Marketline September 2024

Stocks:

September was a decent month, with some recovery in the tech sector and the same roughly 2% return on the Dow and S&P that we saw in August. Escaping with only a few bumps and scrapes inflicted by volatility was a minor miracle, but we must get through October before we can say the words "Santa Claus rally" ahead of the holidays. Overseas, returns were mixed. Canada pulled out a solid price increase of 2.8%, but Mexico's Bolsa declined 0.8% driven by still-high inflation and interest rates more than twice the levels of ours. Meanwhile, Europe was worse at -1.7%, dragged down by energy constituents in the FTSE-100.

Around the world, interest rates are declining, and central bankers are debating only how much to cut next time around, not whether to cut. This sea change will re-value assets upward over time, following the axiom that – overwhelmingly – only two factors matter to stock investors in the long run: interest rates and earnings. Where we've become overweighted in bonds or cash, we're rebalancing toward stocks. Now's the time. Third-quarter earnings reports are coming up, and we're planning for the occasional idiosyncratic downdraft, providing an opportunity to round out our buy list with new names. We're particularly interested in industrials and forgotten technology companies busted by post-Covid disappointment. Our research has turned up names like Paycom, a provider of human resources payroll and benefits solutions. The service is cloud-based and offers one-stop-shopping to the user. It does not integrate with outside services; instead, it operates solely inside Paycom's ecosystem. The service has proved so effective that it actually cannibalized sales from Paycom's other products for a time. Earnings are reaching new records, but the stock price is off from $559 in 2021 to $167 now. This is the kind of disconnect we look for when pursuing stocks – a mismatch between fundamentals and price.

Given the state of the world, it's worth spending a few words on wars and stocks. Becoming concerned about your portfolio when wars are breaking out in tinder-box areas of the world is natural. Historically, an outbreak of war means a soft stock market for a few days. But stocks typically *gain* over the year following the initiation of fighting, so long as the economy was growing at its outset. The gain averages 9%. If the underlying economy is weak when a war starts, losses average about 11%. The US is growing, albeit slowly, so it's likely we'll shake off the effects of this unfortunate turmoil.

Bonds:

August's bond market was substantially entertaining, and I thought it would be hard to top. But then September rolled around, and bonds just didn't stop for a breath. Rates continued to sink, all along the maturity spectrum. Of course, we knew the shortest bonds were headed down in yield – the Fed told us so – but the long end kept slumping too: the thirty-year sank from 4.2% to 4.12%, and now it sits just a hair over 4%. The ten-year – already dropping like a stone into a well – just kept going, falling all the way to 3.78%. We remind readers regularly that this rate is particularly important to the economy, being the benchmark for mortgage loans, but we forget to mention that short-term rates are also important, being where companies and consumers often finance operations or purchases. Relief from this corner of the bond market will manifest over time, but it's coming.

In terms of sectors, I learned something interesting recently. Aggregate statistics show that municipalities have very light debt loads – historically light. Consequently, there's plenty of scope for more issuance without straining credit quality. While our conviction that more supply would weaken prices and keep upward pressure on yields was correct, maintenance of overall credit metrics while prices have been soft prompted us to wade into a few municipal issues lately. These purchases were to replace existing bonds; we didn't add to allocations.

We still prefer corporate issues over municipals, but the race is becoming tighter. As mentioned in the *Stocks* section above, we're more constructive on equities than bonds at the moment, so we're net sellers of bonds overall.

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