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Are We Still Talking About a Recession?

We, like most economics and investment professionals, saw an inverted yield curve, as well as many other leading indicators, as a strong sign that a recession lay ahead. Quarter after quarter of positive GDP made me weary of being wrong! How did this happen?

Yes, the Fed had raised rates at the fastest rate in history to quell rampant inflation. They also sold bonds. Each strategy was designed to take liquidity out of the markets, slowing

demand which drives inflation. Interestingly, the intended effect was significantly moderated by Fiscal policies which included significant increases in government spending. Therefore, we witnessed inflation that was “sticky” and rates that would “remain higher for longer.” Recession and stagflation fears were mitigated as time moved forward with surprisingly robust GDP

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Q3 Economic and Market Review

As inflation continued to slow, there was extensive speculation that the Fed would finally start reducing interest rates. There was significant debate as to whether the Fed would cut 25 basis points or 50 basis points, and at the September meeting, the Fed reduced the Federal Funds rate by 50 basis points. For the third quarter, the Bloomberg 500 returned 5.76%. When we look at the style indices, the Bloomberg 1000 Growth returned 4.87% and the Bloomberg 1000 Value Index returned 8.53% during the third quarter¹. Value stocks benefited from the expectation of lower inflation and the start of the Fed’s easing cycle. International equity, as represented by the

Bloomberg World ex U.S., was up 8.41% and small cap market as represented by the Bloomberg 2000 Index, returned 9.95%¹. Market segments other than growth had a strong showing during the third quarter.

Looking at fixed income, the Bloomberg Aggregate Bond Index returned 5.19% and the Bloomberg 1–3-year Government/Credit Index returned 2.96% during the third quarter¹. The 10-year Treasury Note ended the second quarter with a yield of 4.40% and settled at 3.78% by the end of the third quarter¹. The 2-year Treasury Note ended the second quarter with a yield of 4.75% and settled

at 3.64% by the end of the third quarter¹. The 62-basis point decline in the 10-year Treasury note is what helped drive returns in the Aggregate Bond Index and spreads were generally tighter at the end of the third quarter versus levels at the end of the second quarter.

The Fed stayed consistent with telegraphing their expected rate cut and delivered the consensus reduction in the Federal Funds Rate of 50-basis points at the September meeting. Equities performed well because the market is focused on the Fed’s

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ability to navigate the lessening of inflation, with a slower but not recessionary environment. The lessening of inflation saw interest rates rally and fixed income performed very well during the third quarter. The most recent reading of the Personal Consumption Expenditures Index was 2.2% and this is very close to the Fed's 2.0% inflation target¹. By holding rates at a higher level, the employment market has shown some cracks with unemployment up over 4%, and we also have witnessed slower job growth with significant negative revisions to previous new job creation reports¹. Expectations are for at least 75 basis points of further cuts with the belief that the Fed sees inflation in a manageable range and is now focused on preserving economic activity to protect the job market.

The market is now very focused on the outcome of the Presidential election and by every measure, we expect this to be an extremely close race, and it is entirely possible it may take a day or two to declare a winner. The market is also closely watching the Senate and House races to try and decipher the ultimate construction of our next Congress. To be fair, both sides are equally uninspiring when it comes to being serious about the persistent Federal budget deficit and the mounting overall Federal debt. This is one of those problems that seems to not be a problem until it is. We believe this

is one of those cases in that discipline will either be adopted by the government or forced upon it by the bond markets. Our current debt-to-GDP ratio has only been this high during World War II when we constructed the Arsenal of Democracy to fight Nazi Germany and Imperial Japan.

“Expectations are for at least 75 basis points of further cuts with the belief that the Fed sees inflation in a manageable range and is now focused on preserving economic activity to protect the job market.”

As we look through all the market statistics, it is apparent that the Fed has now pivoted from fighting inflation to supporting employment. Recall that the Fed has a dual mandate of promoting full employment and maintaining low inflation. It has been well chronicled that the Fed got it wrong with respect to “transitory” inflation and we believe the 50-basis point cut was a statement that they were not going to be late to protect employment. As consumer consumption represents over 70% of U.S. economic activity, keeping the consumer strong will be the best means of keeping the economy afloat.



Tony joined Knights of Columbus in 2005 and is responsible for the day-to-day management of the Knights's General Account

investment portfolio and mutual fund strategies. He is also responsible for overseeing the internal investment staff, fixed income, and preferred stock investment strategy. In his role as CIO, Tony provides oversight for the investment managers in the Knights' defined benefit pension plan, defined contribution plan, and charitable assets, all of which are externally managed.

We are seeing the first wave of refinancing activity as those with mortgage rates over 7% are seeing an ability to refinance. Household spending remains focused on staples because groceries, rent, and insurance remain quite costly. Consumers have enjoyed some relief as fuel prices have declined.

The geopolitical landscape is still quite concerning. The world is growing weary of the protracted conflict in Ukraine. The U.S. provided more military armaments to the Ukrainians, but we have not provided a green light to use missiles deeper into Russian territory. The Iranians are very close to achieving their ambition of nuclear weapons

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and the conflict in Gaza continues while the Israelis are fighting Houthis and Hezbollah. We also remain concerned that China will finally assess our resolve by taking more direct action with respect to Taiwan. Overall, the world is as fragmented as it has been since the fighting during World War II. While we do not believe we are on the precipice of a major global conflict, there are so

many conflicts occurring, it is not too hard to paint a picture where these smaller conflicts conflate into something much larger.

We continue to focus on portfolio rebalancing because equity valuations are getting stretched and fixed income yields are still attractive enough to provide strong return input in a well-diversified, multi-asset portfolio.

The market’s wall of worry remains tall, and we will start to see some resolution during the fourth quarter as we elect a new President and seat a new Congress. We will be watching for a second bout of inflation that has many times been an echo of any period of inflation. ☐

¹ Source: Bloomberg

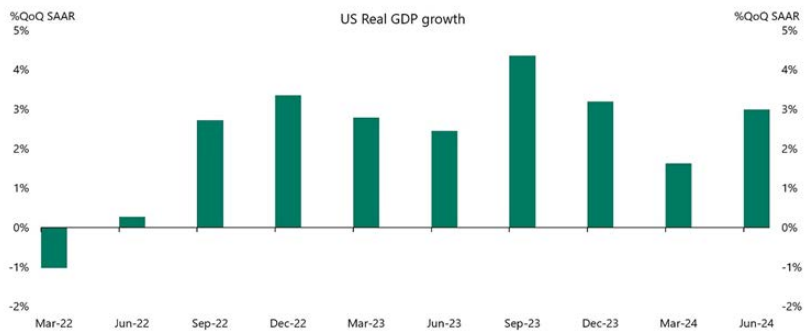
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growth combined with favorable employment numbers. So, despite the slower than desired reduction in inflation rates and a continuously inverted yield curve, there were no signs of recession or stagflation.

At a recent board meeting, my client and I discussed the probability of recession and I explained that I had recently switched to the “soft landing” camp. My client suggested that I was wrong and that we were indeed currently in a recession: it just was not yet reflected in the numbers. I provided the accepted standard definition of a recession: two consecutive quarters of negative GDP growth. While the US economy is not in recession, by definition, it does feel that way to some clients in certain industries.

During the year, several industry sectors have been facing

Where is the slowdown?



Source: BEA, Haver Analytics, Apollo Chief Economist

economic challenges due to global macroeconomic factors like high inflation, interest rate hikes, and supply chain disruptions. These factors have pushed some industries into recession or near-recession conditions. Here are the key sectors experiencing or facing significant downturns:

- 1. Technology and Startups
 - Venture capital slowdown: With rising interest rates,

funding for startups has declined sharply. Many tech companies have been forced to cut costs, lay off workers, or downsize projects.

- Ad-tech and digital marketing: Slowing consumer demand and reduced ad spending by businesses have impacted companies

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dependent on advertising revenue.

- **Cloud and SaaS:** While still growing, many cloud services and SaaS companies are seeing slower growth rates compared to the boom during the COVID-19 pandemic.

2. Real Estate

- **Commercial Real Estate (CRE):** High interest rates have made borrowing more expensive, and many companies are downsizing office space due to the rise of hybrid or remote work. Retail real estate has also been affected by reduced foot traffic and changing consumer behavior.
- **Residential Real Estate:** Rising mortgage rates have slowed home-buying demand, particularly in high-cost urban markets. Property developers are delaying new projects due to reduced demand and financing challenges.

3. Retail

- **Non-essential consumer goods:** Many retailers in areas such as clothing, luxury goods, and home furnishings have been hit by reduced consumer spending, as inflation and higher borrowing costs erode disposable income.
- **Brick-and-mortar retail:** Store closures, particularly in malls and physical retail spaces, continue to affect the traditional retail sector as more shopping moves online.

4. Manufacturing:

- **Automotive:** Some segments of

the auto industry are facing reduced demand, especially in luxury or high-end vehicle categories, as higher borrowing costs make financing more expensive for consumers.

- **Industrial production:** Global supply chain bottlenecks and reduced demand for capital goods and industrial equipment have hurt manufacturing output in some regions.

“Several industry sectors have been facing economic challenges due to global macroeconomic factors like high inflation, interest rate hikes, and supply chain disruptions.”

5. Media and Entertainment

- **Streaming services:** Many streaming platforms are struggling with slowing subscription growth and higher competition. Profitability pressures have led to cutbacks in content production and layoffs.
- **Film and TV production:** The film and TV production industry has been affected by strikes (such as the Writers Guild of America strike), as well as reduced

consumer spending on entertainment.

6. Finance

- **Fintech:** Financial technology firms, which thrived in the low-interest environment, are now facing difficulty as venture funding tightens, and consumer borrowing slows due to higher rates.
- **Banking:** Regional and smaller banks are facing challenges from higher interest rates, which affect their lending businesses and profitability, along with exposure to commercial real estate loans.

7. Logistics and Shipping

- **Freight and logistics:** The shipping industry has been affected by slowing global trade, reduced demand for goods, and post-pandemic excess capacity, especially in container shipping.

8. Construction

- **Residential construction:** The housing sector, particularly homebuilding, has slowed down due to higher mortgage rates, declining homebuyer demand, and increased material costs.
- **Infrastructure projects:** Some construction firms are facing delays and cost overruns on infrastructure projects due to labor shortages and higher

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material costs.

9. Energy

- **Renewables:** The renewable energy sector, including wind and solar, has seen investment slow due to high financing costs. However, longer-term trends favor continued growth in this sector.
- **Oil and gas:** While the energy crisis of 2022–23 saw prices spike, in 2024, oil prices have stabilized, and some companies are scaling back investments due to economic

uncertainty and energy transition policies.

While these sectors are facing downturns or challenges, not all companies within these industries are equally affected, and some sub-sectors are more resilient than others. Additionally, many of these industries may see recovery as macroeconomic conditions change over time. So, many clients are likely to continue to feel pain, as if in recession, until we are well underway to a cyclical change. That means

lower inflation and interest rates, low or stable unemployment, normalization of the yield curve, and an uptick in global trade...just to name a few things to get all parts of our economy humming again. Of course, this all ignores the possibilities of a black swan event which could be caused by the various socio-political stress points and conflicts around the globe. Now that we are in the soft-landing camp, I am fearful of Murphy's Law! ☐

Spotlight on Equities



Mr. Eixmann is the Chief Investment Officer as well as a Senior Portfolio Manager for Chilton Capital Management.

Prior to joining the firm in 2017, he served as Managing Director at Globescan Capital, an investment advisory firm managing active portfolios for individuals. Before Globescan, he was VP & Portfolio Manager at American Century Investments, where he worked for over 11 years in roles ranging from investment analyst to lead portfolio manager responsible for a multibillion dollar mutual fund and related separate accounts. Mr. Eixmann has an MBA in Finance from the University of Texas at Austin and a BA in Economics and Managerial Studies from Rice University. He is a CFA charter holder and a member of the CFA Institute and CFA Society of Houston.

Despite a few brief unsettled periods in August and September, the S&P 500 moved 5.9% higher in the third quarter of 2024, closing at an all-time high of 5,762 and bringing its very solid year-to-date gain to 22.1%. While the job market softened somewhat, inflation growth continued to slow, positive GDP growth persisted, and the Federal Reserve began lowering interest rates with a 0.5% cut in September.

In the third quarter, the strongest sectors were Utilities, Real Estate, and Industrials while Energy, Information Technology, and Communication Services were the weakest. For the first nine months of 2024, the best sectors were Utilities, Information Technology, and

Communication Services, while the worst sectors were Energy, Consumer Discretionary, and Materials. Market leadership shifted in July, but the sustainability of this change remains an open question.

Volatility Picks Up

After an extended period of calm with the volatility index (VIX) pinned down in the low teens (see the VIX chart on page 6), the market underwent two short-lived but severe spikes of investor fear beginning on August 5th and September 3rd. Factors contributing to the August upset, which saw the largest VIX spike since the pandemic, included the Fed's decision to

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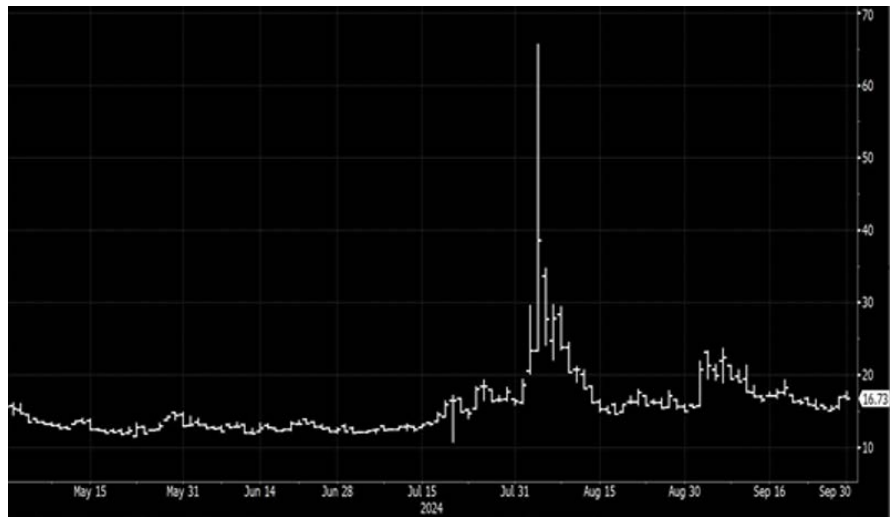
hold interest rates near a 20-year high when many felt that a cut was warranted, a weaker-than-expected jobs report, and the unwinding of the yen carry trade following a surprise rate hike by the Bank of Japan.

These episodes of volatility proved to be buyable pullbacks. Despite some turbulence, the S&P 500 never officially reached correction status, dropping just 8.5% before ripping back to record highs by the end of the quarter. August and September tend to be seasonally weak, volatile months, and markets can be quite inefficient when investors become short-term focused and trade on emotions rather than fundamentals, which generally change more slowly.

The Mag 493?

As slower inflation growth and a gradually deteriorating employment picture gave market participants more confidence that the Federal Reserve would soon embark on a rate cutting cycle, a long-awaited broadening of market leadership began in mid-July. From July 16th through September 30th, the S&P 500 equal weight index (+5%) outperformed the cap-weighted S&P 500 (+2%) as well as the cap-weighted Magnificent 7 stocks, which were actually negative (-1%).

Collectively, the Mag 7 will average nearly 30% earnings growth in 2024. This will likely slow to around 20% in 2025 and possibly mid-teens in 2026, per Bloomberg. This compares to the overall S&P



Source: Bloomberg

500, which will likely see 5% growth in 2024 accelerating to mid-teens in 2025 and slowing back down to around 10% in 2026. The higher earnings growth of the Mag 7 largely explains their past outperformance and supports continued absolute upside despite higher valuation than the overall market. However, this group may cede sustained leadership relative to the other 493 names as the earnings growth spread narrows. Less reliance on these 7 companies, which currently make up over 31% of the index, would likely be a positive development for the overall market.

A New Cycle

The Federal Reserve was probably late to address the worst inflation spike in over 40 years. However, the Fed has arguably made up for its slow start with an aggressive rate hiking cycle that appears to have cooled inflation without

causing a recession—the so-called soft landing. With inflation growth now slowing steadily towards its 2% goal and the unemployment rate hooking modestly upward (see the unemployment rate chart on page 7), the Fed has ample room to cut rates at a pace that can be adjusted based on incoming economic data.

The good news now is that the economy is still growing and mass layoffs are not occurring. Unemployment was recently at historic lows and job openings had spiked after economies reopened in 2020. So, some softening following the significant monetary tightening was to be expected. For now, the Fed's actions seem to be having the desired effects. Monetary loosening should be supportive of rate-sensitive industries like housing and

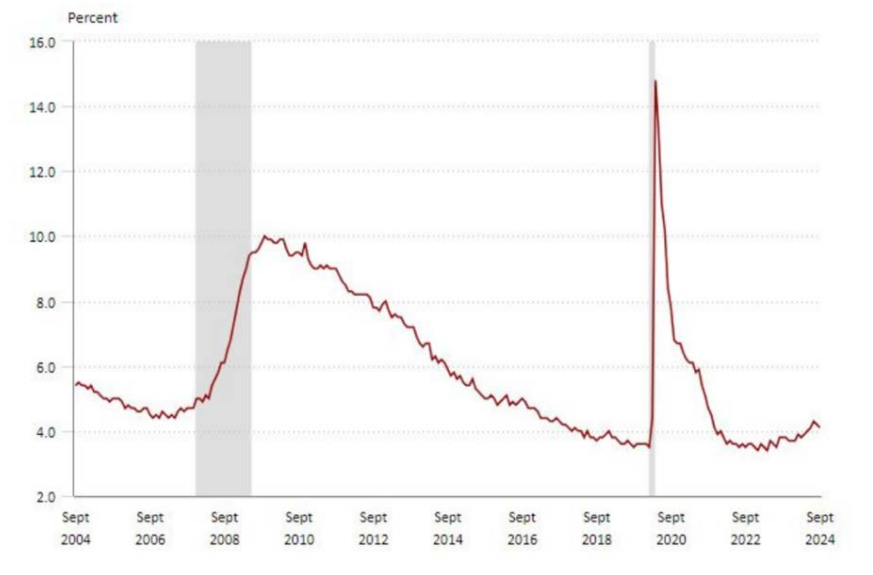
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positive for consumer spending and growth of risk assets.

Domestic Equity Outlook
Market volatility is likely to return in the coming months as market participants scrutinize the Fed’s rate cut path, economic (especially employment) data, and a closely-contested election. In times like these, patience and a focus on company fundamentals, specifically current and future earnings, are paramount.

Major secular themes like AI could continue to boost corporate growth and margins for years to come. These tailwinds, plus fading headwinds from high interest rates and inflation, can continue to drive earnings and the market higher into



Source: US Bureau of Labor Statistics

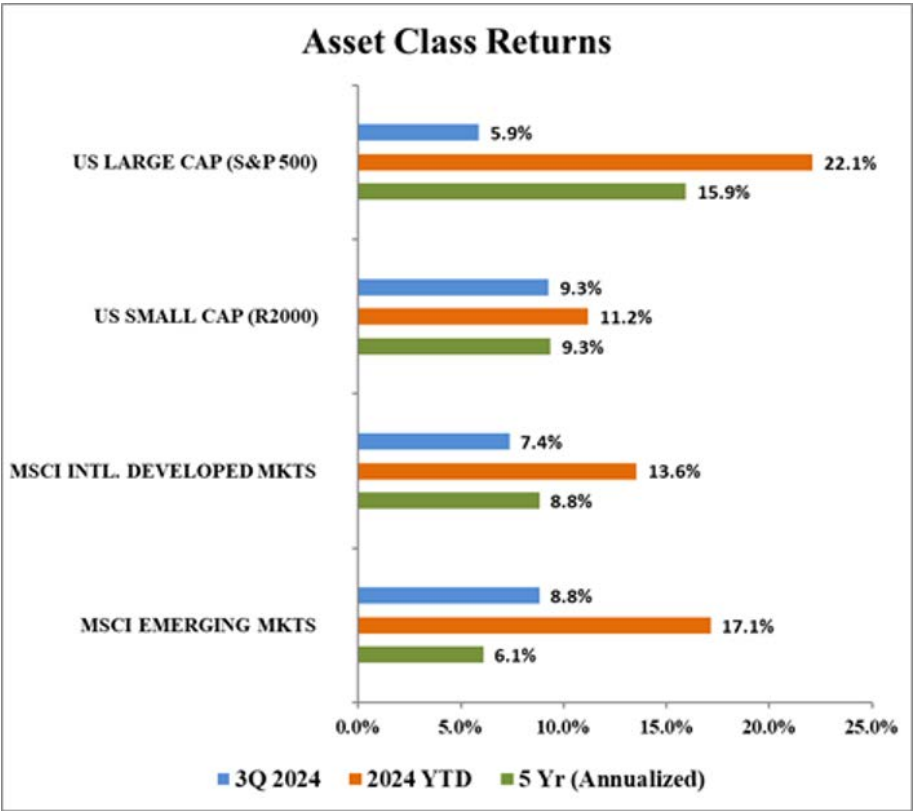
next year.

Global Markets Outlook

Global markets performed strongly in the third quarter of 2024 as economies remained stable amid interest rate cuts by major central banks worldwide. New leadership emerged with US small cap stocks returning 9.3% for the quarter. Emerging markets followed with an 8.8% gain, international developed markets added 7.4%, and US large caps finished up 5.9%. Year-to-date, US large cap stocks remain on top with a 22.1% return, followed by emerging markets at 17.1%, international developed markets at 13.6%, and US small caps at 11.2%.

Several significant shifts emerged in the third quarter. Notably, value outperformed growth after six consecutive quarters of underperformance, with the Russell 1000 Value

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Source: Bloomberg, Chilton Capital Management

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Index returning 9.4% compared to 3.2% for the Russell 1000 Growth Index. The Federal Reserve also cut interest rates for the first time this cycle, and markets expect further cuts this year and next. Other prominent central banks, including the Bank of England, European Central Bank, Swiss National Bank, and Bank of Canada also implemented cuts, while the People's Bank of China cut rates and introduced additional stimulus measures. A notable change in sector performance also emerged, as growth heavy sectors Communication Services and Information Technology—previous leaders—became the second and third worst performers of the quarter, ahead of only the energy

sector. In contrast, traditionally value-weighted sectors like Utilities, Real Estate, and Financials, which had previously lagged, took the lead.

Historically, it is not unusual for value stocks to outperform growth, and for defensive sectors to outpace cyclical in the early stages of a rate-cutting cycle. As the economy slows, investors tend to shift toward more defensive assets. However, growth stocks typically start to outperform value 12 months after the first rate cut, driven by the potential onset of economic expansion and

lower interest rates, which reduce borrowing costs and enhance the present value of future earnings.

Of course, every cycle is unique. In the 12 months after the first cut in late 2019, growth outperformed value by 35.8%, thanks to a pandemic/stimulus induced demand boom. While today's environment is unlikely to produce such extreme results, investors with a strong conviction that growth will outperform over the next year may find U.S. large-cap stocks particularly attractive. On the other hand, those favoring value may look to international and small-cap stocks. ☐

Upcoming Events

Carl Terzer is speaking at the NRRRA National Conference in Chicago. Join us on Wednesday, November 13 for his session, "Economy & Investments."

The CapVisor team will be at the Cayman Captive Forum from

December 3-5. We look forward to seeing you there!

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Carl E. Terzer
Principal & Editor in Chief
CapVisor Associates, LLC

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P.O. Box 1084 Gainesville, GA 30503
(973) 665-6370
Email us at: info@capvisorassociates.com

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