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We invite you to listen to our quarterly conversation with Harold Kotler, Bill Sterling, and moderator Dan Fasciano as they review events from the third quarter of 2024 and discuss:

- The potential impact of the upcoming US election on the economy and markets;
- The importance of maintaining a disciplined asset allocation and avoiding overthinking political dynamics, as markets have historically risen regardless of which party controls the White House; and
- The global economic landscape, including China's recent stimulus package and its limited impact on the US economy due to low export dependency.

Edited transcript

Dan Fasciano: Welcome to the Third Quarter Client Conference call for GW&K Investment Management. This call represents the views and opinions of GW&K Investment Management and does not constitute investment advice, nor should it be considered predictive of any future market performance.

My name is Dan Fasciano, Director of Private Wealth here at GW&K. Joining me on today's call is Harold Kotler, GW&K's Founder-Chairman and Chief Investment Officer, as well as Bill Sterling, our Global Strategist.

Harold, I'm going to start with you. We're less than a month away from the election, and I know you have some thoughts about what this means for investors. As you've been reflecting about the current political landscape, what observations, what advice, can you share about the economy and markets?

Harold Kotler: There's no question that the policies for either candidate will be different. Having said that, we don't know how different and what they might be. The takeaway for me and for you as an investor is that, for better or for worse, presidents have a very hard time killing the economy. This private sector that we so under appreciate — and should really understand its complete dynamics — has a life of its own and will be able to adjust to policies.

I have my own issues and thoughts, but that's irrelevant to investing. The investing part, which I wrote in my quarterly letter, is that in 95 years, there are only three administrations that saw a down market and those were extreme periods. So, the takeaway is yes, things will be different. Yes, things will have to be adjusted. On the other hand, you have to stay the course and we as a manager will take advantage of and avoid some pitfalls that we see unfolding as the four years are engaged.

Dan Fasciano: That's important perspective and I suppose it makes me think of a similar question for you, Bill. I know you've done some work around patterns and behaviors leading into

and following election periods. What are some of your takeaways or the takeaways from your work, and what do you make of things as we head into November?

Bill Sterling: I'd echo a lot of what Harold just said, in the sense that it is a fact that since 1990, equity market volatility has tended to spike up in the few weeks ahead of and few weeks after presidential elections. And I think that's basically because investors tend to hate uncertainty and emotions can obviously run very high around election time, but our strong advice is that investors should try to ignore the noise and ignore some of their emotions and stick to a disciplined asset allocation.

Harold Kotler: I would say that Bill put out a piece that hopefully you've all read, called "Keeping Your Portfolio Above the Political Fray," and you talk about how one position that a president might have had, had the exact opposite impact in reality, and that what was said didn't lead to what would be the assumption of the conclusion.

Bill Sterling: I'll give you a couple of examples, Harold, of so-called obvious bets on sectors or companies that turned out to backfire. For example, many thought that the Energy sector would boom under Donald Trump, but it turned out to be one of the worst-performing sectors in the S&P 500 in his four-year term. And conversely, clean energy stocks were up more than 300% in those years. And under Joe Biden, it was the reverse. The traditional Energy sector was the strongest performer while clean energy, which you might have thought would have been favored by the Democrats, fell by 50%.

And our biggest takeaway is simply that investors should try not to overthink political dynamics and how they affect the market. Similar to what you said up front, because historically markets have tended to rise regardless of which party has control of the White House, or Congress for that matter. So making big partisan bets in your portfolios can be pretty hazardous to your wealth. That's our big takeaway.

Dan Fasciano: I ask both of you questions that were political and macroeconomic, and you've taken us to the to the market response to that. Harold, let me go back to you for a minute. When you look at essentially all markets here in the US, equities, munis on a on a rolling 12-month basis, over the last 12 years, we've really had good returns.

In fact, if you take a look at equity markets, which you all have been touching on, we're at near all-time highs on most all US equity indices. It just doesn't feel like anything in the world right now is cheap. So, as we head towards 2025, when you sit down with the investment teams, are we finding any long-term value anywhere? And how should we be positioning portfolios?

Harold Kotler: You're right about the results of the markets, but most people are making money with one foot out the door. Everybody's insecure about these returns because of the election, because of Israel, because of Ukraine, because of the power politics that we're dealing with. This year, no one would ever say, "Oh my God, we've had a great bull market, let's celebrate! Where's the champagne?" People's attitudes are not that way. This is not 2000.

So there's a side to me that says, this isn't really a bull market, because a bull market climbs a wall of worry. I know that to be a fact. And worry is out there — as it should be. There are a lot of problems and a lot of issues: Debt and policy — you could go one and on and on. But the market keeps on going up. So no, there's nothing cheap. There is no obvious place to go. Certainly not cash anymore because that rate is coming down very quickly, so you have to diversify. And I argued in my last quarterly letter that I think you want to be out of currencies. The gold market is hitting a new high, silver's hitting a new high, bitcoin's hitting a new high, the stock market's hitting a new high...What is it saying? It's saying no one wants cash. Yes, you're getting 5% or 4% or 3%, but, in the end that might get down to 2%. So the truth is, the commodity that might be most at risk is cash.

Dan Fasciano: I'm going to push you a little harder on that in a moment, but you're steering us to the conversation around rates and cash. So let me go to Bill for a minute here. Bill, last month the Fed finally made its first move toward accommodation. In fact, they lowered by 50 bps. So let me get you to start out with a few questions here.

First, is it too early for us to declare the war on inflation won? And second, now that the Fed has embarked on an easing campaign, what data are you monitoring most closely from a macro standpoint as we kind of head to the end of the year?

Bill Sterling: Well, a couple of observations. One, I do think the Fed has to be wary of prematurely hanging up a “Mission Accomplished” banner, but there has been unmistakable progress. For example, the Fed's preferred PCE inflation measure looks like it will come in right about 2% year on year for September, which is basically on its 2% target.

But the so-called core measure that excludes volatile food and energy components, which it pays a lot of attention to as well, is running around 2.7%. So, still a bit higher than that target. But that said, I think there's still a pretty good case for the Fed to continue its easing cycle with perhaps two more quarter-point rate cuts in the remainder of this year and perhaps four more over the course of next year.

And it's pretty clear that the Fed is now paying more attention to labor market data, which means the rest of us need to pay close attention to that data as well. And even though the latest jobs report was a bit stronger than expected, the unemployment rate is now up from 3.4% in early 2023 to 4.1% now and that trend clearly has the Fed's attention. If it were to break materially higher, that could justify more aggressive action by the Fed. And I'd also say that consumer spending data should be watched really carefully too, for the same reason, but so far, there's no indication of a big crack in the consumer and a so-called soft landing for the economy still seems most likely, in coming quarters.

Dan Fasciano: I suppose with that as a backdrop, Harold let me go back to something you said a year ago. You recommended clients not stay complacent, don't just sit in cash. You knew that we weren't going to be at the 5.5% level in cash forever.

For those that didn't heed your counsel then, and given what Bill just shared, what do you recommend clients do now? Not specifically around fixed income, but maybe start with municipal bonds and fixed income. Where's your head at as we approach 2025?

Harold Kotler: Well, I think most of our bond portfolio managers stay at the intermediate level, 3- to 5-year duration, which I think is the sweet spot of the market. I worry it doesn't seem to be in the press enough that the yield curve will normalize, short rates will continue to decline, and long rates will be stubbornly high because both administrations, whoever wins, are going to increase this deficit. And yeah, we'll be able to finance the debt. I'm not worried about that. There's always a buyer, but at what price?

Which means that yields on longer bonds could stay higher. Now they could try to refinance everything on the short end and take advantage of the shorter-term interest rates, and that might put some upward pressure on the short end as well. But I think that in the bond market right now, you have to be intermediate, not long and not short.

Dan Fasciano: And that it's consistent with what you said in your newsletter: stay reasonably diversified, don't get overly thematic. And now you're saying the value in munis is probably in the intermediate part of the yield curve, that's where to be.

Harold Kotler: Yeah, and I think the inflation that has occurred since Covid is not going away — it's here — all we're talking about is the rate of change. The rate of change is 1% or 2%. The problem is, it's not zero and it's not negative. So all these inflated values and costs are part of our system now. And that has a major effect on one's ability to not only live, but also invest for the future. How do you really maintain your lifestyle as you get older, when things cost so much more than they did five years ago, when you thought you had enough money? Can you really rely on 1% or 2% interest to cover your overhead?

And unless you're incredibly wealthy, it is a challenge. So therefore, talking about our business and why I think we're very important for our clients, we have to think about how to create a diversified portfolio that will help you get to that area of security with rates so low and costs so high.

Dan Fasciano: That's sage advice, regardless. Both of you have done a really good job touching on the domestic part of the conversation here. But Bill, I am not going to let us exit this quarter's call without getting your perspective on a global lens. Also late last month, China's central bank announced an aggressive stimulus package.

And we saw that the initial reaction in Chinese stocks was to be up 15% – 20% right out of the gate, which has now slowed a bit. What do you make of this stimulus package for China, but also its impact on the larger global economic ecosystem?

Bill Sterling: Well, the numbers were just stunning, because in just a few weeks from mid-September through early October, the main Chinese index was up 40% on the aggressive monetary measures that were announced, but that had raised hopes for an aggressive fiscal package to support consumer spending as well. And, the market has now given back about a third of its gains on

disappointing follow-through by the fiscal authorities. I think a muddle through scenario for China's economy is much more likely than any vigorous rebound, given the extent of what is called a balance-sheet recession due to massive losses in real estate, that are impacting the Chinese consumer.

But, taking it to the global landscape, the impact of a prolonged China slowdown on the US economy would likely be pretty minor, because our exports to China represent less than 1% of our GDP. So, let's say you even had a 10% decline in those exports, it would amount to a rounding error on US GDP.

Europe has a bit higher exposure, but it's still modest. Not surprisingly, China's neighbors in Asia have the greatest direct exposure and certain industries like technology, basic materials, agriculture and luxury goods are more exposed to a Chinese slowdown as well. But I think it's also important to remember that the Chinese stock market is not all that well correlated with China's economy, so that's another thing to keep in mind.

Dan Fasciano: Well, thank you for that. Let me just say, Harold, Bill, thank you for sharing all of these thoughts.

As always, should anyone listening in have follow up questions, please feel free to get in touch with your GW&K advisor, and to all our clients and friends who do listen in, we hope you have a great rest of your year, a happy, healthy and safe holiday season for everyone. We'll look forward to reconvening in January. Thank you.

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