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## Quarterly Review: Stock Gains Stay in Focus, but Volatility Moves into the Frame

Sep 25, 2024

### KEY TAKEAWAYS

- The S&P 500 hit record highs, while the tech-heavy Nasdaq lagged the broader market.
- The Fed lowered interest rates by a half percentage point, its first reduction since 2020.
- Small cap stocks outperformed large caps, and value stocks beat growth for the quarter.

US stocks built on a strong first half, with many market indices at or close to record levels as the third quarter neared an end.<sup>1</sup> But those gains came amid a spike in volatility unseen since the COVID pandemic.<sup>2</sup> Fulfilling expectations that had been building for months, the US Federal Reserve in September cut interest rates—another thing investors hadn't seen since 2020—as core inflation eased.<sup>3</sup> Developed equity markets outside the US rose, and emerging markets were slightly higher for the quarter.<sup>4</sup> In the bond market, US Treasuries posted price gains, sending the benchmark 10-year yield below 4%.<sup>5</sup>

The Fed's cut to the federal-funds rate, by half a percentage point to the 4.75%–5% range, came on September 18.<sup>6</sup> Policymakers cited the uncertain economic outlook and higher unemployment rate as part of the reasoning for lowering rates by a half point instead of a quarter point.<sup>7</sup> It was the first rate cut since March 2020's COVID-related market turmoil. The move came after inflation hit its lowest level since 2021, with the August core consumer price index, which excludes more-volatile food and energy items, showing prices rose 3.2% from a year earlier.<sup>8</sup>

Aside from a brief downturn in April, stocks had trended up for much of the year. But in early August and again in early September, major stock indices sank. They recovered losses both times and were higher as they neared the quarter's end, helped by a rise after the Fed's move. The S&P 500 Index rose 4.8% for the quarter as of September 20.<sup>9</sup> The technology-heavy Nasdaq lagged behind the broader market, gaining 1.4%. Nvidia and the other Magnificent 7 stocks were hit especially hard during the August declines, collectively losing about \$1.3 trillion in market value at one point before rebounding.<sup>10</sup>

Shares of Nvidia have risen sharply this year amid strong demand for its computer chips, which are used to power cutting-edge AI applications. In late August, the company reported second-quarter revenue of \$30 billion, up a whopping 122% from a year earlier.<sup>11</sup> Despite this, Nvidia's share price declined following its earnings announcement. While this may seem counterintuitive, it could indicate huge earnings growth was **already priced in by the market**. This is further evidence that high expectations for Nvidia and the other Magnificent 7 companies could mean it's harder for them to impress investors in the future.

Treasuries saw their longest monthly winning streak in three years, as US government bonds posted a fourth month of gains in August.<sup>12</sup> Prices continued to rise in September, sending yields lower, with the benchmark 10-year yield declining to 3.73% as of September 20, more than a percentage point off its recent peak in October 2023. US Treasury yields decreased across the curve, and the 10-year yield rose above the 2-year.<sup>13</sup> The reverse—a yield curve inversion—had been the case for just over two years.

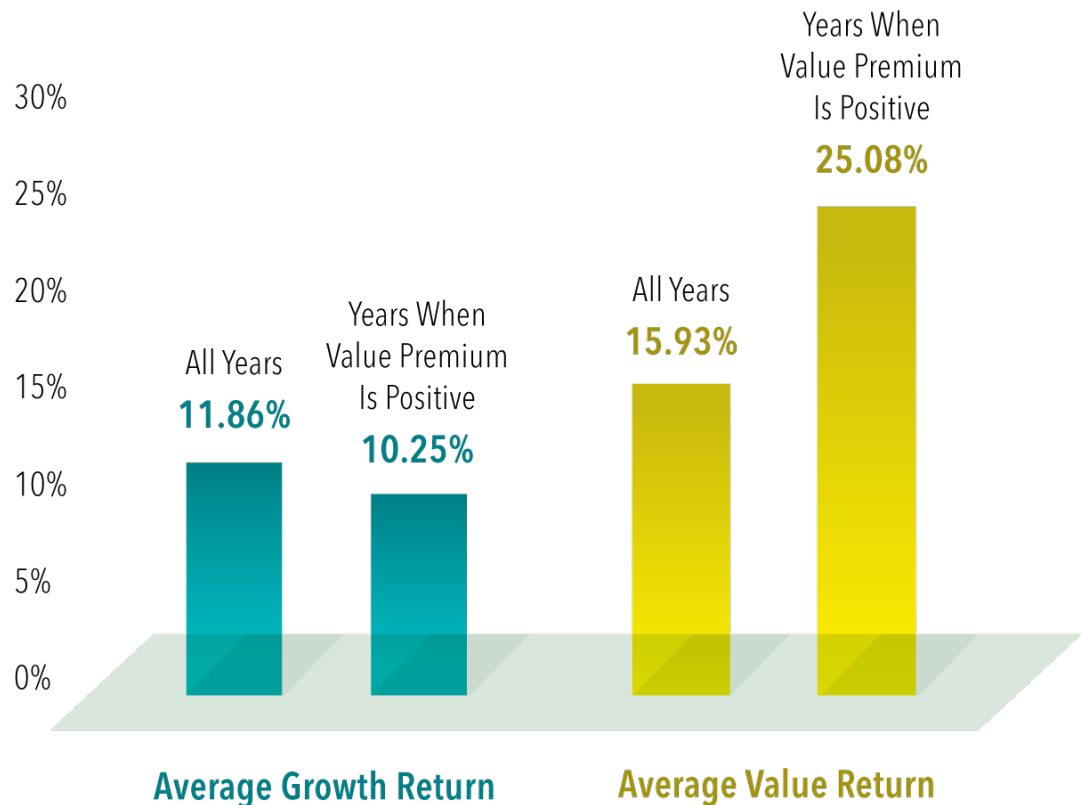
### VIGOR IN VALUE

Globally, value stocks and small caps outperformed their growth and large cap counterparts during the third quarter. Through September 20, value stocks—or those with low relative prices—outdid growth stocks by 5.4 percentage points. Small cap stocks also shined, outperforming large cap equities by 2.4 percentage points as of September 20. However, high profitability stocks lagged low profitability stocks by 2.0 percentage points in developed markets and 1.4 percentage points in emerging markets as of August 31, the latest data available.<sup>14</sup>

Value stocks were winners versus growth stocks, as the latter underperformed the broader market. But that dichotomy **has not been the norm**. Between 1927 and 2023, there were 58 years when value stocks outperformed the broader market; in fact, growth's return was negative in only 17 of those years. On the other hand, value's average return in years when the value premium was positive markedly exceeded its long-run average return, as **Exhibit 1** shows.

**Exhibit 1****Up and Away**

Average annual returns for US value and growth, 1927–2023



### Past performance is not a guarantee of future results.

*In USD. US value and growth represented by the Fama/French US Value Research Index and the Fama/French US Growth Research Index, respectively. Data provided by Fama/French. The Fama/French indices represent academic concepts that may be used in portfolio construction and are not available for direct investment or for use as a benchmark. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. See "Index Descriptions" for descriptions of the Fama/French index data.*

In other words, value stocks have posted strong relative returns not only because growth stocks fell, but also because value delivered a strong absolute performance. This is a good reminder of the importance of focusing on premiums over the long term, and of avoiding the temptation to view one in relation to the performance of another.

### EYES ON NOVEMBER

Amid the market activity, the US presidential election approached, with a late shake-up atop the Democratic ticket changing the contours of the race. National polls showed a tight contest, with no clear front-runner ahead of Election Day. Citizens can understandably have strong feelings about the outcomes of political races. But when thinking about investments, they may take heart that history shows the president is only one of many inputs to the market. Stocks have **generally trended higher** regardless of

who is in office. At a time when passions may be running high for many, it's a reminder that taking the long view can be a source of reassurance.

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1. Connor Smith, "S&P 500 and Dow Rally to New Highs," *Barron's*, September 19, 2024.
  2. The Cboe Volatility Index (VIX), a measure of US stock market volatility, reached as high as 65.7 on August 5, its highest level since the COVID pandemic.
  3. "Midyear Review: Stocks Maintain Momentum at Year's Halfway Point," Dimensional Fund Advisors, June 2024; inflation data is as defined by the consumer price index (CPI), US Bureau of Labor Statistics, 2024; the core CPI is an aggregate of prices paid by urban consumers for a typical basket of goods, excluding food and energy, from "Consumer Price Index for All Urban Consumers," Federal Reserve Bank of St. Louis, 2024.
  4. Developed international stocks, as represented by the MSCI World ex USA Index, added 5.6%, and emerging markets stocks, as represented by the MSCI Emerging Markets Index, returned 2.7%, as of September 20. MSCI data © MSCI 2024, all rights reserved.
  5. Return based on the Bloomberg US Treasury Bond Index as of September 20. Bloomberg data provided by Bloomberg Finance LP. Source for US Treasuries: US Department of the Treasury.
  6. The federal-funds rate is the overnight interest rate at which one depository institution (like a bank) lends to another institution some of its funds that are held at the Federal Reserve.
  7. "Federal Reserve Issues FOMC Statement," Federal Reserve, September 2024.
  8. Jeanna Smialek, "Inflation Cooled in August, Keeping the Fed Poised to Cut Rates," *The New York Times*, September 11, 2024.
  9. S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.
  10. The Magnificent 7 stocks include Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla. Named securities may be held in accounts managed by Dimensional; between July 31 and August 5, the Magnificent 7 lost roughly \$1.3 trillion in market value. Source: Bloomberg.
  11. "Nvidia Announces Financial Results for Second Quarter Fiscal 2025," Nvidia, August 2024.
  12. Ye Xie, "Treasuries Set for Longest Run of Gains Since 2021 as PCE Awaits," Bloomberg, August 29, 2024.
  13. "Daily Treasury Par Yield Curve Rates," US Department of the Treasury.
  14. The MSCI All Country World Value Index rose 7.6%, and the MSCI All Country World Growth Index added 2.2%; the MSCI All Country World Small Cap Index returned 7.2%, and the larger-cap MSCI All Country World Index gained 4.7%. ; the Fama/French Developed High Profitability Index rose 3.8% versus 5.8% for its low profitability counterpart; the Fama/French Emerging Markets High Profitability Index rose 1.2%, and its low profitability counterpart rose 2.6%.

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**Fama/French Developed High Profitability Index:** Provided by Fama/French from Bloomberg data. Includes stocks in the upper 30% operating profitability (OP) range in each region; companies weighted by float-adjusted market cap. Rebalanced annually in June. OP for June of year t is annual revenues minus cost of goods sold; interest expense; and selling, general, and administrative expenses, divided by book equity for the last fiscal year-end in t - 1.

**Fama/French Emerging Markets High Profitability Index:** July 1991–present: Fama/French Emerging Markets High Profitability Index. Courtesy of Fama/French from Bloomberg and IFC securities data. Includes stocks in the upper 30% operating profitability range in each country; companies weighted by float-adjusted market cap; rebalanced annually in June. OP for June of year t is annual revenues minus cost of goods sold; interest expense; and selling, general, and administrative expenses, divided by book equity for the last fiscal year-end in t - 1.

**Fama/French US Value Research Index:** Provided by Fama/French from CRSP securities data. Includes the lower 30% in price-to-book of NYSE securities (plus NYSE American-listed equivalents since July 1962 and Nasdaq equivalents since 1973).

**Fama/French US Growth Research Index:** Provided by Fama/French from CRSP securities data. Includes the higher 30% in price-to-book of NYSE securities (plus NYSE American-listed equivalents since July 1962 and Nasdaq equivalents since 1973).

Results shown during periods prior to each index's inception date do not represent actual returns of the respective index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance

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