Monthly Commentary

Nov 6th 2024

One and Done? | Steve Henderly, CFA

Twenty years ago, an influx of dominant high school basketball players caused controversy among the NBA and its players union, and in 2005 the "one-and-done" rule was implemented. The rule stipulated players coming out of high school must spend at last one year at the collegiate level or alternate organization to better prepare for the physical and mental demands of the NBA. While "one-and-done" is generally associated with athletes fixated on going pro, a dramatic reversal higher in interest rates last month leaves some already questioning whether the Fed's recent pivot to rate cuts will be "one-and-done" after the FOMC meeting this week.

We intentionally delayed sending this month's update with the idea we might be better equipped to offer some comments relating to the outcome of the election. Despite many believing that one candidate or the other will be of detriment to the market, historical data does not support that perspective. There is negligible difference in overall market performance under one party's leadership compared to another.

Style	October	YTD
S&P 500	*-0.9%*	*+21.0%*
Mid-Cap Stocks	-1.0%	+13.2%
Large-Cap Stocks	-1.1%	+18.1%
Avg US Stock Fund	-1.1%	+14.9%
Small-Cap Stocks	-1.8%	+9.0%
Bloomberg Bond Idx	-2.5%	+1.9%
Foreign Stocks	-5.4%	+6.9%

Election years are often marked with elevated volatility, particularly leading up to the election. Markets prefer certainty vs. uncertainty, and with the election now behind us, companies should begin feeling more comfortable finalizing any pending plans to invest back into their businesses and growth. There is evidence in the form of company surveys that many were hoarding capital in recent months awaiting clarity. The worst outcome for the markets (and arguably the country in general) of the current election would have been lack of a clear winner for an extended period.

At the margin, the financial media and economists suggest Trump's presidency may result in both higher economic growth as well as government spending. Higher government spending without credible efforts to pay for it in real-time would require additional debt issuance and apply continued upward pressure on interest rates. The level of government debt is increasingly a concern for financial markets. Further, Trump's vocal support for tariffs is viewed as less friendly toward international trade and could result in higher prices (inflation) for consumers. Higher inflation and stronger economic growth suggest the Fed may not cut interest rates as much, or as quickly, as market expectations imply.

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In our 3Q Nvest Nsights newsletter we discussed the "whiplash" investors are experiencing around interest rates in 2024. It seems quick sentiment shifts around rate expectations will remain for some time longer. At the time of the Fed's September rate cut, market consensus was for 6-7 additional rate cuts between now and the end of 2025. This would imply all rates and the cost of borrowing might continue to ease. Yet to the surprise of many, most bond yields reversed sharply higher last month with the 10yr US Treasury rate moving from 3.6% on September 18 to as high as 4.35% in the last week.

Action in bond yields seems counterintuitive to the expectation for additional rate cuts, but occurred because better than expected economic data continues to arrive. Additionally, shifting odds in the Presidential race were cited for moving the markets in October. Polls and betting markets showed a tightening race throughout October causing markets to recalibrate different policy dynamics. Bonds forfeited some of their attractive 3Q performance due to rising yields (bond prices suffer when interest rates rise).

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Rates affect not only the bond market. Over the past two years, stocks appear to suffer "indigestion" when rates approach and/or rise above 4.5%, as we witnessed in October 2023 and April 2024. Thus, the S&P500 experiencing only its 2nd negative month of 2024 last month (roughly -1%) should not be surprising. In fact, if not for the outsized influence of the gravity-defying Magnificent 7 stocks, weakness in the stock market was generally more pronounced than observed through the S&P500. Most areas of the market experienced even greater drawdown.

Stocks most levered to the level of interest rates (mid- and smaller-sized companies, cyclically sensitive sectors such as real estate and homebuilders) felt pressure. International equities suffered acutely during the month. Markets appeared "anxious" in recent weeks, perhaps looking for an "October Surprise". Headlines during the month highlight anxiety:

- "Economists Warn of New Inflation Hazards After Election" – WSJ
- "US Bond Market Braces for Trump Trade of Large Tariffs & Deficits" – NYT
- "Treasuries Sell-Off Reverberates Through Global Markets" – Financial Times
- "10-Day Test Coming for Bond Market Battered by Selloff." - Bloomberg

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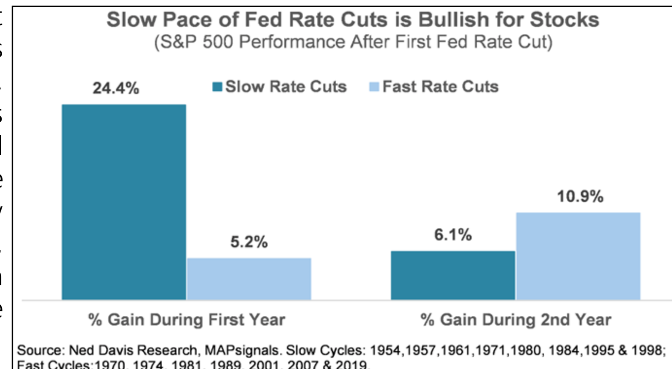
S&P 500 Forward Performance vs. S&P Trend on Election Day		
S&P in an Uptrend	**+3-Months**	**+6-Months**
Average	5.4%	7.0%
% Positive	84.6%	84.6%
S&P in a Downtrend	**+3-Months**	**+6-Months**
Average	-2.6%	-0.1%
% Positive	40.0%	40.0%

Historically, the market tends to provide the most desirable performance in the 4th quarter and this theme is upheld during election years. Studies show that Presidential elections, regardless of outcome, tend to restore or give new energy to whatever was the market's dominant trend heading into the election. When trend was positive leading up to the election, the market resumed upward after the election result; when trend or the economy was weak or softening, it similarly continued in that same direction thereafter (recall 2008). A change in the White House does not, on its own, change the overall direction of the economy in meaningful ways over the short- to intermediate-term. Our primary concerns about the Trump win are rhetoric around tariffs as well as single-party control. Tariffs invite retaliation from other countries and raise prices for consumers (inflation part II?); single party control also suggests policy proposals made during the campaign are more likely to become enacted and thus lead to higher spending.



Back to the Fed and Rates; should we expect "one-and-done" after a cut this week? It's possible if yields remain elevated. Regardless, we maintain the perspective that interest rates are likely to remain higher and more normal (fewer than 6-7 cuts and not ultra-low) in the years ahead. We welcome more historically normal rates and prefer a slower cutting cycle. Fed easing cycles are typically associated with economic weakness and declines in corporate earnings.

With the election behind us, any "air pocket" we experienced in economic activity may be near its end as companies refocus on investing in their businesses for future growth. We envision the Fed will likely cut at its remaining two meetings in 2024 in pursuit of "insurance" against bumpy economic data including soft patches. New Government spending in pursuit of fulfilling campaign promises without realistic ways of paying for those initiatives is at risk of re-awakening the bond vigilantes and stoking moves higher in interest rates. This would limit the Fed's ability to ease as much as expected. We anticipate a strong conclusion to 2024 and continuation of the bull market in 2025, but at a more hesitant pace.

Remain invested… time is your greatest investment ally regardless of an election outcome. Companies, like citizens, will find ways to continue moving forward, regardless of who calls 1600 Pennsylvania Avenue home for the next four years.

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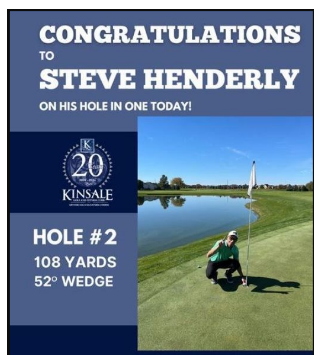
Nvest Engagement: Delivering financial peace of mind is our ultimate goal. A quick summary below of the content our team shared over the past month via LinkedIn and Facebook. We hope you find these updates useful and informative. Please take a moment to follow us to receive on-going updates:

Like us on Facebook | Follow us on LinkedIn

- Congrats to our very own Steven Henderly, CFA on his first ever hole in one!
- As we celebrate one year in our new office at 9757 Fairway Drive, we are thankful for our wonderful clients. Please schedule a visit!
- Futures traders are expecting a 95% chance rates will fall 25 basis points at the Federal Open Market Committee (FOMC) meeting on November 6–7, based on the CME FedWatch Tool. LINK
- Interesting article for those still holding I-Bonds. We are always happy to answer questions and offer our perspective. Enjoy! LINK
- Happy Birthday to our very own Diane Carpenter! We are so grateful for her passion to help our team and clients. Enjoy your day!



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