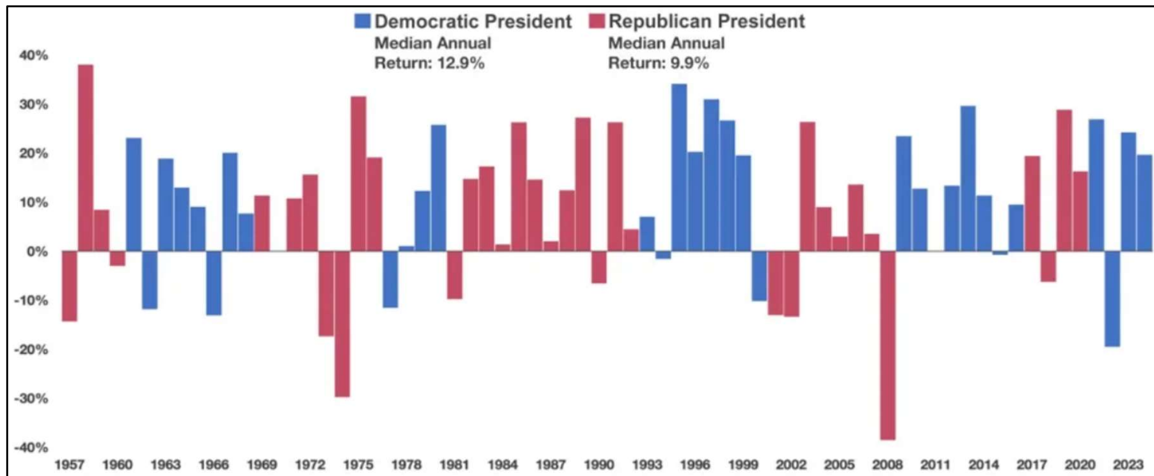
Gas Prices

Gas prices during the Trump administration averaged about a dollar less per gallon than under Biden. However, Trump was not directly responsible for the low prices. He came into office as the fracking boom neared peak production. Energy providers all around the world were overproducing, deciding to forego profits and compete for market share. This approach created low oil and gas prices for consumers, but the lack of profitability caused oil company stocks to be the worst performing sector in the market.

When COVID hit in 2020, energy profits collapsed further, and the whole industry went through a shakeout. Investors now force energy firms to prioritize profits and capital discipline over market share. Any recommended policies from candidates aimed at increasing production to push prices lower would likely be met with strong trepidation from domestic oil and gas companies. In short, they got burned during the last cycle, and they're not going to do that again. So, gas prices are likely to remain elevated.

GDP Growth
Both Trump and Biden administrations have touted strong economic growth during their tenures. The reality is that it was pretty much more of the same. During the three years leading up to COVID, Trump saw the economy grow about 2.8% per year. The four years preceding his term, Obama saw annual growth of 2.5%. Growth under Biden has been a bit stronger, about 3.0% per year. Nevertheless, higher inflation and interest rates have more than offset the growth in voters' minds. Americans still feel stung by three years of a hot economy in which cheap imports and plentiful energy no longer cushioned shocks the way they used to. This year's presidential election isn't likely to change that.

Presidential Stock Market Returns
Below are the annual returns of the S&P 500, color coded for the president's political party.



Data Source: The White House Historical Association, YCharts

As you can see, there has not been a significant difference in performance under different parties. Remember, presidents do not control the stock market or the economy. Their influence is limited to nominations and budget proposals, both of which Congress must approve. Furthermore, some influential events are beyond the control of any elected or appointed official. Consider the dot-com bubble, the global financial crisis, and more recently the COVID pandemic. No one person could have prevented them.

At the risk of repeating ourselves, be careful mixing politics and investing. It is usually a bad recipe. Whoever is elected the next president will face a new set of challenges. Some we can see clearly; others are still hidden from sight. They will also inherit a resilient economy with inflation continuing to come down and a Federal Reserve that has recently become accommodative. As investors, we must focus on the fundamentals and stick to our plan, regardless of which way the political winds are blowing.

Thank you again for your continued confidence and trust as we work through these extraordinary times. We welcome your comments, questions, and referrals. Please don't hesitate to contact us. Stay safe and well.

Summit Asset Management LLC