Doll's Deliberations®

Weekly Investment Commentary

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Summary:
Equities fell last week (S&P 500 -1.35%), marking the second weekly decline in a row. Large technology was the drag with Treasury yields continuing to rise. Best sectors were communication services (+1.53%) and consumer discretionary (+0.48%); worst sectors were technology (-3.27%) and real estate (-3.05%).

Key takeaways:

1. Real GDP in 3Q was solid, growing 2.8% q/q versus 3.0% in Q2. Nominal GDP slowed to 4.7% from 5.6%. Government spending alone added 0.9%, meaning private real GDP growth was only 1.9% (too much growth is being driven by the public sector).

2. The Fed's preferred measure of inflation (core PCE) met expectations of a reacceleration to +0.3% m/m and +2.7% y/y.

3. In a somewhat confusing monthly jobs report, only 12,000 jobs were added in October (the worst report in four years), with the weakness due to the impact of the hurricanes and labor strikes. (Prior two months were revised down by 112,000.) The unemployment rate held steady at 4.1% with average hourly earnings up 0.4%.

4. In October, the Conference Board's Consumer Confidence Index jumped 9.5 points to 108.7, the highest level since January.

5. The latest Federal Reserve Beige Book reveals a U.S. economy that is largely stagnant since early September, with only two districts reporting modest growth.

6. The large fiscal transfers from Congress to middle- and working-class households had a longer impact than we expected. With that impact lessening, we are likely to witness an economic slowdown.

7. Consensus S&P 500 EPS growth estimates continue to move lower for both 2024 and 2025. Estimates for 2024 have dropped to $239 (up 8.7% from y/y, not the double-digit percentage that was anticipated for so long) and $275 for 2025.

8. After ignoring the nominal seasonal headwinds so far this fall, the stock market finally seems to be feeling the effects of overbought signals, signs of complacency, and bullish sentiment.

9. Valuation levels (P/E ratios) are not very helpful in determining short or intermediate term returns, but are very useful in predicting long-term returns. Recent work by BCA and Goldman Sachs (and earlier in our white paper) speak to likely sub-par long-term returns (3-5%, including dividends) for equities.

10. A Trump win would probably be positive for financials as the market anticipates less financial regulation, further economic growth, and a steepening yield curve.

EQUITY MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.15	13.28
S&P 500	-1.35	21.47
NASDAQ	-1.50	22.21
RUSSELL 1000	-1.59	20.33
RUSSELL 1000 GROWTH	-1.59	25.03
RUSSELL 1000 VALUE	-0.78	15.43
RUSSELL 2000	-0.50	9.56

S&P EQUITY SECTORS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	1.53	31.22
CONSUMER DISCRETIONARY	0.48	14.84
CONSUMER STAPLES	-1.28	15.37
ENERGY	-2.05	8.45
FINANCIALS	-0.15	25.33
HEALTHCARE	-0.57	9.72
INDUSTRIALS	-1.02	18.90
INFORMATION TECHNOLOGY	-3.27	29.83
MATERIALS	-1.21	9.95
REAL ESTATE	-3.05	9.38
UTILITIES	-2.78	26.40

A less-than-clear forward outlook

Ongoing global economic expansion, central bank policy easing, and abundant financial liquidity continue to tempt investors. Despite a slight bump last week, global equities are near record highs, credit spreads are historically tight, and gold and cryptocurrencies are rallying from elevated levels. Equities are expensive as is corporate credit. Investors have overestimated how much the Fed and some other central banks are likely to cut interest rates in the year ahead, implying that bond yields could go higher on a six- to 12-month horizon, even after their sizable rise since mid-September.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN %)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.56	16.00
MSCI ACWI EX U.S.	-1.31	8.61
MSCI EAFE	-1.19	6.85
MSCI EM	-1.45	11.66

FIXED INCOME MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.17	1.86
BLOOMBERG U.S. CORP HIGH YIELD	-0.03	7.42
BLOOMBERG U.S. GOV/ CREDIT	-0.14	1.90
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.05	4.49

ALTERNATIVES (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-1.84	9.75
COMMODITIES (DJ)	-2.08	3.88
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.32	16.51
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.63	11.52

The U.S. remains the linchpin of the global economy and is still humming along. U.S. Q3 economic growth was a still-solid 2.8% and even stronger consumer spending growth, consistent with the underlying trend over the past two years and well above the underlying potential rate. Elsewhere survey data is mixed, with the PMI composite indicator for the euro area hovering just below the 50-expansion line but trending lower, while that for EM signals modest, but moderating, growth. More positively, global trade growth continues to expand, albeit also at a historically modest pace.

Consensus U.S. earnings growth over the next 12 months is a strong 15% in view of a domestic and global economy likely to grow at less than half that rate in nominal terms. Moreover, U.S. profit margins are already high by historical terms, but are projected to widen materially again in the year ahead, which we view as overly optimistic.

Government bond yields and other key interest rates have risen since the September FOMC meeting. This reflects a combination of too-aggressive rate cut expectations in advance of the meeting, positive data surprises, and rising odds of a second Trump presidency.

We agree that the odds of a U.S. recession are lower following the BEA's revision to the U.S. savings rate. Still, the U.S. is probably nearing the end of its current expansion and is therefore on the path to an eventual contraction in activity and corporate profits. The timing is less certain to us than it was previously, but we would still expect it to begin at some point over the coming year.

The U.S. has avoided a recession despite elevated interest rates because of the deployment of excess savings, combined more recently with optimism about easier monetary policy. Excess savings are now gone, and the latter effect is self-limiting. Bond yields are likely to rise even further if U.S. economic data continues to surprise to the upside, which could put the U.S. back on a recessionary path.

A Harris victory without full control of Congress would cause long-maturity government bond yields to fall modestly and is the electoral outcome that is most consistent with a soft landing. We would expect the recent jump in the 10-year Treasury term premium to unwind if Harris wins.

A Republican sweep has the potential to be positive for U.S. economic growth on a six- to 12-month time horizon, but we lean toward the view that trade action under a second Trump presidency will be aggressive and economically damaging unless deftly offset by sufficiently large fiscal thrust.

Source: Macro Research Board, Bank Credit Analyst

Data from Bloomberg as of Nov. 1, 2024

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