Please Prepare the Cabin for Landing

It's a phrase that needs no explanation. And it's precisely where we find ourselves in the US economy today. Now is the time to ready our portfolios—putting tray tables up, adjusting seats to their upright positions, and clearing away empty cups. In financial terms, this means revisiting the cash and money market positions that were established out of fear or anxiety. It involves fastening our seat belts and ensuring our equity exposure is appropriate given the rally of the last two years. And it means planning for our arrival by considering the right size for an allocation to alternative assets. The wait is over. We are landing.

How's the landing so far? At first glance, fairly smooth. The Fed seems to have tackled the worst of the inflation problem, in our view. And the Fed would likely agree. Their recent announcement of not just the first rate cut of the cycle, but of an oversized half-point cut—with more reductions expected later this year and into 2025—clearly projects that confidence.

But that's not to say that all will be smooth from here. Remember the first week in August, when the Japanese market fell by 12% in a few hours? The world's markets were briefly rattled on the back of weaker-than-expected—though still fairly solid—US labor market data. While we don't expect a replay, other shocks could still emerge. For instance, a year after the October 7th attacks, our eyes are once again turning to the risks of escalating conflict in the Middle East and possible ramifications for global oil markets.

Plus, even with that Japanese episode, most asset classes performed well during the quarter, enhancing already robust year-to-date returns.

US large caps led the way through the end of the quarter, returning 22% for the year and setting "new all-time highs" 42 times. Global equities performed nearly as well, racking up 18% returns so far this year. Commodities have generated only around 5%, as investors aren't convinced that they can dodge a Fed-engineered global slowdown. Taxable US bonds have nearly matched that at 4% and municipal bonds have also returned around 2% year-to-date. All in all, a good year so far.

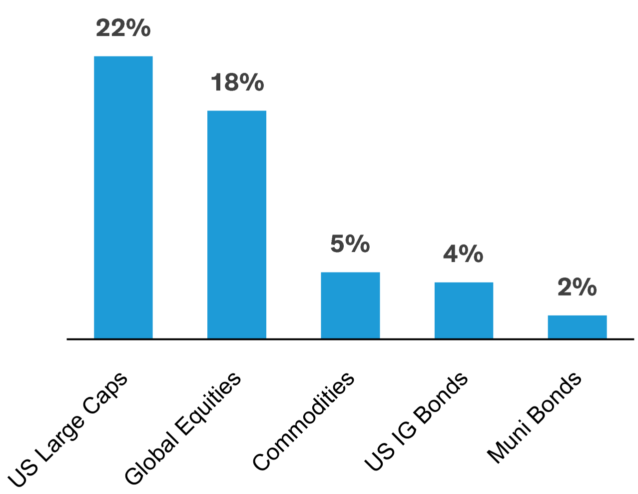
The Next Phase

With inflation almost back to the Federal Reserve's 2% target and continuing to ease gradually, and the labor market settling into a more normal environment, rate cuts have finally arrived. (Hooray!) This next phase of the economic cycle began in earnest with the Fed's move in September, its largest reduction in 16 years.

What can we expect from here? We think growth will continue to slow but remain positive. Our base case is definitively ***not*** calling for a recession. But we expect GDP to expand at a rate below both its long-term trend and potential for a few quarters, as tight-but-moderating monetary policy continues to act as a governor on growth. This doesn't mean a recession is off the table; it's always a possibility, and the odds remain somewhat elevated during this late phase of the cycle.

YEAR-TO-DATE RETURNS OF MAJOR ASSET CLASSES

Percent



As of September 30, 2024.
Past performance does not guarantee future results.
Source: Bloomberg and Bernstein analysis

Yet, as I discussed in my last quarterly letter, the global manufacturing sector—being much more rate-sensitive—has effectively been in recession for two years. This hasn't mattered much to the US economy overall, though, as two-thirds of it is tied to services. This heavy reliance has played a key role in allowing the economy to remain so buoyant in the face of interest rate hikes by the Fed and other major central banks around the world.

The question from here is which will happen next—a catch-up from the manufacturing sector or a catch-down from services? The Fed's 50 basis point rate cut, and the specter of further reductions at their meetings in November and December, improves the odds that we'll see manufacturing catch up as opposed to services dipping down.

And with its initial cut, the Federal Reserve has made clear they believe the balance of risks between its dual mandate of full employment and stable inflation has evened out. With that said, we will continue to keep our eyes on inflation. We do foresee it continuing to recede, despite shelter inflation, in particular, remaining stubbornly high—even surpassing expectations based on historical housing price changes. If that's because the market is pulling forward pricing, then it's less concerning. However, we are monitoring the risk of reacceleration as we cycle past the relative low in housing prices set in early 2023, which should now be reflected in the inflation data due to the year-and-a-half lag.

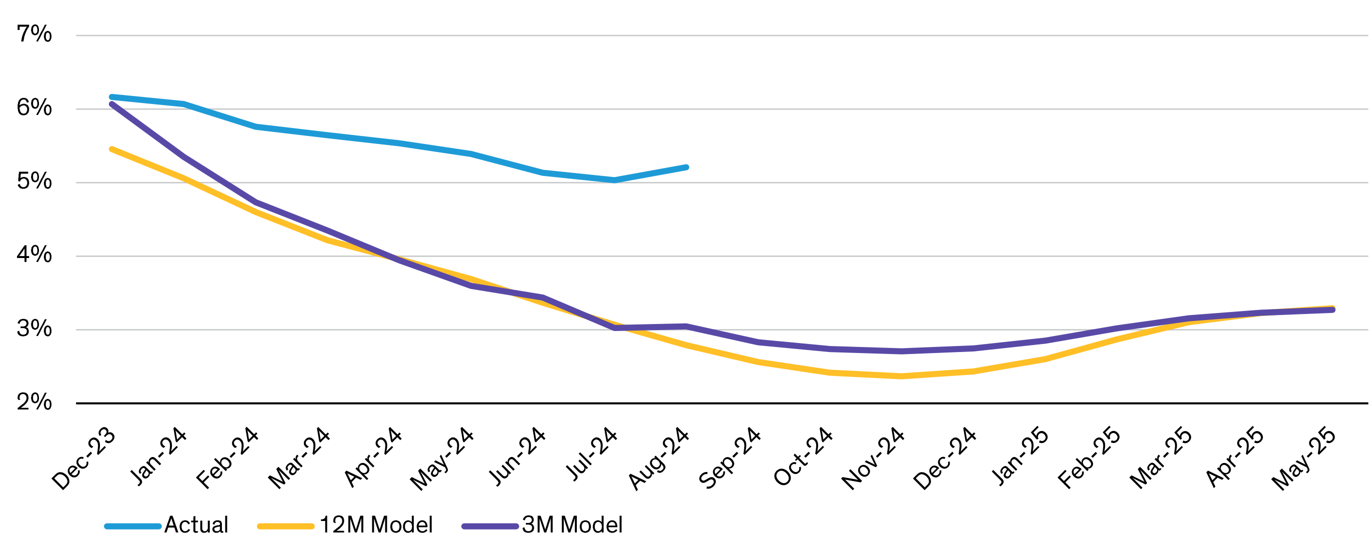
Looking ahead, the key question regarding interest rates will be how quickly they decline and to what level. We anticipate that the Federal Reserve will adopt a more measured approach to rate cuts unless there is a significant shift in the data. As for the ultimate target, we believe a rate around 3% is a reasonable benchmark to keep in mind.

In each of the past six major rate-cutting cycles dating back to 1980, bonds have delivered positive returns over the subsequent three quarters, with an average return of around 10%. As those statistics indicate, these cycles generally create favorable conditions for fixed income. But don't be complacent. We anticipate ongoing volatility amid elections and cooling economies .

As we saw in early August, there is more potential for higher volatility from here. Yet one silver lining in market panics is that many of our clients view them as opportunities—rather than financial setbacks. Our team, along with Bernstein's wealth advisors, will work closely with you to ensure your asset mix is optimized to withstand such turbulence, giving you the confidence to ride out bumpy stretches of the flight. For many of you, we have already conducted analyses of your long-range wealth plan and asset allocation targets, including alternative investments. If you'd like to have your analysis updated, or run for the very first time, please let your Bernstein advisor know.

SHELTER INFLATION HAS STAYED HIGH VS. ITS HISTORICAL RELATIONSHIP WITH HOUSE PRICES

Percent



Source: Bureau of Labor Statistics, Bloomberg, and Bernstein analysis

What Makes Interest Rate Cuts So Important?

- **Signals inflation fight near its end**
- **Lowers cost of borrowing for companies**
- **Loosens constraints on manufacturing sector**
- **Reduces burden on commercial real estate**
- **Promotes equity flows (already has)**
- **Supports bond prices**
- **Lessens appeal of cash and pushes investors toward long-term allocations**

Remember, Remember, the 5th of November

I'm proud to have made it halfway through the letter without discussing the election, but we must press on. We can't ignore the fact that historically, the market starts to care more about the election in the month or so beforehand. Higher volatility typically ensues. Likewise, with two campaign platforms that remain deeply at odds—and a race that's a virtual toss-up—we expect a rapid reassessment of sector and company prospects once a winner emerges.

One additional area to consider before and after the election is the impact both administrations could have on the municipal bond market. We compared candidate policies on personal income taxes, the alternative minimum tax (AMT), state and local tax deductions (SALT), and long-term capital gains taxes in order to form a view of the likely effects. While elections haven't mattered much to the municipal market in the past, there are differences that we highlight for you.

As for the stock market, it performs well under both parties. Historical data prove that point. If your portfolio could vote, it would choose a divided government because oddly enough, gridlock tends to produce the best investment returns. Once a winner is declared, we'll share lots of related insights on the implications for tax and estate planning, the economy, and of course, the markets. But first we need to have the election. By the time you receive this letter, we will be a month out. And as I said in my opening, buckle your seat belts.

We look forward to providing you with our views on the future after November 5th.

No matter who wins, we anticipate that the federal government will continue to run relatively large budget deficits, further adding to the national debt. This time around, this issue will be compounded as bonds issued during periods of low interest rates are replaced with bonds at today's higher rates. If you haven't read our recent white paper on the topic , we highly recommend it. It's an impartial review of the debt situation, exploring various paths forward along with the costs and benefits of each potential solution.

Have Some Faith… in Bernstein

In general, we try to be more prepared than predictive in our investing. But it's worth noting that much of what we have anticipated in recent years has come to pass.

One major call we made a year and a half ago was that "the stock market priced in a recession last October [2022] and a new multiyear bull market may have begun. Don't be underweight equities—ensure your long-term equity allocation is implemented." We also wrote, "Just know that the next few quarters won't be a straight line higher." Both of those have proven prescient, with the market up almost 40% over that period despite a sell-off around this time last year that took the market back to the same level it was at when we wrote those words last March.

Coming into this year, we expected a modest economic slowdown, rate cuts supporting a light fall in yields, inflation slowly falling toward target, and cash significantly under-performing other assets. Those views are generally on track, with growth slightly higher than expected even though people's views on it are more negative. Over the last several years, we have been directionally right and our forecasts have enabled our clients to create significant wealth.

More to Come

As we enter the final quarter of 2024, we'll really turn our attention to 2025 and beyond. What will define that period? Probably today's interest rate cuts by the Federal Reserve and other central banks. The incoming presidential administration and whatever crises they'll face will also matter. Hopefully, the current conflict in the Middle East will be resolved into a more peaceful balance rather than escalating into something worse. And, of course, technology will drive change as well, with AI at the vanguard and other "science fiction turned science fact" ideas like autonomous vehicles coming to market in the years to come.

Whatever defines all these years in the future, we'll continue to navigate it in a sensible and responsible way here at Bernstein. As always, thank you for trusting us as stewards of your capital.

Best regards,

Alex Chaloff
Chief Investment Officer

Alex Chaloff is the Chief Investment Officer and Head of Investment and Wealth Strategies at Bernstein. In this role, he leads a national team of strategists across investments and wealth planning—including asset allocation advice, investment platform oversight, model portfolio construction, new product development, manager research, tax planning and solutions, and estate planning research—while remaining continuously focused on moving our clients forward with strong after-tax risk-adjusted returns. Alex has spent his Bernstein career refining our investment platform, listening to clients, and conducting deep research into investment and wealth planning topics that are critical to achieving clients' goals.

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