Independent Banker

October 2024

Portfolio

[tag] Portfolio Management

[hed] **October, effectively**

[dek] How have the financial markets performed in the tenth month?

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As we embark on the fourth quarter of 2024, there are a lot of wild cards in the community banking deck that could be dealt in the very near future: national elections, expiring tax cuts, commercial real estate and geopolitics, just to name a few. Let’s quickly recap just the previous nine months of 2024:

* The 10-year treasury note’s yield—which ended 2023 well below 4%—quickly ran up to 4.70% before more than retracing itself by the start of August.
* The bond market’s expectation of aggressive rate cutting by the Federal Reserve was quickly proven wrong. At the start of the year, fully seven rate cuts for the year were in the Fed Funds Futures numbers. It turns out there were none until September. Currently, there are a total of four cuts in the numbers for 2024. However, this can change quickly!
* By and large, equity markets have done pretty well, especially considering that we were supposed to be in a recession by now. All the major indices had positive returns through August, though that too could change before year-end.

**[subhed] Recent history**

October has a reputation of a month that should be approached with extreme caution. If you have memories of the aughts, the start of the Great Recession in 2008 contained several watershed events in October of that year. The sound bite “Red October” appeared in print early and often, and in fact, the S&P 500 index lost 16.9% in that one month. Those with grey (or no) hair who were in the financial circles in 1987 still have “Black Monday,” Oct. 19, etched indelibly in their memories. That date remains the largest one-day meltdown in history, as the Dow Jones Industrial Average dropped 22.6% in that one trading session. There’s even a term in the lexicon of market pundits called “The October Effect,” which is the notion that equity prices tend to decline this month.

But it’s worth asking if the facts support this supposed phenomenon. A look back a quarter century to 1998, reveals some surprising (to me, at least) results. Using the S&P 500 as a benchmark, the calendar month of October produced net advances in 20 months, and next retreats in only five. That is an arithmetical landslide. As the research website Investopedia concludes, “The October Effect is considered to be more of a psychological expectation than an actual phenomenon, as most statistics counter the theory.”

**[subhed] Direct impact**

Let’s turn our attention now to what is of more import to your community bank: interest rates. Again using the last quarter century as our window, what have short- and long-term rates done in October? These results may surprise you, too.

First, we’ll look at Federal Open Market Committee activity. As we know, the FOMC directly controls overnight rates, and on occasion—like most of the past 16 years—has influenced longer tenors through its intervention in the open market. Since 1998, it has not raised the target rate of fed funds in October. Conversely, it has cut rates five times (in 1998, 2001, 2007, 2008, and 2019).

This may seem disingenuous to Fed watchers for a couple of reasons. First, interest rates have had a secular trend toward lower levels in the last quarter century, the past three years notwithstanding. Secondly, in many years, there isn’t an FOMC meeting in October, depending on how the calendar falls. Still, it’s a bit of a statistical outlier that there has been not a single October rate hike in the past 25 years.

**[subhed] Farther out there**

This last point is especially driven home when we look at the yield history of the 10-year treasury note. The 10-year has an outsized influence on economic activity in the U.S. because of its correlation to 30-year mortgage rates. Unlike fed funds, the 10-year note has had a variety of outcomes since 1998.

Longer-term rates (using the 10-year as a proxy) have <i>*risen<i>* in fully 17 of the past 25 years, even though the Fed has not tightened even once in the previous 25 Octobers. Stated another way, an interest rate curve steepening has happened in about two-thirds of the time in recent years. What this tells me is that bond investors have considered economic vitality to be generally good as we enter the fourth quarter, equity markets aside.

Will this happen in 2024? It’s highly unlikely we’ll see the FOMC cut rates as it doesn’t convene until November. So, will longer-term rates rise, and the curve steepen? Stay tuned. And you equity investors: buckle up.

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[sidebar] Education on tap

Balance Sheet Academy this month

There are still some spots available for the 2024 Balance Sheet Academy Oct. 28–29. This is an intermediate-level program for portfolio managers and other financial officers, and will cover such topics as enterprise risk management and wholesale funding. It will be held at the Peabody Hotel in Memphis, Tenn. For more information, visit <i>[icbasecurities.com](http://www.icbasecurities.com)<i>

Balance sheet webcast in November

ICBA Securities and its exclusive broker Stifel will host their Quarterly Bank Strategy webinar on Nov. 7 at 1 p.m. Eastern. Several strategists and economists will make presentations, and up to 1.5 hours of CPE are offered. For more information and to register, contact your Stifel rep.

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