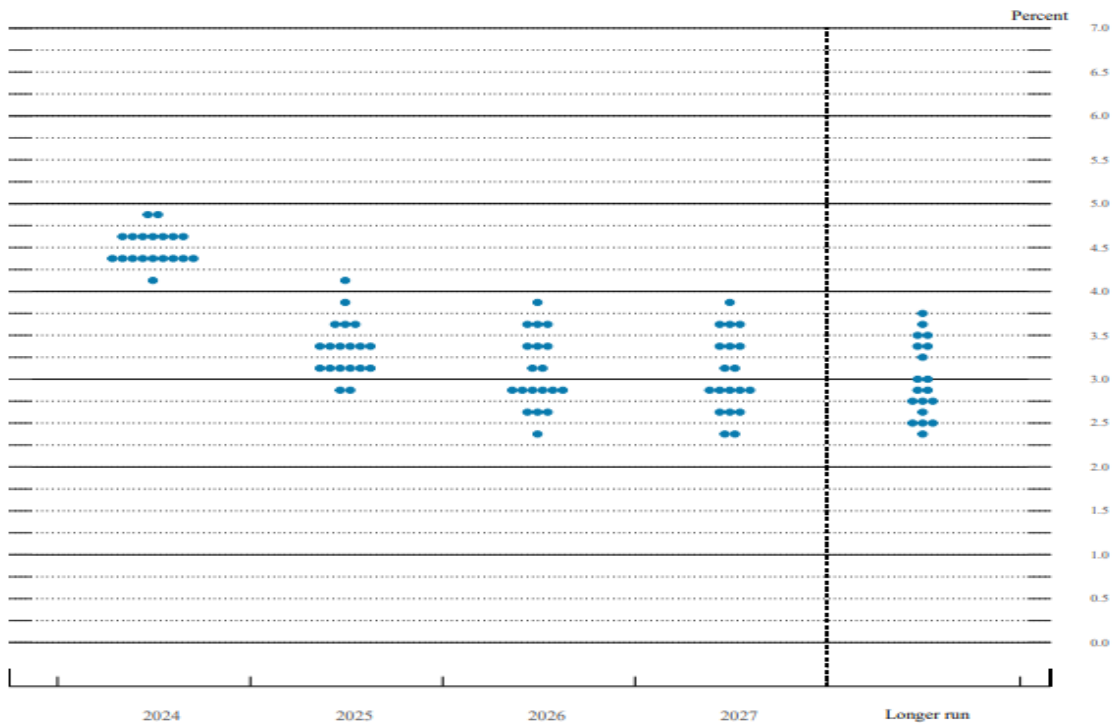


3Q 2024 – Quarterly Commentary

As was widely anticipated, for the first time since 2020, the Federal Reserve voted in September to lower the benchmark federal funds rate by a half-percentage point. The committee opted for a historically large 50 basis point reduction to start this easing cycle to make quick progress on their internal projection that shows a steady decline in the fed-funds rate target to between 3.0% and 3.5% by the end of 2025. (See Chart1). The timing of this shift in policy comes at a time of heightened uncertainty with respect to the economic outlook. The prolonged period of high short-term interest rates has successfully reduced inflation however, it has also resulted in a concerning uptick in the unemployment rate. The downside risk of a more meaningful decline in the labor market most certainly also factored into the decision by Fed officials to vote for a bold start to this easing campaign. If the Fed is going to be successful in achieving the elusive soft-landing the unemployment rate will need to stabilize at current levels.

Chart 1
Federal Reserve Projection for the Federal Funds Rate
 as of September 18, 2024



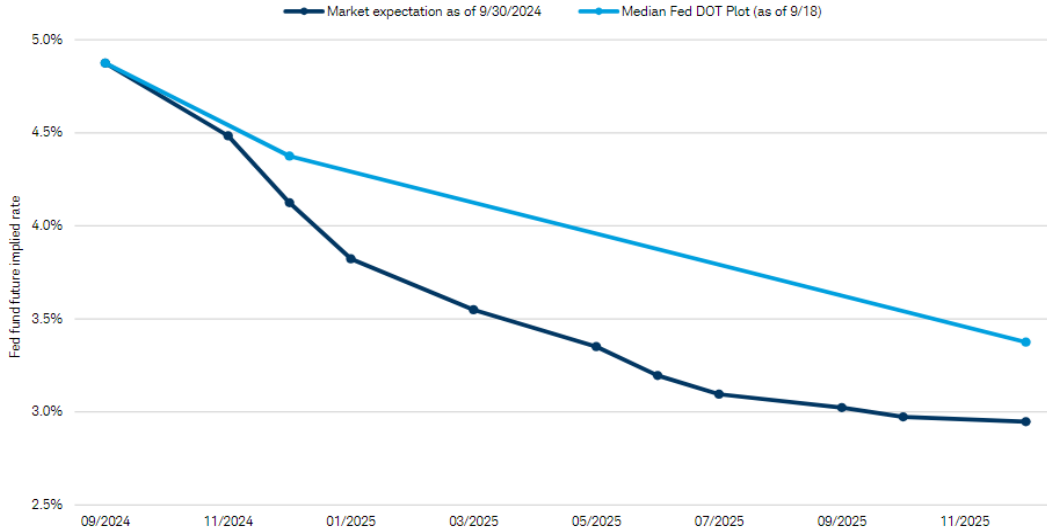
*Each blue dot represents one FOMC member’s projection for the level of the Fed Funds rate at each year end

Illustrating the uncertain economic conditions, after months of evidence in support of lower rates, economic data for the month of September on both inflation and the labor market showed surprising strength which, in isolation, would argue for a slower pace of rate cuts or even a precautionary pause. Correctly navigating these risks and uncertainties in adjusting short term interest rates to lessen the likelihood that either of two negative outcomes, increasing unemployment or a second wave of inflation, occurs is the unique challenge faced by policymakers. While the Fed’s internal projections suggest a target funds rate of approximately 3.5%, market pricing implies more aggressive rate cuts which would see the terminal funds rate closer to 3.0% by the end of 2025 (See Chart 2).

Chart 2

Market expectations on rate cuts

The market's expectation for the timing and amount of rate cuts has shifted lower during the third quarter. The DOT plot for September projects another 50 BPS of cuts, whereas the market projects 75 BPS of cuts for 2024.



Since mid-year the bond market has posted an impressive rally with the Ten-Year U.S. Treasury yield declining nearly a full percentage point to 3.6% just before the FOMC meeting in mid-September. Subsequently, yields have increased and currently stand near 4.0%. We continue to view the near and intermediate trend in yields as lower and view the recent increase in rates as simply a reflection of volatile economic data that may impact the magnitude and timing of future rates cuts, particularly at the upcoming November 7th meeting of the Federal Reserve.

Corporate bond spreads compressed further during the quarter reflecting the increased likelihood of a soft landing and now stand near historically tight levels for both investment grade and high yield bonds alike. While rich valuations will limit further price appreciation relative to safe haven U.S. Treasuries, the sector's yield advantage will be an important driver of portfolio returns in the near term. Yield curve position as the Fed continues to lower short term interest rates will also be a key component to forward returns that we will continue to actively manage in the months ahead.

Birch Run Investments, LLC
September 2024