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Doll's Deliberations®

Weekly Investment Commentary

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Summary:
Equities declined (S&P 500 -0.96%), breaking a six-week upward streak. The biggest market-moving event was a continued rise in Treasury yields to the highest level since the August Fed cut. Best sectors were consumer discretionary (+0.94%) and technology (+0.18%); biggest decliners included materials (-4.01%) and healthcare (-2.97%).

Key takeaways:

1. Our expectation is that rates will remain elevated in the near term and may move higher toward 4.5% (10-year Treasury) in a Trump win before again moving lower when the tightening in conditions cools economic momentum. Our guess is the 60-basis-point (bp) rise since the recent low is more than half related to improved economic growth and less than half related to the rise in the probability of a Trump win.

2. At one point, the Fed funds future curve priced in 250 bps of cuts from the recent high. That is down to 175-200 bps.

3. Wolfe Research estimates a 1.1% hit to GDP and 110 bp boost to inflation from a 10% across-the-board tariff and 60% tariffs on China.

4. The U.S. dollar has risen due to higher Treasury yields coupled with better U.S. economic releases and weaker non-U.S. data.

5. For a variety of reasons (e.g., slowing rent, unit labor costs), inflation may slow a bit more in the near term, but expansionist monetary (M2 and Fed rate cuts) and fiscal (federal spending) policies point to problematic inflation down the line.

6. Since mid-September, bond yields have been rising along equity prices, reflecting the return to a regime where growth surprises (and not inflation) are driving markets. However, yield levels now pose a threat to equities.

7. The four-week average on the rate of upward EPS estimate revisions for the S&P 500 is just 43%, suggesting we are seeing slightly more downward than upward revisions.

8. Risk assets are "priced for perfection," implying a high hurdle for further outperformance of equities and credit. Analysts project a 14% increase in 2025 S&P 500 earnings-per-share, which, along with tight credit spreads, reveals markets are betting on a soft landing. The same goes for investors' willingness to pay a 22x multiple on already-optimistic 12-month-forward EPS.

9. Since the start of the latest bull market on Oct. 12, 2022, the forward P/E of the S&P 500 has increased 43% from 15.3 to 21.9. Over that same period, forward EPS increased 13.9%.

10. With the election one week away, Trump is being viewed as the "higher inflation and interest rates" candidate, likely to create wider deficits (due to tax cuts). Trump is also viewed as the candidate with the best equity outcome. Harris is viewed as the opposite in these categories.

EQUITY MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
DJIA	-2.66	13.45
S&P 500	-0.96	23.14
NASDAQ	0.16	24.06
RUSSELL 1000	-0.99	22.37
RUSSELL 1000 GROWTH	0.02	27.05
RUSSELL 1000 VALUE	-2.23	16.34
RUSSELL 2000	-2.51	10.66

S&P EQUITY SECTORS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-0.14	29.25
CONSUMER DISCRETIONARY	0.94	14.29
CONSUMER STAPLES	-0.99	16.87
ENERGY	-0.62	10.72
FINANCIALS	-2.07	25.51
HEALTHCARE	-2.97	10.34
INDUSTRIALS	-2.74	20.13
INFORMATION TECHNOLOGY	0.18	34.22
MATERIALS	-4.01	11.30
REAL ESTATE	-1.46	12.82
UTILITIES	-1.91	30.01

All eyes on the election

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN %)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.27	17.87
MSCI ACWI EX U.S.	-1.91	10.04
MSCI EAFE	-2.03	8.07
MSCI EM	-1.78	13.27

FIXED INCOME MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.74	2.22
BLOOMBERG U.S. CORP HIGH YIELD	-0.40	7.43
BLOOMBERG U.S. GOV/ CREDIT	-0.69	2.23
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.05	4.39

ALTERNATIVES (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-0.96	12.88
COMMODITIES (DJ)	2.13	6.08
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.97	18.45
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.32	10.82

The economy and markets

A positive corporate profit backdrop and aggressive Fed rate-cut expectations have sustained the risk-on phase. Meanwhile, other central banks are following the Fed's dovish move at its last FOMC meeting, with the BoC cutting rates by 50 bps and the ECB hinting of a more forceful rate-cutting cycle than it has previously been suggesting. U.S. economic growth is reasonably strong, and activity is decent and expected to firm modestly outside the U.S., although global manufacturing activity has been weak. Although policy rate cuts will likely not match the expectations priced in the U.S. forward market, the Fed is still likely to ease a bit more. For now, positive global corporate profits and lower policy rates favor risk assets.

The election

With election day only days away, former President Donald Trump has pulled slightly ahead of Vice President Kamala Harris in the aggregate of polls for key swing states. However, Trump's lead is thin and within the margin of error of the polls, underscoring that the race is a statistical dead heat. When it comes to the Congress, the Republicans are favored to win a majority in the Senate, while control of the House of Representatives could go either way. That said, the winner of the presidency typically drives downballot victories such that the party controlling the White House also ends up with a majority in the House of Representatives.

These dynamics have led the financial markets to coalesce around the notion that the two most likely outcomes of the election are either a Republican sweep or a Harris win with a split government. A Trump victory with Republican control of the Congress increases the odds of lower taxes and deregulation, which would be initially cheered by the stock market, although it would also come with a less dovish Fed and the prospect of rising bond yields that could cap a post-election equity rally. The timing and size of trade tariffs are also a wildcard. A Harris win with a divided Congress would likely have a neutral impact on equities as government gridlock would limit the scope for significant changes to policy. The same is true of a Trump victory with a divided Congress. However, a Democratic sweep would likely illicit a negative reaction from stocks as it would bring the prospect of higher corporate taxes and more regulation.

Homebuilders would benefit from the policies of either candidate to increase home ownership, but Harris has proposed a more detailed plan to address housing affordability, implying that homebuilding stocks would react more positively to a Harris victory. Trump's more restrictive immigration policies would tighten the supply of labor, thus pushing up wages and costs for industries dependent on immigrant work forces such as construction, retail, leisure and hospitality, and agriculture. His plan to impose tariffs more universally on imported goods would negatively impact the consumer discretionary sector (especially retailers that source merchandise from China) and finished goods manufacturers reliant on imported inputs, while leaving companies with exposure to the Chinese market vulnerable to retaliatory actions. On the flip side, U.S. steel producers would be a beneficiary of tariffs, which would protect their domestic market share without raising their costs, given that they are not reliant on imported inputs to manufacture product. Although both candidates support strengthening the capabilities of the U.S. military, Trump is likely to be viewed as more positive for defense spending and the shares of defense contractors.

Data from Bloomberg as of Oct. 25, 2024