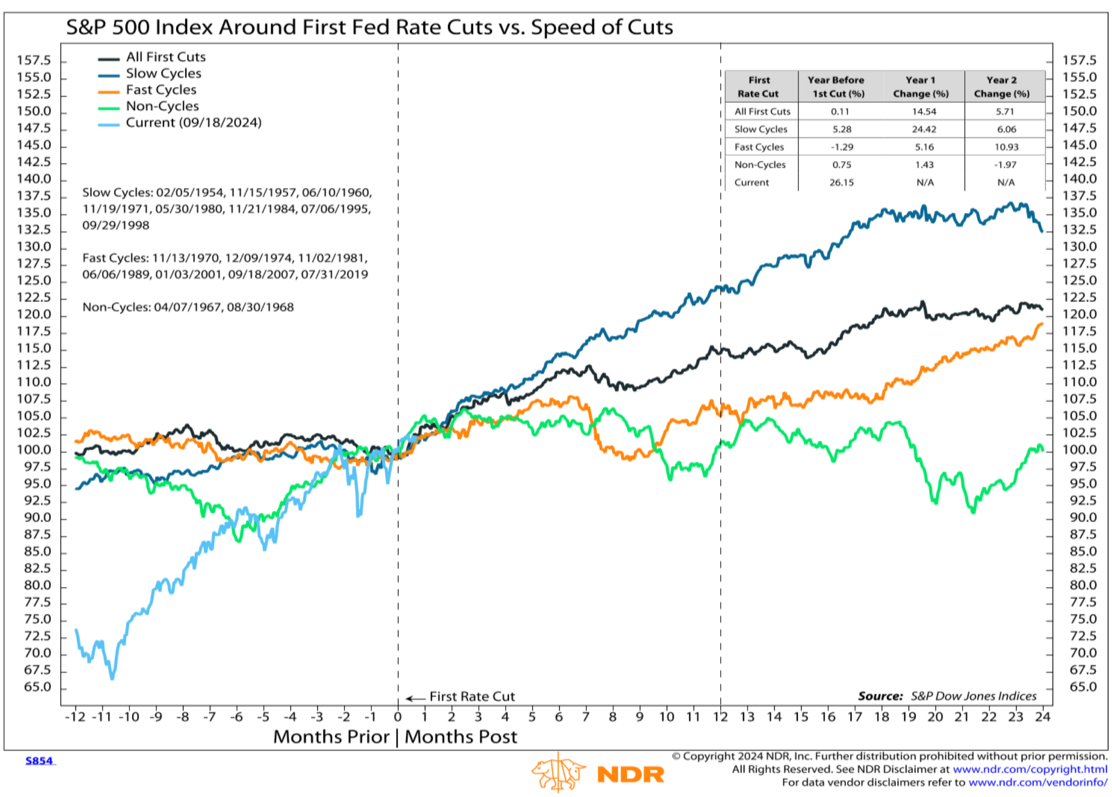
Running With Scissors

October 2024

Raising three sons has been the joy of my life, but it has not always been easy. Rules that seemed self-evident were often ignored even when repeated (and repeated). Risks were rarely fully-assessed before actions were taken. Consequences were dismissed, even when their likelihood was a virtual certainty. Only my Dad seemed to take endless joy in the chaos, as he had raised not three, but FOUR boys – apparently payback is hysterical.

A healthy respect for risk is a necessity in both economics and investments, and I believe my Dad (ultimately) taught me well. As our name implies, **Cornerstone Capital** endeavors to build high-quality, durable portfolios that we believe will not only withstand the test of time, but benefit from it. As Warren Buffett said, *"Successful investing takes time, discipline, and patience."*

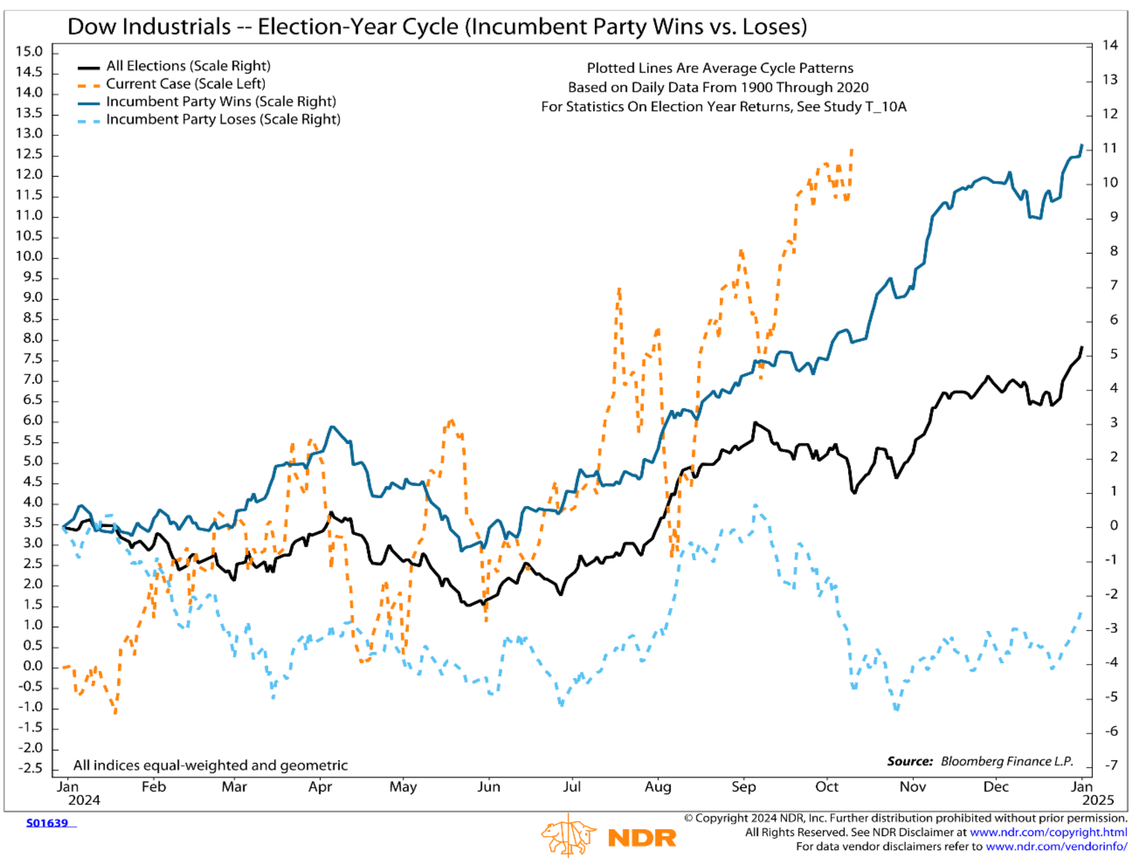
The Federal Reserve faces a similar challenge. They must maintain a disciplined focus on the long-term health of US businesses and consumers, while balancing countless risks that confront the world's largest economy. This is parenting at an exponential scale. At their most recent meeting, the Federal Reserve voted to cut the Federal Funds Rate, the interest rate it controls and which then drives interest rates across the economy, by 50 basis points, or 0.50%. In our view, a 25 basis point reduction would have been more prudent, and in line with the gradual normalization we have seen across the economy over the last two years. As the chart below illustrates, a more gradual approach has also led to stronger stock market returns in the past. Cutting by 50 basis points brought to mind running with scissors – in our view, a bit more caution was advisable.



First Rate Cut	Year Before 1st Cut (%)	Year 1 Change (%)	Year 2 Change (%)
All First Cuts	0.11	14.54	5.71
Slow Cycles	5.28	24.42	6.06
Fast Cycles	-1.29	5.16	10.93
Non-Cycles	0.75	1.43	-1.97
Current	26.15	N/A	N/A

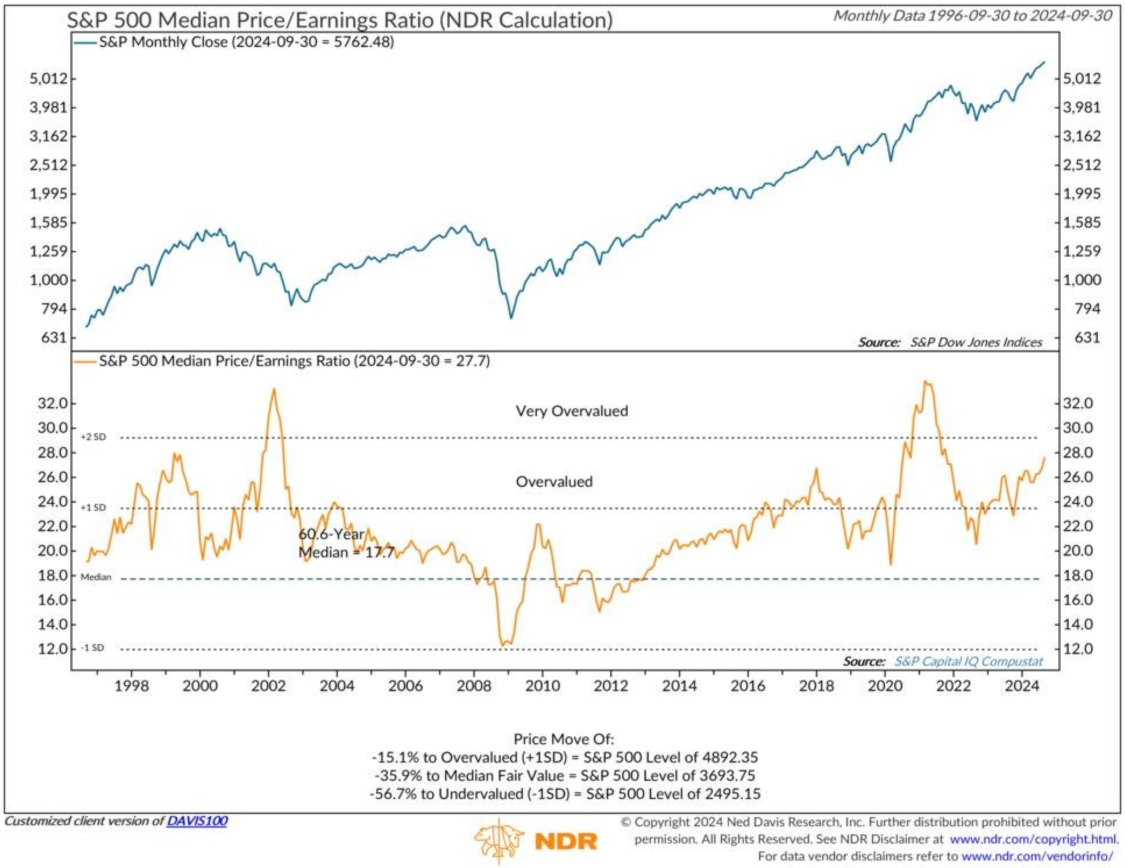
The Fed has a dual mandate – maintain price stability and maximize employment. Prices, as measured by the Consumer Price Index, increased by 2.4% y/y in September. This is above the Fed's stated target of 2.0%, but prices have been trending steadily toward this goal over the last two years. On the employment side, the most recent numbers came in far stronger than economists had expected. The U.S. economy added more than 250,000 jobs in September, far above the expectation of 150,000. [1] With inflation still above target and employment trends quite strong, we would expect further rate cuts in 2024 to be minimal.

Not surprisingly, the primary topic in recent client meetings has been the U.S. election in November. While we are not political prognosticators, one interesting historical trend has been that the markets tend to be volatile early in an election year, and then move higher just ahead of the election. We believe this happens because as we get closer to the election, likely outcomes become discounted in the markets as investors and businesses begin to adjust to the political environment to come. This pattern has certainly held in 2024, with markets advancing even more rapidly than the historical norm, as shown below.



1 *All data sourced from the U.S. Bureau of Labor Statistics https://www.bls.gov/*

As a result of this rally and the strong markets of 2023, stock market valuations have become fairly extended. The following chart shows the Price-to-Earnings ratio of the S&P 500,[2] which is now well above its historical median. Given these valuation levels, we believe further market advances in 2024 are likely to be fairly muted.



To be clear, we are not forecasting a significant decline. The economy has shown remarkable resilience, inflation and interest rates are declining, and corporate earnings continue to expand. But with valuations above their historical norms, much of this good news appears to be priced into the markets. Our intention is always to maintain a disciplined strategy, balancing a long-term focus with a healthy respect for risk. This mindset must have some merits - it has even allowed my Dad and me to get seven adventuresome boys to adulthood.

Brad Dinsmore

2 *The S&P 500 Index is a market-capitalization weighted index that includes the 500 most widely held companies chosen with respect to market size, liquidity, and industry. You cannot invest directly in an index.*