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Doll's Deliberations®

Weekly Investment Commentary

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Key takeaways

U.S. equities were mixed last week. The S&P 500 (+0.99%) and NASDAQ (+3.36%) were up; DJIA (-0.53%) and Russell 2000 (-1.56%) were down. Tech leadership was a key piece of the upside, while extreme sentiment readings and overbought conditions remain overhangs. Outperformers were consumer discretionary (+5.90%), communication services (+4.11%), and technology (+3.36%); worst sectors were energy (-4.51%) and utilities (-3.81%).

EQUITY MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.53	20.57
S&P 500	0.99	29.34
NASDAQ	3.36	33.19
RUSSELL 1000	0.72	29.01
RUSSELL 1000 GROWTH	3.64	37.00
RUSSELL 1000 VALUE	-1.86	20.48
RUSSELL 2000	-1.56	19.68

S&P EQUITY SECTORS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	4.11	40.95
CONSUMER DISCRETIONARY	5.90	34.61
CONSUMER STAPLES	-0.69	20.06
ENERGY	-4.51	11.51
FINANCIALS	-1.71	35.70
HEALTHCARE	-2.03	7.15
INDUSTRIALS	-2.28	24.70
INFORMATION TECHNOLOGY	3.36	39.58
MATERIALS	-2.91	8.70
REAL ESTATE	-2.62	12.10
UTILITIES	-3.81	28.97

1. Non-farm payrolls increased a slightly more than expected 227,000 in November as the unemployment rate increased from 4.1% to 4.2%. Stripping out the public sector (government, healthcare, and education), employment continues to fall. Average hourly earnings were up 0.4% m/m and 4.0% y/y.

2. The November ISM Manufacturing index beat expectations, increasing to 48.4 from 46.5 in October. Only 17% of industries reported growth, down from 28% in October, marking the low of a downtrend in place since April.

3. The November ISM Services PMI disappointed, but an increasing number of industries reported growth. Overall, the data is consistent with a slowing economy coupled with a weakening labor market.

4. The Fed's preferred measure of inflation, core PCE, met expectations of 0.3% m/m in October, and accelerated to 2.8% y/y from 2.7% in September.

5. We continue to expect the Fed to cut rates by another 25 basis points at their meeting later this month. The market's odds for a cut increased from 70% to 90% after the payroll report (after being in the 50% range not long ago).

6. The election outcome has fattened the tails for the U.S. economy, but the economy's healthy underlying fundamentals support a positive growth outlook. The Fed is in easing mode, but will dial its dovish intent down next year, amid sticky inflation and upside risks to inflation from above-potential growth, as well as trade and other policies.

7. Consensus earnings growth expectations for 2025 are +14%. All sectors are forecasted to increase, with technology and healthcare accounting for more than half the expected increase.

8. Cyclicals (financials, industrials, and consumer discretionary) continue to show leadership in the equity market. Technology has been more neutral, with software strong and semiconductors weak.

9. We have become increasingly worried about the possibility of a near-term 5-10% pullback in the S&P 500, primarily due to elevated positioning, recent froth in sentiment, and valuation that has gotten even richer, which leaves the S&P 500 vulnerable to bad news and perhaps simply in need of a breather. Note that seasonally, stocks tend to be strong November through December but more prone to weakness in January and February.

10. Scott Bessent has been selected by President-elect Trump to serve as his Treasury secretary. If Mr. Bessent can delay or limit an across-the-board tariff policy, while extending tax cuts and pushing deregulation, that would be cheered on by the market.

As we head toward year-end …

Risk assets continue to have tailwinds that are likely to last into the New Year against a backdrop of ongoing global economic expansion and supportive monetary policy. In the U.S., incoming President Trump's pro-growth promises of fresh tax cuts and deregulation reinforce the risk-on climate in the near term, given the already firm U.S. economy. Conversely, his desire for broad-based trade tariffs and mass deportations are potentially highly disruptive to the U.S. and global economy. How things play out in 2025 will hinge to a considerable extent on whether, how, and when Trump's policy proposals translate into action.

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN %)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.13	21.71
MSCI ACWI EX U.S.	1.78	9.54
MSCI EAFE	1.85	8.20
MSCI EM	2.19	10.01

FIXED INCOME MARKETS (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.23	3.17
BLOOMBERG U.S. CORP HIGH YIELD	0.31	9.00
BLOOMBERG U.S. GOV/ CREDIT	0.25	3.15
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.06	4.97

ALTERNATIVES (INDEX TOTAL RETURN %)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-2.26	11.12
COMMODITIES (DJ)	-0.59	3.71
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-0.38	23.58
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-0.17	11.32

We expect that much of Trump's tariff talk is a negotiating stance and that he will not jeopardize economic growth. Implicit in this assumption is that tariffs will be applied only selectively, such that the overall effective tariff rate rises only modestly. Nonetheless, a more disruptive outcome is possible and in the interim, policy-related uncertainty and volatility will persist. We expect the global economic expansion will continue and gradually broaden, with the euro area, Japan, and Asia gradually gaining traction and global manufacturing and trade strengthening. Inflation in the G7 economies will likely remain sticky, especially in services and most importantly in the U.S. The Fed and other central banks will cut interest rates less than currently discounted.

While the global growth backdrop should remain supportive, risk asset returns are likely to be lower in 2025 after very strong returns in 2024. U.S. equities are increasingly vulnerable to corrections, given elevated valuations and earnings expectations. Politics are ordinarily a secondary concern for markets, but they are likely to inject volatility over the course of the coming year. Even beyond some of the uncertainties associated with Trump's policies, the global political landscape is a source of potential market risk. There is a worrisome lack of effective leadership in France, Germany, and Japan to address structural economic challenges. And while both the Ukraine and Middle East wars appear to be in their late stages, there is still scope for negative surprises that could upset oil markets as well as economic sentiment.

Investors need to be prepared for higher volatility and occasional bouts of risk-off whenever aggressive protectionist actions are threatened. Bond yields are currently in consolidation mode but another upleg is possible over the course of 2025 to reflect steady economic growth, above-target inflation, and concerns about the G7 fiscal outlook. In the meantime, U.S. equities are stretched in valuation terms and becoming overbought. One clear threat to both stocks and bonds would be a rise in the U.S. 30-year Treasury yield toward or above the 5% peak hit in October 2023, if strong U.S. economic growth coincides with sticky inflation and mounting fiscal concerns that eventually force the Fed to the sidelines. In the other direction, slowing U.S. labor markets and potentially slowing growth in Europe could threaten earnings and multiples.

Conclusion

The ongoing economic expansion should enable stocks to outperform bonds in 2025, albeit by a much narrower margin than this year and with fatter tail risks than usual.

Data from Bloomberg as of Dec. 6, 2024

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