CONGRESS ASSET MANAGEMENT COMPANY

Economic Outlook & Market Review

| 4Q24

KEY TAKEAWAYS:

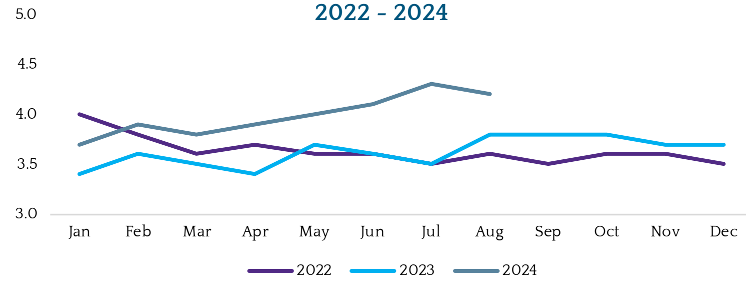
1. The Fed's recent 50bp cut indicates elevated concern around employment and confidence that inflation will continue to moderate. Labor markets remain historically robust but the trend in unemployment and job creation is troubling.
2. Elevated financing costs and low turnover in the housing market also pose a risk. Housing turnover is good for the economy and has positive long-term implications. By easing now, the Fed is trying to balance short term inflation risk with longer term positive economic impacts.
3. Global central banks have broadly switched to monetary easing. China just announced a comprehensive stimulus package that may finally help re-energize Asian growth.
4. We believe the prospect for stocks into year-end is positive. Lower interest rates ease capital constraints and typically support valuation. Investors should benefit from a diversified portfolio as stock market breadth improves outside the largest technology names which have dominated returns over the past few years.

Artificial intelligence, fears of impending recession, and unusually high short term interest rates have dominated investor sentiment over the past few years, resulting in a technology-led stock bull market and a cautious approach to capital deployment elsewhere. In late September, the Federal Reserve (Fed) entered into the breach by cutting short term interest rates by 50 basis points, or one half of one percent. With that action, the Fed hopes to re-ignite capital spending and ensure that the long-feared recession remains at bay.

The magnitude of the interest rate cut, particularly outside of a recessionary environment, sends the message that the Fed is elevating its concerns around employment and has confidence that inflation will continue to moderate as we enter 2025. For the Fed, normally a staid institution, this is a bold move and, in our view, warranted to ensure continued economic expansion. The cut arrives before a potential material downturn in economic activity and may broaden stock market breadth while forcing fixed income investors to adjust their preferences.

As this year progressed, it became clear that the labor market cooled from the heady days of 2022. Monthly job creation thus far in 2024 has averaged 184k jobs, down from 377k in 2022 and 251k in 2023. While August's unemployment rate of 4.2% was not alarming, the trend is as unemployment rose in 5 of the last 7 months. Strong employment and wage growth have supported consumer spending, helping the gross domestic product grow at a 3% annualized rate during the second quarter. Higher unemployment would hinder this virtuous circle and further strain those in lower income brackets. By easing before cracks weaken the economic foundation, the Fed hopes to forestall more job erosion.

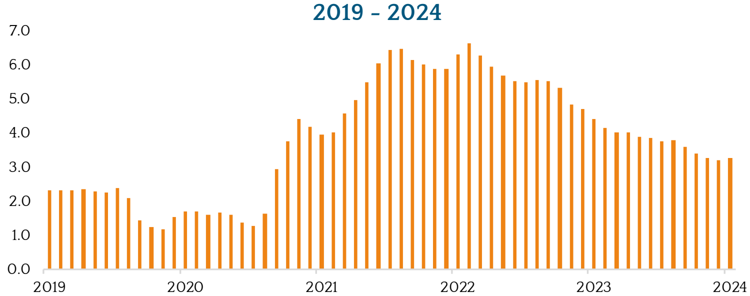
Monthly Unemployment (%)
2022 - 2024



Source: US Bureau of Labor Statistics

Other economic sectors such as corporate and government spending seem solid if unspectacular. The key domestic risks are now inflation and housing. The Fed is betting that inflation's downward trend will continue, but August's CPI reading of 2.5% remains above the Fed's comfort level. Leading inflation indicators suggest that certain service and shelter costs are moderating. In addition, oil and natural gas prices, prominent indicators of higher costs, are near multi-year lows as domestic and Middle East production are easily matching demand.

Monthly CPI (%)
2019 - 2024

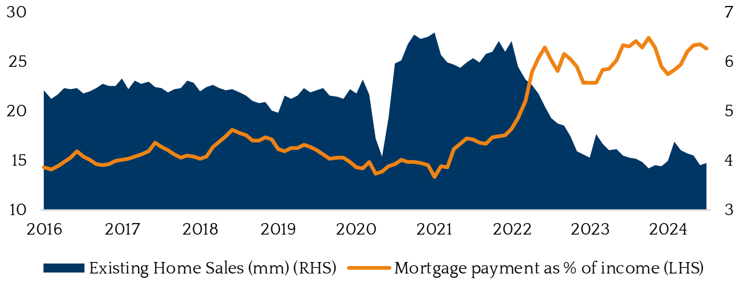


Source: US Bureau of Labor Statistics

While not mentioned by the Fed, it is likely concerned about the housing market as existing home sales are at the lowest levels since 2010. Housing turnover is good for the economy and has positive long term implications. The National Association of Realtors estimates that the median home sale contributes over $100,000 to GDP. First time home buyers can elevate their financial profile by building equity and ensuring a pathway to financial security. In addition, homeowners voluntarily relocating typically spend to modernize, supporting the economy through their purchases.

Pandemic-era ultralow mortgage rates enticed millions to the housing market, many for the first time and many others to upgrade. However, the cost of home ownership has risen to record levels with the median mortgage payment at nearly 26% of income today versus 15% prior to the pandemic. Lower rates should ultimately encourage turnover in the housing market by reducing financing costs for first time buyers and the sticker shock for existing homeowners that are currently enjoying historically lower rates. By easing now, the Fed is trying to balance short term inflation risk with longer term positive economic impacts.

Existing Home Sales & Mortgage Payments as a % of Income 2016 - 2024



Source: Bloomberg

The Fed is playing its cards to ensure domestic economic expansion, but global factors may sober the outlook. The toll on human life and living conditions notwithstanding, the U.S. is largely economically insulated from the wars in Ukraine and the Middle East. Both conflicts appear to be escalating at a time when our politics are firmly focused on the forthcoming election. This is likely not a coincidence and stands to upset the balance of power between now and year end.

While US markets seem confident that lower domestic inflation is here to stay, global central banks are easing monetary policy in an attempt to restart capital investment. China's economic woes are deeper than many, but the Peoples Bank of China just announced a comprehensive stimulus package lowering interest rates, bolstering banks, and supporting the housing market. The actions are aimed at its domestic economy but, when fully enacted, may finally help multinational companies reenergize Asian growth.

Ultimately, we believe the prospect for stocks into year-end is positive. Lower interest rates ease capital constraints and typically support valuation. Market indices, particularly large cap stocks, have become increasingly skewed towards the Technology sector, which is approximately 10% of the US economy but is about 40% of the S&P 500. Investors should benefit from a diversified portfolio as stock market breadth improves outside the largest technology names which have dominated returns over the past few years.

Fixed income investors face the prospect of lower short term interest rates negatively impacting current income. However, longer term yields remain near historical averages and should provide stability and a real return over inflation.

Investment Oversight Committee

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