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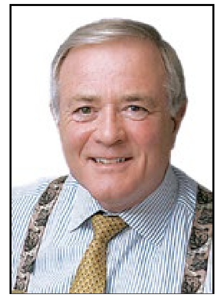
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Breaking tradition: The market rallies in September

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As leaves began their annual transformation in autumn, the stock market defied its usual seasonality. September has historically been a challenging month for U.S. stocks — often the worst of the year — but not this time. This year, September provided noteworthy market returns, spurred by the Federal Reserve's 50-basis-point rate cut, resulting in a resurgence in stock market optimism. Year to date, through the end of September, the S&P delivered its best return since 1997, with an increase just shy of 21 percent.

On Sept. 18, the Federal Reserve, led by Chairman Jerome Powell, lowered the federal funds rate by 0.50 percent to a range of 4.75 percent to 5 percent. This larger-than-expected cut was described by Powell as "recalibrating policy down over time to a more neutral level." In other words, the Fed lowered rates not because the economy needs a boost but rather quite the contrary. Powell explained that the cut is because rates are just too high, not because of weakness in the economy. This reassurance fueled the market bounce. The decision also reflects the Fed's growing confidence in the progress made to tamp down inflation, which has eased from a peak in June 2022 of nearly 7 percent for the PCE to an estimated 2.2 percent as of August, according to the latest PCE data released on Sept. 27. It's a sign of the "soft landing" many people hope for.

The market's reaction to the Fed action and Powell's words was overwhelmingly positive. The day after the announcement, the Dow Jones Industrial Average surpassed 42,000 points for the first time, while the S&P 500 and Nasdaq Composite also reached new heights. This surge in equities was accompanied by rallies in gold and bitcoin, supporting the broad-based optimism sparked by the Fed's move. While the stock market usually performs well in a presidential election year, the S&P was up more than it ever has been at such a time. The S&P 500 rose 5.5 percent for the third quarter and 21 percent year to date — its best Q1-Q3 performance of the 21st century, achieving 43 record highs. Both the Dow and the S&P 500 have now posted gains in five consecutive months.

The recent rate reduction draws interesting parallels to the Fed's actions under Alan Greenspan in 1995. At that time, the Fed initiated rate cuts in response to a cooling labor market, despite no immediate signs of recession. Greenspan's Fed made three quarter-point rate cuts in 1995 and early 1996, which successfully reinvigorated job creation without sparking inflation concerns. That "soft landing" paved the way for the economic boom of the late '90s.

There are, of course, key differences between then and now. This current rate cut is more aggressive, starting with a 50-basis-point reduction rather than 25. While Powell was adamant that the size of the rate cut should only be "taken as a sign of our commitment not to get behind," this reflects the current Fed's assessment that it has more ground to cover, given that rates had risen much higher in the recent tightening cycle compared to the mid-1990s. Another difference is that more borrowers are already enjoying low rates that preceded the rate rises than was the case in the '90s.

Consumers and businesses still enjoying the benefit of low rates locked in during the pandemic are likely causing the considerable slowing of bank lending over the past year — a trend not typically seen outside of recessions. The impact of rate cuts in stimulating economic activity may be limited in this cycle by the fact that many businesses and households will still benefit for some time from these fixed-rate loans secured before the recent rate hikes. Despite the recent drops in mortgage rates to around 6.1 percent, many homeowners are reluctant to move since they are locked into much lower rates, averaging about 3.9 percent. This "lock-in" effect could dampen the stimulative impact of rate cuts on the housing sector. On the other hand, the normal cycle of people moving for new jobs, better schools, to be closer to family, to accommodate growing families, to downsize in retirement, etc. cannot be delayed indefinitely, and this will start to break loose some of the lower interest rate mortgages. However, an increase in housing mobility may also present the anomaly of less discretionary consumer dollars, as their housing costs increase when they move, even as rates decline.

The Fed's move aims to maintain economic strength and support maximum employment. The unemployment rate rose to 4.2 percent in September (it was 3.7 percent in January). This cooling in the labor market, despite unemployment still at historically low levels, influenced the Fed's decision-making. The stronger-than-expected job openings and wage growth report released after the end of September will no doubt tamper their future aggressiveness in lowering rates, with the market currently anticipating only a 25-basis-point reduction at the next Fed meeting.

The Fed's ability to engineer a "soft landing" — bringing inflation down to its 2 percent target without triggering a recession — appears to be on track. The central bank projects further rate cuts, potentially lowering the benchmark rate to around 3.5 percent by the end of 2025. The impact of these cuts in stimulating growth will depend on factors beyond the Fed's control, including global economic and political conditions and the willingness of businesses and consumers to take on new debt at prevailing rates.

The Fed's recent rate cut and related comments about the strength it sees in the economy has injected new optimism into the markets. However, while lower rates generally support higher equity valuations, it's essential to consider the broader economic context. The geopolitical landscape remains fraught, with the threat of unexpected jolts to the stock market from higher interest rates in Japan to higher prices resulting from any number of factors, such as dislocation in energy supplies and sea and rail transportation to tariff wars. The market's current concentration in a handful of tech giants and the related enthusiasm surrounding AI have resulted in higher valuations for stocks overall, as investors have trimmed these winners and bid up other sectors. Can this multiple expansion continue?

The journey of investing is much like tending to a garden. It requires patience, care, and the willingness to adapt to changing seasons. There will be periods of rapid growth and times when progress seems slow. As always, diversification remains key; just as a balanced ecosystem thrives on variety, a diversified portfolio mitigates risk. Embracing long-term strategies is crucial; market fluctuations are inevitable, so adopting a long-term investment horizon helps weather short-term volatility and underpins sustained growth.

U.S. equities have the potential to continue to outperform over time due to the diversity of the U.S. economy, its dynamic financial markets that provide capital for growth, its innovative and productive private sector, its favorable demographics relative to other developed economies due to population growth from immigration, its wealth of natural resources, and its advantageous geographical position.

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