NBC | SECURITIES

INVESTMENT STRATEGY STATEMENT | October 1, 2024

Fed Policy Pivot

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Performance Review & Outlook

Fed Policy Pivot
The Federal Reserve lowered its benchmark borrowing rate by 0.50% in September. While a cut was expected, the magnitude of the cut caught some economists by surprise.

Cutting From a Position of Strength
We believe the Fed acted from a position of strength, proactively cutting rates to prevent policy from being overly restrictive and causing undue harm to the economy.

Disinflation Trend Getting Close to the Conclusion
The August CPI reading showed consumer prices up only 2.5% y/y, the lowest reading since March 2021.

Yield Curve Continues to Normalize
The short end of the yield curve came down more than longer dated maturities in August, putting the 10/2 spread firmly in positive territory.

Equity Markets Continued to Advance in September
For the fifth consecutive month, the S&P 500 finished higher, rising by 2.1% in September. The index is now up 22% for the year on a total return basis.

Data Over the Last Year Has Been Consistent with our View
With inflation falling and the economy continuing to grow, the key themes we have been discussing for more than a year have largely played out consistent with our view.

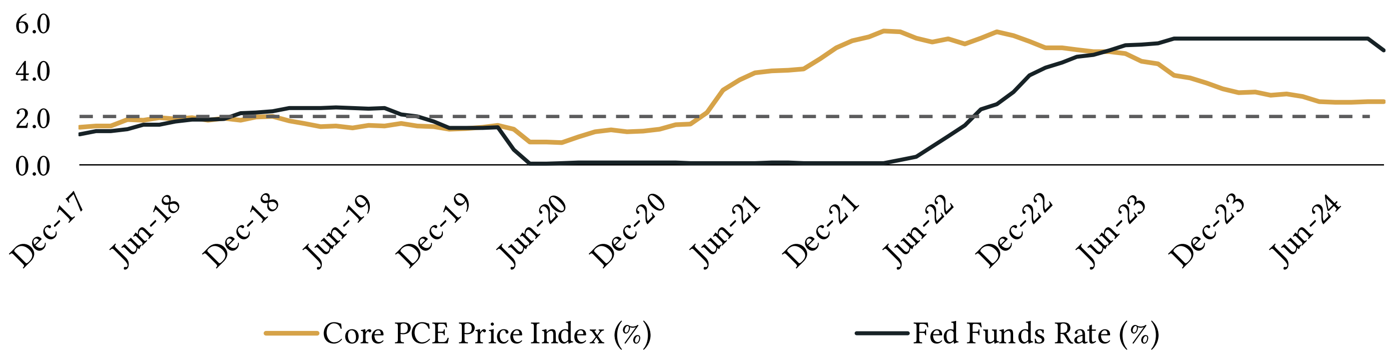
Equity Market Overview

September data was all about the Federal Reserve. In response to progress on inflation and the overall balance of risks, the FOMC lowered the target range for the federal funds rate by 50 basis points to a range of 4.75%-5.00%. While futures markets were pricing in a little better than a 50% chance of a cut of this magnitude, it caught many economists by surprise. To us, this was the Federal Reserve acting from a position of strength, understanding that the real federal funds rate (the current target rate minus the core PCE price index) is still restrictive.

In response, by lowering rates faster, the Federal Reserve is proactively adjusting policy to avoid causing undue harm to the economy. We've written for a while about the economy normalizing, and now it is time for monetary policy to normalize as well.

The summary of economic projections, which is the median of the FOMC members' forecasts for inflation, unemployment, GDP growth, and the federal funds rate, were also updated at the September meeting. The committee's median

Consumer Price Index for All Consumers



estimates for inflation came down for 2024 and 2025, while economic growth was revised slightly lower to 2% for both years. The median estimate for the federal funds rate shows another 50bps of rate cuts for the remainder of the year and another 100bps next year. The Fed will remain data-dependent, meaning that their forecasts are subject to change based on incoming economic information. That being said, the Fed's rate move was a strong signal that monetary policy normalization is underway and falling inflation is allowing the committee to focus on supporting economic growth.

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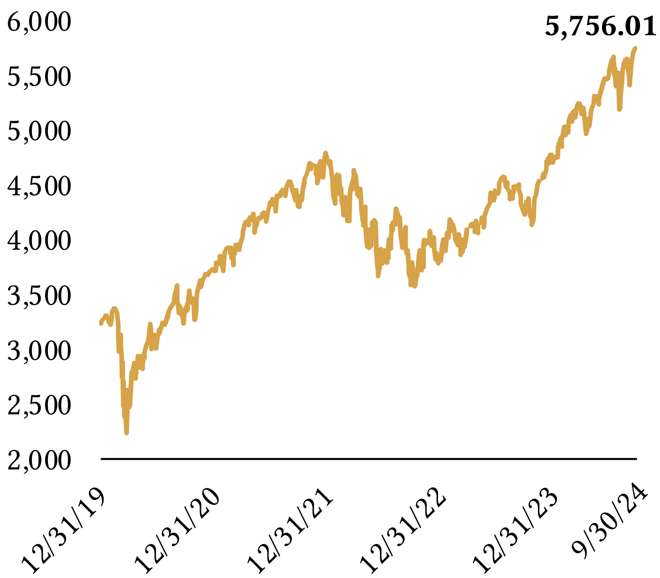
12-Month Percentage Change of Indices

Index (Local Currency)	Level	September	YTD	12 Month
S&P 500	5,762.4	2.1%	22.1%	36.3%
Dow Industrials (DJIA)	42,330.15	2.0%	13.9%	28.8%
Nasdaq	18,189.17	2.8%	21.8%	38.7%
Russell 2000	2,229.976	0.7%	11.2%	26.7%
US 2yr Treasury	3.6349	-7.2%	-14.5%	-9.3%
US 10yr Treasury	3.7828	-3.1%	-2.5%	10.5%
Gold (NY Spot $/oz)	2,631.89	5.1%	27.6%	32.3%
Silver (NY Spot $/oz)	31.1518	7.9%	30.9%	24.3%
Copper ($/metric ton)	9,846.53	8.0%	16.3%	14.8%
Oil (WTI Spot/bbl)	68.19	-7.3%	-4.8%	-11.2%
Oil (Brent Spot/bbl)	71.77	-8.9%	-6.8%	-9.8%
Natural Gas ($/mmBtu)	2.905	36.6%	15.6%	20.5%

Data as of September 30, 2024
Source: FactSet/Bloomberg

How did this impact equity markets in September? As a rate reduction was largely anticipated, we believe a fair amount of the optimism surrounding it had already been priced into markets, although we did see some further gains in the S&P 500 following the meeting. The index was higher by 2.1% for the month and is now up by 22% on a total return basis for the year. Going forward, a less restrictive Fed and the potential for a soft landing should support equity valuations and earnings growth for the remainder of the year and into 2025.

S&P 500 Price Index (12/31/19 -9/30/24)



Fixed Income Market Overview

September was an eventful month in fixed income markets as we saw the Federal Reserve cut a more aggressive 50 basis points to their target fed funds rate. This marked the first rate cut since the Fed began tightening policy back in March of 2022. Fixed-income markets did not move too aggressively on the cut, as most of the move was largely baked into the current interest rate market. September saw 10yr US treasury bond start at a 3.83% yield and finish at 3.79%.

A moderate move given the big news on the rate cut. The 10-2 yield curve continued to steepen throughout the month finishing off at +15 bps. Perhaps most interestingly, after the Federal Reserve's September meeting and subsequent rate cut, we saw intermediate and long-term treasury yields rise.

10 Year US Treasury Yields

NBCS Asset Management has held the position for months that a single rate cut could normalize the yield curve, and over the past few months ISS publications, we have mentioned that it's a real possibility that rates on the longer end of the curve could rise. Increasingly, it looks like that possibility could become reality.

This all fits into the bigger picture of our outlook that as we see core inflation falling back to pre-pandemic levels and we continue to see a strong labor market and overall economy, we are very much indeed getting back to normal.

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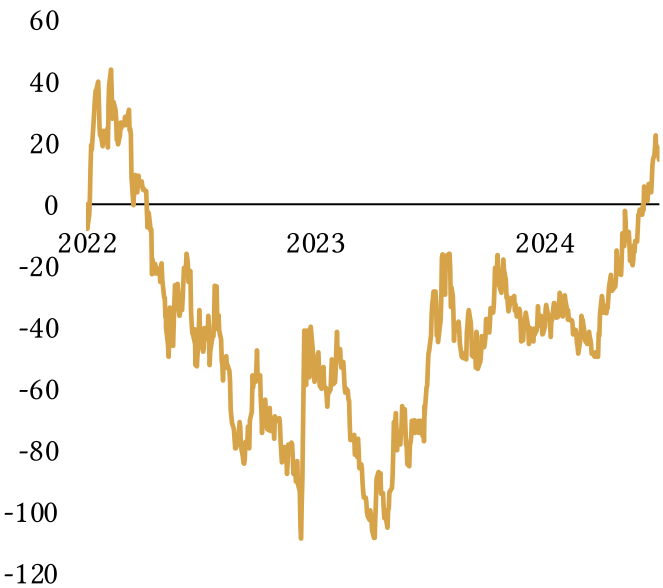
2 Yr/10 Yr Spread (bps)



Fed Fund futures continue to price in the possibility that we could see up to 150bps of rate cuts through 2025. We would note that throughout this economic tightening cycle, futures markets have rarely been correct. This is not because the Fed is not doing their job correctly, but because the Fed has been focused on approaching monetary policy based on economic data. To do this effectively, forecasts must change in correlation with the data presented. For all their criticisms, we believe the Fed has done a good job of moving the needle on both inflation and the jobs market to support the economic data presented. In his post FOMC meeting press conference, Chairman Jerome Powell highlighted that "My own sense is that we are not going back to that," referring to the world of ultra-low interest rates that we have seen for the better part of the last two decades. NBCSAM believes that the 10yr US Treasury rate should be your risk-free rate of return. With a long-term average of 5.85%, if you are in the camp that GDP growth can continue at a moderate pace, we believe that it is completely reasonable to see those intermediate and longer-term rates tick up a bit. This is wonderful news in our opinion. Not only does this normalize the overall yield curve, but it also allows investors to continue to find yield bearing opportunities in fixed income markets, opening the door for the creation of balanced portfolios that can protect investors against downturns in equity markets. Furthermore, this normalization of overall bond market yields increases the possibility that the Federal Reserve may indeed land this plane softly, after all.

Economic Overview

Key Economic Indicators

JOB MARKET

August Employment Report
The Bureau of Labor Statistics (BLS) reported that the U.S. economy added 142,000 jobs in August, a sharp slowdown from June. The unemployment rate ticked down to 4.2% in August from 4.3% in July. Through August the US had had a positive job growth for 44 consecutive months-the fifth longest streak in history.

Job Openings to Unemployed Ratio
Job openings fell to 7.67mm in August, moving the job openings to unemployed ratio to 1.1x which is in-line with the average in 2019 prior to the distortions from the pandemic. Labor supply and demand are currently in balance, no longer providing upward pressure on inflation.

HOUSING MARKET

House Prices
Home prices continued to trend upwards in June as the benchmark 20-city index rose for a seventeenth consecutive month to a new all-time high. The S&P Case-Shiller Home Price Index revealed seasonally adjusted home prices for the 20-city index saw a 0.3% increase month-over-month (MoM) and a 5.9% increase year-over-year (YoY).

Mortgage Rates
According to Bankrate.com, 30-year mortgage rates averaged 6.7% in September. This is substantially down from the highs in October of last year when rates were north of 8%. We believe there is room for mortgage rates to continue to fall as the spread between mortgage and US Treasury yields normalizes. This should help affordability and provide support for the housing market.

PERSONAL INCOME & SPENDING

Retail Sales
The US Census Bureau reported that August retail sales were 0.1% higher than in July and 2.5% above August 2023. These figures are consistent with an economy that continues to grow around trend, but below levels that put upward pressure on prices.

Personal Savings Rate
The Bureau of Economic Analysis reported that the current personal savings rate as a % of disposable income was 4.8% in August, in-line with the pre-pandemic average.

Economic Overview

Key Economic Indicators

ECONOMIC GROWTH

GDP Growth
Gross domestic product increased at a 3.0% annualized rate last quarter, the Commerce Department's Bureau of Economic Analysis said in its third estimate of second-quarter GDP. Further, the Atlanta Fed's GDPNowcast calls for 3rd quarter growth of 3.1%.

INFLATION

CPI
Over the year end of August 2024, the Consumer Price Index for All Urban Consumers increased 2.5%, down from the 2.9% reading in July. The index for all items less food and energy increased 3.2% y/y.

PCE
The Fed's favorite inflation indicator, PCE, the personal consumption expenditures price index rose 2.2% y/y, down from the 2.5% reading in July. This is the lowest level seen since March 2021. Excluding volatile food and energy prices, core PCE increased 2.7% from a year ago.

Conclusion

With inflation falling and the economy continuing to grow, the key themes we have been discussing for more than a year have largely played out consistent with our view. With backward looking measures of inflation inching closer to the Fed's 2% target and expected breakeven inflation rates over the next couple years currently below 2%, the disinflation narrative appears to be drawing to its conclusion.

This has allowed the Federal Reserve to begin shifting monetary policy to support a normalizing economy and should continue to do so. As this dynamic evolves, NBCS Asset Management will continue to monitor and discuss inflation, but we'll likely place more of an emphasis on the labor markets, key indicators for the health of consumers and the economy, and the overall impact on earnings for equity markets and rate moves for the fixed income markets.

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