CROSSMARK GLOBAL INVESTMENTS

Nov. 18, 2024 | Issue 4.46

Doll's Deliberations®

Weekly Investment Commentary

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Summary:
Stocks fell last week (S&P 500 -2.05%), even as new all-time highs were recorded earlier in the week. The defensive tone came from concerns about high valuations, the bond yield backup, and renewed inflation concerns. Best sectors were financials (+1.44%) and energy (+0.86%); worst sectors were healthcare (-5.52%) and materials (-3.26%).

Key takeaways:

1. U.S. CPI inflation for October was in line with expectations and was unchanged from September. Headline inflation re-accelerated to 2.6% from 2.4% on an annual basis, and core stayed steady at 3.3%, both far from the Fed's 2% target.
2. The Fed is still likely in a rate cut cycle. Slowing the pace of rate cuts would give time to gather more data and access both the inflation and unemployment picture.
3. The dollar is up nearly 6% since the Fed raised rates in September, with about half the move coming since the election. This is likely to mean the Fed will slow the pace of rate cuts.
4. Broad labor market indicators continue to soften.
5. The earnings of the S&P 500 will be up by about +8% this year, with the tech sector contributing more than three-quarters of the growth.
6. Valuations may stay high, but further interest rate backup could trigger significant valuation concerns.
7. Berkshire Hathaway (Warren Buffett) now has 28% cash, the highest in over 35 years, highlighting his risk-off caution.
8. President-Elect Trump has proposed having Elon Musk head an effort to cut government spending. However, if Social Security, Medicare, Medicaid, Veterans Affairs, Defense, and interest payments are off the table, there is actually very little of the federal budget left to cut.
9. On geopolitics, President Trump is likely to use increased U.S. strength to pressure Russia, Iran, and China.
10. Bulls are focused on expected deregulation and tax tailwinds, heightened enthusiasm/buying, and good earnings. Those less bullish worry about stretched valuations, bond yield backup, renewed inflation concerns and overly bullish sentiment.

EQUITY MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
DJIA	-1.17	17.11
S&P 500	-2.05	24.56
NASDAQ	-3.13	25.20
RUSSELL 1000	-0.70	25.85
RUSSELL 1000 GROWTH	-2.73	28.59
RUSSELL 1000 VALUE	-1.16	18.65
RUSSELL 2000	-2.60	16.61

S&P EQUITY SECTORS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-2.11	33.23
CONSUMER DISCRETIONARY	-1.11	22.23
CONSUMER STAPLES	-1.18	15.37
ENERGY	0.86	16.20
FINANCIALS	1.44	34.26
HEALTHCARE	-5.52	5.33
INDUSTRIALS	-2.08	23.37
INFORMATION TECHNOLOGY	-3.16	32.60
MATERIALS	-3.26	7.92
REAL ESTATE	-2.05	10.02
UTILITIES	0.16	28.25

The outlook for stocks and bonds is near peak uncertainty

The U.S. economy has solid momentum and, for now, is in line to receive a further boost based on the incoming president's proposed policies. Conversely, a meaningful trade war could easily trip up the global economy, much as occurred during the trade war late last decade.

Global equities are near a new high, credit spreads are at historically very tight levels, and there are growing hopes for much stronger deal flows. A potential warning sign for risk assets is that government bond yields have reversed course and moved higher, although to varying degrees. Rich aggregate valuations in stocks and credit at a time of rising government bond yields usually ends badly. After the recent rise in yields, few bond investors currently are positioned for new cyclical highs in yields, underscoring the potential for a selling panic.

Looking beyond the near-term, some significant portfolio changes could develop depending on the actual policy changes taken by the new U.S. administration and the possible responses from other countries. It is bond-bearish to stimulate the already solid U.S. economy (via both fiscal and monetary policies) at a time when the output gap is positive and inflation is "sticky." A bearish Treasury market will eventually become a threat to other asset prices.

Next year holds the potential to significantly alter the investment landscape. For now, we can only say "stay tuned," as there are a lot of uncertainties about what will actually happen and when and how investors will react. The Middle East and the war in Ukraine remain wild cards, and thus global energy prices warrant close monitoring. Trump's bold steps during his first term were not all bullish for the U.S. equity and credit markets, nor the economy.

Ultimately, the U.S. Treasury market holds the key for equities in 2025. Normally, equities rally on the back of rising earnings expectations when the Fed is lowering policy rates in a non-recessionary backdrop. Yet it is reasonable to assume that the yield curve will also steepen, with long-term bond yields rising as inflation concerns return and the term premium in the Treasury market grinds higher. Meanwhile, the longer the U.S. economy continues to grow at an above-potential rate, the greater the pressure on the Fed to further lift its estimate of the neutral rate, which is bond-bearish and likely to cause the yield curve to steepen. Absent something that undermines the U.S. economic expansion, bond yields are likely to eventually rise to the point where equity markets will de-rate. Critical to the outlook will be whether the U.S. inflation is as sticky as we anticipate, or eventually reverts to 2% as the Fed and many bond investors expect.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN %)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-1.35	18.69
MSCI ACWI EX U.S.	-2.59	6.67
MSCI EAFE	-2.10	4.82
MSCI EM	-4.50	8.20

FIXED INCOME MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	-0.82	1.36
BLOOMBERG U.S. CORP HIGH YIELD	-0.16	8.11
BLOOMBERG U.S. GOV/ CREDIT	-0.83	1.32
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.04	4.68

ALTERNATIVES (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-2.23	8.99
COMMODITIES (DJ)	-1.98	1.97
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-1.34	19.54
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.53	12.62

Conclusion

The anticipation of tax cuts and deregulation under the incoming Trump Administration will continue to fuel risk-on sentiment. However, the longer-term setup for the equity market is demanding, given the high starting point for valuations and already high earnings expectations. Moreover, sticky inflation and upward pressure on bond yields could eventually challenge the positive market sentiment. Upgrades to earnings estimates (which in our view, is unlikely) will be needed to fuel further meaningful upside in equity prices.

Data from Bloomberg as of Nov. 15, 2024