choice one WEALTH MANAGEMENT

OUTLOOKS

November 2024

ECONOMIC OUTLOOK

Summary

October payroll data faced notable distortions due to recent natural disasters, including Hurricanes Helene and Milton, coupled with various worker strikes. Economists projected median job growth at 100,000, with estimates ranging from gains of 180,000 to losses of 10,000 jobs. Actual figures revealed a modest gain of just 12,000 jobs, falling well short of expectations. Notably, net revisions to the prior two months' data reduced previous job gains by 112,000, indicating September's strong payroll figures may have been overstated - though further data will be needed to confirm this in the coming months. Meanwhile, the unemployment rate held steady at 4.1%, providing some stability amid otherwise negative signals.

Recently, this type of weak labor market data would support additional rate cut expectations, due to the improved balance across the Fed's dual mandate. However, rate cut expectations surprisingly decreased following the jobs report, perhaps indicating market participants recognize the current data's unreliability.

Immediately following the presidential election, with a projected Republican victory across the White House, Senate, and House of Representatives, rate cut expectations fell even further. Market sentiment anticipates policies set forth by the new administration could be inflationary in nature, such as increased tariffs and larger fiscal deficits, potentially making the Federal Reserve more cautious about materially lowering rates. While a higher terminal rate would typically pose challenges for the economy, potential pro-business policies from the new administration could provide offsetting benefits. However, at the time of writing, not all election outcomes are confirmed and further clarity on the administration's policies is awaited.

Meanwhile, above-trend economic growth remains a more certain theme, particularly driven by resilient consumer spending. Consumption remains undeterred by nearly two years of restrictive Federal Reserve policy and inflation that, while easing, remains above target. Preliminary GDP growth for Q3 reached 2.8%, outpacing the Fed's trend growth estimate by 1%. Personal consumption also exceeded expectations, rising 3.7%, its strongest value since Q1 2023. Regardless of the future administration's policies, we anticipate consumer strength to persist in the coming quarters.

Positives

GDP remains strong and above trend (2.8%)

ISM services PMI jumped to its highest level (56.0) in 27 months

The Employment Cost Index (ECI) decreased to its lowest level (0.8) in more than three years

Negatives

Year-over-year Core PCE was slightly above estimates (2.7% vs. 2.6% est.)

Factory orders were negative (-0.5%) for four of the last five months

Durable goods orders were also negative (0.7%) for the second consecutive month

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EQUITY OUTLOOK

Summary

The S&P 500 Index finally took a breather closing down 0.9% in October after finishing higher in the previous five consecutive months. This was a fairly predictable pause given the strength seen in equity markets throughout 2024 and closing October with an uncertain election outcome.

Equity markets in the United States were fairly consistent in performance between style and size, though international markets faired much worse. The Russell 1000 Growth Index fell 0.3% while the Russell 1000 Value Index declined 1.1%. The Russell Midcap Index and small-cap Russell 2000 Index lost 0.5% and 1.4% respectively. The MSCI EAFE Index declined 5.4% and the MSCI Emerging Markets Index (MSCIEF) dropped 4.3%.

With Republicans now poised to take control of the presidency as well of both chambers of Congress, the immediate response from the equity market was a fairly strong and broad rally. However, as we move forward there will be some industries and specific companies likely to fair better or worse under the new administration. This may present a period of time where active investing and being nimble is in favor.

Many of the policies voiced on the campaign trail are more radical than what we expect moving forward. Candidates have discussed taxes, tariffs and Federal Reserve independence to name a few potentially market moving agendas. In reality, the approach to these matters is likely to be much more moderate, which should be received well by equity markets.

While some of this noise is likely to move markets over the coming weeks, ultimately it will be company fundamentals and earnings that should drive markets. Earnings expectations, economic conditions and an accommodative Federal Reserve Bank continue to be favorable for equity investors.

Positives

Q3 Earnings results have been solid

The election and the noise that accompanies it will soon be over

Negatives

Equity valuations are extended

Geopolitical tensions remain elevated

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FIXED INCOME OUTLOOK

Summary

Following five months of progressively lower yields and positive bond market returns, interest rates moved sharply higher in October as resilient economic data and the prospect of a "red wave" casts doubt on the amount and cadence of additional rate cuts. Following the Fed's outsized rate cut in mid-September, the yield on the 2-year Treasury note started October at 3.64%. This was near the lowest level since the fall of 2022 when it was on a rapid trajectory upward. As measured by the Fed Funds futures market, investors were expecting an additional 75 basis points (bps) of rate cuts this year and another 125 bps in 2025. Among a batch of robust economic reports, an alarmingly strong payroll report released early October changed that outlook. By the end of the month the market was pricing for just 50 bps of additional Fed rate cuts for 2024 and another 75 bps for the following year. After declining 139 bps over the previous five months, the 2-year yield increased by 53 bps to 4.17%. Likewise, the 10-year Treasury note yield increased by 50 bps to end October at 4.28% erasing over half of its decline during the previous five months.

New issuance of investment-grade corporate bonds was $98 billion in October making it the lowest monthly total and the first of the year below the $100 billion mark. Still, the year-to-date supply total has been $1.374 trillion which is 27% more than last year. Fortunately, with above trend economic growth and solid credit fundamentals, only $6 billion in bonds have fallen from investment-grade to high-yield, or "junk" status. This is the lowest level since 1997 according to Barclays Plc. The easing in new supply along with few downgrades supported the average credit spread narrowing by another 5 bps relative to comparable maturity Treasury notes. This modest compression combined with the incremental yield allowed the sector to once again outperform Treasury notes. Still, October was rough for bond investors as the Bloomberg U.S. Aggregate Bond Index delivered a return of -2.48% and the Intermediate Government/Credit Index was -1.60%. Both of these October experiences were in the bottom 5% of monthly returns over the past 40 years.

There is little doubt some of the yield increase in late October and into the first few days of November is attributable to the rising potential of a Republican sweep and the associated potential for incremental budget deficits and inflation-causing trade tariffs. Now that we know the presidential and Senate results, investors will be eagerly awaiting the likely confirmation of their control of the House of Representatives as well. Given the 85 bps rise in the 10-year Treasury yield over the past seven weeks, we are inclined to believe most of the impact is already expressed. Still, like others, we will proceed cautiously and maintain a portfolio duration equal to that of the benchmark. As we see little downside risk to the economy, we also continue to recommend a higher allocation to high-quality, investment-grade corporate bonds.

Positives

Inflation continues to trend towards 2% target

Fed on track to continue lowering the overnight borrowing rate

Yields have already moved sharply higher

Negatives

Republican sweep could create larger federal budget deficits

The markets may be anticipating too many rate cuts

Unknowns

Trump and Republicans ability to balance spending and income priorities

Ability to bring a resolution to Israeli conflict and Russia/Ukraine war