HUNT VALLEY WEALTH

Market & Portfolio Commentary

Q3 2024

Third Quarter Market Review and Commentary

IN THIS ISSUE

The third quarter of 2024 was a rollercoaster ride for investors, with stocks and bonds experiencing significant volatility despite sitting at record highs as the final three months of the year approach.

John Heinlein
Managing Director,
Chief Investment Officer

The Federal Reserve's long-awaited reduction in interest rates played a key role in the returns on stocks and bonds during the period. Throughout July, the stock market experienced a general upswing, despite the decline in technology stocks, which lost momentum and turned downward. There was a brief shift away from high-growth stocks in favor of value stocks and smaller company stocks. However, a severe sell-off in August triggered renewed fears of a recession. This, coupled with the sudden unraveling of significant investments in Japan, caused stocks to plunge roughly 3% in a single day. Subsequently, equities gradually recovered and ended the quarter with a positive return as the S&P 500 index was up 5.89%.

The resurgence in the equity markets was believed to be fueled by the resolution of months of investor uncertainty surrounding interest rates. As inflationary pressures subsided, the Federal Reserve cut its target rate by half a percentage point at its September meeting, and investors now anticipate the central bank to aggressively continue lowering rates. This increased clarity contributed to bond markets moving further into positive territory during the quarter. Yields began to fall in June and July as the prospect of rate cuts became more concrete.

Stocks rebounded as the rotation from tech finally took hold and the Fed cut rates.

Quarterly Market Performance Barometer

U.S. Stocks	Q3 2024	*Market Sell-Off* 7/16/24 - 8/6/24	Year to Date
S&P 500 Index	5.89%	-7.50%	22.08%
Russell 200 Index (small cap)	8.90%	-8.77%	11.16%
S&P 500 Growth Index	3.55%	-10.70%	28.14%
S&P 500 Value Index	8.44%	-2.93%	15.36%
Bloomberg "Magnificent 7" Index	5.43%	-13.58%	44.40%

U.S. Bonds			
Bloomberg US Corporate Bond Index	5.84%	0.91%	5.32%
Bloomberg US 1-5 Year Bond Index (short term)	3.75%	0.88%	5.37%
Vanguard Long Term Corporate Bond ETF	7.08%	0.59%	1.35%

Figure 1: Quarterly Market Performance Barometer - Q3 2024

Key Stats: Q3 2024

- The US Stock Market recovered from a sell-off in August to end the quarter up 5.89%. During the sell-off, investors rotated away from the big tech names into value and small-cap stocks.
- Technology and growth stocks lagged the market for the quarter as investors looked to other areas.
- Bonds rallied as the outlook for interest rates and chances of a soft landing for the economy strengthened.
- Bonds held their value during the brief stock market correction.
- The Fed cut interest rates for the first time since 2020, lowering the target range for the federal funds rate to 4.75% - 5.00%. The market anticipates more cuts through the end of the year.

Outlook

Overall, we think investors should expect more volatility in the fourth quarter. As we start the quarter, companies will begin to report earnings and give their outlook for next year, which can cause a few surprises. In addition, this is an election year and looks to be close and contentious, which could cause the market to sway sharply in either direction, no matter the outcome.

However, we believe the long-term outlook for both stocks and bonds remains positive. As always, if there is unexpected volatility in stock prices, we look to take advantage of Mr. Market to buy great businesses at a discount.

2024 Election: What should investors do?

Matthew Holman, CFA
Portfolio Manager

Back in January, we hosted a webinar recapping 2023 and discussing our thoughts for 2024. This included a poll gauging our viewers' primary focus for 2024. Unsurprisingly, the U.S. election won in a landslide with over 70% of the votes, followed by interest rates, inflation, and the risk of a recession, in that order. This should not be surprising since election years are an emotional time for many, and the unpredictable and often sensationalized news cycle only compounds matters.

Historically, equity markets have performed well during election years. 2024 has been no exception, with the S&P 500 index generating 22.1% of total returns year-to-date. The chart below shows historical total returns for the S&P 500 for each year of each president's 4-year term since 1928. For example, during year four (election years), the index averaged 11.5% per year[1]. Note that the median (16.0%) is much higher since the distribution of returns heavily skew towards positive results. This is especially prevalent in the third year of a president's term[2].

Election years also tend to bring elevated levels of volatility, especially in the months leading up to election day. Again, 2024 is a prime example, as share prices began trading wildly beginning in mid-July. Heightened emotions and uncertainty about the next four years can easily lead investors to react irrationally, causing broader market sentiment to temporarily become unstable.

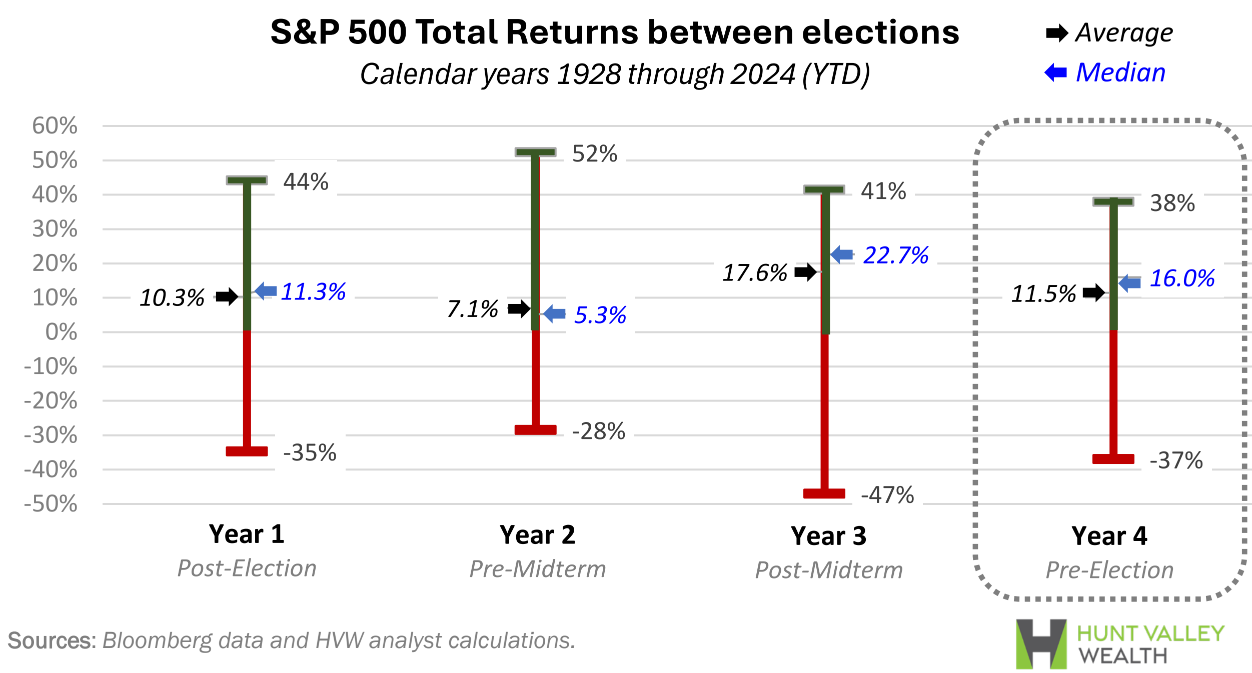

Figure 2: S&P 500 Total Returns between Elections (Calendar Years 1928 - 2024)

[1] This is a simple average and not compounded over the sample period.

[2] If we exclude 1931 from the study, when the S&P 500 declined -47%, the next lowest return was -0.07% in 1939.

That said, there are a few trends that are particularly notable. Looking back to 1933, equity markets have generally outperformed under Democratic presidents. Conversely, a Republican majority in both the House and Senate has outperformed a unified Democratic Congress (see chart below).

We also notice that a divided Congress has historically been more favorable for market performance than a unified one (see chart below). This is likely attributable to legislative stagnancy (or gridlock) limiting the chances of new, major legislation, which could ease investor uncertainty and boost overall market sentiment.

Many studies have tried to uncover the most favorable election outcomes for market performance. We have done our own research and arrived at similar conclusions. It is important first to note that statistics are easy to manipulate to support a desired outcome. For example, the results are highly dependent on the period tested since this can capture or omit periods of extraordinary performance in either direction. Second, the sample size is relatively small, with reliable data only available back to the beginning of the 20th century. Also, remember that past trends are not always indicative of future performance.

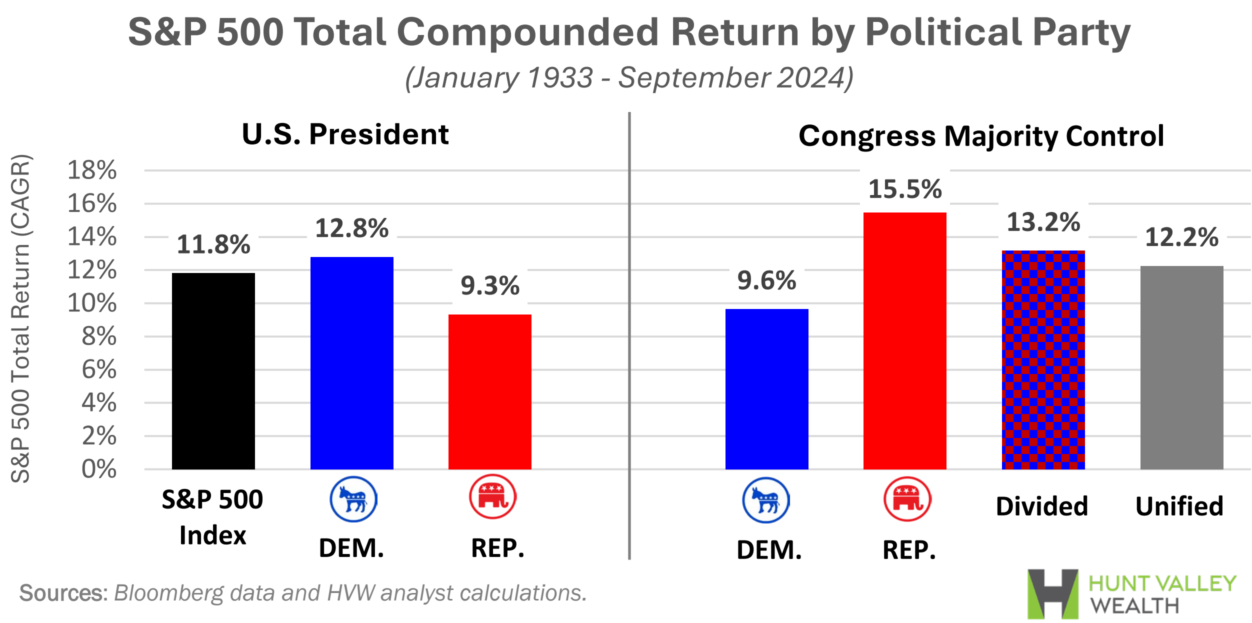

Figure 3: S&P 500 Total Return by Political Party (Jan 1933 - Sep 2024)

Election years are also an opportune time for some to advise re-positioning capital to targeted industries to capitalize on a particular candidate's victory. Some of this election's popular trade ideas include: [3]

- Investing in clean energy and infrastructure if Vice President Kamala Harris wins, while being cautious with technology firms and further healthcare reform.
- A victory for former President Donald Trump could benefit legacy energy companies and defense contractors, while higher proposed tariffs could harm larger multinational firms.

This is a form of thematic investing. We acknowledge that the election outcome could impact underlying businesses to varying degrees. But we prefer to limit its influence in our investment mosaic and focus on longer-term drivers.

[3] https://www.kiplinger.com/investing/stocks/how-will-the-election-impact-the-stock-market

What should investors do with this information?

We believe positioning portfolios on this basis can be dangerous and unlikely to be a winning strategy because:

1. Partisan policy changes are not the only factor influencing company results.
2. Promises made on the campaign trail sometimes fail to come to fruition once in office.
3. An investor would still have to pick the right companies and correctly time their entry and exit trades to be successful.
4. Again, data analysis can manipulated to support a given narrative or desired outcome.

The underlying takeaway should be that election results commonly influence equity markets less than investors think. If we zoom out and look at the big picture, longer-term equity performance has not been correlated to which party is in office (see chart below).

When it comes to your portfolio, we believe investors would be better off blocking out the noise from the around-the-clock media cycle and focusing on the true drivers of business value. Equity markets are nonpartisan, and we believe investors should be too when it comes to financial decision-making. The alignment of corporate profitability, the economic cycle, and the Federal Reserve's policy matters far more in the long run than who resides in the White House, in our view.

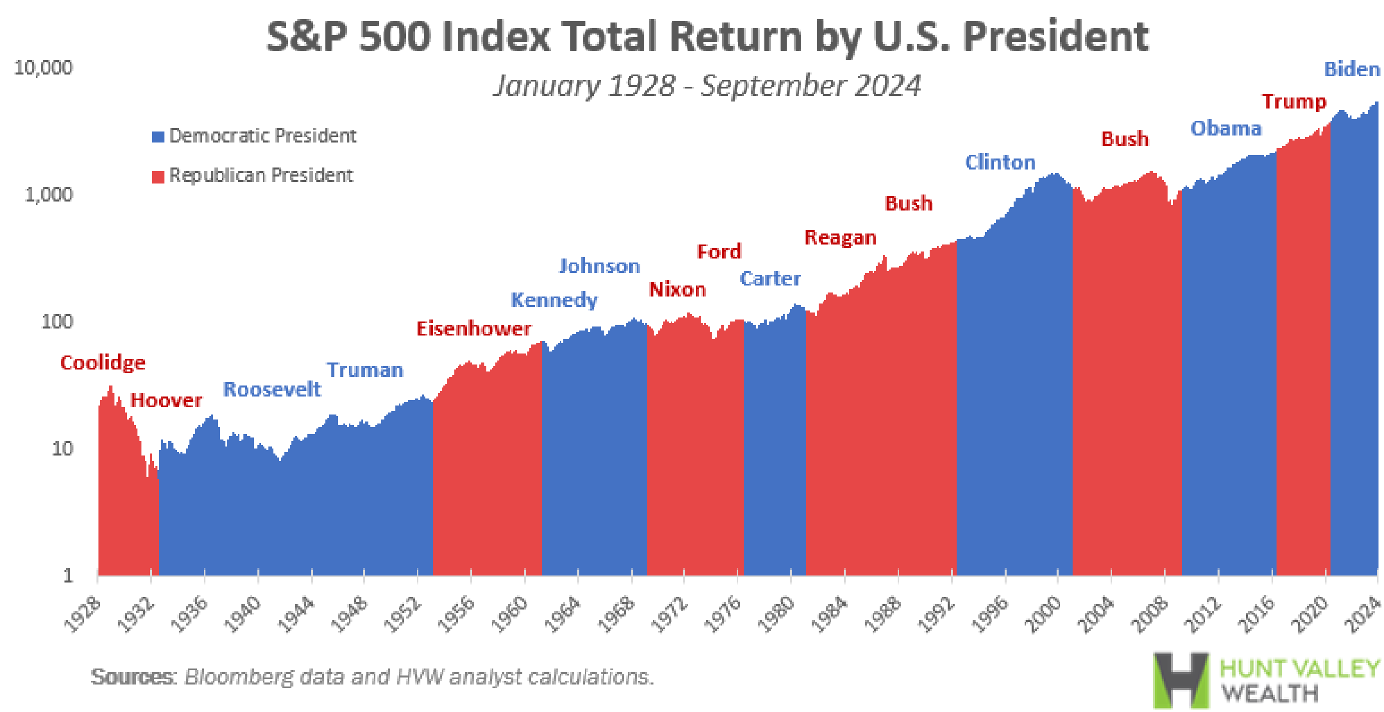

Figure 4: S&P 500 Total Return by U.S. President (Jan 1928 - Sep 2024)

Company Spotlight

Q3-2024

Louis Foxwell, CFA
Portfolio Manager

TransDigm Group, Inc. (TDG) is an aerospace parts supplier for commercial and military aircraft. Its products are in nearly every aircraft in operation in the world.[4]

Before exploring the qualities of TDG, it is worth spending some time explaining its business model. TransDigm initially sells aircraft parts to original equipment manufacturers (OEMs), and these parts go through a very rigorous, expensive, and time-consuming qualification process. This includes FAA certification, testing, and planning. Once a part is qualified for an aircraft "platform" (e.g., Boeing 737), it is used on that aircraft for decades. TransDigm also focuses on selling proprietary parts that cost very little relative to the total cost of the aircraft – seat belts, valves, clamps, actuators, faucets, batteries, etc. The low-cost nature of these parts, combined with the expensive and time-consuming qualification process, disincentives the OEMs from seeking alternative products.

As a sole-source supplier, TransDigm is well positioned in the aftermarket, which is where it generates most of its free cash flow. When an aircraft withstands increased usage and goes out of warranty, TransDigm sells replacement parts to airlines and MRO (maintenance, repair, and overhaul) shops. Since most aircraft platforms operate for decades, we believe aftermarket revenue is predictable, durable, and recurring. Further, TransDigm has excellent pricing power due to the lack of alternative products and the low-cost nature of the parts themselves. These attributes place TransDigm in an advantageous competitive position within the aerospace industry, and the resulting economics are attractive to us as investors.

TransDigm is a decentralized organization with an entrepreneurial culture at the subsidiary level. Executive compensation is tied to growth in intrinsic value per share, which we believe is both optimal and rare among publicly traded businesses. The company is highly acquisitive and has a track record of improving margins and optimizing acquired subsidiaries. It historically has a flexible capital allocation framework, buying shares when they are undervalued and paying special dividends when it cannot find acquisition opportunities.

TDG is not a widely held stock in client portfolios, though we have opportunistically purchased it in cash-heavy accounts at various points in time. We have highlighted it today to demonstrate the extensive due diligence that we perform on stocks that may not yet be core holdings. We maintain a library of potential ideas like TDG, and we consistently look to reallocate capital in new areas to meet the needs of each individual client.

** Company Spotlight is meant to illustrate our data points of analysis in different businesses we research and then consider investing in based on each client's personalized investment profile.*

This is not a recommendation of the individual security above.

[4] 2023 Annual Report (Page 2) – https://transdigmgroupinc.gcs-web.com/static-files/a3400bf4-df53-4180-9a26-069866ee0761)

Hunt Valley Wealth: Company News & Highlights

We are excited to introduce the newest members of the Hunt Valley Wealth team: Wealth Advisors Gennadiy Todd and Lauren Szczybor.

Gennadiy most recently worked as a Financial Planner with Verdence Capital Advisors. Gennadiy has bachelor's degrees from Brooklyn College and Towson University and is a Certified Financial Planner®.

Lauren comes to us from T. Rowe Price, where she worked as a Senior Financial Consultant. Lauren attended Stevenson University where she received her B.S. in Business Administration.

Please join us in welcoming Gennadiy and Lauren to the Hunt Valley Wealth family.

We are here to support you and your wealth management objectives.

Especially now, we invite you to connect with your advisory team to discuss the markets, inflation, or your personalized wealth management strategy. We remain committed to your goals, both near and long-term.

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