BLUE GRANITE CAPITAL, LLC

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The Federal Reserve's highly anticipated decision in September to lower interest rates by 50 basis points marked a significant shift in monetary policy, signaling the end of restrictive measures aimed at controlling inflation. This larger-than-expected cut has set the stage for an interest rate easing campaign designed to stimulate economic growth. With inflation falling sharply over the past year and no recession in sight, the economy stands to benefit from both lower inflation and reduced interest rates. The Fed's forecast for additional cuts through 2026 has improved investor sentiment, as many hope for steady growth without triggering a recession. While the equity market may see a potential "melt-up" due to lower rates, caution is needed as stock valuations are stretched following the 2022 selloff. In fact, the current two-year rally has exceeded 62%, which is the third highest return on record for a bull market lasting 2 years or more.

Historically, easing cycles have had a more pronounced effect when stock valuations were lower, and the economy was weaker. It is uncertain whether continued rate cuts will further extend the current bull market, which has already seen significant gains this year for both the S&P 500 and the Nasdaq (22.08% and 21.17%, respectively). While inflation remains subdued, the recent labor report came in stronger than expected prompting a bond sell-off. With a strong labor market, stable economic growth, controlled inflation, and a bullish stock market, there seems little urgency for the Fed to act aggressively to prevent a recession.

Equities had their best first nine months since 1997, which also marks the best performance through three quarters in over two decades. We experienced some volatility in September, with an initial 4% drop followed by a 5% rally. The "Magnificent 7" tech stocks lagged the broader S&P 500 Index, possibly due to sector rotation and valuation concerns, despite strong growth metrics.

On the geopolitical front, tensions are rising, with the conflicts in Ukraine and the Middle East showing no signs of resolution. However, one piece of positive international news came from China, which announced a fiscal stimulus package on September 26th to support its struggling economy. This move has been welcomed by global markets due to its potential to boost growth, particularly benefiting China's major trading partners, including the U.S. In response, the Chinese stock market experienced its largest one-day rally in 16 years, a sign of renewed confidence in the country's commitment to economic recovery. A sell-off in China ensued, as some investors are skeptical that the government will follow through on its commitment.

An ever-growing concern on the domestic front is the U.S. federal deficit, now exceeding $32 trillion, along with an annual budget deficit that has nearly doubled since 2019. The costs of which are noteworthy: servicing the national debt is now over $900 billion annually, surpassing Medicare and defense spending. As interest rates stay elevated, the rising cost of debt threatens to limit the government's ability to address (and fund) critical domestic issues. This fiscal imbalance is a significant challenge that requires more attention.

In summary, while the outlook for equities is still positive, and the Fed's actions have provided a boost, there are important factors, such as stretched valuations, geopolitical risks, and a ballooning federal deficit, which warrant caution. Balancing optimism with prudent risk evaluation is essential in managing your portfolios as we navigate these uncertain times.

Wishing you a wonderful fall season.

Warmest regards,

Scott, John & Dave