Easy Does It

Avalon portfolio returns were positive in the third quarter, as the markets bounced back from a period of extreme volatility. In August, global stocks plummeted in response to a chain of events starting with the Bank of Japan's surprise decision to raise interest rates, and the resulting unwinding of the Yen carry trade. By the end of September, US equities trended higher, despite fears around labor and economic indicators in addition to uncertainty regarding the election. This environment was also impacted by anticipation of the Federal Reserve interest rate cut, and the resulting 50 basis point reduction.

The U.S. has joined a global easing cycle with a larger-than-anticipated rate reduction. Seven of the ten major central banks have now started easing monetary policy. Economic data indicates most major developed economies are seeing continued positive growth, with signs that inflation is approaching targets. It appears that the gains in U.S. stocks are due at least in part to the Fed's aggressive positioning to prevent a recession and bolster the strength of the labor market. The hope is that these actions support a continued soft landing where growth is maintained, and inflation continues to trend lower.

Benchmark Returns for the 3rd Quarter 2024

Negative Total Return | Positive Total Return

	All Members	
1)	VANECK GOLD MINERS ETF	17.36%
2)	ISHARES US REAL ESTATE ETF	16.92%
3)	SPDR GOLD SHARES	13.05%
4)	SPDR S&P DIVIDEND ETF	12.31%
5)	ISHARES RUSSELL 2000 ETF	9.25%
6)	ISHARES 20+ YEAR TREASURY BOND ETF	7.93%
7)	ISHARES MSCI EMERGING MARKETS ETF	7.68%
8)	ISHARES MSCI EAFE ETF	6.77%
9)	SPDR S&P 500 ETF TRUST	5.75%
10)	ISHARES CORE U.S. AGGREGATE	5.30%
11)	INVESCO QQQ TRUST SERIES 1	2.01%
12)	ISHARES NORTH AMERICAN NATURAL RES ETF	0.89%

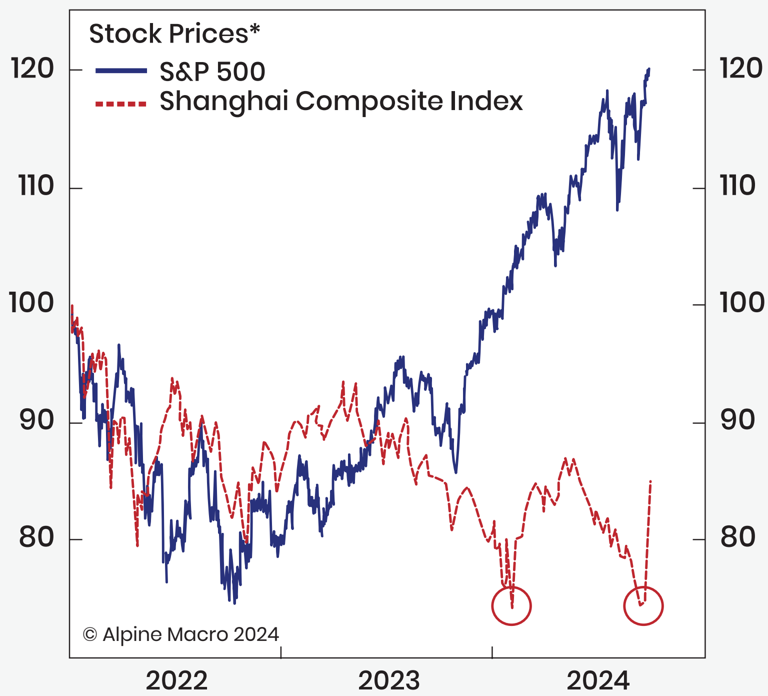
Source: Bloomberg

As we discussed in our client letter in the second quarter, stock market performance this year has been dominated by a concentration of companies primarily focused on AI and related technologies. The third quarter saw a broadening in the equity markets away from this trend, as the major technology stocks underwent a correction. As tech stocks stumbled, market performance was more balanced as value stocks outpaced growth, and small and mid-cap companies outperformed large-cap. Avalon portfolios were well positioned to benefit from this market broadening due to our allocations to emerging markets, precious metals and precious metals stocks, REITs, and long duration fixed income, in addition to select U.S. stocks that outperformed this quarter.

China / Emerging Markets

In recent weeks, Chinese equities have rallied to their highest point this year in response to a series of domestic fiscal stimulus measures. It is too soon to tell if this will correspond with a meaningful economic recovery, but it is clear that Beijing recognizes the economic challenges facing the country after a decade of falling growth and a youth unemployment rate approaching 20%. Stock valuations had been so depressed that the new policies sparked a dramatic rally. Avalon portfolios have benefited due to increased allocations to China and emerging markets. If the stimulative policies continue with the promised robustness and the Chinese economy responds positively, it will benefit U.S. multinational companies with a Chinese presence, industrial commodities, and oil consumption. There is a deep valuation discount to global counterparts, so the rally could be in the early stages.

Chinese and U.S. Equity Performance in Perspective



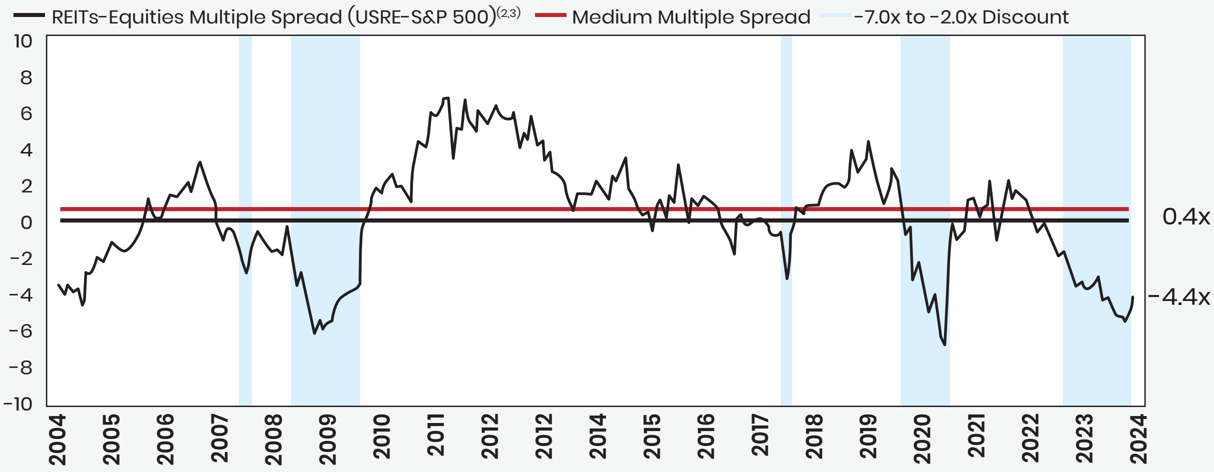
*Rebased to Jan 2022=100

Real Estate

The real estate sector was the second strongest performer in the third quarter, driven primarily by interest rate declines. Within the asset class, several sectors were among the top performers this quarter, including healthcare, industrials, data centers and cell towers. U.S. REITs are trading at historically low discounts relative to equities. Over the last 25 years, in periods following the end of Fed rate increases, REITS have averaged nearly 20% returns over the next twelve months. We continue to watch this sector's depressed prices for longer term opportunities.

U.S. REITs are Trading at Historic Discounts Relative to Equities

U.S. REITs vs. U.S. equities earnings multiple spreads[1]
August 2004 – August 2024



At August 31, 2024. Source UBS, Bloomberg, Citi Research – US Equity Strategy, and Cohen & Steers.

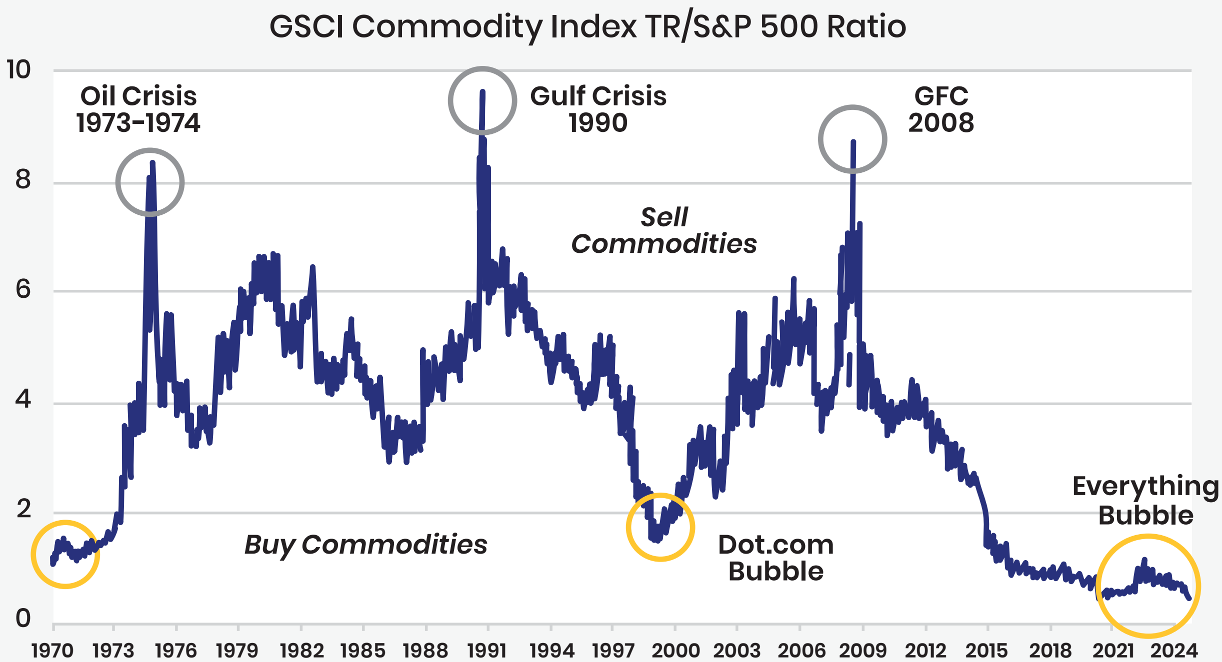
Hard Assets

Gold hit record highs this quarter as precious metals and precious metals stocks benefited from lower interest rates, the weaker dollar, and concerns about geopolitical uncertainty. Gold and silver prices surged after the Fed rate cut. Our positions in gold and other precious metals ended the quarter in a strong position and have been the best performing asset class in 2024, as these investments, along with other hard assets, typically become more attractive in periods of high volatility. We continue to monitor the performance of the actual commodities as well as the stocks in companies related to those assets, as the stocks in companies have been playing catch-up to the price of the metals themselves. The stocks now offer large opportunities to expand margins with gold bullion near $2,600 per ounce and break-even mining costs near $1,400 per ounce. The stocks are at a large discount to both gold bullion and the S&P 500.

Geopolitical Uncertainty

Geopolitical risk remains high as we enter the end of the year, with the conflict in the Middle East and the U.S. Presidential election on the near horizon. If the situation in the Middle East escalates further, it is likely to have significant implications for the price of oil, which has been down this year and saw a significant decline in the third quarter. And while history suggests it is underlying fundamentals and not the winning candidate or party that has long-term bearing on market returns, the next President will face significant fiscal challenges upon taking office. U.S. debt levels are at an all-time high, threatening economic growth and increasing the risk of a national fiscal crisis. Neither candidate has set forth a plan to address the rising debt burden, and both of their proposed spending plans are predicted to increase the debt by trillions of dollars. The rising debt load will act as a headwind to bond prices and a tailwind to gold bullion. We are watchful for an initial reaction to the election outcome and continue to hedge the portfolios against geopolitical risks through significant allocations to hard assets and reduced duration in fixed income.

Gold and Gold Equities Act as Safe-Haven Assets



Source: Meridian Macro Research LLC. Gold & Silver Report, February 17, 2024. Data updated to September 11, 2024

Conclusion

While riding the ups and downs of market volatility this quarter, one thing has been clear: it is better to be invested. As returns on cash decrease with lower interest rates, an intentional allocation is critical to maximize opportunities in other asset classes beyond mega-cap US stocks. Still, if technology companies report strong earnings through the end of the year, we are likely to see that sector rally back, potentially pulling the rest of the market higher. As the U.S. joins a global cycle of easing monetary policy, recent employment data appears to be trending in the direction of stronger employment data, slow but steady economic growth, and diminishing inflation - all supportive of a strong finish to the year.

Clara Basile   Ross Revenaugh

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