The Bottom Line - Q4 2024

THE BOTTOM LINE

FOURTH QUARTER : 2024

BUFFALO FINANCIAL QUARTERLY NEWSLETTER

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2024 PRESIDENTIAL ELECTION

BY JEREMY I. BECK

We all know what happens every four years and will keep happening every four years for the rest of our lives. No, I'm not referring to a leap year (although 2024 is a leap year!) I'm referring to the consistently tight race for the white house. The most frequently discussed topic in client meetings over the past few months has been the contentious Presidential election. Elections are often a time of great uncertainty in which investors want to prepare their portfolios for increased volatility.

Whether you are a democrat or republican, supporters of each party will claim that voting for their candidate will boost the economy, and choosing the other will cause financial turmoil.

2024 PRESIDENTIAL ELECTION - CONT'D

Instead of diving into the specifics of these claims, let's take a step back and review historical data to examine whether election years and political party control influence the stock market.

We'll address two key questions: First, how has the stock market performed in non-election years compared to Presidential election years? Second, has the market responded differently based on whether a Republican or Democratic President is in office?

Election Years and Market Performance

To answer the first question, we'll look at the S&P 500 Index from 1926 to 2024, covering 23 Presidential elections. Over this period, the average annual return for the S&P 500 was slightly higher than 12%. However, during election years, the return averaged slightly lower at 11.5%, compared to 12.3% during non-election years. This difference could be attributed to the uncertainty that comes with elections, as markets generally don't favor uncertainty.

Digging deeper, election outcomes provide more insight. When the Presidency stayed with the same party, the average annual return was 16.0%. However, when the Presidency switched parties, returns averaged only 6.3%. There is an old saying on Wall Street that bad certainty is better than uncertainty. This suggests that markets may prefer continuity over change, although it's likely that poor economic conditions, rather than political campaigns, drive these changes in party control.

Does Party Matter for Market Returns?

Now, turning to our second question: Does the stock market treat Republican and Democratic Presidents differently? From 1926 to 2024, the S&P 500's average annual return was 9.3% under Republican Presidents and 14.8% under Democratic Presidents. While this 5.5% premium for Democratic administrations is notable, it's important to avoid oversimplifying this relationship. Individual presidencies, economic conditions, and external factors all play a role.

For example, Republican Calvin Coolidge oversaw average annual returns of 30.57%, while Herbert Hoover (also Republican) saw returns of -27.2% during the Great Depression. Similarly, Democrat Bill Clinton led during a period of strong returns, averaging 17.2% annually. The President's actual control over the economy is limited, and market performance during any administration can be influenced by various factors beyond political decisions.

2024 PRESIDENTIAL ELECTION - CONT'D

Takeaways for Investors

While historical data offers interesting patterns, it's not a crystal ball for future market performance. The stock market incorporates all known information, including political factors, so it's unlikely that historical election-year trends alone will dictate future outcomes. It may be prudent to focus on the specific policies of the incoming party and focus on the companies within these specific business sectors that would benefit from their policies.

Kamala Harris is on record stating that protecting the environment is a core part of the Democrats economic plan. If the government can provide incentives for electrification and clean fuel production, I would expect these sectors to see increased demand. Energy efficient product manufacturers as well as waste management and recycling companies also stand to benefit.

Trump has repeatedly vowed to crack down on crime, secure the southern border, strengthen our military and ensure energy dependence for the United States. I'd like to focus on two specific sectors: U.S. Energy & Aerospace and Defense. Trump is on record for saying "drill, baby, drill". You can extrapolate that he would reduce regulations for domestic oil and gas producers and increase LNG exports.
U.S. producers could see a major tailwind if his administration is able to push this policy forward. Looking at Aerospace and Defense, would Trump continue to push his agenda of withdrawing from the North Atlantic Treaty Organization (NATO)? If so, I would expect the United States to dramatically increase military spending, which clearly benefits this sector.

It's also a good practice to focus on which sectors would benefit under either a Democrat OR Republican holding the highest office in the land. Using previously appropriated funds from multi-year initiatives, both parties have discussed the Infrastructure Investments and Jobs Act (IIJA), as well as the CHIPS for America Act. In the bipartisan IIJA legislation, building, construction and infrastructure companies all seem to be major beneficiaries. Since the CHIPS Act legislation will fund domestic semiconductor productions and research, there are several companies that stand to benefit.

In conclusion, investors should prioritize long-term goals and ensure their asset allocation aligns with their risk tolerance and financial objectives. To gain an edge in the markets, focusing on specific business sectors can be advantageous, particularly given the contrasting positions of the Presidential candidates.

Jeremy Beck, Founder & CEO

FIXED INCOME OUTLOOK: THE ELECTION

BY MATTHEW J. PITROLA

As we count down the end of our summer in Buffalo, take a moment to soak up the last 80-degree days. As we know all to well, when the Bills start becoming the center of attention, the cold weather is just around the corner. But does that mean we are also set to begin a "cold winter" for fixed income investors?

Undoubtedly, investors have a lot on their mind. Factors ranging from ongoing geopolitical threats, a slowing labor market, a Federal Reserve set to cut interest rates and a Presidential election right around the corner. While inflation, the labor market and geopolitical threats have been the main topic of conversation over the last few years. I would like to take a moment to highlight the upcoming election, and the effects that this could have on the fixed income landscape over these next four years.

How does the president affect the Federal Reserve?

While U.S. Presidents do not have direct authority over the Federal Reserve, they do have power to impact Federal Reserve leadership.

The President has the authority to reappoint or appoint a new Federal Reserve Chair, but this action must be confirmed by the Senate. Jerome Powell serves as the current Fed Chairman through May 15th, 2026. His re - appointment will almost certainly hinge on how the labor market and inflation perform over the next two years. Although it has never happened before, theoretically the President does reserve the right to oust the current Federal Reserve Chairman and replace them with someone new. This notion came up more than a few times during Trump's previous tenure from 2016 - 2020. This was a tumultuous time as the Federal Reserve was trying to raise interest rates to cool down an overheating economy.

Outside of nominating a Federal Reserve Chairman, the President also reserves the right to nominate the seven members of the Fed's Board of Governors. Their responsibility is to oversee the 12 Reserve Banks.

While the Presidential administration does not have any say over Federal Policy, they clearly can plant individuals that align with the current administrations goals. The final way an administration can exert its powers on the Federal Reserve is through political rhetoric. We have seen this time and time again over the years on both sides. Whether it is Biden mentioning his support of rate cuts by the end of 2024 during his months on the campaign trail or Trump back in 2018 urging the Federal Reserve to stop its current hiking cycle. These dynamics and calls to action could ultimately push the Fed to act in a manner that it originally would not have.

FIXED INCOME OUTLOOK - THE ELECTION

Is there a correlation between the winning party and fixed income returns historically?

When examining the returns on the U.S. aggregate bond fund over the last 40 years. The same conclusion is drawn time and time again. Regardless of political party, both the stock and bond markets are driven more by a healthy, stable economy with growing earnings. The chart below shows the trailing 1 year returns for both stocks & bonds during the trailing 12 months of all election years dating back to 1980. You will see that the average return across both asset groups is positive. Regardless of administration.

Figure 1: Market Returns of Stocks & Bonds during election years (1980 - 2020)

Market returns after US presidential elections, 1980-2020

Election Year	US Stock Market					US Bond Market				
	1 day	1 mo	3 mos	6 mos	1 year	1 day	1 mo	3 mos	6 mos	1 year
1980	1.82	6.39	0.05	3.13	1.01	0.00	-0.19	2.59	-0.64	4.29
1984	-0.68	-4.08	7.78	8.72	19.16	0.00	1.79	5.63	7.76	19.49
1988	-0.55	3.28	8.15	7.39	14.13	0.00	-1.21	0.71	2.49	12.49
1992	-0.55	3.28	8.15	7.39	14.13	-0.02	0.49	3.69	7.13	11.22
1996	1.53	4.49	9.23	15.93	34.11	-0.04	0.77	1.05	1.68	8.10
2000	-1.86	-6.97	-7.45	-12.51	-22.53	0.06	2.63	5.21	7.25	15.30
2004	1.17	5.76	6.45	4.51	11.25	0.08	-0.82	0.88	1.18	1.04
2008	-5.22	-16.06	-16.10	-7.12	8.38	0.49	3.03	4.53	6.28	11.71
2012	-2.24	-0.56	7.06	14.96	27.76	0.33	0.54	-0.34	0.82	-1.19
2016	1.16	5.61	8.13	13.35	23.70	-0.98	-2.23	-1.33	-0.86	1.25
2020	2.23	9.83	15.72	26.41	40.99	0.61	0.76	0.14	-1.45	-0.59
Average	**-0.29**	**1.00**	**4.29**	**7.47**	**15.65**	**0.05**	**0.51**	**2.07**	**2.88**	**7.55**
Median	**-0.55**	**3.28**	**7.78**	**7.39**	**14.13**	**0.00**	**0.54**	**1.05**	**1.68**	**8.10**

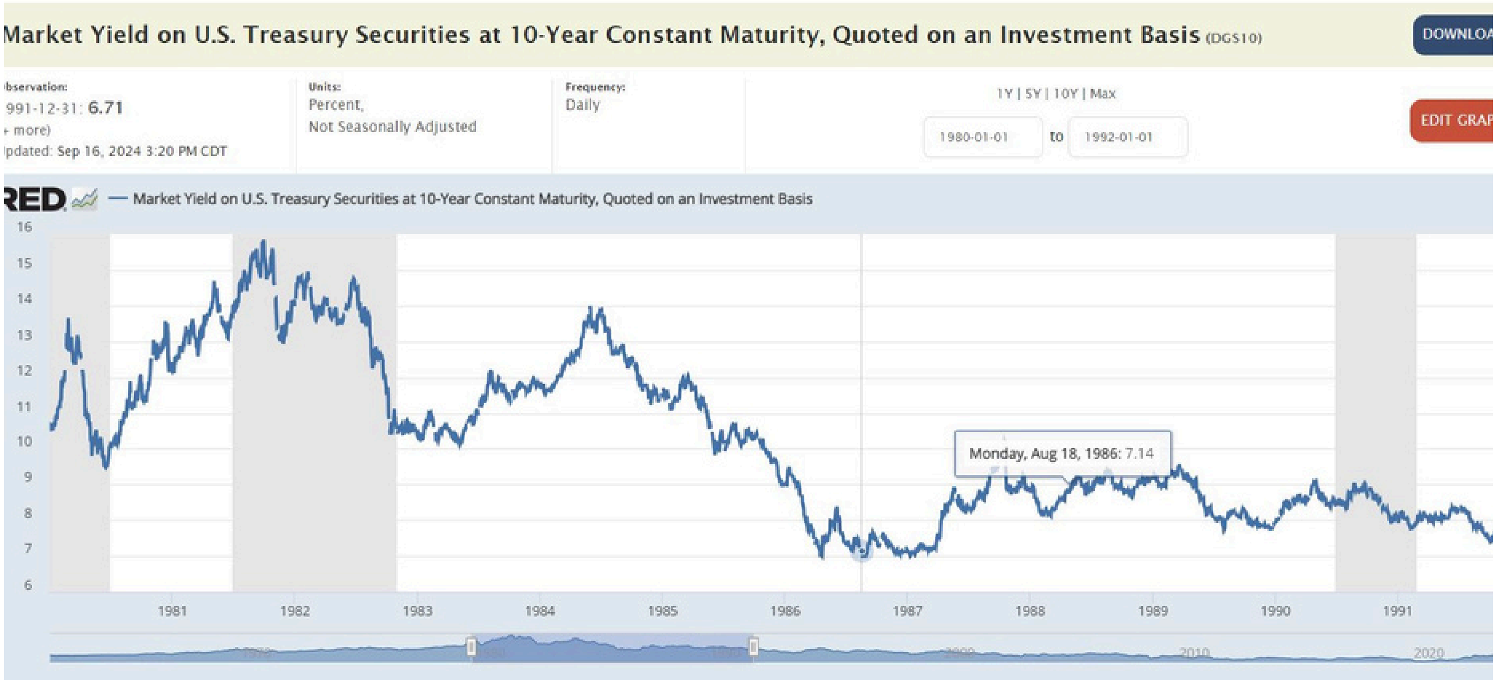
Source: MorningstarDirect. U.S. Stock Market represented by the Russell 1000 Index. U.S. Bond Market represented by the Bloomberg US Aggregate Bond Index.

Examining things further, let's look at fixed income returns during the period from 1980 - 1992. The Bloomberg aggregate bond index had a hallmark 12-year return over this period, even with multiple administration changes. Pundits could point to both Democrat and Republican parties for the success over this period. But the true driver of outsized returns over this period was consistently falling interest rates.

The 10 Year Treasury yield hit an all time high of 15.81% in September of 1981 following a grueling decade long battle with inflation. Interest rates then proceeded to fall precipitously over the coming years, creating large returns for fixed income investors.

FIXED INCOME OUTLOOK - THE ELECTION

Figure 2: 10 Year U.S. Treasury Yield (1980 - 1992)

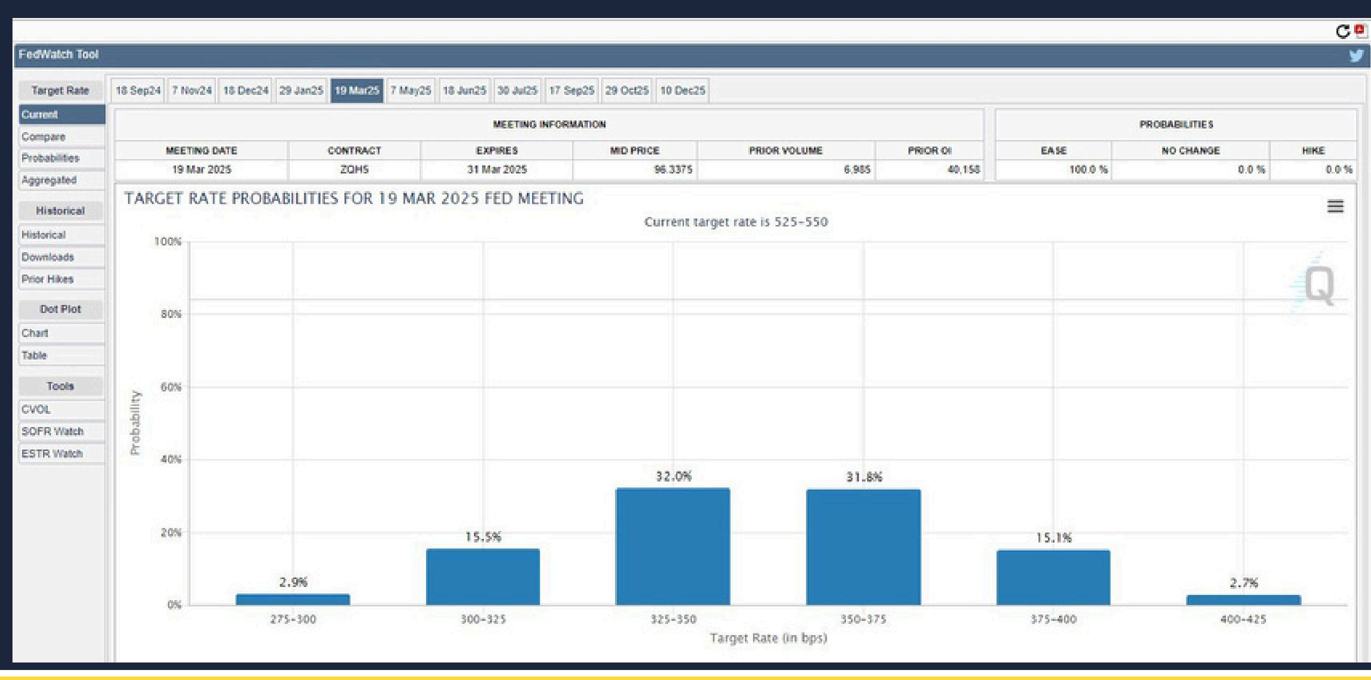


Source: Federal Reserve Economic Database

The reality of the fixed income landscape in 2024:

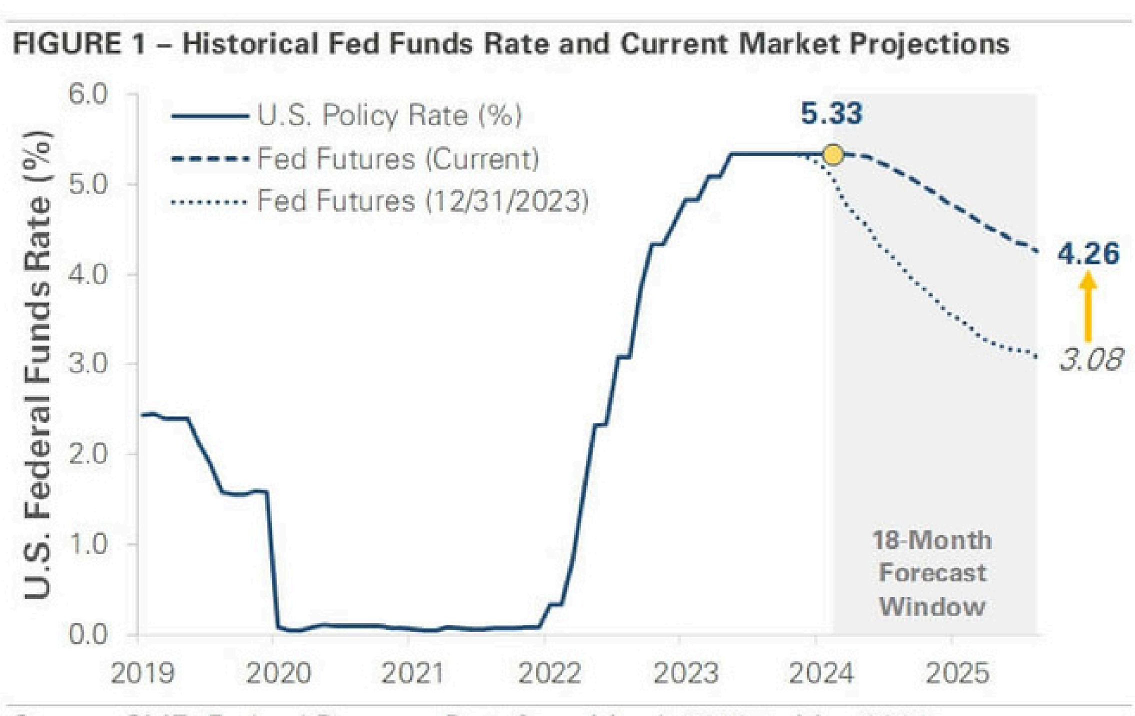
Now that we have examined the President's powers over the Federal Reserve and the correlation between Presidential elections and fixed income returns. Let's revisit the current state of the fixed income markets as we enter the final quarter of 2024.

Returns for fixed income investors this year have been plentiful, with the Bloomberg Aggregate Bond Fund returning 5.04% year to date as of my writing. The main source of these returns has been due to the 10 year Treasury yield retreating from 4.00% at the beginning of the year down to 3.65% today. This move lower in yields has been spurred by healthy inflation data, and a few worrying data points in the labor market. The market is currently pricing in a 2.00% reduction in the effective federal funds rate over the next 6 months!



FIXED INCOME OUTLOOK - THE ELECTION

Seeing data like this more than likely has fixed income investors excited & worried at the same time. While we think that these projections for rate cuts are optimistic at best, there are a few ideas for investors with longer time horizons to consider now that rate cuts are imminent.



Money Market Investors - If you are currently holding money market funds enjoying the high yields. You should expect that rates have reached their peak, and your current returns will begin to decline as money markets have historically moved in tandem with Federal Reserve rate cuts due to the short-term nature of their investments. If you have a slightly higher risk tolerance and time horizon, you should begin to look towards short term bond positions.

CD Investors - Investors in FDIC Insured Certificates of Deposit should consider laddering their positions to provide a hedge for additional interest rate declines. You will sacrifice a small amount of current yield by utilizing this strategy, but you will gain longer term yield protection in the event of rates falling quickly.

High Yield Bonds - With interest rates beginning to decline, intuitively investors will begin looking for higher yielding alternatives. I urge all investors to be wary of junk or high yield bonds due to credit spreads being extremely tight and near their historic lows. In the event of a slowdown in the U.S economy, these positions could struggle as investors may demand a higher yield for holding borderline insolvent companies.

Summary:
It has been a great year for fixed income investors, and I expect this trend to continue through year end even with the upcoming election in November. While the cold weathers arrival is a formality for us Buffalonians, I believe that fixed income investors will continue to enjoy the warmth of higher yields and better expected returns.

Take care!

BUSINESS RETIREMENT PLAN END OF YEAR CHECKLIST

BY JACOB WOOD

As we approach the end of the year, it's the perfect time for both business owners and plan participants to reflect on their retirement plans and ensure they're on track for the future. For business owners, this means reviewing contributions, compliance requirements, and potential tax benefits. Meanwhile, participants should focus on their individual retirement goals and investment strategies. In this article, we'll outline key to-do items tailored for each group, helping you navigate the year-end complexities of retirement planning and set the stage for a successful new year.

Participant Checklist:

Assess & Maximize Contributions

As the year draws to a close, now is the perfect time to assess and maximize your retirement plan contributions. Review how much you've contributed so far and see if you can increase contributions before the year-end deadline to take advantage of tax-deferred growth and potential employer matches. If you're not yet maxing out your contributions, consider adjusting to meet the annual IRS limits.

This is also a good time to ensure you're contributing enough to stay on track for your long-term retirement goals. I highly recommend using a compound interest calculator to get an estimate on how much your contributions will grow by retirement.

Evaluate Investment Options & Performance

The end of the year is the best time to evaluate the performance of your retirement plan's investments. Review your asset allocation and ensure it aligns with your risk tolerance, time horizon, and overall financial goals. Check if any funds are underperforming or if you need to rebalance your portfolio. Market conditions can change, and your retirement plan should reflect these changes. This review ensures that your investments are working efficiently toward your retirement objectives.

Review Fees

Many participants tend to overlook the fees associated with their retirement plans, but these costs can accumulate and affect your overall returns. Year-end is an ideal time to review the fees you're paying for administrative services, investment management, and other plan-related expenses. Compare these fees to industry benchmarks and explore cost-effective alternatives. Reducing unnecessary fees can have a long-term positive impact on your savings. Additionally, if you have accounts from former employers, consider rolling them into an IRA or a new 401(k). Staying in an old plan means you may still be paying for benefits you no longer receive.

BUSINESS RETIREMENT PLAN END OF YEAR CHECKLIST - CONT'D

Participant Checklist Cont.

Set up a meeting with your advisor to review retirement goals
Before the new year begins, schedule a meeting with your financial advisor to review your retirement goals. This is the time to assess if you're on track or if adjustments are needed based on changes in your income, expenses, or life circumstances. Your advisor can help you refine your strategy, optimize contributions, and ensure your investment approach aligns with your long-term objectives. Regular check-ins are key to keeping your retirement plan on course.

Outline your plan for the next year
Take this opportunity to outline your retirement plan for the upcoming year. Start by setting specific goals, whether it's increasing contributions, adjusting investments, or refining your retirement timeline. Having a clear, actionable plan in place can help you stay disciplined throughout the year. Consider any life changes or upcoming financial milestones that may affect your retirement.

Business Owner Checklist:

Run Plan Testing
As a business owner, it's crucial to run plan testing to ensure your retirement plan complies with IRS regulations. Conducting nondiscrimination tests, such as the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests, helps confirm that contributions and benefits do not disproportionately favor highly compensated employees. These tests are essential for maintaining the tax-qualified status of your plan and avoiding costly penalties. If your plan fails these tests, corrective actions may be required before the year ends to ensure compliance and protect both the company and the participants.

Communicate with Employees & Conduct Employee Education
Year-end is an ideal time to communicate with employees about their retirement savings. Consider scheduling educational sessions to help employees better understand retirement planning and how to make the most of the plan you offer, a service Buffalo Financial would happily provide. Providing education on topics like contribution limits, investment options, and the benefits of maximizing contributions not only improves engagement but can also help in meeting nondiscrimination test requirements by encouraging broader participation across the workforce.

BUSINESS RETIREMENT PLAN END OF YEAR CHECKLIST - CONT'D

Review Fees

Take this opportunity to review the fees associated with your retirement plan, including administrative, investment, and record-keeping expenses. It's essential to ensure these fees are reasonable and transparent, both for the company and for the employees participating in the plan. Compare current fees to industry benchmarks, and if necessary, negotiate with service providers or explore alternative vendors to ensure you are providing a cost-effective plan. Lowering plan expenses not only enhances the value for participants but also helps you meet your fiduciary responsibility as a plan sponsor. If you're unsure of how to do these tasks, reach out to Buffalo Financial for a complimentary plan fee review.

Check for Plan Amendments & Consider Plan Design Changes

Review your retirement plan design to determine if any amendments are necessary before the year ends. Legislative or regulatory changes, such as updates to contribution limits or eligibility rules, may require you to amend your plan to remain compliant. Additionally, consider whether you need to make any plan design changes for the next year, such as adding new features like automatic enrollment or increasing employer matching contributions. Proactively addressing these amendments ensures your plan stays competitive and compliant with evolving regulations.

Document Compliance & IRS Forms

Year-end is a critical time to gather and organize the necessary documentation to demonstrate your plan's compliance with IRS and Department of Labor (DOL) regulations. Ensure that you are ready to file required IRS forms, such as the Form 5500, which provides key information about your plan's financial condition, investments, and operations. Proper documentation and timely filing help you avoid penalties and ensure your plan is audit-ready, protecting both your business and the interests of your employees.

As the year wraps up, it's a great time to pause and reflect on where you stand with your retirement plan. Whether you're a business owner looking to fine-tune your plan or a participant making sure your savings are on track, these small year-end actions can make a big difference. Taking just a little time now to review and adjust your strategy can help set you up for a successful year ahead. Remember, your future self will thank you for the effort you put in today!

Happy Fall and Go Bills!

Jacob Wood - Wealth Manager

JOE DUNN MARKET COMMENTARY

Digesting the Fed: Rates Start to Fall Before the Leaves

The Federal Open Market Committee (FOMC) met this week and voted to cut rates by a half-percent, bringing its policy range to 4.75 percent to 5 percent. This decision comes after committee members had elected to hold rates steady at the preceding eight meetings after their hiking cycle concluded in July 2023. This vote also marks the first time in recent periods that a voting committee member dissented from the popular vote. We saw 11 committee members vote in favor of the action, with Fed Governor Michelle Bowman as the sole dissenter, preferring a quarter-percent cut.

While it seems fitting that rates are beginning to fall within days of the Autumnal Equinox, I doubt Fed officials were aiming for the play on words. So, what were they paying attention to as they made this most recent decision, and what should we keep our eyes on as the seasons change?

Follow the Trends

August's Consumer Price Index (CPI) data was released last week and showed headline inflation has come down to 2.5 percent year-over-year. This is a far cry from mid-2022 when that number peaked around 9 percent, and it is a testament to the progress made in the fight against rising prices. Fed Chair Jerome Powell and his colleagues have been waiting for more consistent and convincing evidence that inflation is coming down sustainably, and the data in recent periods has provided that confidence boost.

The labor market is the other largest consideration, and recent data points to deteriorating employment conditions. This is likely what persuaded the committee to start with an outsized cut of a half-percent. To be clear, the labor market remains in a solid position for now, but signs of softening have led to concerns about what could lie ahead. While the unemployment rate remains low by historical standards at 4.2 percent, it is following an upward trend. At the same time, the pace of new job creation is slowing. The August reading of changes in non-farm payrolls showed an increase from July, but the larger trend of falling job creation remains intact. This combination of stalling job creation and an increasing unemployment rate could spell potential trouble if the trends persist.

2024 Midyear Outlook: Slower Growth Ahead for U.S. Economy? - Cont'd

Is the First Cut the Deepest?

While a half-percent cut is larger than the quarter-percent many economists anticipated leading up to the meeting, it is still relatively small compared to the increases of 5.25 percent the Fed enacted between March 2022 and July 2023. Rather, the change in direction and expectations for what's to come will move the needle. An updated Summary of Economic Projections was produced through this meeting and pointed to committee expectations for 50 basis points of additional cuts in 2024 and 100 basis points (1 percent) of cuts throughout 2025. If realized, that would bring us to a full 2 percent of cumulative cuts by the end of next year. There is plenty of room for these expectations to change over time, so what will dictate the speed and magnitude of additional rate cuts from here?

Look no further than what was discussed in the prior section. Inflation readings and the labor market will continue to be the primary areas influencing monetary policy decisions. With inflation near the Fed's target, employment is coming more into focus as the main driver behind how much and how quickly rates will come down. The goal is to orchestrate a soft landing, and employment must remain decently strong for that to happen. Should monthly changes in non-farm payrolls continue to fall or even reach negative territory, that could surely prompt a quicker pace of rate cuts. But if those numbers hold up, the Fed may opt for a slow and steady pace as it seeks to normalize the interest rate environment.

While the recent balance of risks has moved some attention from inflation to employment, Fed officials will certainly not take their eyes off the inflation ball. As evidenced by the 1970s, it's always possible that price increases could rebound if monetary policy eases too quickly. This is the absolute last thing the Fed wants to see, so it is undoubtedly approaching this cutting cycle with caution, despite starting it off with a double cut. Trends and backward-looking data are helpful when it comes to making guesses, but we know all too well that past performance is no guarantee of future results. For that reason, we'll have to see what the future has in store for us.

Looking to November

Ultimately, the FOMC maintains its stance of meeting-to-meeting data dependency, so we'll be keeping tabs on incoming data and additional Fed comments in the weeks and months to come. We plan to continue these post-meeting blogs, so be sure to subscribe to The Independent Market Observer to stay up to date. The next FOMC meeting is scheduled for November 6–7, and we'll be here to help you digest Fed developments as we progress through the year.

Joe Dunn - Investment Research Analyst, Commonwealth Financial Network

NEWS AND EVENTS

Please join us for the third annual Buffalo Financial Charity Golf Tournament to benefit Oishei Children's Hospital! Our golf tournament will be held on Saturday, October 5th at Diamond Hawk Golf Course in Cheektowaga. Jake Wood is challenging all clients to a putting contest (since he can't really hit the ball off the tee)! Please RSVP as soon as possible by contacting Tyler (flyer is below).

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