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Investment Committee Review

Outlook Q4 2024

SS&C ALPS Advisors is an open architecture boutique investment manager offering portfolio building blocks, active insight and an unwavering drive to guide clients to investment outcomes across sustainable income, thematic and alternative growth strategies.

Asset Class Reviews

- 2 [Introduction](#)
- 3 [Macro Summary](#)
- 5 [Equities Summary](#)
- 8 [Fixed Income Summary](#)
- 12 [Real Estate Summary](#)
- 15 [Commodities Summary](#)

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Introduction

Third Quarter Review

Risk assets rallied in the third quarter, with positive returns across asset classes as central banks cut rates. Inflation has slowed, aligning with the Federal Reserve's (Fed) target, making bonds more attractive as labor market softening increases the likelihood of a mild recession. While an earnings recovery continues, slower profit growth and macroeconomic uncertainties, including upcoming US elections, pose risks to future market performance.

Fourth Quarter Outlook

Executive Summary

We believe the economy and the job market show signs of softening, but GDP should continue to grow through the end of 2024. The Fed's 50 basis point (bps) rate cut in September reflected some concern of further weakness in the job market. Even as economic growth slows, we still believe opportunities exist and investors would be well served sticking to target allocations.

Equities

Following a strong start to 2024, US Equities continued to perform well, but leadership, for the moment, has shifted. The S&P 500 Index gained 5.89%, driven primarily by interest rate sensitive sectors such as Utilities, Real Estate, Industrials and Financials. Breadth also improved, as the equal weight S&P outperformed the market cap weighted index.

We continue to believe that equity valuations remain attractive outside of the largest growth stocks where returns had been concentrated. That said, we continue to favor higher quality, free cash flow generating stocks with an emphasis on dividends. International and emerging market equities should also benefit as US interest rates come down.

Fixed Income

Fixed Income returns were positive across all sectors in the third quarter, led by mortgage backed and investment grade bonds. As the Fed has begun easing, this tends to favor fixed-rate, high quality bonds. With that in mind, we recommend investors **strengthen their Core with Active Management**. Specifically, we recommend investors:

- Selectively extend duration into the Intermediate Core.
- Upgrade in Credit Quality across sectors.
- Move into certain sectors with better valuations. Our favorites would be high quality (AAA/AA) **Asset-Backed Securities (ABS)** and **Investment Grade Municipal Bonds**.
- Stay diversified and do not get over-weighted in US Treasuries as volatility is likely to continue. We do favor a slight overweight in **Agency Mortgage-Backed Securities (MBS)** in the intermediate part of the yield curve.

Real Estate

Real Estate Investment Trust (REIT) returns rebounded in the third quarter, with the FTSE NAREIT All Equity REITs Index returning 16.79% for the quarter and 34.77% for the prior twelve months, led by Office and Self Storage. Lodging/Resorts and Residential, while positive, were laggards.

REITs continue to exhibit attractive characteristics such as net operating income (NOI) growth, relatively low leverage and favorable debt terms and maturities. These characteristics, along with an expectation of lower rates, should provide a tailwind for the sector. We favor non-traditional sectors with secular growth, such as Data Centers, Self Storage and Cell Towers.

Commodities

Commodities ended the quarter with a gain of 0.68%, with mixed performance across sectors. Gold delivered a 13% return, offset to some extent by an 11% decline in energy commodities. Dollar weakness and a Fed rate cut provided a small tailwind to the asset class.

In our view, positives such as continued dollar weakness and lower rates are offset to some extent by a weaker US job market, a relatively weak Chinese economy and weak energy demand. Consistent with our second quarter review, we are broadly neutral on commodities.

Summary

Consistent with the second quarter review, we believe investors should remain fully invested at target allocations. In Equities, we continue to prefer quality, dividend paying stocks and see an opportunity in International Equities. In Fixed Income, we encourage investors to selectively extend duration and take advantage of sectors with attractive valuations. The opportunity in Real Estate is in select REITs experiencing secular tailwinds. Finally, our view on Commodities broadly remains neutral in the near term, but constructive longer term.

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Macro Summary

Liquidity Cycle

Nearly all asset classes were higher in the third quarter of 2024. Core bonds came back in a big way as softer pricing and economic data in July and August fueled a bond rally almost as great as the S&P 500 Index's return on the quarter. The Fed lowered their benchmark rate by 50 bps to the range of 4.75% to 5.00% and has signaled further rate cuts before year end. As we wrote in June, a recalibration of monetary policy was needed, and the Fed delivered.

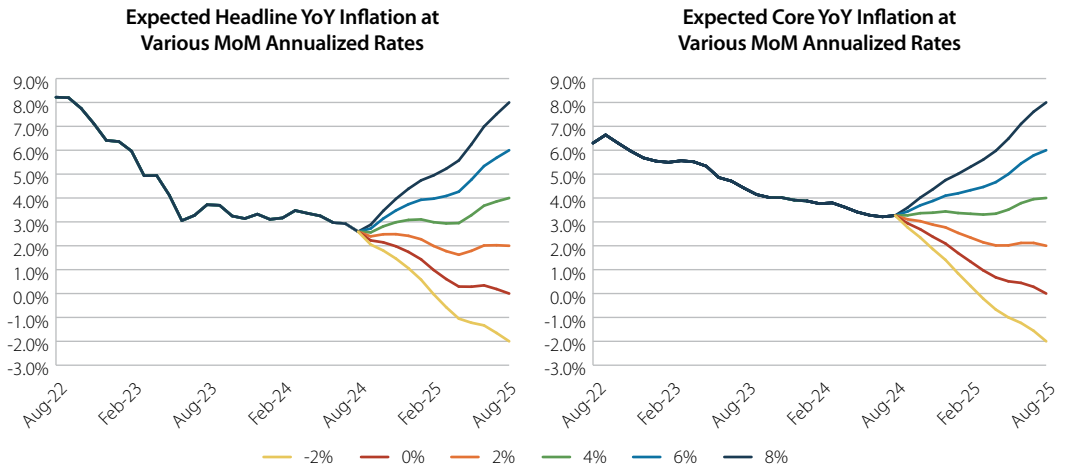
Furthermore, liquidity conditions appear to be turning up on a global basis. The European Central Bank began cutting rates in June and China has recently taken desperate stimulus measures to support its stock market and economic growth goals. Notably, the US Treasury continues to run a 6% fiscal deficit in an economic expansion. The debt ceiling suspension is set to expire on January 1, 2025, which will require a full reassessment of the fiscal forces that have supported post-COVID-19 Pandemic economic growth. These events have contributed to a weaker US Dollar environment over the quarter.

Inflation Cycle

In June, headline inflation month-over-month came in negative for the first time since the pandemic. As we discussed last quarter, inflation is likely to slow to the Fed's target. That scenario has only been strengthened by weaker economic and labor market data that came in July and August.

We modify our 2024 outlook for both headline and core inflation from 2.5% - 3.5% to 2.0% - 3.0% and we maintain our view that inflation will not be a major market risk into year end.

As we have stated before, the trend lower in inflation reduces implied volatility in bonds over time, making bonds generally more attractive in the asset allocation portfolio than they have been for the last two years. Those with convexity, or embedded optionality on lower interest rate volatility, are especially interesting in this environment. We adjusted our model portfolios' fixed income allocations accordingly on April 10th, and we look for an opportunity to add convexity on any substantive backup in rates.



Source: Bloomberg, 8/31/2022 – 8/31/2025

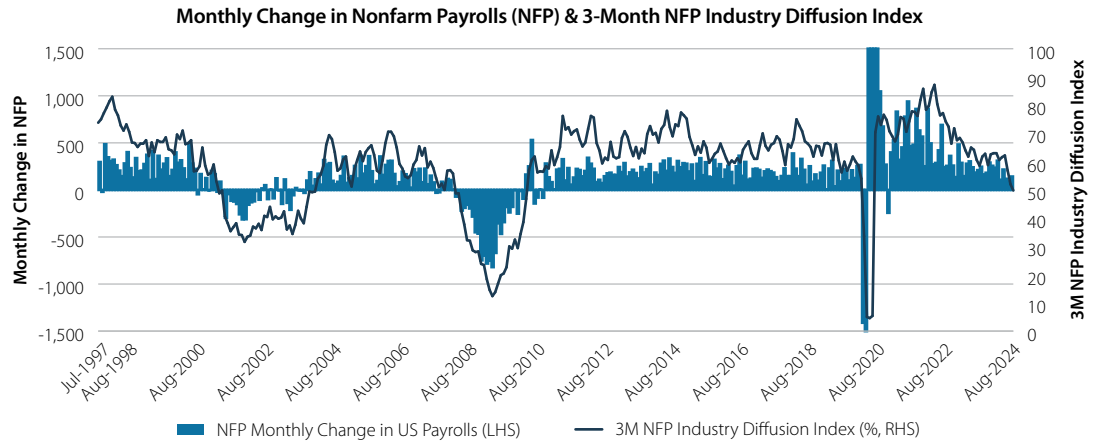
Headline Inflation represented by the Consumer Price Index (CPI) and Core Inflation represented by the Personal Consumption Expenditures Price Index (PCE).

Growth Cycle

Last quarter we wrote on the topic of the US consumer and labor market growth, that these two driving forces for US economic growth may be finally softening from their remarkable run over the last two years. Real-time data of US economic growth shows we are not currently in a downturn, satisfying the current base case assessment of a continued soft landing. However, labor market signals have continued to deteriorate.

Job openings have fallen below the pre-COVID-19 Pandemic trend line and the unemployment rate reached a level in May of 2024 that was equivalent to the Fed's real-time consensus expectation for the end of 2024. The rapid pace of cooling in the job market in 2024 is likely what led the Fed to start big with a 50 bps rate cut.

One of our favorite leading indicators for the job market is the 3-month breadth of hiring across industries as captured in the Nonfarm Payrolls (NFP) report. As shown in the chart below, the breadth is falling below 50%, indicating there are more industries losing jobs than there are those gaining jobs. The ongoing softening of the job market leaves us content with a full bond allocation as the probability of a mild recession in the US economy in the next six to twelve months has increased in our view.

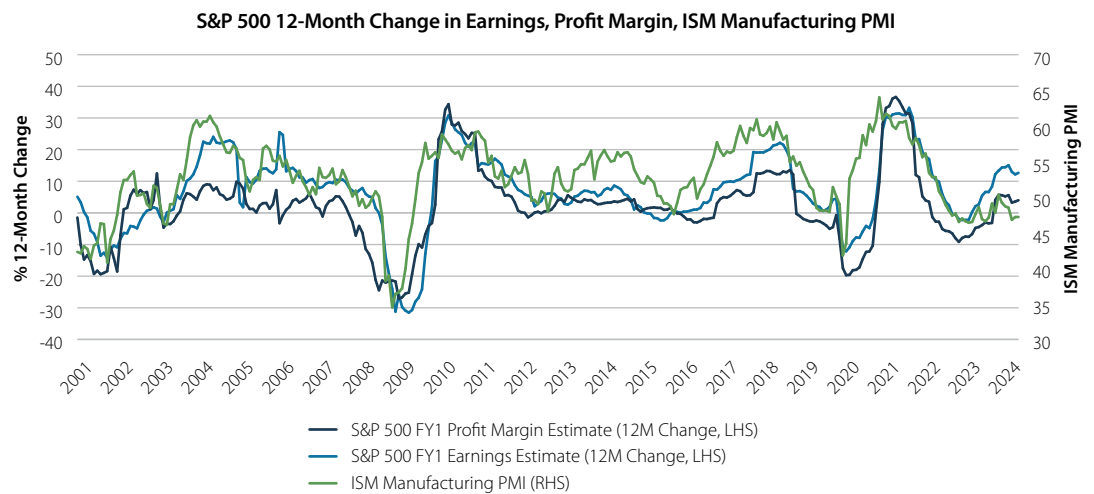


Source: Bloomberg, as of 8/31/2024

Profit Cycle

The recovery from the 2022 US earnings recession remains intact, keeping equity valuations above their historic trend. However, the rate of change of earnings and margin estimates has slowed relative to those observed in 2023 and the first half of this year. While the profit cycle remains modestly positive, we are watching closely for clues of a potential negative impact from the softening macroeconomic environment. Notably, the ISM Manufacturing PMI has not fully recovered back into expansionary territory, creating a potential risk for future profits.

Finally, the uncertainty surrounding scenarios of the forthcoming US elections may also significantly impact the profit cycle. While Republican and Democratic sweeps of executive and legislative government remain lower probability events, a full reassessment of the profit cycle would be underway in either outcome. Unless the US labor market fell into a rapid deterioration, we remain cautiously optimistic on the current profit cycle and its ability to continue propelling the bull market in equities.



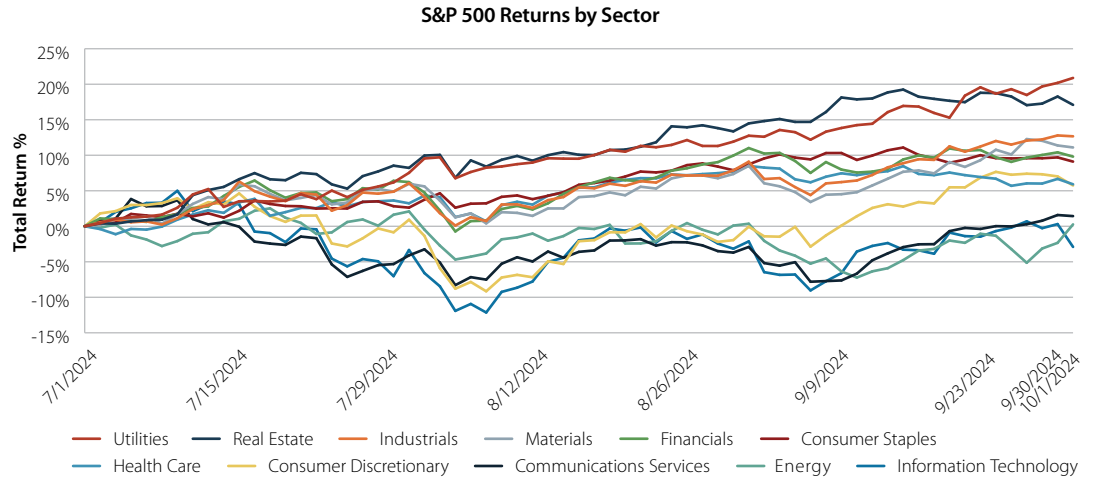
Source: Bloomberg, as of 9/30/2024

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Equities Summary

Third Quarter Review

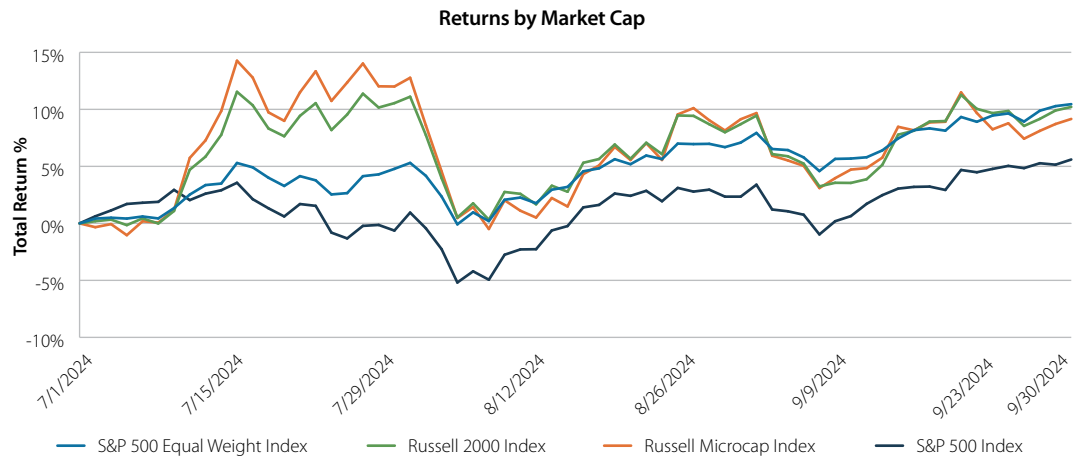
During the third quarter, we observed a reversal in the interest rate trade that had dominated the past few years. Interest rate-sensitive sectors generally outperformed, driven by lower inflation readings and the start of the Fed's rate-cutting cycle. The Semiconductor rally, which had gained momentum over the past two years, began to slow and appeared to be replaced by Utilities, as investors anticipated increased energy demand driven by future artificial intelligence (AI) projects. The quarter ended with the S&P 500 Index up 5.89%, the Nasdaq 100 Index rising 2.12% and the Dow Jones Industrial Average gaining 8.72%.



Source: Bloomberg, 7/1/2024 – 10/1/2024

Past performance is no guarantee of future results.

Similarly, during the third quarter, large companies underperformed smaller ones, highlighting the relief of lower interest rates on leveraged companies, which tends to be higher in smaller companies. As expected, the transition to lower interest rates has significantly broadened the market rally as more leveraged firms find relief.

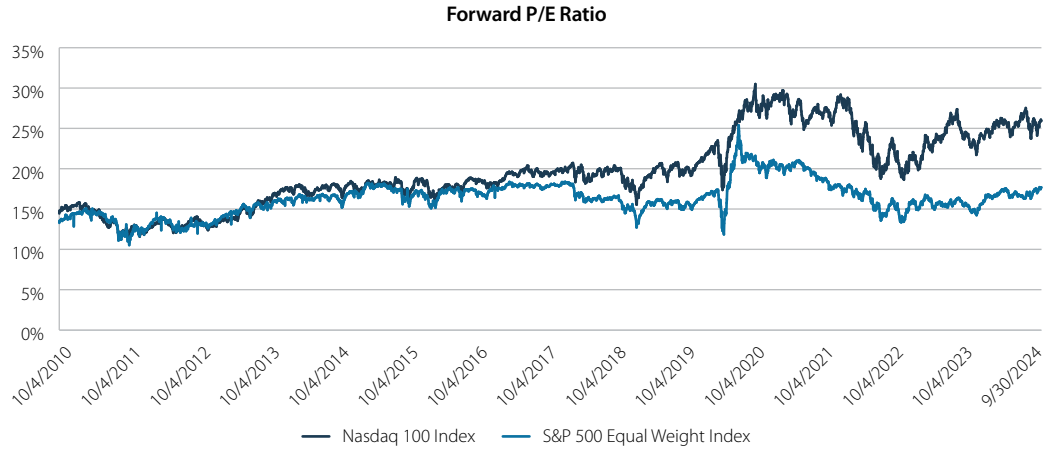


Source: Bloomberg, 7/1/2024 – 9/30/2024

Past performance is no guarantee of future results.

Fourth Quarter Outlook

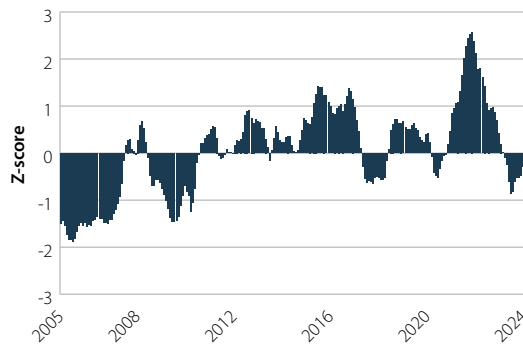
With the Fed shifting toward interest rate cuts and prioritizing the labor market over inflation, we view these positive developments as genuinely encouraging. If the labor market remains strong, we expect the rate-cutting cycle to lead to greater dispersion in returns, reducing the current concentration in a few large stocks. All else being equal, lower interest rates should strengthen bank balance sheets and promote increased lending. And while valuations are relatively elevated for the largest growth companies, they remain favorable for most stocks as highlighted by the valuation gap between the Nasdaq 100 Index and the S&P 500 Equal Weight Index.



Source: Bloomberg, 10/4/2010 – 9/30/2024

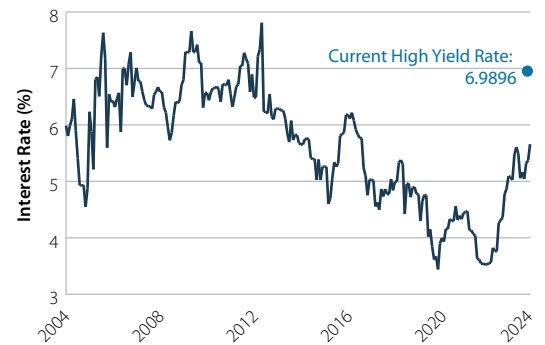
Despite the expectation of lower future interest rates, we remain cautious about highly leveraged companies, as we believe they still do not offer significant value, even in an improving environment. Additionally, we anticipate that future debt refinancings will result in higher overall interest payments, as illustrated in the accompanying chart. While we maintain a positive outlook for the broader equity market, we currently see limited specific opportunities and therefore recommend maintaining a diversified approach.

Valuation Spread Between Top and Bottom Quintiles Based on Leverage



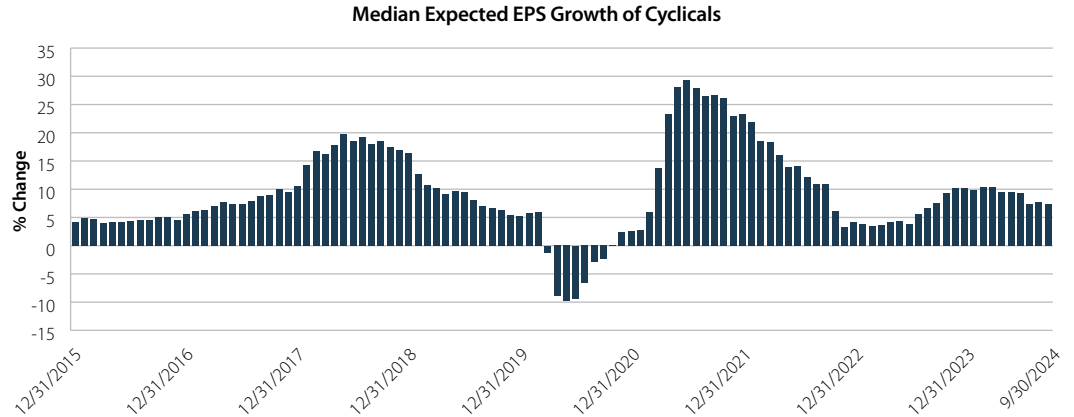
Source: Bloomberg, Bloomberg US 1000 Index, 9/30/2005 – 9/30/2024

Median Interest Rate for Companies with Interest Coverage < 2



Source: Bloomberg, Bloomberg US Corporate High Yield Bond Index, 12/31/2004 – 9/30/2024, yield-to-worst

As noted earlier, our base case remains one of relatively accommodative conditions for equities. Monetary policy is now aligned with fiscal policy, creating a supportive environment for growth. Historically, this has led to reflationary conditions, and forecasts for cyclical companies remain promising. However, if a downturn occurs, we expect cyclical stocks to signal early warning signs and we will continue monitoring this situation.



Source: Bloomberg, Bloomberg US 1000 Index, 12/31/2015 – 9/30/2024

Cyclicals are defined as the bottom quintile of companies based on Free Cash Flow Volatility.

With lower interest rates, we continue to promote international and emerging markets. Historically, United States rate-cutting cycles have allowed emerging markets to reduce their own rates and stimulate growth. Additionally, we expect the dollar to weaken in this environment. Combined with recently announced stimulus policies from China, we believe this will create fertile ground for returns outside the US.

We also believe that the current economic environment differs significantly from the decade leading up to the COVID-19 Pandemic, primarily due to the increased influence of fiscal policy, in contrast to the previous reliance on the Fed's monetary tools. This shift is likely to result in new market leaders emerging. Although the ongoing rise in technology stocks may seem like business as usual, it is important to remain aware of the evolving landscape, potential risks and future developments.

Amid these conflicting signals and growth drivers, our focus remains on maintaining a foundation in high-quality and dividend-paying stocks across all sectors. If the economy achieves a soft landing alongside rate cuts, these stocks are well-positioned to benefit from a broader market recovery. On the other hand, if downside risks materialize, these stocks can act as a defensive shield.

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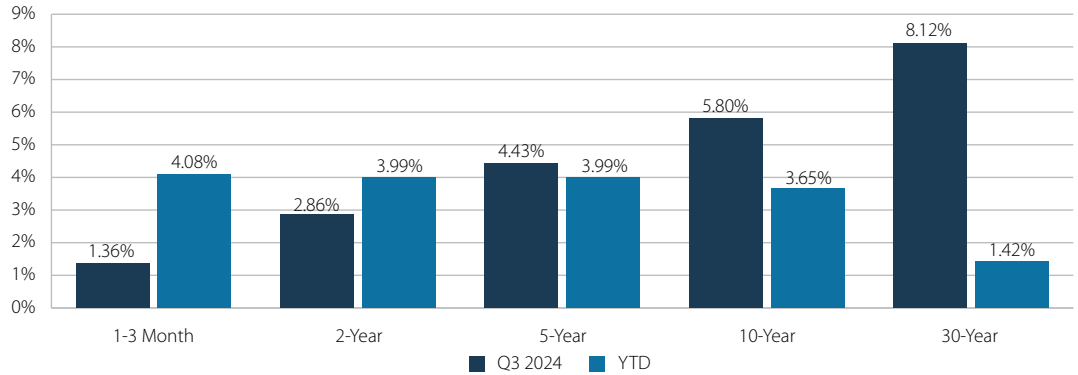
Fixed Income Summary

Third Quarter Review

The US bond market delivered robust performance in Q3 2024, with nearly every sector posting strong returns. The core bond market, represented by the Bloomberg US Aggregate Bond Index, gained 5.20% during the quarter—its second-best quarterly return in the last decade.

The Fed’s first rate cut in over four and a half years was a key driver of this performance, marking the end of a prolonged period of rising short term rates driven by inflationary pressures. Additional tailwinds, including a softening labor market and a flattening yield curve, contributed to renewed interest from investors seeking diversification and higher income. Longer duration Treasuries and securities with yields exceeding cash and short-duration options, such as corporate bonds outperformed, as shown in the nearby charts:

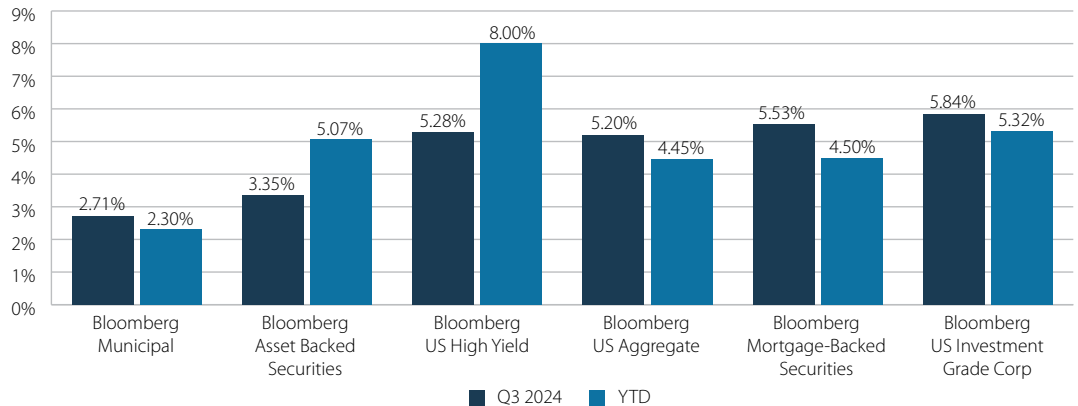
US Treasury Performance



Source: Bloomberg, total returns as of 9/30/2024

Past performance is no guarantee of future results.

US Sector Performance



Source: Bloomberg, total returns as of 9/30/2024

Past performance is no guarantee of future results.

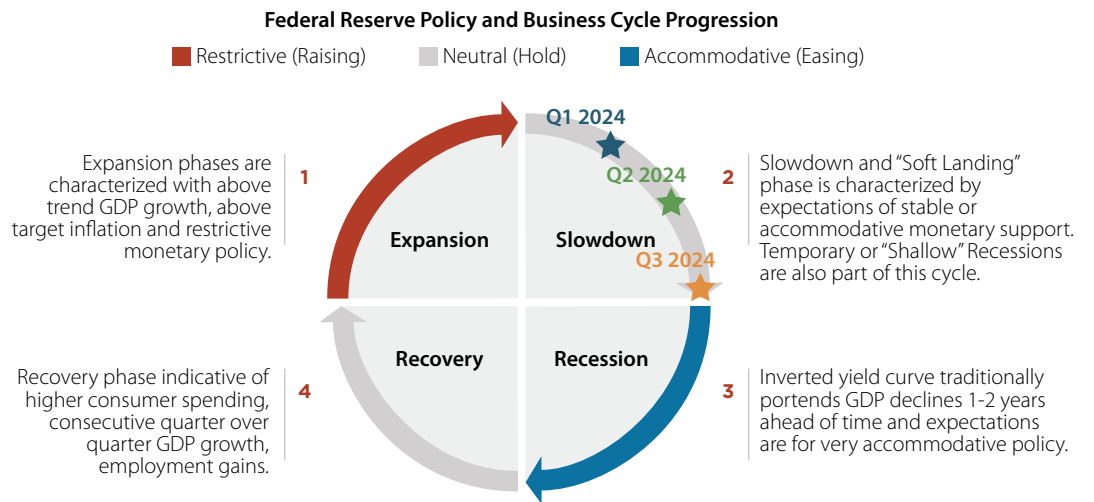
Policy Analysis and Fourth Quarter Outlook

The Fed has shifted from merely delaying rate cuts to actively implementing them, aiming for a “soft landing” for the economy. The decision to lower rates in Q3 aligns with data showing a slowing economy, with unemployment having bottomed a year earlier. The Fed acknowledged that “stickier” inflation persists, especially in services sectors such as housing and rental markets. However, core inflation has steadily trended lower. Thus, the Fed’s shift from inflation to growth concerns is warranted.

Despite this data, market participants have consistently underestimated the resilience of the US economy, which continues to add jobs—albeit at a slower pace—while GDP growth remains above trend. As a result, many of the macroeconomic and policy risks that defined 2023 remain relevant in 2024. Chief among these is the potential for wage growth and consumer spending to remain more elevated than anticipated, which could prompt the Fed to reconsider its rate cut trajectory.

In addition to lingering risks, there are new challenges for Q4 and 2025, including geopolitical tensions, the upcoming national elections and, finally, concerns over the level of fiscal spending and national debt. While these factors may elevate economic risks and increase volatility in fixed income markets, they could also create opportunities for bond investors.

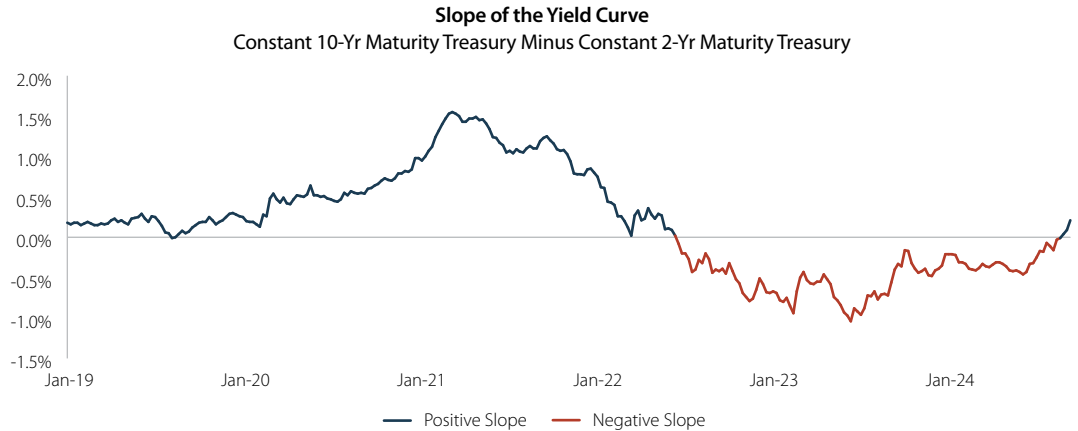
With a balanced view of these risks, we maintain a constructive outlook for Fixed Income. The transition of the business cycle, paired with a clearer shift in monetary policy, forms the foundation for our outlook, as depicted in the nearby chart.



Source: SS&C ALPS Advisors Proprietary Research
For Illustrative Purposes Only

Yield Curve

A notable signal of regime change is the recent shift in the yield curve, which has un-inverted, meaning it is now positively sloped (as measured by the spread between the 10-year and 2-year Treasury yields).

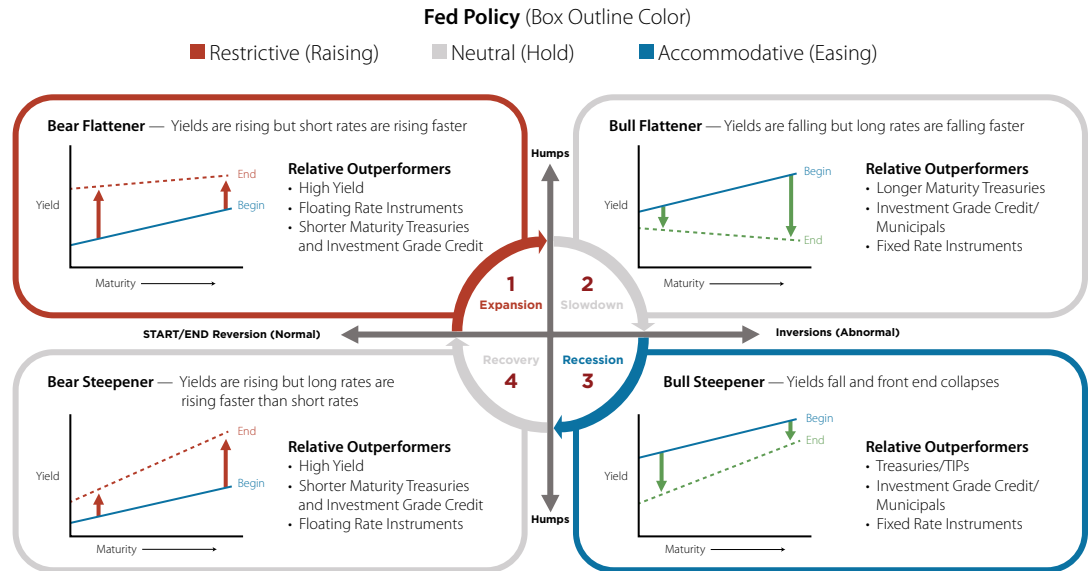


Source: Federal Reserve Economic Data-FRED, 10-Year Treasury constant maturity minus the 2-Year Treasury constant maturity yield, 1/23/2019 – 9/26/2024

This yield curve shift has impacted investor preferences, with many seeking higher yields further along the curve. Historically, core intermediate bonds have performed best when the yield curve is positively sloped and when monetary policy is deemed supportive. The Fed’s anticipated rate cuts later this year and next reinforce this trend. Moreover, the long-term flows into fixed income continue to serve as a potential hedge against equities.

Positioning

Historically, fixed income has generated positive returns in late business cycle phases, as seen in the third quadrant of the chart below. Fixed-rate, high-quality investments tend to perform well in a slowing economy, while floating-rate, short-term and high-yield assets often struggle until a sustainable recovery takes hold.



Source: SS&C ALPS Advisors Proprietary Research For Illustrative Purposes Only

Recommendation – Strengthen Your Core: A Soft Landing is Still Soft

It is important for bond investors to recognize shifts in policy and market sentiment and adjust within a risk-conscious framework. Even if a recession is avoided, slower-trend growth supports a favorable environment for fixed income.

However, in the current environment—marked by rising debt loads across most sectors—we believe that the market-weighted Bloomberg US Aggregate Bond Index does not adequately reflect the bond market's risks and opportunities. The Index is heavily skewed towards US government related debt, representing two-thirds of its composition, and certainly does not capture the benefits of sector diversification.

We feel it is a prudent time to **Strengthen Your Core with Active Management**. We recommend the following actions as market conditions allow:

- **Selectively extend duration** into the Core (Intermediate sectors).
- **Upgrade in Credit Quality**, even within High Yield allocations.
- **Shift into sectors with better valuations**. Our favorites would be high quality (AAA/AA) Asset-Backed Securities (ABS) and **Investment Grade Municipal Bonds**.
- **Maintain diversification** and avoid getting over-weighted in US Treasuries as volatility is likely to continue, especially during the election season and heading into the Debt Ceiling events early next year. We do favor a slight overweight in **Agency Mortgage-Backed Securities (MBS)** in the intermediate part of the yield curve.

Though risks remain for fixed-income investors in the coming year, higher short-term rates are unlikely to be among them. In this transitional environment, active management is increasingly likely to add value to your overall asset allocation strategy.

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Real Estate Summary

Third Quarter Review

REIT returns rebounded sharply in Q3 2024, with the FTSE NAREIT All Equity REITs Index returning 16.79% for the quarter and 34.77% for the prior twelve months. Every major REIT sector was positive for the quarter, with Office (29.53%), Specialty (26.66%) and Self Storage (22.72%) as the top performers, while Lodging (1.46%), Residential (9.09%) and Warehouses (13.26%) were relative laggards.

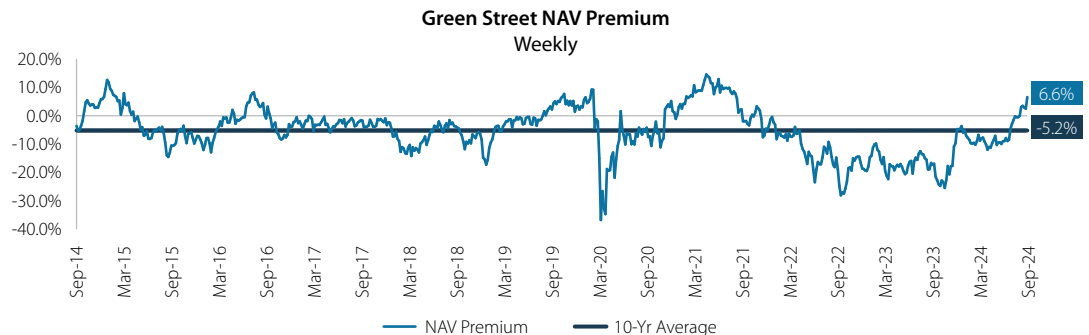
REIT performance was driven by low vacancies, improving cost structures and NOI growth, attractive valuations and Fed rate cut guidance—generally favorable catalysts which renewed investor interest in real estate.

Overall, REITs appear to be emerging from the negative sentiment of work-from-home and its impact on record levels of commercial office space vacancies.

REIT Indices	QTD	YTD	1 Year
	7/1/2024 - 9/30/2024	1/1/2024 - 9/30/2024	10/1/2023 - 9/30/2024
FTSE NAREIT All Equity REITs	16.79	14.23	34.77
REIT Sector Indices:			
Residential FTSE NAREIT Equity Residential	9.09	17.74	28.88
Retail FTSE NAREIT Equity Retail	17.76	18.02	43.28
Lodging FTSE NAREIT Equity Lodging/Resorts	1.46	-4.93	16.86
Office FTSE NAREIT Equity Office	29.53	22.32	51.11
Industrial Warehouses FTSE NAREIT Equity Industrial	13.26	-1.27	15.64
Technology - Cell Towers and Data Centers FTSE NAREIT Infrastructure REITs	21.37	6.93	39.69
FTSE NAREIT Equity Data Centers	13.59	15.85	29.48
Health Care FTSE NAREIT Equity Health Care	20.23	32.58	46.47
Self Storage FTSE NAREIT Equity Self Storage	22.72	19.92	48.11
Diversified FTSE NAREIT Equity Diversified	15.24	1.50	22.20
Specialty FTSE NAREIT Equity Specialty	26.66	50.60	84.44

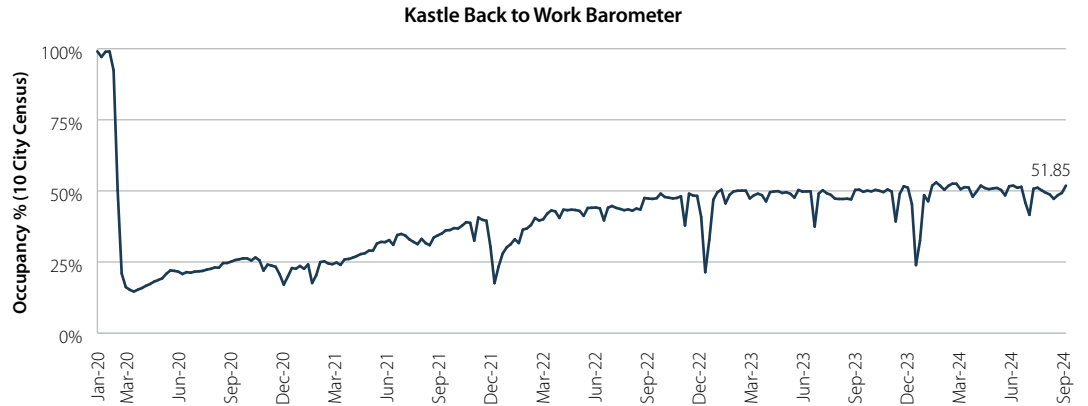
Source: Morningstar, as of 9/30/2024, returns presented are total return
Past performance is no guarantee of future results.

REIT net asset value (NAV) premiums ended the quarter at +6.6%, a significant shift from persistent 10%+ discounts over the past six quarters.



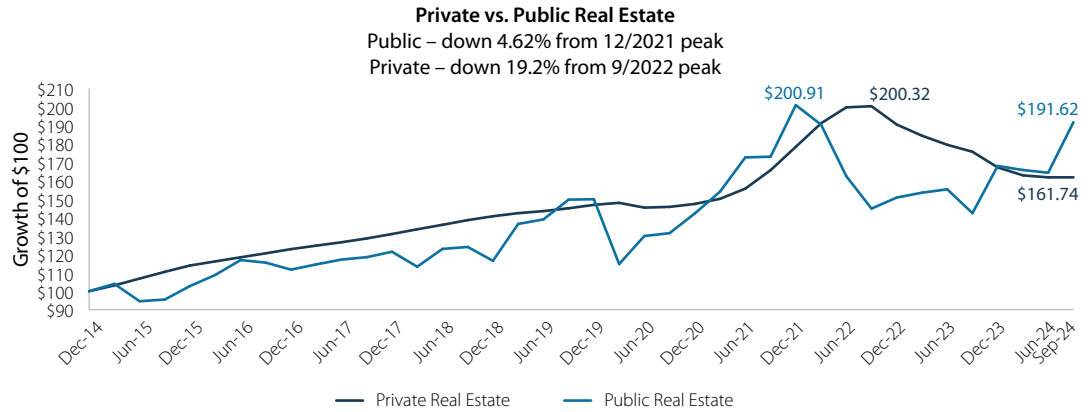
Source: Green Street, as of 9/13/2024

Office vacancies continue to hover around 50% as companies update remote work policies with increases in mandatory office days. Publicly listed office REIT valuations appear to be stabilizing, as listed REITs generally manage higher quality properties in more desirable locations. Although occupancy levels are expected to improve, we don't anticipate pre-COVID-19 Pandemic levels in the near term.



Source: Bloomberg, as of 9/11/2024

The valuation disparity between public and private real estate continued in the third quarter. Privately held real estate, where individual properties are valued roughly once per year and returns are reported quarterly, appears to be nearing a bottom, with returns down 19.2% from the September 2022 peak. Public REITs, which are bought and sold daily on exchanges, rebounded sharply, and ended the quarter down only 4.62% from December 2021 peak levels.



Sources: Morningstar, NCREIF, quarterly returns as of 9/18/2024

Private Real Estate represented by the NCREIF NFI-ODCE Index (net return); Public Real Estate represented by the FTSE NAREIT All Equity REITs Index (total return).

Past performance is no guarantee of future results. One may not invest directly in an index.

Fourth Quarter Outlook

REITs continue to generate strong NOI growth with strong balance sheets, relatively low leverage, attractive debt terms and maturities and access to additional capital for potential mergers & acquisitions (M&A). Several attractive themes persist, including Data Centers, Self Storage, and Cell Towers with supportive economics. Although unlikely to repeat the performance of Q3, REITs appear to be recovering from strong negative sentiment with a continuation of favorable returns and income for investors.

Residential

Valuations have improved but are still down 20% from the 2021 peak. Tenant retention remains strong; however, softening job/wage growth coupled with significant supply is likely to mute NOI growth and outlook.

Retail

With properties generally in premium locations with strong retail brand customers, retailer earnings have been relatively solid over the last several quarters. However, consumer sentiment appears to be softening, with value brands and affiliated locations positioned to outperform.

Lodging/Resorts

Strong recent earnings have been overshadowed by relatively pessimistic forecasts through fiscal year-end. Heightened macro concerns, with a slowdown/recession are likely to weigh on NOI growth.

Office

Return to office appears to be stabilizing. Valuations appear to have bottomed with NOI growth expected in higher quality properties in more desirable locations.

Industrial Warehouses

Slowing demand and NOI growth, in concert with general economic conditions. Of note, Prologis is diversifying with an \$8 billion data centers investment with plans to sell once stabilized.

Cell Towers

Slowing NOI growth but healthy fundamentals. Nearing full market penetration with 5G-related growth expected to trail prior generations.

Data Centers

Favorable valuations, margins and growth prospects with potential initial public offerings (IPOs) by privately held providers.

Health Care

Although NOI growth has been consistent, valuations appear to be stretched.

Self Storage

Highly influenced by the buying/selling of houses and sold off sharply earlier this year. Although rent growth has softened, demand is expected to improve as housing activity increases.

Specialty

Iron Mountain (IRM) is the strong performer in this sector, with growing high-margin recurring revenue. Rapid expansion into data centers has been positive, however valuations are stretched.

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Commodities Summary

Third Quarter Review

The commodity complex managed to finish the third quarter of 2024 with a slight gain of 0.68%, thanks in large part to an impressive 13% return from gold over the quarter.^{1,2} Energy commodities were the main detractor in Q3, with -11% return for the sector and -16% return for crude oil as demand continued to fall short of expectations.^{3,4} All other sectors were slightly positive, buoyed by dollar weakness and a rate cut by the Fed in September. Industrial Metals returned 3%, Agriculture returned 4% and Livestock returned 5%.

Fourth Quarter Outlook

We are leaving our broad commodities outlook at neutral. While US dollar weakness and lower real rates are generally positive for commodity prices, we remain concerned with weak energy demand, a stagnant Chinese economy and a softening US labor market. Energy markets continue to face concerns on a bleak demand outlook and persistently strong supply, though geopolitical tensions have brought short-term supply disruptions (actual in Libya and potential in Iran) back to the front of everyone's minds. Industrial Metals have regained some balance after some short-term market dislocations, and China's recent stimulus package has brought enthusiasm back to the volatile sector. This exuberance may be somewhat premature, as the impact of the stimulus on the real economy will not be apparent for some time. We remain concerned about Gold's disconnect from real interest rates, but the current environment of falling US rates, a weaker dollar and geopolitical risk are all highly supportive of precious metals prices.

Energy

Global energy markets are under competing pressures, but appear to be primarily concerned with a bleak outlook for demand growth from the US and China, the two biggest consumers of oil.^{4,5} In response to these concerns, OPEC pushed out its plan to increase production from October to December, and the Wall Street Journal reported on October 2nd that Saudi Arabia is frustrated with cartel members producing over the agreed-upon production limits, rendering them ineffective.⁶ The decision to push out the production increases did nothing to support prices, with Brent crude actually dropping 8% on the week of the announcement.^{7,8}

The strongest price support in Q3, decreased exports out of Libya, looks likely to fall away as a deal was struck at the end of September that included lifting an oil blockade imposed in September during a political standoff over Central Bank Control.⁹

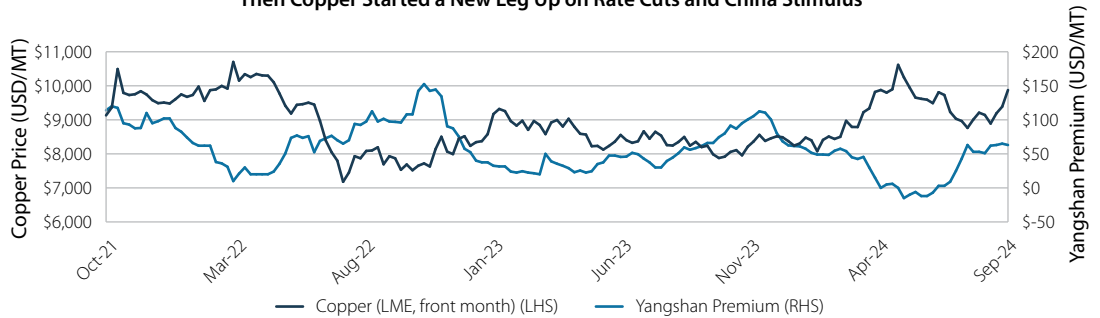
While oil markets seem to have generally grown accustomed to the ongoing conflict in the Middle East, Israel's shift of focus from Hamas to Hezbollah, Iran's most powerful proxy force and Iran's second direct attack on Israel this year, highlights the potential for a significant supply disruption if Iran's energy operations become a military target.¹⁰ As of the time of this writing, there appears to be a premium to the price of oil based on the heightened risk, but we have seen similar premiums deteriorate rapidly after risk events over the last few years as market participants grow comfortable with successively higher levels of risk.¹¹

One of the biggest downward pressures on energy markets has been poor growth in China.⁴ In mid-September, China announced a stimulus package intended to drive up the stock market and breathe life back into the economy.¹² While the impact on the stock market was obvious and immediate, it is unclear if the new measures will be enough to turn around a crashing housing market.

Industrial Metals

Industrial metals face similar competing concerns, with weak growth in China being perhaps the biggest problem. After a supply glut in Q2, evident in the Yangshan Premium dropping below zero, copper prices dropped and the Yangshan Premium normalized in Q3.¹³ The Fed’s rate cut announcement and China’s stimulus package kicked off a new rally, as copper markets appear more optimistic than oil markets about the impact of these policies.¹⁴

Copper Premiums in China Normalized as Prices Fell, Then Copper Started a New Leg Up on Rate Cuts and China Stimulus



Source: Bloomberg, 10/3/2021 – 9/29/2024

Yangshan Premium: the premium over London Metal Exchange (LME) copper prices that traders pay to import copper to the Shanghai Metals Market. A negative value indicates an oversupply.

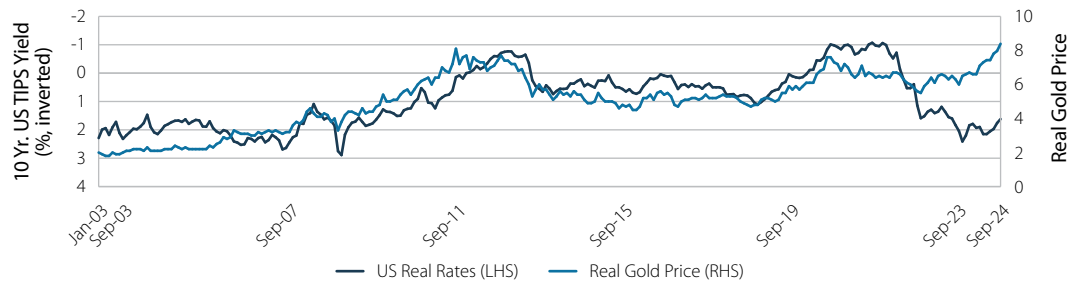
One potential rationale for a comparatively outsized reaction from metals markets is the relatively constrained new production, a problem not currently faced by oil markets, which have plenty and growing spare capacity.¹⁵ However, the move seems premature to us, as it will likely take months to determine the degree to which the new policies will impact the real economies of both the US and China.¹⁶

Precious Metals

Precious metals continue to climb, with Gold returning 43% over the last year and Silver returning 40%.¹⁷ The US dollar weakened significantly over the last quarter, and a drop in real rates contributed to the upside pressure.¹⁸ Retail investor interest also finally materialized, with \$3.6 billion of net inflows to Gold ETFs in July alone, the highest one-month total since March of 2022, right after Russia’s Ukraine invasion.¹⁹ Geopolitical concerns are no doubt adding to the upward pressure in gold, and we believe that central bank buying and growing middle class in India will be supportive of gold prices for years to come.

We remain concerned about the disconnect between the real price of gold and real interest rates, as what has been a historically strong relationship has broken down in recent years. When real rates climbed in 2022, one might have expected real gold prices to fall based on the long-term relationship, but real gold prices actually climbed steadily throughout the second half of the hiking cycle.²⁰

Breakdown of Empirical Correlation Between the Real Price of Gold and Real Interest Rates Started in 2022

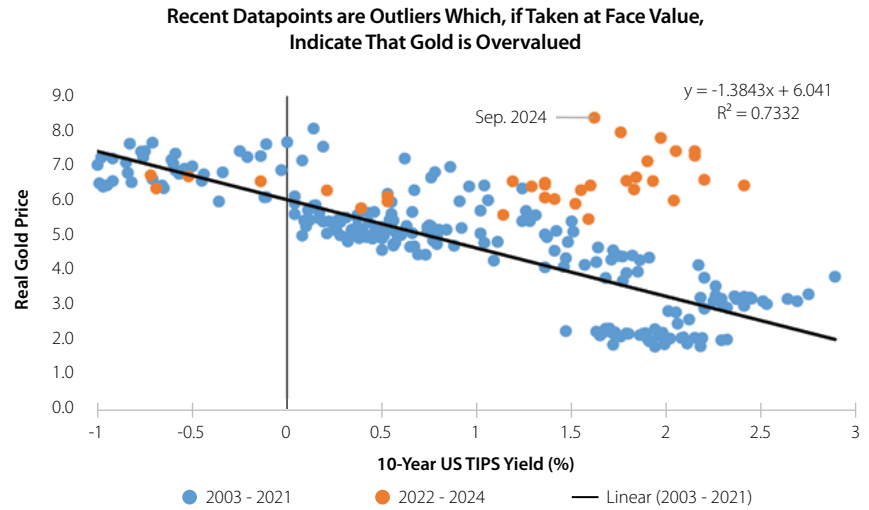


Source: Bloomberg, 1/31/2003 – 9/30/2024

Real gold price is calculated as the price of gold in USD divided by the same date’s Consumer Price Index (CPI) value.

Referenced instrument for real rates is the Federal Reserve US Treasury H15 Constant Maturity 10 Yr Real Yield Curve Rates series.

Plotting the two time series against each other (instead of against time, as in the chart above), we are able to visualize the strength of the relationship and easily identify the outliers. The very strong relationship between the two variables from 2003 through 2021 is visible in the R^2 statistic of 0.73, which drops to 0.47 if the time period is expanded through 2024.



Sources: Bloomberg, SS&C ALPS Advisors Proprietary Research, 1/31/2003 – 9/30/2024
 Real gold price is calculated as the spot price of gold in USD divided by the same date's CPI value.
 The trend line and the regression formula displayed on the chart cover only the time period of 1/31/2003 - 12/31/2021.

We are now at an inflection point, where real rates are dropping and adding to the myriad other factors putting upward pressure on precious metals. However, gold has yet to experience a correction after its trend-bucking increase. This begs the question of whether falling real rates will actually provide the same price support they historically have, pushing gold up from its already elevated position and re-establishing the relationship at a higher base. Alternatively, gold may simply have reached its equilibrium price ahead of interest rates, implying poor gold returns in the future and near-zero or even negative real rates.

Risks to Outlook

The conflict in the Middle East remains the most salient risk to commodity markets, as a large-scale state-on-state conflict looms large. Although Iran's April attack on Israel did not provoke a large-scale response, Israel's military position seems much-improved given its highly successful campaign against Hezbollah, and President Biden recently stated an Israeli strike against oil infrastructure is being considered.^{21,22} Removal of Iran's oil production from energy markets and the potential spillover effects would have a material impact on price, presenting an upside risk to our outlook.

Another high-impact risk is the potential for high interest rates to spark a crisis within the financial system. Although interest rates have begun to decline, average interest expenses will likely still continue rising, as rolling over debt from vintages older than a couple years will still be at relatively higher rates. Crises in the financial economy tend to spill over into the real economy, presenting a downside risk to our outlook.

Returns for indices are total returns, while returns for individual commodities are price returns only.

All performance data sourced from Bloomberg.

The energy sector proxy used for this analysis is the Bloomberg Energy Subindex Total Return (BCOMENTR Index). The precious metals proxy is the Bloomberg Precious Metals Subindex Total Return (BCOMPRTR Index). The industrial metals sector proxy is the Bloomberg Industrial Metals Subindex Total Return (BCOMINTR Index). The agriculture sector proxy is the Bloomberg Agriculture Subindex Total Return (BCOMAGTR Index).

¹ Q3 time period is 6/30/2024 – 9/30/2024.

² Gold return is calculated using the generic front-month gold contract listed on the COMEX exchange (GC1 Comdty).

³ Crude oil return is calculated using the generic front-month WTI crude oil contract listed on the NYMEX exchange (CL1 Comdty).

⁴ IEA. (September 2024). Oil Market Report (OMR). IEA.

⁵ United States Energy Information Administration (EIA). (April 11, 2024). Frequently Asked Questions (FAQs). EIA.

⁶ Faucon, B., Said, S. and Hirtenstein, A. (October 2, 2024). Saudi Minister Warns of \$50 Oil as OPEC+ Members Flout Production Curbs. The Wall Street Journal.

- ⁷ The announcement was made on Thursday, September 5, 2024 (see endnote 8), and the return for the front-month ICE Brent crude contract for the time period 8/30/2024 - 9/6/2024 was -7.63%.
- ⁸ Organization of the Petroleum Exporting Countries (OPEC). (September 5, 2024). Saudi Arabia, Russia, Iraq, the United Arab Emirates, Kuwait, Kazakhstan, Algeria, and Oman extend voluntary cuts [Press release].
- ⁹ Yee, V. and Al-atrash, I. (September 27, 2024). Deal to Reopen Libya's Central Bank Eases Fears of Renewed Conflict. *The New York Times*.
- ¹⁰ Reed, S. (October 2, 2024). Why the Conflict Between Iran and Israel has Raised Oil Prices Only Modestly. *The New York Times*.
- ¹¹ After ending the day on September 30, 2024, at \$71.77, the front-month ICE Brent crude contract sits at \$74.55 as of the time of this writing (mid-day October 2nd), an increase of 3.9% that is widely attributed to heightened geopolitical risk after Iran launched a ballistic missile attack on Israel on October 1st. This is still significantly down from 2024's year-to-date high of \$91.17 hit on April 5th. Prices sourced from Bloomberg.
- ¹² Stevenson, A. (September 30, 2024). China Removes Curbs on Home Buyers, Sparking Stock Market Surge. *The New York Times*.
- ¹³ Source: Bloomberg. Time period (Q2): 3/31/2024 – 6/30/2024. Price normalization refers to the Yangshan Premium reaching \$43 on 8/4/2024, near its 3-year average (based on 10/3/2021 – 9/29/2024) of \$58.
- ¹⁴ Spence, E., & Pashankar, S. (October 3, 2024). Copper Pares Gains Driven by Enthusiasm Over China Stimulus. *Bloomberg News*.
- ¹⁵ McGlone, M. (September 25, 2024). Increasing Dependencies and Falling Commodities. *Bloomberg Intelligence*.
- ¹⁶ *Bloomberg News*. (October 3, 2024). Sudden Shift in China Metals Sentiment Drives LME Week Optimism.
- ¹⁷ Source: Bloomberg. Time period: 9/30/2023 – 9/30/2024. Referenced instrument for gold returns is the front-month COMEX gold contract (GC1 Comdty). Referenced instrument for silver returns is the front-month COMEX silver contract (SI1 Comdty).
- ¹⁸ Source: Bloomberg. Time period: 6/30/2024 – 9/30/2024. Referenced instrument for the US dollar is the Dollar Spot Index (DXY Currency). Referenced instrument for real rates is the Federal Reserve US Treasury H15 Constant Maturity 10 Year Real Yield Curve Rates series (H15X10YR Index).
- ¹⁹ World Gold Council. (September 23, 2024). Gold ETFs, holdings and flows.
- ²⁰ Source: Bloomberg and SS&C ALPS Advisors Multi-Asset Research Team. Time period: 10/31/2022 – 5/31/2024.
- ²¹ Palmer, A., Byman, D., Jones, S. G. and Bermudez Jr., J. S. (May 3, 2024). Assessing Israel's Strike on Iran. CSIS.
- ²² Mufarech, A. and Kumar, D. K. (October 3, 2024). Oil Soars on Biden Remarks About Possible Israeli Retaliation. *Bloomberg News*.

Definitions

Basis Point (bps): a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument.

Bear Market: a condition where a market experiences prolonged price declines, usually when securities prices fall 20% or more from recent highs amid widespread pessimism and negative investor sentiment.

Bloomberg Agriculture Subindex (BCOMAGTR Index): formerly known as the Dow Jones-UBS Agriculture Subindex (DJUBAGTR), the index is a commodity group subindex of the Bloomberg CTR. The index is composed of futures contracts on coffee, corn, cotton, soybeans, soybean oil, soybean meal, sugar and wheat. It reflects the return on fully collateralized futures positions and is quoted in USD.

Bloomberg Energy Subindex (BCOMENTR Index): a commodity index composed of futures contracts on crude oil, heating oil, unleaded gasoline and natural gas. It reflects the return of underlying commodity futures price movements only and is quoted in USD.

Bloomberg Industrial Metals Subindex (BCOMINTR Index): reflects the returns that are potentially available through an unleveraged investment in the futures contracts on industrial metal commodities.

Bloomberg Intermediate US High Yield Index: measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. The intermediate duration segment of the index includes bonds with maturities of 1 to 10 years.

Bloomberg Municipal Index: serves as a benchmark for the US municipal bond market.

Bloomberg Precious Metals Subindex (BCOMPTR Index): reflects the returns that are potentially available through an unleveraged investment in the futures contracts on precious metals commodities. The Index currently consists of two precious metals commodities futures contracts (gold and silver).

Bloomberg US 1000 Index: a float market-cap-weighted benchmark of the 1000 most highly capitalized US companies.

Bloomberg US Aggregate Bond Index: a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, fixed-rate agency MBS, ABS and CMBS (agency and non-agency).

Bloomberg US Asset-Backed Securities Index: a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index only includes ABS securities.

Bloomberg US Corporate Bond Index: measures the investment grade, fixed-rate, taxable corporate bond market.

Bloomberg US Corporate High Yield Bond Index: measures the USD-denominated, high yield, fixed-rate corporate bond market.

Bull Market: a financial market in which prices are trending upward or are expected to trend upward.

Consumer Price Index (CPI): a measure of the average change over time in the prices paid by urban consumers for a representative basket of consumer goods and services.

Dow Jones Industrial Average: a stock market index of 30 prominent companies listed on stock exchanges in the United States. The DJIA is one of the oldest and most commonly followed equity indexes.

Federal Reserve US Treasury H15 Constant Maturity 10-Year Real Yield Index: the interest rates for US Treasury securities that have a constant maturity of 10 years, adjusted for inflation. These rates are derived from the yields on Treasury Inflation-Protected Securities (TIPS). The "real yield" indicates the return on investment after accounting for inflation, providing a more accurate reflection of the purchasing power of the returns.

FTSE NAREIT All Equity REITs Index: a free-float adjusted, market capitalization-weighted index of US equity REITs. Constituents of the index include all tax-qualified REITs with more than 50 percent of total assets in qualifying real estate assets other than mortgages secured by real property.

FTSE NAREIT Equity Data Centers Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Data Center REITs in the parent index.

FTSE NAREIT Equity Diversified Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Diversified REITs in the parent index.

FTSE NAREIT Equity Health Care Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Health Care REITs in the parent index.

FTSE NAREIT Equity Industrial Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Industrial REITs in the parent index.

FTSE NAREIT Equity Lodging/Resorts Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Lodging/Resorts REITs in the parent index.

FTSE NAREIT Equity Office Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Office REITs in the parent index.

FTSE NAREIT Equity Residential REIT Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Equity Residential REITs in the parent index.

FTSE NAREIT Equity Retail Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Retail REITs in the parent index.

FTSE NAREIT Equity Self Storage Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Self Storage REITs in the parent index.

FTSE NAREIT Equity Specialty Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Specialty REITs in the parent index.

FTSE NAREIT Infrastructure REITs Index: a subsector index of the FTSE NAREIT US Real Estate Index containing all Infrastructure REITs in the parent index.

Investment Grade (IG): a rating that signifies that a municipal or corporate bond presents a relatively low risk of default. To be considered an investment grade issue, the company must be rated at 'BBB' or higher by Standard and Poor's or Moody's. Anything below this 'BBB' rating is considered non-investment grade.

ISM Manufacturing PMI: measures the change in production levels across the US Economy from month to month.

Kastle Back to Work Barometer: a measure of current average weekly (first time a day) swipe activity across a 10-city sample of commercial office buildings which utilize Kastle building security, compared to a weekly average from before office use dropped due to COVID-19. The 10-city sample includes: Houston, Chicago, Austin, New York, Dallas, Los Angeles, San Francisco, Washington D.C., San Jose and Philadelphia.

NASDAQ 100 Index: one of the world's preeminent large-cap growth indexes. It includes 100 of the largest domestic and international non-financial companies listed on the Nasdaq Stock Market based on market capitalization.

NCREIF Fund Index - Open End Diversified Core Equity (NFI-ODCE Index): an index of investment returns reporting on both a historical and current basis the results of 38 open-end commingled funds pursuing a core investment strategy. The NFI-ODCE Index is capitalization-weighted and is reported gross of fees. Measurement is time-weighted. NCREIF (National Council of Real Estate Investment Fiduciaries) will calculate the overall aggregated Index return.

Nonfarm Payroll (NFP) Industry Diffusion Index: the percent of industries with employment increasing plus one-half of the industries with unchanged employment, where 50 percent indicates an equal balance between industries with increasing and decreasing employment.

Definitions (continued)

Personal Consumption Expenditures Price Index (PCE): a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The PCE is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

Price/Earnings (P/E) Ratio: a valuation ratio of a company's current share price compared to its per-share earnings.

Real Estate Investment Trust (REIT): companies that own or finance income-producing real estate across a range of property sectors. Listed REITs have characteristics of both the income potential of bonds and growth potential of stocks.

R-Squared (R²): in investing, R-squared is generally interpreted as the percentage of a fund or security's movements that can be explained by movements in a benchmark index. An R-squared of 100% means that all movements of a security are completely explained by movements in the index.

Russell 2000 Index: measures the performance of the small-cap segment of the US equity universe.

Russell Microcap Index: measures the performance of the microcap segment of the US equity market.

S&P 500 Equal Weight Index: the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the index is allocated a fixed weight.

S&P 500 Index: widely regarded as the best single gauge of large-cap US equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

Yield Curve: a graphical representation of the yields (y-axis) on debt instruments with different maturities (x-axis).

Z-Score: a numerical measurement that describes a value's relationship to the mean of a group of values, measured as standard deviations from the mean. If a Z-score is 0, it indicates that the data point's score is identical to the mean score. A Z-score of 1.0 would indicate a value that is one standard deviation from the mean.

One may not invest directly in an index.

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