GRANT STREET ASSET MANAGEMENT, INC.
QUARTERLY LETTER
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One of our biggest unknowns coming into 2024 was U.S. interest rates and how long they would remain at elevated levels. Chairman of the Federal Reserve, Jerome Powell, provided long-awaited clarity during his speech in Jackson Hole, Wyoming in August. At the conclusion of the annual economic policy symposium, Powell said, "the time has come for policy to adjust". This year's symposium discussions focused on interest rates and whether current levels were too accommodating or too restrictive. Over the past several years, the Fed's objective has been to cool down economic activity by tightening financial conditions to a point that reduced inflation while also being conscious that too much tightening may stifle growth and lead to recession. Ultimately, The Fed has been trying to achieve Goldilocks conditions that are "just right" to lower inflation yet maintain a stable labor market, all while avoiding recession.

So far, "just right" is exactly what the Fed has accomplished. While it may be too soon to declare victory in the battle with inflation, the Fed has been satisfied with progress across the U.S. economy (i.e. growth has slowed, and inflation has cooled). At the most recent Federal Open Market Committee meeting in Mid-September, the Fed executed the much-anticipated reduction in the federal funds rate to a target range of 4.75%-5.00%. Until this cut, the Fed held their target rate at a two-decade high of 5.25%-5.50% since July of 2023. These elevated rates have had a material effect on lowering inflation and cooling consumer spending, all while maintaining a steady labor market, as evidenced by the following:

- **Inflation:** the Consumer-Price-Index (CPI) is a widely recognized measure of inflation. The August CPI measurement showed a year-over-year increase of 2.5%, down from 3.7% in August 2023, and the smallest 12-month increase since early 2021. This doesn't mean that prices have fallen, but simply that they are rising at a much slower rate. While shoppers have seen prices at the grocery store stabilize, shelter costs (rent and mortgage payments) remain the top contributor to inflation. For example, the increase in shelter inflation accounted for over 70% of the total 12-month increase in CPI. A reduction in the federal funds rate has already resulted in lower mortgage rates which should help ease costs for home buyers.
- **Labor Market**: Given the Fed's restrictive financial conditions over the past two years, we historically would anticipate a struggling labor market, but that has not materialized. The U.S. labor market has shown signs of softness in recent months, but it remains historically strong. Just recently, the unemployment rate reached 4.2%, breaking a historic streak of two-and-a-half years of readings at or below 4%. September's reading fell to 4.1%, suggesting strength continues. While the rate is up slightly from a year ago, it remains significantly below the 50-year average of 6.2%. The number of job openings remains above pre-2020 openings, but we have achieved a healthier balance of openings-to-workers than seen in the last few years when labor was exceptionally tight.

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- **Consumer Spending:** A stable labor market, coupled with slowing price increases, has continued to support consumer spending. For example, summer travel volumes were roughly 8.5% higher than last year as of August. Back-to-school shopping numbers also came in strong. Early estimates show spending was down slightly (1.7%) from 2023 but still 25.5% higher than pre-Covid levels in 2019. In aggregate, consumers continue to spend, resulting in corporate earnings growth and reinforced strength of company balance sheets.

For those investors that have maintained equity exposure throughout the year, their balance sheets have also been positively reinforced by a strong equity market as shown in the table below:

Equity Index	3Q 2024	Year-to-Date	Last 12-months
S&P 500 (Large Companies)	5.9%	22.1%	36.4%
Nasdaq 100 (Technology-heavy)	2.1%	20.0%	37.5%
S&P 400 (Mid-sized Companies)	6.9%	13.5%	26.8%
Russell 2000 (Small-sized Companies)	9.3%	11.2%	26.8%
MSCI EAFE (Europe, Australia & Far East)	7.3%	13.0%	24.8%
MSCI Emerging Markets	8.7%	16.9%	26.1%
MSCI ACWI (All Country World Index)	6.4%	18.9%	32.4%

Source: Morningstar Direct

The three most-tracked equity indexes (S&P 500, Dow Jones Industrial Average, NASDAQ Composite) each broke through to new all-time highs in the third quarter, supported by strong growth and lower interest rates. We finally started to see the equity rally broaden outside of the large cap technology sector this quarter. Recent years' performance in the tech sector, and the S&P 500 as a whole, has revolved around the "Magnificent Seven" which includes Apple, Amazon, Google, Meta, Microsoft, Nvidia, and Tesla. These names still account for a large portion of S&P 500 performance, but for the first time in a long time, the other 493 names in the S&P 500 collectively outpaced the giants for the quarter, as measured by the S&P 500 equally weighted index.

Utilities stocks, after a dismal 2023, have overtaken technology as the top performing sector for 2024, up over 30% for the year. The most likely reason behind this strong performance in utility companies relates to artificial intelligence (AI) and the energy required for continued development and innovation. The data centers that train and host AI programs require a significant amount of electricity and rely on these utility companies for that crucial piece of the puzzle. The need for energy by tech companies has become so critical that some tech firms have begun to establish partnerships with utilities to develop new sources of energy creation. One recent announcement by Microsoft and Constellation Energy detailed an effort by Constellation to bring back online a recently decommissioned nuclear reactor in Pennsylvania to supply Microsoft's power needs.

As noted in the table below, fixed income provided a much-anticipated boost to the portfolio in the third quarter as interest rates across the curve fell in reaction to the Fed's rate cut.

Fixed Income Index	3Q 2024	Year-to-Date	Last 12-mos.
Morningstar US Core Bond	5.2%	4.5%	11.4%
U.S. 10-year Treasury	5.7%	3.7%	10.6%
ICE BofA 1-3 Yr. U.S. Treasury	2.9%	4.2%	6.8%
U.S. 3-month T-Bills	1.4%	4.0%	5.5%
ICE BofA U.S. High Yield	5.3%	8.0%	15.7%
ICE BofA 7-10 Yr. Municipal Bond	3.0%	1.7%	8.8%

Source: Morningstar Direct

From a total-return (income plus appreciation) standpoint, core bond performance was on par with the S&P 500 index for the quarter. Much of the return in bonds this past quarter can be attributed to the bond market pricing in the Fed's 0.50% rate cut, leading to bond price appreciation. With the start of a rate-cutting cycle now in motion, cash is no longer king for conservative investors. The outlook for traditional fixed income and the potential price appreciation is much more appealing as yields on money market funds have started to shrink and will continue to do so. Historically, once the Fed starts to reduce their target rate, cash begins to underperform core fixed income. For example, the last six Fed rate reduction cycles have resulted in an average return of 2.9% for cash in the six months after the first cut, compared to 6.0% for U.S. investment-grade debt.

Grant Street's portfolio adjustments in the first three quarters of the year have been additive to performance thus far. Throughout 2023, our investment committee was focused on extending duration on the fixed-income side of the portfolio to capture the potential appreciation when rates dropped. Client portfolios are now reaping the benefits of that positioning, and we expect this trend to continue in the quarters ahead. Within Grant Street's equity allocation, the committee continues to prefer sustainable growth in quality companies. Small and mid-sized companies rallied ahead of large caps in the third quarter, and we expect them to continue to be a positive contributor to portfolio performance. As interest rates continue to come down, we expect smaller companies to benefit from more affordable financing options.

We maintain our positive outlook for equities and fixed income in the fourth quarter and into the new year, regardless of the upcoming November election results. As we have noted in previous quarters this year, election years tend to be a non-factor for equity markets. The economy and profit environment for companies are what drive market performance. In the short-term, equities tend to rally following an election. We believe this is because the uncertainty of the political path forward is finally resolved.

Grant Street's investment committee continues to actively manage portfolios based on our analysis of the fundamental data. Analyzing macro-economic data trends allows our committee to identify areas of strength or weakness within the equity and bond markets and informs our decision making. As always, we value your trust and confidence in the Grant Street team, and we thank you for allowing us to serve you.