Chilton Trust

Third Quarter 2024

Quarterly Commentary

Market Overview

Rate Relief, At Long Last.

The third quarter of 2024 was a strong one but relative to recent market performance, and the Magnificent Seven, it was a very different composition of stocks drove returns this quarter, a healthy shift from recent quarters. In the U.S., during the third quarter the S&P 500 advanced 5.9% the Nasdaq 2.8%, and the Russell 2000 9.3%. International markets also had a strong quarter, with the MSCI All Country World Index advancing 6.8% and Emerging Markets rose 8.9% driven by a strong bounce in Chinese equities and strength in Indian markets.

The Federal Reserve's announcement to cut interest rates by 50 basis points was the largest takeaway from the third quarter, spurring reactions within both the Fixed Income and Equity markets. While markets were highly conflicted on the degree of rate cuts at the September meeting, Chair Powell, and all but one voting member, felt that easing financial conditions by 50 basis points would serve as a recalibration on the pathway to neutrality and allow us to maintain the current strength of the economy.

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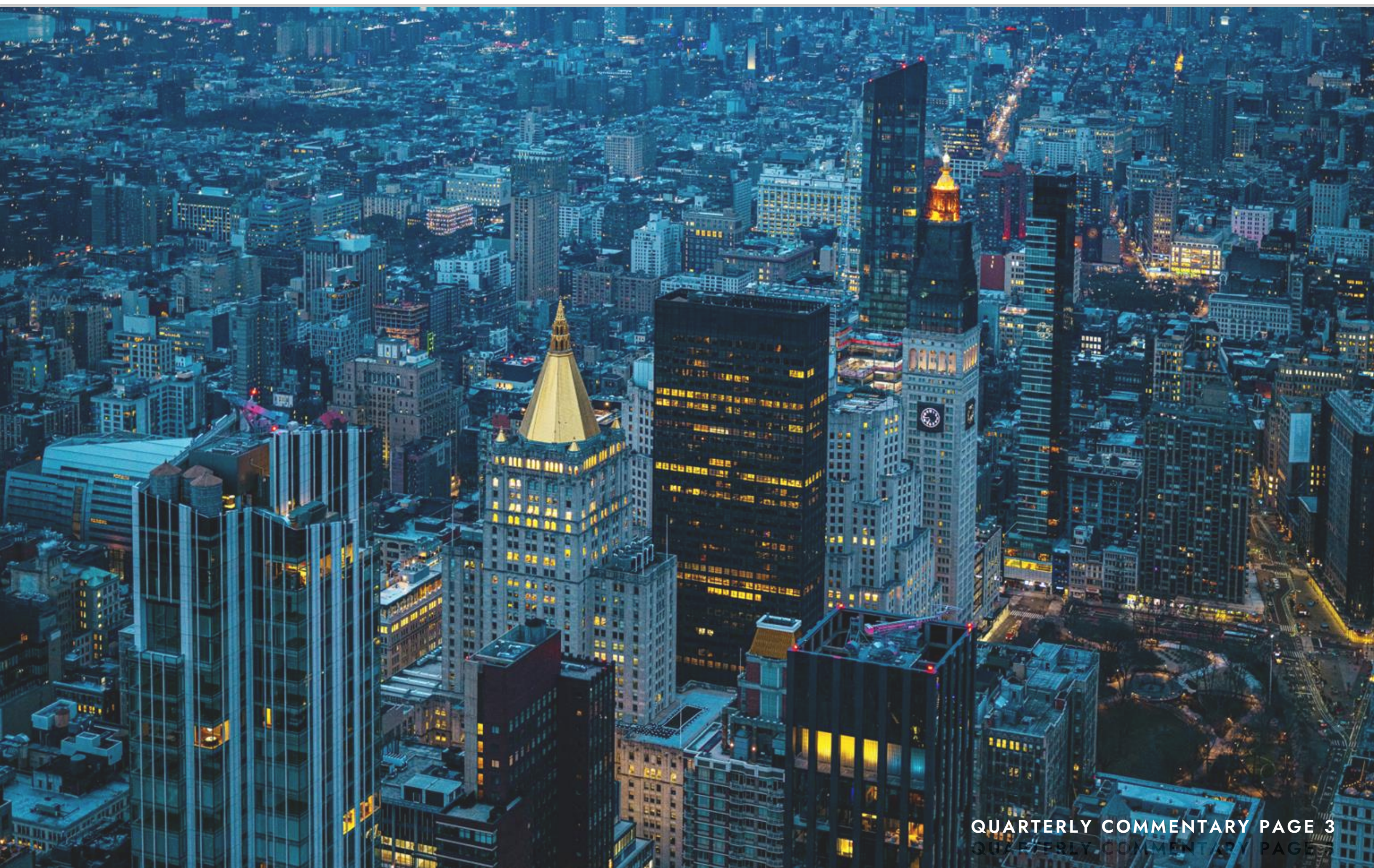
Equity Markets

The equity market had a strong performance during the third quarter, buoyed by investors' belief that as inflation continued to subside the Federal Reserve would pivot towards cutting interest rates and the economy remained strong enough to maintain a "goldilocks" environment for common stocks.

Throughout the third quarter, in addition to strong earnings growth, we saw a continued broadening out of equity markets away from the uber large-cap companies, affectionately known as the "Magnificent Seven". This favored well for the rest of the S&P 500, which is commonly referred to as the S&P 500 equal capitalization, or the "RSP". Notably, the RSP outperformed the SPY over the last three months by 5.9% vs. 3.3%. We view this outperformance as a very healthy market indicator, but whether this shift from high beta towards lower beta will continue is anyone's guess. However, the valuations for the Magnificent Seven are excessive and the broadening out in the market is a reflection of dramatically lower valuation coupled with the strong earnings growth of these companies.



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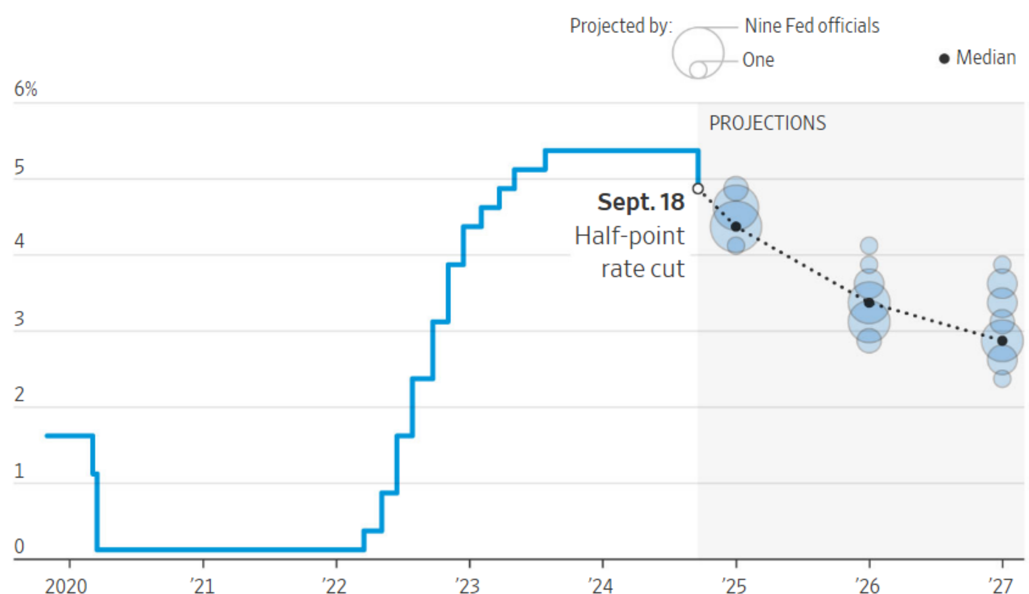
Fixed Income Markets

The third quarter began with the Federal Reserve opting not to cut rates at the July meeting. At the time, this decision drew criticism from market participants as it was on the heels of a rising unemployment rate – increasing to 4.3% in July 2024 from the lowest print of 3.4% in April 2023. Some even believed that the inaction could potentially trigger the "Sahm Rule", which historically has proven successful in predicting the start of a recession from a downturn in the business cycle. However, the Fed remained focused on its inflation mandate and did not believe they were falling behind the curve by not shifting its priorities to a weakening employment picture.

Powell began to pivot in his remarks about the economy and inflation at the Jackson Hole Annual Economic Symposium in August. The change in sentiment was heard loud and clear and demonstrated the Federal Reserve's shift in focus from the pathway to the 2% inflation target towards the present challenges with employment. By quarter-end the stage was set for a September rate cut. Powell, responding directly to the weakening labor market, put together a coalition of voting members and secured, an almost unanimous, outcome for a 50-basis point cut in the Federal Funds Rate to begin the "recalibration" back to a level of rate neutrality that would continue to support a healthy economy, full employment, as well as price stability.

The long-awaited move by 50- basis points demonstrated a pragmatic approach by the Federal Reserve. Powell has long said that the expectations for their 2% inflation target were into 2025/ 2026 and this proved his resolve in achieving that inflation target rather than to panic at fears of recession.

Federal-Funds Rate with Federal Reserve Projections



Note: Chart shows midpoint of the target range
Source: Federal Reserve / Peter Santilli/ WSJ

While one Fed member favored opening rate cuts with a 25-basis point move, the Fed felt it was necessary to remove the aggressive restrictive policy stance before higher monetary tightening could damage the trajectory for growth and prompt the need for an even bigger rate adjustment in the future.

We believe it was important for the Federal Reserve to start the easing process ahead of the U.S. Presidential and Congressional election as the Fed aims to project a non-partisan stance. Furthermore, the Federal Reserve wants the public to understand that their decisions are anchored in acting in the best interest for the economy, rather than politically grandstanding. The results of the election, whichever candidate that may be, will have a direct influence on fiscal policy. With the November FOMC meeting occurring on November 6th – 7th, the Federal Reserve will have to account for both scenarios and fully measure changes to fiscal policy into its calculus as it moves incrementally toward rate neutrality.

At Chilton Trust, our Fixed Income Investment team is maintaining a central case that the Federal Reserve will continue to cut rates by 25 basis points at each successive meeting to get Federal Funds back to 4%. It may even be possible that the Federal Reserve adjusts the target to 3.5% to ensure a healthy" soft landing" in the broader economy.

Price stability and full employment considerations will continue to guide the Federal Reserve's decisions and create opportunities for investors to harvest attractive yields while gaining safety and security of principal, even once neutrality is achieved.

Our Portfolios

Equities: Harnessing the Power of Fundamentals

When we reflect on the valuation levels of our portfolio companies, we are mindful of the strong year we have had within these investments. We are also mindful of the continued outperformance that can occur when companies demonstrate this fundamental earning power. The fact that these names keep beating earnings estimates is due, in large part, to the continued scale and dominance that their business models possess and their ability to increase market share vs. their competition. When we feel that this isn't the case, we actively trim or sell the investment.

Most recently we have dramatically reduced our position in Canadian Pacific Kansas City (CP). CP is a company that we have long admired and first became owners of through the purchase of Kansas City Southern, which we first engaged with deep in the depths of the COVID pandemic in March of 2020. Although they have a wonderful business model with very good earning power, we felt that the P/E multiple has discounted a lot of the future three-year earnings growth. We have dramatically reduced the position in order to build some cash for future deployment into better opportunities.

We remain highly selective in our pursuit of new investments; both in the quality of their business models and in the price at which we purchase them. Although we feel that corporate earnings growth is strong for the next few years and that a lower inflationary, lower interest rate environment is very favorable for continued outperformance in the equity markets it has been a while without a meaningful correction in the market. Market corrections are normal, even during a bull market, so it is always prudent during these periods to sharpen your valuation pencil and remain patient.

Our Portfolios

Fixed Income: The Rate Cut Heard 'Round the World.

In the anticipation of rate cuts, we have worked to minimize reinvestment risk across our portfolios and adding duration where appropriate. We are continuing to layer in new money at an intermediate duration for our taxable clients, to capture higher yield before the Federal Reserve's recalibration process fully sets in. We're also looking at corporate preferreds of systemically important banks to layer in good solid yield while yield is still available.

Short-Term Commentary

Within the third quarter we saw indications of a weakening labor market, consistent signs of stability in inflation, and some deflationary themes which made for a compelling argument for the Federal Reserve to ease financial conditions. The market responded to these themes with sizable price action and decline in yields, specifically seen in the front end of the US Treasury curve. The 2-year U.S. Treasury bonds had the largest decline in yield, dropping to ~3.64% on September 30th from ~4.75% at the start of the quarter. The U.S. Treasury Bills became the shock absorber of the rate cut, with the 3, 6, and 12-month bills declining quarter over quarter.

This was highly anticipated as the market repriced to align more closely with the Federal Funds rate and future expectations for further rate cuts. This decline in front end yields resulted in a positive reshaping of the curve. The shape of the curve has been a focal point for many investors and economist as it reached an inversion of -108 basis points while the tenors remained inverted for over 2 years. It is worth noting that we are still seeing an inversion between the 3-month and 10-year US Treasuries, another closely watched data point.

Within our short-term strategies we've prioritized the reduction of reinvestment risk as we have slightly extended duration in our portfolios within our short-term investment horizon. The focus remains on high quality corporate bond issuers and U.S. Government and Agency debt as credit spreads have remained tight. Additionally, we continue to anchor our short-term crossover portfolio with municipal bonds as they offer attractive tax-advantaged yield. The objective remains to focus on constructing durable portfolios that benefit from an attractive rate environment.

Municipal Commentary

Municipals exhibited solid performance in the third quarter. Municipal specific factors, such as, strong seasonal technicals aided the market. On the supply side, new issue volume for the third quarter was up 38%, with $136 billion of new debt issued, compared to $98 billion from the same period last year. Strong demand continued to play a pivotal role in the performance of the municipal market throughout the quarter as municipal bond funds reached approximately $8 billion in net inflows.

With much of the new issuance structured over 7-years and with an inverted yield curve inside 5-years, institutional and retail investors looked to the intermediate and long-end of the curve for additional yield and experienced outperformance. The municipal curve steepened throughout the quarter with the spread between 1 and 30-year securities widening 44 basis points from June to month-end September.

Throughout the third quarter, Municipal/Treasury ratios modestly underperformed U.S. Treasury with ratios widening in the 10-year and 30-year sectors of the yield curve. However, despite municipal yield underperformance, tax-advantaged securities have started to see a slight reversal and continue to be well bid, given the attractive ratios. We are somewhat concerned that buyers will wait for a better entry point if issuance remains robust and technicals weaken.

Taxable Market Commentary

Corporate bonds and preferreds securities produced strong gains during the third quarter of 2024, propelled mainly by treasury rates.

Corporate bonds continue to be well bid as credit spreads remain tight. Corporate bond spreads, which is the additional yield that investors require to buy corporate bonds compared to US Treasuries, remain close to historical lows. Investment Grade corporate spreads as measured by the Bloomberg/Barclays Corporate Bond Index closed the third quarter and are virtually unchanged from the end of the second quarter.

Corporate credits remain strong in the face of multiple macro headwinds, including multiple regional wars, stubborn global inflation and a U.S. presidential election. U.S. corporations have very strong balance sheets, having refinanced their debts when rates were cut to almost zero, while revenues and margins are at record levels. Additionally, leverage and credit metrics remain reasonable and defaults are low.

Preferred securities also produced strong gains as investors continued to add higher yielding, longer duration assets. Contributing to the bid for preferreds is the fact that equities of financial companies, which issue the majority of preferred securities, continue to perform well as a result of improving fundamentals and declining rates.

Chilton corporate bond and preferred portfolios have anticipated these moves in the rate market and credit spreads. We have proactively positioned our portfolios to take advantage of the current market conditioning while balancing risks. With an intermediate duration we have benefited from the move in rates and spreads, while balancing macro risk and maintaining the flexibility to extend duration as the yield curve further normalizes.

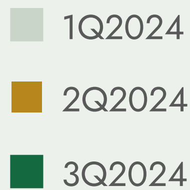
Our Portfolios

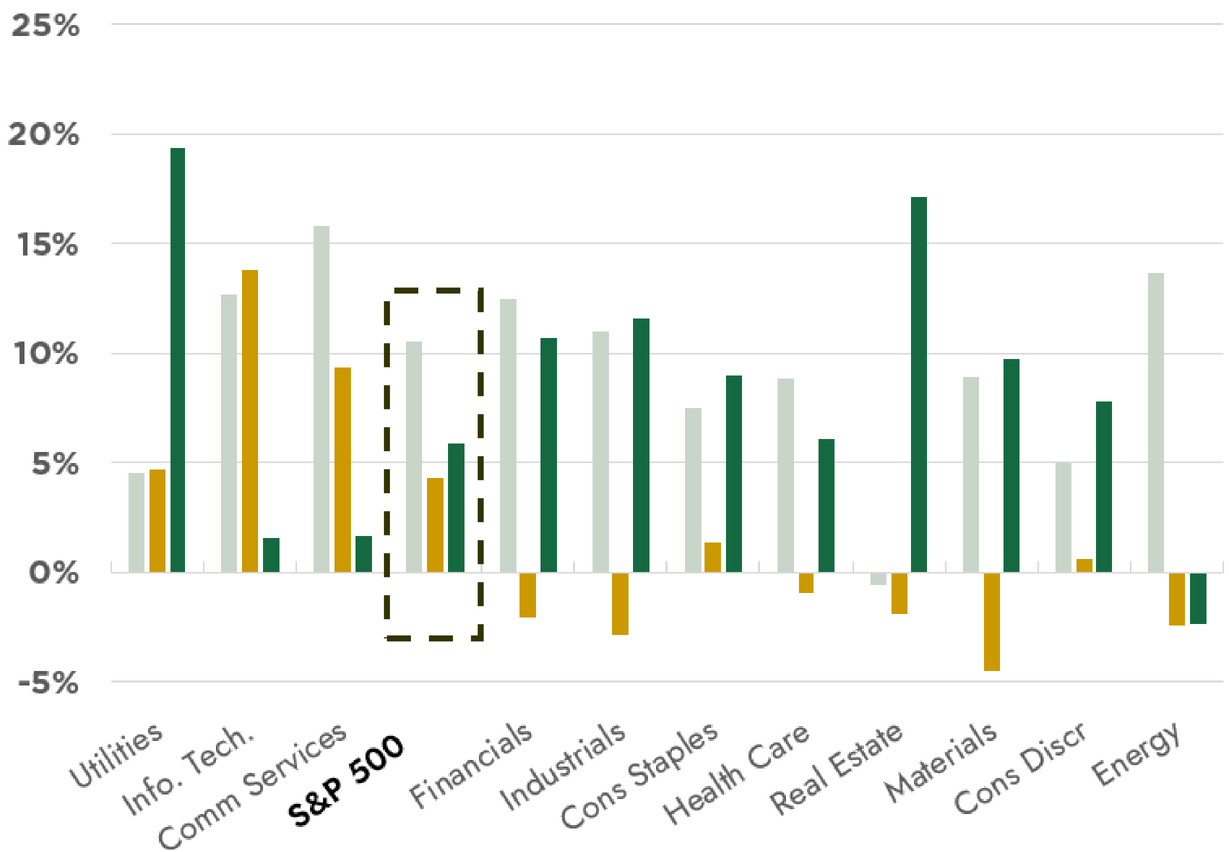
External Managers: Broadening Markets Shift Performance Drivers

The first half of 2024 was one in which Technology and Artificial Intelligence-related names dominated performance metrics, drove the majority of market returns through a narrow list of names, and commanded the bulk of market commentary and investor conversations.

As earnings remained solid, markets celebrated the long-anticipated Fed decision to cut rates by 50 basis points. This backdrop was supportive of a welcome broadening of stock performance, with the large cap Technology names pausing to make room for a dramatic re-shuffling of performance drivers. The below graphic demonstrates the shift in performance drivers during the quarter.

S&P 500 Performance by Sector





Source: Bloomberg

Our external managers had a strong quarter of performance, largely keeping pace with or exceeding their relative indices. Our long only managers delivered very strong performance, with alpha generation coming from strong stock selection. As markets broadened out over the course of the quarter, we saw pronounced rebound in small cap stock portfolios, particularly those that had underperformed through the first half of the year.

Technology-focused portfolios continued their strong performance, but to a lesser degree as other sectors captured the bulk of performance during the third quarter. Equity hedge funds, particularly our sector-focused funds have delivered strong year-to-date returns as the higher interest rate environment has created challenges for lower-quality balance sheets, an environment from which astute short investors can benefit. Our credit hedge funds continue to deliver very solid returns, helping to provide both ballast and solid returns for portfolios.

Private markets remained relatively quiet during the quarter, but overall M&A activity continues to improve, and a lower interest rate environment should provide a nice tailwind for transaction volumes to march higher over time. Recent transactions reflect a strong bias to quality assets which supports our ongoing thesis of maintaining a strong filter to finding partners that have a long history of good alpha generation through a combination of a tight underwriting process, price discipline and good organic growth improvements. Our underwriting bar remains high as we look for new investment opportunities.

Portfolio Spotlight: Electron Capital Partners, LLC

Electron Capital Partners is an investment firm with whom Chilton Trust has partnered for a number of years and is a terrific example of how we make use of external managers to provide diversification and amplify investment themes, in which we have a strong conviction.

The investment team at Electron has an average of 24 years of industry experience with a focus on the Energy Transition and other key areas within its ecosystem, such as electric generation, transmission and distribution, mobility and storage.

Electron has a 19-year track record of investment excellence; it has generated a strong record of outperformance over the near and longer term. As the velocity of structural change within the energy transition ecosystem accelerates, Electron's investment expertise and risk management acumen, combined with structural tailwinds to key areas of the energy transition, make this investment opportunity appealing. As investors, we believe it is important to look for differentiated sources of return and uncover unique opportunities for alpha generation. It is clear that the demand for power will continue to accelerate driven by AI/data centers, onshoring of manufacturing and supply chains, EV penetration, etc. As the team at Electron has stated:

> *"The energy transition will present investors with an opportunity to identify winners and losers within the equity markets. It will bring an abundance of new market entrants, some of which will follow the trajectory of large successful technology companies and become dominant players; however, companies unable to innovate fast enough, or finance themselves in the short-term, will fail. We believe the opportunity for alpha generation within the renewables, infrastructure, and utility sectors will last decades."*

We believe that Electron Capital presents a terrific opportunity for a differentiated source of returns for portfolios and welcome any conversations with any of you that may have an interest in learning more.

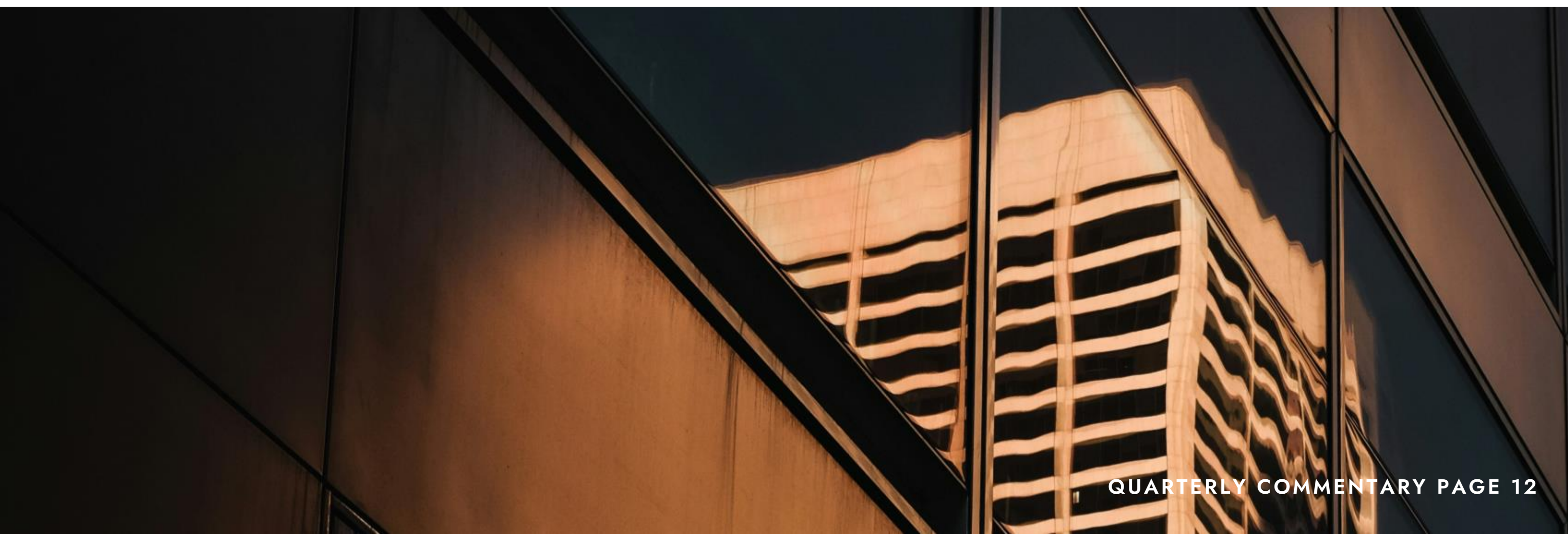
Our Outlook

Resiliency is Reason for Optimism.

As we progress into the final quarter of 2024, the landscape of the US equity market presents a mixture of opportunities and challenges. With fragile economic conditions at hand, global uncertainties and conflicts, election related policy change on the horizon, and the welcome shift to lower interest rates, investors have a lot to navigate. In addition, equity markets are trading toward the high end of historical valuation range which requires us to balance optimism with some level of caution.

After more than two years, the battle to stem inflation through tight monetary policy, the Federal Reserve decided to cut interest rates by 50 basis points at the end of September in a welcome shift to looser policy. This move comes in response to weakened inflation readings and fragile economic reports that highlight the risks of tight monetary policy, especially as it pertains to the Fed's other charge of maintaining stable employment. Investors celebrated the decision and markets moved to anticipate what lower rates might mean for various sectors, particularly housing, that could bolster overall economic strength in the coming year. Lower interest rates generally lead to lower mortgage rates and make home financing more affordable. This can spur demand in the housing market, driving construction activity and related industries, such as home improvement and consumer goods.

A revitalized housing market can have a multiplier effect on the economy by creating jobs and increasing consumer spending. Other areas may benefit, as well, including non-residential construction, consumer durables (frequently purchased on credit), and interest rate relief for all companies that carry financial leverage. Amid investor excitement about this more accommodative shift in monetary it is important to take account for any risks on the horizon.



As we look out to 2025, earnings expectations for many companies are already elevated. The S&P average consensus earnings growth for 2025 is about 14%, which is double the historic average. The agility that corporate companies demonstrated in the face of sky-high inflation readings of the last few years confounded skeptics. But due to monetary stimulus, the macro economy is poised to gradually improve in the year ahead and delayed investment could eat into earnings expectations. Many management teams use the October/November earnings calls to offer preliminary thoughts about the year ahead. So, any hint in the coming months that 2025 earnings growth expectations are too lofty may result in selling pressure.

Globally, "tail risk" seems heightened as geopolitical tensions persist in Europe, the Middle East and Asia. These risks are hard to pinpoint with any level of precision, but the conflict in the Middle East seems to pose the most near-term risk to stability in the region. This would, of course, affect the price of oil as well as global economic reverberations.

In addition, the US Presidential Election is just a few weeks away and while Vice President Harris and Former President Trump are both known entities, because of their respective tenure in the Executive branch, their precise personnel appointments and policy initiatives remain elusive and therefore hold the potential to disappoint or delight markets as they become known. With an extremely close election at hand, markets do not seem to be discounting one outcome over another. We anticipate that investors will wait until there is election certainty to begin to factor in the policy implications of the election.

If Former President Trump wins, we believe that banks and energy companies will anticipate some degree of deregulation, while industrial companies may face the threat of high tariff costs throughout their supply chains. With a Vice President Harris victory, consumers and domestic businesses may have to contemplate higher taxes ahead. The political outcome that has more certainty pertains to both houses of Congress, as Republicans have a good chance of picking up seats in West Virginia and Montana while Democrats are favored to take control over the House.

This split government means that our next President will not be able to enact their agenda easily or swiftly. Rather debate, bi-partisanship, and a slower timetable for policy change should be the order of the day, just as our founders envisioned government working. This tends to be good for financial markets, which tend not to like surprises.

Despite these risks, our confidence about the generally better economic conditions and the wide range of companies who will benefit keeps us optimistic. For too long, equity markets have been narrow with valuation afforded to those with the highest and most certain paths of growth. With a potentially better economic backdrop at hand, we expect equity markets to continue to broaden out and a larger set of companies to be rewarded by investors.

Given the current environment, we advocate for a selective approach to equity investment. High-quality companies with strong fundamentals and compelling valuations offer the most attractive opportunities. Our tried-and-true approach of investing in companies with the deepest moats, the strongest balance sheets, and the best business models is a good match for today's macro backdrop. We are putting new cash to work carefully, waiting for entry prices that afford ample forward returns.

As always, we thank you for your continued support and partnership, and we look forward to visiting with you in the months ahead.

Our Team

RICHARD LOCKWOOD CHILTON, Jr. is the Founder & Chairman of Chilton Trust Company. Since founding Chilton Investment Company with his Flagship Strategy in 1992, Mr. Chilton has built a broad organization and a team of investment professionals focused on long term capital growth. The Chilton Flagship Strategy has generated impressive and consistent returns with moderate volatility since inception. In addition, in 2010 Mr. Chilton founded Chilton Trust Company which is a nationally chartered broad-based wealth management trust company focusing on services to high-net-worth individuals and families. Mr. Chilton is vice chairman of the Metropolitan Museum of Art, trustee emeritus of the Robin Hood Foundation, chairman emeritus of Greenwich Academy and a trustee of Classic American Homes Preservation Trust.

JENNIFER L. FOSTER is a Portfolio Manager and Co-Chief Investment Officer—Equities. Jennifer has worked at Chilton for over 27 years. Jennifer's previous roles at Chilton include equity analyst, Director of Research, and Portfolio Manager. During her tenure at Chilton, Jennifer has served on the Risk Committee, the Responsible Investment Committee, the Executive Committee, and the Board of Directors.

Prior to Chilton, Jennifer worked at GE Capital as part of GE's Financial Management Training program. She graduated summa cum laude with a B.A. in English from Boston College and earned an MBA with distinction from Harvard Business School. She currently serves on the Advisory Board of the Center for Excellence in Investment Management at UNC Kenan-Flagler Business School, and as a trustee for the Mather Homestead Foundation in Darien, CT. Jennifer is married and has three grown sons.

NICK FRELINGHUYSEN is a Portfolio Manager and Co-Chief Investment Officer – Equities. Nick is responsible for investments on clients' equity portfolios, with more than 30 years of experience in equity research and portfolio management. Most recently, he was a partner at the boutique investment firm, Eagle Ridge Investment Management, LLC where he served as a portfolio manager and Co-Head of Research for an organization with $950m in assets focused on high net worth individuals and institutions. Prior to his role at Eagle Ridge, Nick worked at Oppenheimer Capital (Allianz Global Partners) as Co-Portfolio Manager on a $2B Mid Cap value mutual fund and served as Cohead of Mid-Cap and All-Cap investments for the $25B firm. He began his career on the sell side at Donaldson, Lufkin & Jenrette. Nick attended Princeton University as an undergraduate and holds an MBA from The Wharton School at the University of Pennsylvania.

LOUISA M. IVES is a Managing Director & Head of External Managers. Ms. Ives is responsible for external manager selection and due diligence for Chilton clients and is also a member of the Executive and Investment Committees at Chilton Trust. Prior to joining Chilton, Ms. Ives was a Managing Director at Chilton Investment Company, where she was a research analyst covering the financial services sector. She also served on the company's Board of Directors. Prior to joining Chilton, she worked at Coopers & Lybrand Consulting Group, reporting directly to the CEO, and began her career at Chemical Bank in their Middle Market Lending Group. Ms. Ives graduated cum laude from St. Lawrence University with a B.A. in English Literature and earned an M.B.A. from Harvard Business School.

Ms. Ives serves on the boards of The First National Bank of Long Island, The Project Y Theatre Company, and on the Investment Committee of Vinalhaven, ME Land Trust.

TIMOTHY W.A. HORAN is an Executive Vice President & Chief Investment Officer—Fixed Income.
With over 30 years of experience, Mr. Horan is a specialist in fixed income investing, ranging from municipal and US taxable securities to international bons and currencies. He leads a team of professionals managing client assets across a variety of strategies including liquidity, tax-advantaged, taxable, international and global.

Prior to joining Chilton Trust, Mr. Horan was a Managing Director at Morgan Stanley Smith Barney and served as MSSB's Chief Investment Officer of Fixed Income Investment Advisers, a division of MSSD, foundations, and family offices, primarily in North America, the Caribbean and Latin America. Earlier, Mr. Horan led Morgan Stanley's Private Wealth Management Fixed Income business in London serving European, Middle Eastern and Swiss private bank clients. Mr. Horan also served on the Morgan Stanley Global Asset Allocation Committee. Before joining Morgan Stanley, Mr. Horan was Director of International Fixed Income at Lord Abbett & Co. He also held senior management positions in fixed income and foreign exchange portfolio management at Credit Suisse, Aubrey G. Lanston & Company, Inc. and Bankers Trust. At Bankers Trust, he helped pioneer the portfolio management at Credit Suisse, Aubrey G. Lanston & Company, Inc. and Bankers Trust. At Bankers Trust, he helped pioneer the fixed income risk management frameworks. Mr. Horan began his career at the Federal Reserve. During the Volcker years, he was an Economist in the Sovereign Debt Unit at the New York Fed, working on the debt restructuring of Brazil, Mexico and Argentina. Following the Plaza Accord, he also served as a foreign exchange trader for the Federal Reserve Bank of New York. Mr. Horan earned an AB with honors in Economics and History from the University of Pennsylvania, Wharton-Sloan Program. He was an Andrew Mutch Scholar in Economics and Politics at the University of Edinburgh and holds a post graduate law degree from the University of Cambridge, where he was a Thouron Scholar.

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