O'Brien WEALTH PARTNERS
ADVISORS | ANALYSTS | ADVOCATES

October 14, 2024

Dear O'Brien Client,

It's hard to believe that we are entering the final stretch of 2024. Kids are back in school, leaves are starting to turn, the Patriots are once again mired deep in another losing streak, and we are making awful holiday season lyrical parodies into Investment Letter titles. Tis the season…

After a bit of volatility to start the quarter, 3Q wound up being an early holiday gift for investors. Global stocks rose over 6% and high-quality U.S. bonds were up over 5%. The drivers of those returns broadened as well: U.S. small/mid cap and international stocks outperformed U.S. large cap stocks, and treasury bonds with longer times until maturity outperformed cash and cash equivalents. Year-to-date, global stocks are pushing close to a 20% return and bonds are now in the black (up roughly 4.5%).

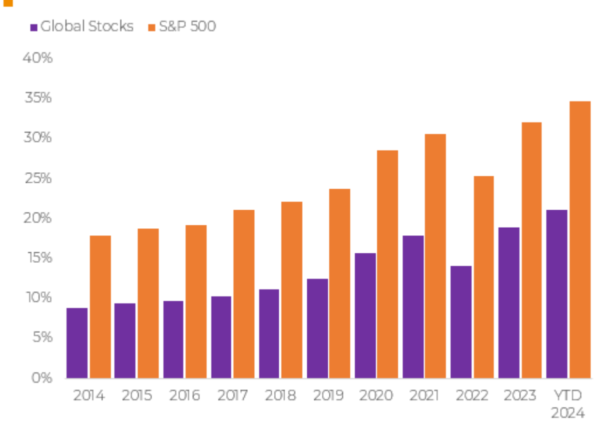
	3Q 2024	2024	3 Years	5 Years		3Q 2024	2024	3 Years	5 Years
Real Estate Stocks	16.8%	14.2%	3.5%	5.1%	U.S. Large Cap Stocks	5.9%	22.1%	11.9%	16.0%
Gold	12.9%	27.2%	14.0%	11.3%	Investment Grade Bonds	5.7%	5.2%	-1.1%	1.1%
U.S. Small Cap Stocks	9.3%	11.2%	1.8%	9.4%	Mortgage-Backed Bonds	5.5%	4.5%	-1.2%	0.0%
U.S. Mid Cap Stocks	9.2%	14.6%	5.8%	11.3%	High Yield Bonds	5.3%	8.0%	3.1%	4.5%
Emerging Market Stocks	8.7%	16.9%	0.4%	5.7%	**U.S. Aggregate Bond Index**	**5.2%**	**4.4%**	**-1.4%**	**0.3%**
Non-U.S. Stocks	8.1%	14.2%	4.1%	7.6%	Treasuries	4.7%	3.8%	-1.8%	-0.2%
Non-U.S. Developed Market Stocks	7.3%	13.0%	5.5%	8.2%	Municipal Bonds	2.7%	2.3%	0.1%	1.4%
Global Stocks	**6.6%**	**18.7%**	**8.1%**	**12.2%**	Commodities	0.7%	5.9%	3.7%	7.8%

Past performance is no guarantee of future returns. You cannot invest in an index. 3-year & 5-year returns are annualized.
Source: Morningstar Direct, O'Brien Wealth Partners, as of 9/30/24.

While the relative outperformance in 3Q of market laggards during the first half of the year has slightly reduced concentration risks in global financial markets, those risks remain elevated compared to history.

As shown below, over the past decade the weight of the largest 10 companies in U.S. (orange bars) and global (purple bars) stock markets have roughly doubled and tripled, respectively. This market share growth is due to the significant outperformance of a narrow subset of companies.

Weight of Top 10 Stocks in Market Indices



Share of Stock Market Returns Driven by the 10 Largest Contributors

	Global Stocks	S&P 500
Last 10 Years	30%	42%
Last 5 Years	37%	52%
Last 3 Years	46%	57%
Since Year-End 2022	50%	68%

Global Stocks: MSCI All-Country World Index. LEFT: The top 10 companies are based on the 10 largest index constituents as of the end of each year. Source: Bloomberg Finance, LP, O'Brien Wealth Partners, as of 9/30/24. RIGHT: Source: Bloomberg Finance, LP, O'Brien Wealth Partners, as of 9/29/24.

Over the past decade the 10 largest performance contributors accounted for 30% of global stock returns and 42% of S&P 500 returns (see table above). Since the end of 2022 returns from those largest contributors have jumped to 50% and 68% of index returns, respectively.

To be sure, there are fundamental reasons why these winners have so dramatically outperformed and there is the potential for that outperformance to continue. But there is also the potential that other companies and markets could uncover other growth engines that are being overlooked today that would allow them to become the winners of tomorrow.

History, in fact, points to that being the more likely outcome. According to a recent analysis from the American Enterprise Institute and Goldman Sachs, just over 10% of the original Fortune 500 companies – which was created back in 1955 – are still members of that group today[1].

Moreover, historically concentrated markets also magnify company-specific risks, as those few winners can have a greater impact on market-level performance and volatility than is typically the case. Today, it can be argued, NVIDIA's quarterly earnings reports matter as much for overall market performance as the monthly employment reports from the Bureau of Labor Statistics.

Given all of this, we continue to believe the best course of action for long-term investors is to remain diversified both across and within asset markets, even though it may seem like a diversified portfolio is underperforming the NVIDIA's of the world in the short run.

Turning to the economic outlook, the pace of global activity is resilient entering 4Q. Core inflation has edged lower, which has resulted in central banks broadly beginning to cut interest rates.

All else being equal, lower interest rates are a stimulus for economic growth via reduced borrowing costs for consumers and businesses. But it takes time for that stimulus to flow through to the economy and, ultimately, interest rates are still restrictive (i.e. well above the pace of inflation). As such, the start of the rate cut cycle will likely have little immediate impact on economic activity but should become a growth contributor by the second half of next year.

Beyond interest rate cuts, the other notable development in 3Q came from China. For several years now, China policymakers have been focused on addressing structural imbalances of the economy, which has resulted in outright deflation and subdued demand for well over a year now. But at the end of 3Q they abruptly changed course, announcing a barrage of new stimulus. While the announcements were a good first step to reinvigorate growth, additional actions will likely be necessary to make any growth pick-up sustainable. New stimulus also pushes policymakers farther from their longer-term restructuring goals for that economy.

The U.S. expansion, by comparison, continues – although underlying fundamentals remain mature. Credit access has been reduced following the Fed's rapid tightening and the banking crisis, monetary policy is still restrictive when compared to the current inflation rate, corporate profit growth has been soft, and hiring has slowed. That said, profits are still growing and hiring is still occurring, so there is little sign entering 4Q of imminent recession risk.

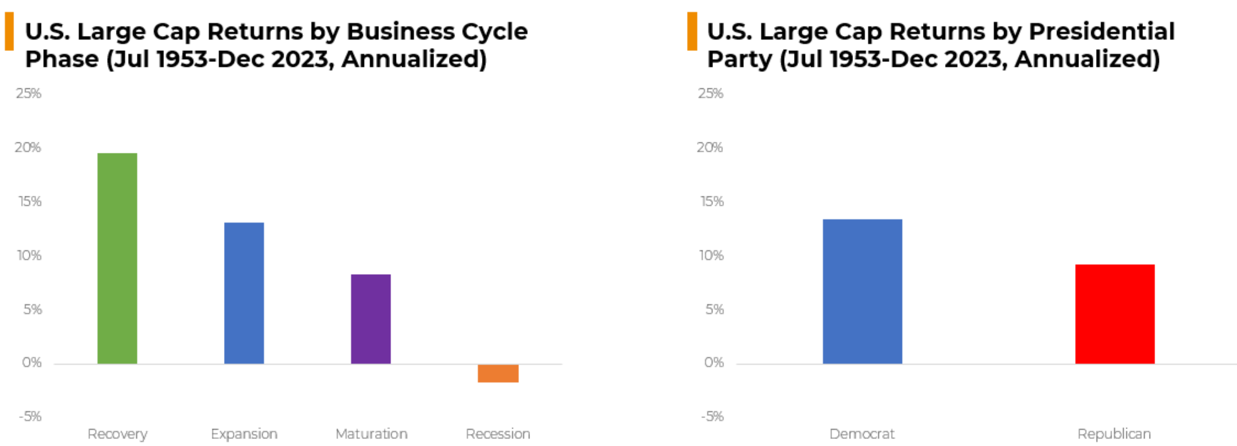
[1] Source: American Enterprise Institute, Goldman Sachs, O'Brien Wealth Partners, as of 9/6/24.

The Fed initiated the first cut in its easing cycle during 3Q, lowering interest rates by 50 basis points. While talking head commentary has been focused on the risk that the Fed has waited too long to ease, keep in mind that the Fed is, in practice, trying to thread a needle in achieving their "soft landing."

Recession is the outcome on the right-side of the needle (i.e. they waited too long to ease and growth stalls out), but on the left-side of the needle is inflation reaccelerating (i.e. they cut rates too soon and will need to shift focus back to curbing inflation). The stronger-than-expected employment and wage growth data from the latest employment report demonstrates that this left-side risk still exists.

Threading these risks is why "soft landings" are so difficult to achieve, and why it is unlikely that we will know whether they have achieved this goal anytime soon. As such, we continue to position portfolios to try to mitigate potential risks if they do not, while still capturing as much upside as we can if they succeed.

Finally, in addition to the holiday season, 4Q brings with it the general elections. Election years tend to create anxiety in voters and market volatility for investors – particularly in the immediate run-up to the election. But for long-term investors, remember that shifts in the economic backdrop (see left chart below) have tended to have a more meaningful impact on stock performance than which political party controls the Oval Office (right chart below).



Source: CFA Institute, SBBI, Bloomberg Finance, LP, O'Brien Wealth Partners, as of 3/31/24.

When examining these market and macro dynamics from a portfolio construction perspective, the initial observation we have is that the start of Fed easing cycles has historically been a good time to put excess cash to work in financial markets.

Over the past 40 years, the yield on cash and cash-like investments has tended to fall more than longer-duration treasuries in the year following the start of a Fed easing cycle. This relatively larger drop in yield has resulted in cash returns consistently underperforming high quality bonds and stocks (provided a recession is avoided) – over such periods.

This dynamic may already be starting to unfold in this easing cycle. During 3Q, the U.S. Aggregate Bond Index (a benchmark for high-quality U.S. credit bonds and treasuries) outperformed cash by roughly 4%.

Stocks continue to price in a benign economic outlook entering 4Q. The U.S. equity rally since 2022 has been driven almost entirely by multiple expansion, resulting in valuations entering the final quarter of 2024 being more expensive than is typical relative to the past 142 years. A recession will need to be avoided, and corporate earnings will need to improve, to justify these lofty future earnings expectations.

High quality bonds, by comparison, are still historically cheap entering 4Q. While these bonds have rebounded over the past year, the past half a decade has still been a painful time to be a bond investor. But this pain has silver linings – valuations are attractive and income at a reasonable price exists again. Historically, current valuations have been an attractive entry point in high-quality bonds for long-term investors.

We hope you are all taking care and enjoy the upcoming holiday season. If there are any changes in your personal or financial situation that might impact your investment objectives, or if you have any questions and would like to talk, please contact your Advisor.

Your O'Brien Team

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