blue river
CAPITAL MANAGEMENT

QUARTERLY NEWSLETTER 2024.Q3

October 2, 2024

Asset classes across the board enjoyed a strong third quarter to the year. Driven by continued resilience in the domestic economy, lowering interest rates, and a fiscal stimulus package announced in China, investors continued to pile funds into various markets. This time, it wasn't just the S&P 500. While the popular index's return of 5.89% over the quarter is nothing to slouch at, other equity markets had even stronger performances.[1] The Russell 2000 Total Return, an index that measures the performance of smaller domestic companies, returned 9.27% for the quarter, and the MSCI ACWI Ex-US index, our preferred index for measurement of international stock performance, returned 8.06%. In particular, emerging markets, driven in large part by strong performance from Chinese equities, was a bright spot. The asset class returned 8.88% as measured by the MSCI Emerging Markets Total Return Index.

Through the first half of the year, fixed income markets had lost 0.71% as measured by the Bloomberg US Agg Bond Index. With the Federal Reserve lowering rates in September by 0.50% and the market's anticipation of further rate cuts throughout 2025 (more on that later), that trend reversed in the third quarter. Fixed income markets returned 5.20% during the quarter, bringing their year-to-date performance well into positive territory.

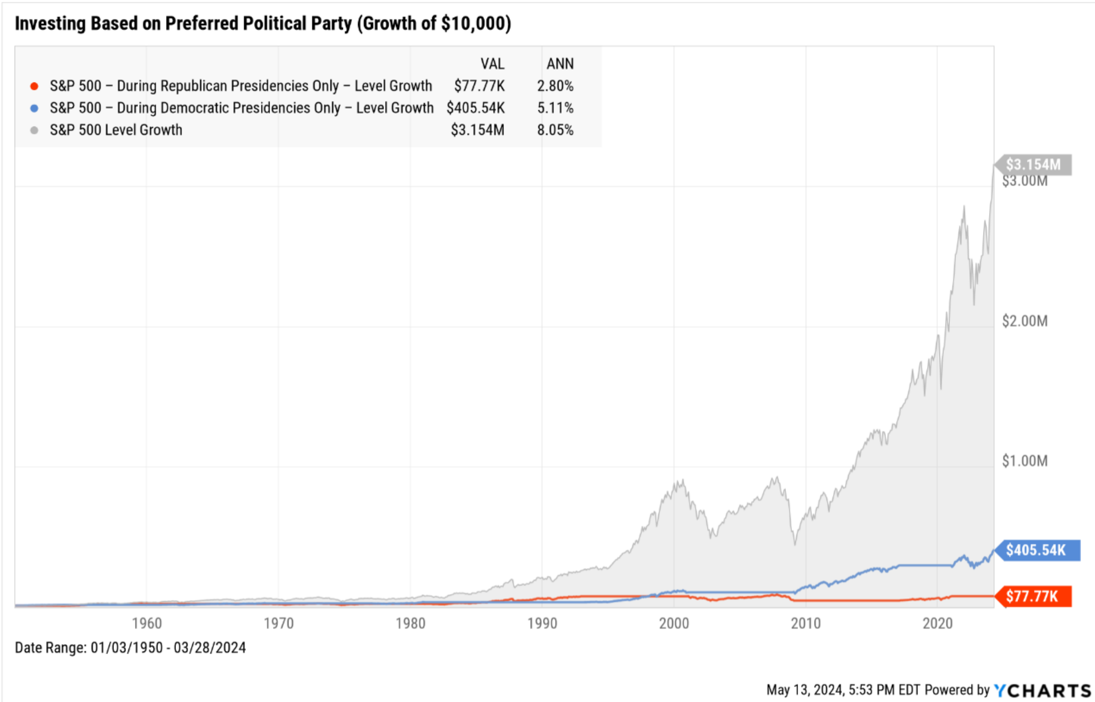
Lowering interest rates likely impacted real estate markets and their associated stocks, which performed very strongly. The US REIT market, as measured by the S&P 1500 Real Estate Total Return Index returned 17.19% for the quarter and the iShares US Home Construction ETF (ITB), which owns mostly homebuilding companies, building suppliers, and home improvement stores returned 25.89%. Mortgage rates fell to just above 6% at quarter-end, which is a welcome respite for many home buyers, but rates still have not lowered enough to coax many homeowners out of their 3% mortgages they acquired years ago. The residential real estate market remains frozen, with US existing home sales at its lowest point since 2010.[2]

Presidential Election

With the prospect of election controversy regarding who will be our next President, it would be easy for investors to want to significantly reduce risk, move entirely to cash, or let their political views drive their investment decisions. We believe this would be a mistake.

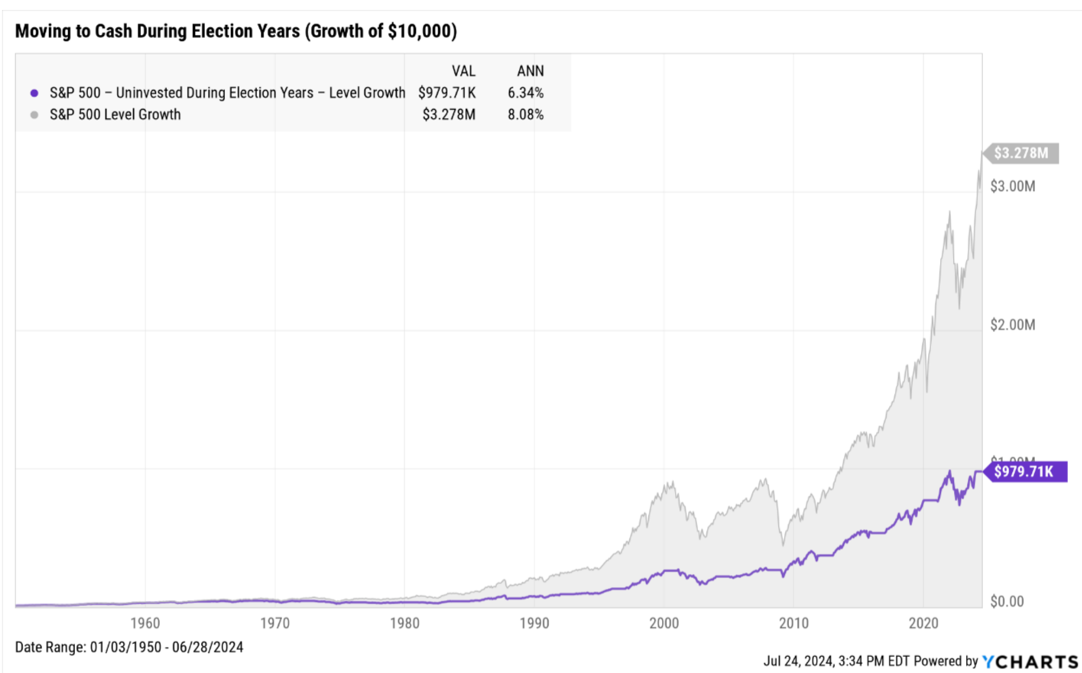
The following chart shows the outcome of investing $10,000 in the S&P 500 but only staying invested during periods when a specific political party holds the Presidency since 1950:

[1] All index and security return data from YCharts
[2] Existing home sales data from National Association of Realtors



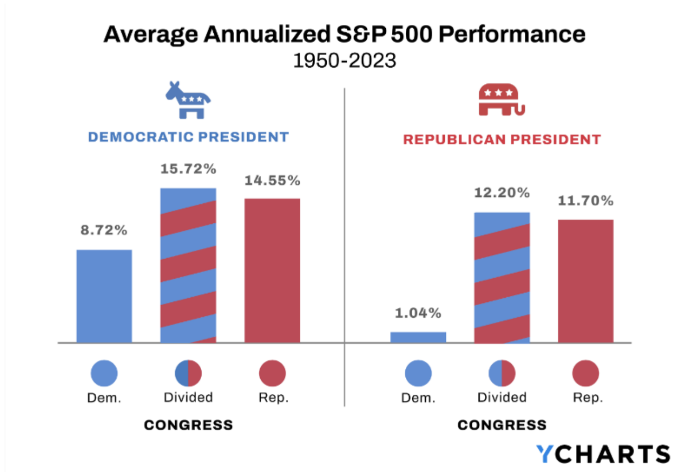
We find these figures truly stunning. While both Republican and Democratic Presidents delivered overall positive returns for investors, it should be clear that the best strategy is to stay invested, no matter which party is in power.

The next chart shows the outcome of investing $10,000 in the S&P 500 but moving to cash during election years since 1950:



While not quite as stark as the prior chart, again the best strategy is to stay invested.

Our final chart brings in the additional variable of which party is in power in Congress. Returns here are annualized since 1950:



Again, the best strategy is to stay invested (We supposed there is some evidence a Republican President and a Democratic Congress is a poor environment for stocks, but we suspect it is more likely a statistical anomaly and/or a low sample size driving that figure).

Interest Rates

At its September meeting, the Federal Reserve (the Fed) lowered the federal funds rate by 0.50% to a range of 4.75% to 5.00%. We were somewhat surprised by the "double cut" from the Fed, as we were expecting a 0.25% cut (we have seen some outlets argue the reason for the "double cut" was because the Fed does not have a meeting in October, and this is equivalent to two "single cuts" in September and October). Nevertheless, the Fed continues to telegraph its future moves, and we are confident rate cuts will continue through the end of the year and at least the first half of 2025. The Federal Reserve Open Market Committee (FOMC) median participant believes the federal funds policy rate will be at 3.4% by the end of 2025. The market is pricing in slightly more aggressive cuts, with many calling for 8 more rate cuts by the end of 2025, which would put the policy rate at 2.75% to 3.00%.[3]

The Fed has stated it believes that long-run structural unemployment should be about 4%, and it targets 2% inflation. With unemployment sitting at 4.2% and underlying inflation estimated at 2.2% in the twelve months ending in August, the Fed will play Goldilocks trying to find the "just right" level of interest rates that are neither too cold (restrictive) nor too hot (stimulative) so that the economy can stabilize around its unemployment and inflation objectives. Currently, the FOMC median projection of long-run interest rates (Baby Bear's "just right" bowl of porridge) is 2.6%, and we expect the federal funds rate to converge towards that figure. Of course, macroeconomic variables are likely to change, so the Fed cannot get too comfortable with that objective.

As we have mentioned before, it is important to keep in mind that the Fed does not control most interest rates; instead, they only control and directly influence rates on the shortest-dated US debt

[3] Fed funds rate expectations from the Federal Reserve Bank of Atlanta

securities. As an illustration, we noted that after the Fed meeting on September 18, rates on US debt securities with maturities over 2 years, mortgage rates, and corporate debt rates all *increased*. The reason for this is not completely clear, but it could be a reflection that the pace of expected interest rate cuts by the Fed was *lower* than the market had already priced in. We should also note that with the Fed openly communicating its next moves, market-based interest rates are likely to lower well before the Fed cuts. For example, mortgage rates dropped from an average of 7.2% in May to 6.2% by September 12, before any cuts by the Fed.[4]

As always, we thank you for trusting us with your investment accounts. While we are constantly navigating the uncertainty of the financial markets, we feel confident we have built our clients portfolios that will be resilient over the long term, and we are pleased with our performance over the last quarter. If you have any questions, life updates, or would like to chat with us, we are always available.

Jack Dukeminier, CPA, CFA

Philip Bagdade, CFA

[4] Mortgage interest rate data from Federal Reserve Economic Data

Disclaimers:

Blue River Capital Management, LLC is a registered investment adviser. This publication is in no way a solicitation or offer to sell securities or investment advisory services. Reference to market index information is included for informational purposes only and is not representative of any particular investment or plan. It is not possible to directly invest in an index. Indexes are unmanaged, hypothetical vehicles that serve as market indicators. Index total return performance data reflects the assumptions of the reinvestment of interest and dividends but does not include the deduction of fees or transactions costs which otherwise reduce performance of an actual portfolio. Past performance is not indicative of future results.

Index Definitions:

S&P 500 – A representative sample of 500 leading companies in leading industries of the US economy. The S&P 500 Index focuses on the large-cap segment of the market; however, since it includes a significant portion of the total value of the market, it also represents the market.

MSCI ACWI Ex-US – A market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI). It is designed to provide a broad measure of stock performance throughout the world, with the exception of U.S.-based companies. The MSCI ACWI Ex-US includes both developed and emerging markets.

Bloomberg US Agg Bond – A broad-based fixed-income index that includes government Treasury securities, corporate bonds, mortgage-backed securities, asset-backed securities, and Municipal securities to simulate the universe of bonds in the market.

Russell 2000 Total Return – The Russell 2000 tracks the roughly 2000 securities that are considered to be US small cap companies. The Russell 2000 serves as an important benchmark when investors want to track their small cap performances versus other sized companies.

S&P 1500 Real Estate Total Return – Comprises those companies included in the S&P 500 that are classified as members of the GICS® Real Estate sector. The S&P Composite 1500 index (^SPSUPX) includes small cap stocks that may have high growth potential but also meet investability and financial viability criteria.