2024 3rd Quarter *Review & Outlook*

As of September 30, 2024

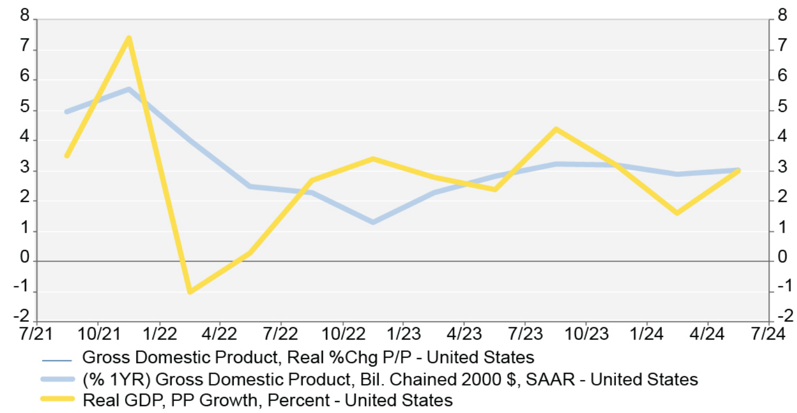
MidWestOne™ PRIVATE WEALTH

Executive Summary

- We expect GDP to remain positive in the coming quarters with a soft-landing our base scenario,
- With inflation seemingly in check, the Fed has 'recalibrated' to focus on full sustainable employment,
- The U.S. Consumer should remain stable despite a moderate increase in the unemployment rate,
- Lower interest rates and higher household Net Worth should support aggregate spending,
- U.S. elections are too close to call and will have significant implications regarding trade & tax policies,
- A closely divided congress will decrease the probability of passing significant new legislation,
- Geopolitical issues are intensifying worldwide: armed conflicts, and potential trade tensions loom,
- Equity market leadership has been narrow but is broadening,
- Fixed Income markets have enjoyed a tailwind of falling yields and narrow credit spreads,
- Market volatility will likely increase as the elections draw closer and new data points are scrutinized,
- The case for a comprehensive a financial plan to provide context for investment decisions is strong.

The Big Picture

Starting with a macro view, the broad economy remains above stall speed. The estimates for real Gross Domestic Product (growth ex inflation) hover around 1 %. Second quarter reported a year-over-year real growth rate of 3% and a current-dollar nominal rate of 5.5%. The likelihood of a recession (a period of negative GDP growth) has been hotly debated and the strength of the U.S. consumer is watched intently. Consensus forward estimates for real GDP growth in 2025 and 2026 are 1.8% and 2.0%, respectively. A 'soft-landing' remains our base case.



The U.S. economy is consumer-centric with two-thirds of activity reliant on consumer consumption. The remainder is attributed to Business Investment (20%), Government Spending (10%) and net exports (-3%). The contribution of net exports is negative because we import more than we export. The heavy reliance on the U.S. consumer is notable and the financial health of the consumer deserves attention, especially their ability to spend. Consumers can spend from three sources of funds: Savings, current income or borrowing.

Savings: During the Covid-pandemic the government injected households with excess cash while spending opportunities (say, going out to dinner or a movie) were limited. Household savings increased and peaked in April 2020. In dollar terms, the peak was $2.7T from a baseline of $400B. This savings has been steadily drawn down to a current level of $800B. The pandemic-related excess savings is rapidly depleting. Aggregate U.S. Household Net Worth has continued to advance, largely due to increases in housing prices. U.S. Household Net Worth at $163.8 trillion. As net worth rises, consumer confidence in spending increases (aka the wealth effect). However, we note that homeownership hovers around 66% of households, the remaining third have not benefitted from the increase in home values.

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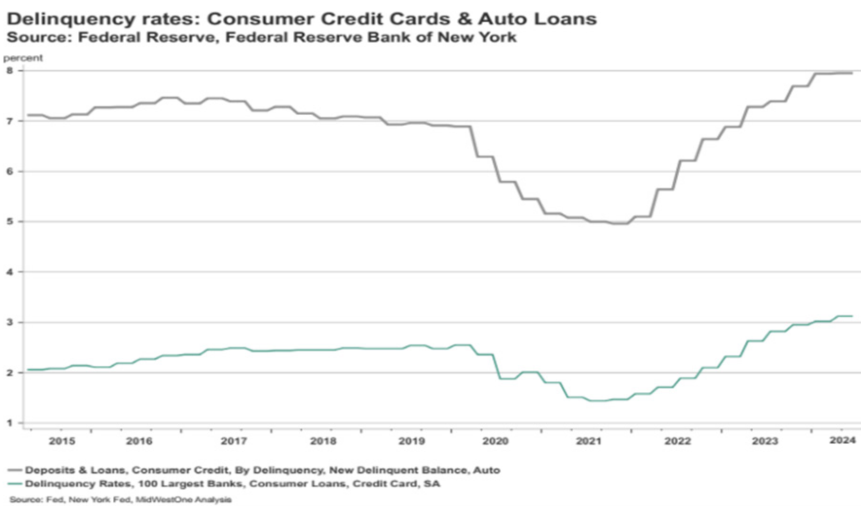
Current Income: Pre-pandemic, real median household income was $81,820. Post-pandemic real wages (net of inflation) declined 4.7% to $77,540 in 2022 and is climbing but not yet fully recovering to pre-pandemic levels. The decline has left many households struggling to close the gap. The ability to generate income is highly dependent on the availability of jobs. The employment statistics remain high relative to historical averages. The current unemployment rate is 4.2% vs a longer-term average of 5.9%.



Borrowing: Post-pandemic, Consumers have increasing relied on credit to support spending. The total amount of revolving credit (aka credit cards) has hit record levels, $1.1T. Borrowing rates have increased substantially during the Fed's tightening cycle. Mortgage rates, for example, increased from under 3% in 2020, to a peak of over 8% in 2023, before falling to just over 6% at quarter-end. As consumer borrowing rates have increased, the Delinquency rate in car loan and credit card payments have noticeably increased.

The Accelerator or The Brake?

For the first time in four years, the Federal reserve cut the target Fed Funds rate. The size of the cut, 50 basis points (0.5%), was a surprise to many. The Fed Funds rate is the interest rate at which banks lend excess cash to other institutions overnight. It has a strong influence over how other lending rates are set. The Federal Reserve is charged with a dual mandate: 1. Keep prices stable and 2. Maintain maximum sustainable employment. The pandemic provided a shock to both mandates. Employment fell precipitously as businesses struggled in the wake of cratering demand while disruptions to the supply chain resulted in pockets of price shocks. The Fed policy was to provide as much liquidity as needed to keep economic activity flowing. The Zero Interest Rate Policy (aka ZIRP) was utilized to avoid a depression-era deflationary spiral. The combination of supply chain disruptions and excess liquidity stoked inflation to 8%, a level not seen since the early 1980's and subjected the Fed to criticism that it remained too accommodative for too long. In response the Federal Reserve began raising interest rates from near zero in 2022 to a peak Fed Funds target of 5.25-5.50%. The rate of inflation has moderated in the face of higher borrowing costs.

The August headline Consumer Price Index (CPI) was up 0.2% for the month and 2.5% annually, coming close to the Fed's target of 2%. The Core CPI (ex-food and energy) was slightly higher than expected at 0.28% due to pressure from shelter. The annual rate for Core CPI was 2.5%. Headline Producer Prices (PPI) were in-line with expectations at 0.2% while core was also slightly hotter (+0.1%) than expected at 0.3% due to an increase in the services sector. As inflation has fallen closer to the long-term target range the Fed adjusted policy in September and invoked a "recalibration"of focus from the price stability mandate to the full sustainable employment mandate. After weeks of speculation, the Federal Reserve announced a decrease in the target Fed funds rate of 50 basis points (0.50%) to a range of 4.75 – 5.00%. This is the first Fed Funds reduction in four years. Fed Chair Powell added a new term to the FedSpeak dictionary: Recalibrating. As an extension of last month's 'it's time', the recalibration narrative focuses on adding support for a weakening labor market as opposed to a materially weaker broad economy. While the size of the rate cut was a surprise to many, the bond market had largely anticipated the move and had re-priced accordingly, while the financial press remained divided up until the release.

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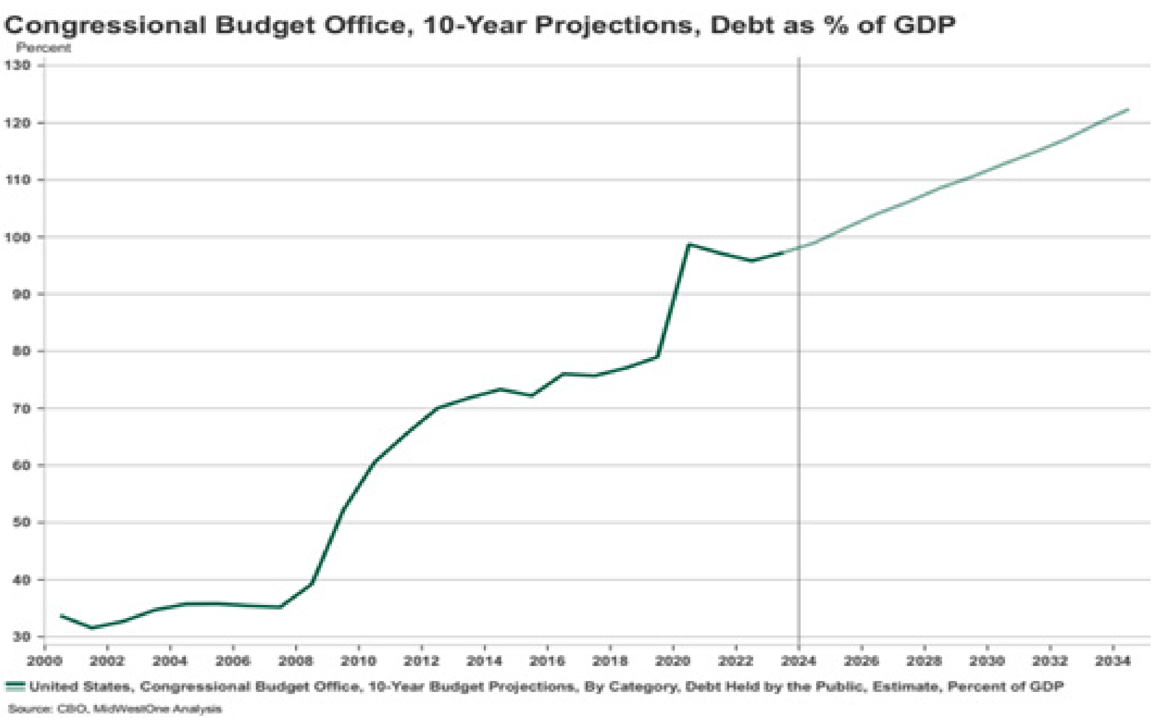
As we look toward the remainder of the year, the Fed's latest Summary of Economic Projections shows the median 2024 fed funds rate at 4.4%, or 100 bp (1%) of cuts, by year-end and an additional 100 bps of cuts in 2025.

Too Close to Call

We are just a month away from the Election Day, Tuesday, November 5th. The race is close and polls currently fall within the margin of error. Party platforms differ on many issues, including tax policy, trade policy and level of government regulation.

One significant issue that both parties will need to address is the size of the federal debt relative to national output (GDP). The current projection from the Congressional Budget Office (CBO) based on laws currently on the books, indicates that the Debt-to-GDP will grow from the current level of about 100% to greater than 120% over the next 10 years. That growth rate is unsustainable and has significant implications for future financial flexibility. Neither party is currently promoting a plan to aggressively address this situation.



The second of the ‘twin deficits’ is the current Budget Deficit as a % of GDP. The current calendar year deficit is 6.7%, with 2024 and 2026 forecast at about the same rate. This is viable only as long as it can be financed.

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Election Outlook

With a month to go before the general election the news cycle will be full of points, counterpoints and fact checks. The political rhetoric is intense and can stoke uncertainty. The current polls show a statistical dead-heat. While the market continues to advance regardless of the combination of party leadership in Washington. The underlying driver of growth is corporate profits which is significantly impacted by the general environment for growth, including tax policy, trade policy, and the relative change in the complexities of regulation. Higher taxes, restrictive trade and higher levels of regulation tend to hamper economic activity and corporate profitability.

One significant issue is that the Tax Cut and Jobs Act is scheduled to sunset at the end of 2025, unless acted upon by Congress. With no action, the tax rate for the majority of filers would increase along with changes to the standard deduction, child tax credit and estate/gift tax exemptions.

The following is a high-level summary of the current tax proposal voiced by each party:

Republican	Democrat
Extend Tax Cut & Job Act Provision	Provide “financial Cushion” for startups. Increase startup expense deduction to $50,000 and spread over multiple years if needed.
Eliminate tax on Social Security	Increase Capital Gains Tax to 28% for earners with incomes over $1mm
Eliminate tax on tips/overtime income	Eliminate tax on tips
Increase child tax credit to $5,000 and possibly remove income cap	Restore Child Tax Credit to $3,600 and provide $6,000 Credit for newborns
Reduce Corporate Income Tax Rate	Increase Corporate Income Tax Rate to 28%

Trade Policy

The direction of U.S. government trade policy will be impacted by the election. The U.S. imports more goods & services than we export. Current U.S. policy is centered around restoring U.S. leadership and cooperation, while balancing the need to further U.S. economic and political interests.

The use of tariffs and other trade restrictions remain a part of the equation. A tariff is a tax imposed by one country on the goods and services imported from another country to raise revenues, protect competitive advantages/favored industries or exert influence.

The unintended consequences of the use of tariffs can include prolonging/encouraging inefficiencies in domestic production, potentially stoking inflation via higher prices for the targeted goods and the incitement of retaliatory action by the target country.

The Republican platform includes plans to more heavily utilize tariffs and other protectionist measures to support favored U.S. industries.

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How Does the Market React?

As we noted in our mid-year review, lookback to S&P 500 returns during the post-WWII era indicates that market returns tend to excel during periods of split control of Congress. Likely, when control is split, neither party can enact extreme policy changes. The nature of the division requires negotiation and compromise which retrains actions.

President	R	D	D	R	R/D	R/D	R	D	R/D
Senate	R	D	R	D	R	D	Split Congress	Split Congress	Split Congress
House	R	D	R	D	R	D			
	9.82%	**12.18%**	**17.03%**	**8.58%**	**13.18%**	**10.50%**	**16.26%**	**19.84%**	**17.61%**
	Average 12.47%								

Sources: Standard & Poors; History.House.gov; MidWestOne Private Wealth Management

CEO Outlook and Corporate Earnings

Data from the Conference Board's Measure of CEO ConfidenceTM report indicates that CEOs are cautiously optimistic about the future yet their views about the current economic situation declined slightly in the most recent quarter. Most planned to keep their workforce unchanged, with planned wage increases in the 3-3.9% range, and the majority indicate no revisions to their capital spending plans.

Similar results were reported in the 2024 KMPG CEO Outlook. 72% of respondents were optimistic about the economy, 92% expected to increase headcount over the next three years and all plan to invest in Artificial Intelligence (AI) in some form.

Forward earnings estimates for the S&P 500 remain solid. The full year consensus for 2024, 2025 and 2026, are \$243, \$278 and \$304, respectively. Based on the Sept 30th closing price of \$ 5,762, valuations are 23.7x, 20.7x, and 18.95x, which are elevated relative to the 10-year average of 18.0.

A Look Back

U.S. Equity markets have enjoyed a year of strong returns. Over the past 12-months share prices have advanced from 20.6% in the small value style to 40.5% in large cap growth.

3 month

Domestic	Value	Core	Growth
Large	8.07%	5.53%	3.04%
Mid	8.97%	6.55%	4.37%
Small	10.68%	9.65%	8.63%

International	
Developed	8.30%
Emerging	8.13%
Fixed Income	
Bloomberg Aggregate	5.27%
Bloomberg US Credit HY	3.26%
Real Assets	
Commodities	-7.86%
Real Estate	15.92%
US Dollar	-4.82%

YTD

Domestic	Value	Core	Growth
Large	13.01%	20.81%	26.89%
Mid	8.27%	12.24%	15.99%
Small	4.20%	7.88%	11.53%

International	
Developed	12.10%
Emerging	14.73%
Fixed Income	
Bloomberg Aggregate	2.55%
Bloomberg US Credit HY	2.53%
Real Assets	
Commodities	-0.51%
Real Estate	13.37%
US Dollar	-0.56%

12 Month

Domestic	Value	Core	Growth
Large	27.76%	34.38%	39.26%
Mid	22.36%	24.77%	27.06%
Small	19.91%	23.52%	26.94%

International	
Developed	23.41%
Emerging	23.27%
Fixed Income	
Bloomberg Aggregate	8.94%
Bloomberg US Credit HY	9.21%
Real Assets	
Commodities	-12.59%
Real Estate	33.70%
US Dollar	-5.14%

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Market breadth has been narrow for much of the year but is beginning to widen. For the first half of the year, Large Growth style driven by Information Technology and Communication Services have led.

AI related companies such as NVIDIA (NVDA) dominated YTD, up 145%. The value of the company now exceeds $3T and represents over 5% of the total U.S. (all-cap) market. The top seven companies in terms of market cap (MSFT, AAPL, NVDA, GOOG/L, AMZN, META) represent over 26% of the US Equity market.

S&P 500 Sector	3 Mo %	YTD %	12 Mo %
Cyclical			
Materials	9.20%	12.62%	22.88%
Financials	10.22%	20.41%	36.58%
Consumer Discretionary	7.59%	13.21%	27.01%
Real Estate	16.29%	11.48%	31.17%
Sensitive			
Communication Services	1.42%	27.89%	41.58%
Information Technology	1.44%	29.63%	51.56%
Energy	-3.12%	5.69%	-2.55%
Industrials	11.15%	18.90%	33.76%
Defensive			
Consumer Staples	8.28%	16.46%	22.06%
Health Care	5.65%	12.96%	19.67%
Utilities	18.46%	27.45%	37.13%

Over the past quarter, leadership has shifted to value over growth and small over large. The Information Technology and Communication Services have cooled as valuations have become stretched and forward guidance from some firms have been solid yet failing to stoke additional enthusiasm. The AI-driven momentum has paused.

Overseas, in a surprise move, China's politburo provided a September economic update and announced aggressive policy support measures. The Chinese equity markets enjoyed the largest one-week rally in 16 years. The prospect of a resurgent Chinese economy provided a boost to emerging and European market equity returns.

The ongoing conflicts in Ukraine and the Red Sea inject an element of uncertainty as the risk of conflict expansion persists. The disruption of the shipping lanes adds cost as materials are diverted via longer routes. The risk of expansion of the Israeli-Hamas conflict is increasing, putting upward pressure on oil prices.

Volatility Measures, VIX / MOVE

To gain a picture of anticipated near-term stress to the markets, we look to the VIX Index, MOVE Index, and credit spreads.

Volatility measures remain subdued. The VIX (aka the fear index) measures implied forward 30-day volatility in the Chicago Board Options Exchange (CBOE) S&P 500 index options. A reading above 20 indicates stress. The Hurricane-impacted employment report prompted a sell-off in equities and a spike in the VIX to around 40. As we enter the fourth quarter, the fear gauge is reading a sanguine 16.82.

A similar gauge of relative stress is available in the bond market. The ICE BofAML (Intercontental Exchange Bank of America/ Merrill Lynch) MOVE Index measures U.S. Treasury rate volatility on the options market. The index is considered a proxy for term premiums of U.S. Treasury bonds (i.e., the yield spread between long-term and short-term bonds). A reading above 100 indicates stress. The index currently reads 94.61.

Credit Spreads, the premium over Treasury yields that investors demand to offset higher default risk, remain low relative to history.

The picture at this point, is relative calm.

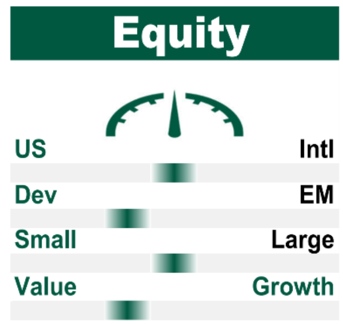
Resurgence in Fixed Income…

Fixed income has caught a tailwind as yields have fallen. The 10-year yield has fallen 86 basis points (0.86%) over the past year. As yields fall, bond prices rise. Given the downward direction in rates, the Bloomberg U.S. Aggregate Bond index has rallied over 9 percent over the past 12 months. High yield bonds have benefited by a firm economic outlook and narrow credit spreads relative to history. The Bloomberg U.S. Credit high yield index has advanced 9.46% year-over-year.

Portfolio Implications

Equities

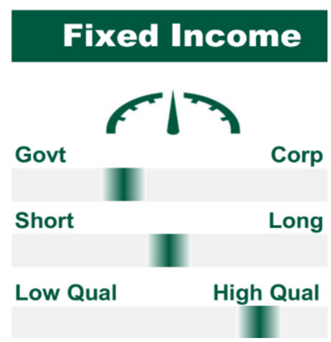
Equity markets have enjoyed a strong run year-to-date. Corporate earnings are on pace to grow 9.5% for the full calendar year 2024 and are projected to expand 14.9% in 2025. Enthusiasm for continued development of Artificial Intelligence has driven valuations of some Technology stocks to extreme levels. Oveall market valuations are elevated at 20.3x forward earnings but short of extreme levels. The combination of current valuations, a potentially weakening consumer and election uncertainty suggest a neutral equity allocation.
We recommend target weighting in U.S. and international, however, within the international markets, we favor developed economies over emerging. Within U.S. Equities we maintain our slight bias to Value and are neutral relative to size. We remain cautiously optimistic.



Fixed Income

The forward path for fixed income is largely dependent on the path of inflation and subsequent Fed action. The recent disinflation trend and cuts to the Target Fed Funds rate has shifted the entire yield curve downward and toward normalization (a curve sloping upward to the right).

We have removed the barbell duration strategy that we have employed for much of 2024 and shifted exposure to intermediate part of the curve. We continue to favor high credit quality fixed income including investment grade corporates, securitized assets, and U.S. agency debt. Relative value opportunities are still present across these sectors and yield levels remain attractive. Credit spreads over Treasury yields remain tight on a historical basis but further appreciation from spread compression could occur under a soft-landing scenario. We recommend caution in high yield/low quality fixed income. The relatively attractive yield is easily offset by a widening of historically narrow credit spreads in the event of an economic downturn. While a soft-landing is our base case, we are taking a cautious approach to high yield at current levels.



The Case For Having a Plan….

Given the uncertainty surrounding the upcoming election and potential impact on the markets, we suggest revisiting your overall financial plan. Your MidWestOne team has the required experience and resources to help you chart your path. A comprehensive plan will help you identify those goals that you value most and align your resources, cash flows and invesm-tent portfolio to increase the likelihood of achieving them. Contact your MWO team, revisit your plan and optimize your investment strategy.

Disclosures:
Indices used in the Market monitor S&P 500, 400 and 600. Bloomberg US Aggregate, Bloomberg US Credit High Yield (B1), MSCI EAFE, MSCI Emerging Markets, DJ Equity REIT, S&P Goldman Sachs Commodity.