Economic & Market Update

November 2024 Outlook

Global Economy

- September's Consumer Price Index data came in a touch hotter than expected, but broader disinflationary trends remain intact. Given that most investors (and central bankers) had fully turned their attention to the state of the labor market, we were all probably overdue for a reminder that inflation is not yet dead and buried. Services prices continue to respond to strong consumer demand, but we still expect gradual progress on shelter inflation, which was one bright spot in the most recent report. In the meantime, subdued goods inflation should continue to buy us time, although it will be important to keep an eye on tariff policy in 2025. Wage inflation is also still running above broader inflation rates, but measures of productivity have increased, which indicates that companies are largely getting what they pay for in terms of output.
- Consumption is still the key driver of U.S. economic growth, with recent strength reflected by an impressive 0.7% monthly gain in the retail sales control group for October. It's true that other pockets of the economy have been struggling (for example, housing, manufacturing, and commercial real estate). However, at almost 70% of our gross domestic product (GDP), consumption of goods and services has enough weight to carry the broader economy forward. In this all-important area, momentum remains as strong as ever.
- October's labor market data was mixed and skewed by a handful of one-off factors that we expect to at least partially reverse in the near future (if they haven't already). Weekly initial jobless claims have already fully reversed their early October spike that was primarily driven by the tragic and destructive back-to-back hurricanes that wreaked havoc on the South. Hurricane impacts were also felt in the month's nonfarm payroll report (as were the impacts of major strikes that have since been resolved). The report showed only 12,000 new jobs in October, although the unemployment rate held firm at 4.1%. All in all, we feel that labor conditions are now much more balanced and should stabilize near current levels.
- Elsewhere in the world, most other economies are still struggling to keep up with the United States. Growth in the European region remains tepid, with Germany a key source of weakness. Global central banks, including the European Central Bank, Bank of England, and Bank of Canada, are all responding with policy easing while being mindful of dormant inflation pressures. As central banks ease, we are looking for early signs of recovery, but we aren't seeing anything notable just yet.
- China's stimulus-fueled equity rally has started to fizzle, as investors begin to question whether authorities are doing enough to craft a sustained recovery in the beleaguered economy. In our opinion, most of the measures announced so far address the economy's symptoms, but not the underlying disease. To

us, the Chinese bond market's reaction was a better reflection of the fundamental outlook than its equity markets. Interest rates have risen modestly, which indicates that the announced measures are a good start, but there is plenty more work to be done. At the end of the day, structural headwinds like demographics, elevated debt levels, and declining foreign investment will be a high hurdle to clear. Given the breaking news of Donad Trump's reelection as president of the United States, we expect tariff policy and economic competition to accelerate significantly in the near future.

Equity Markets

- With roughly three-quarters of S&P 500 Index earnings in the books, Q3 earnings season is bringing about decent results. Revenues and earnings are both expected to be up about 5% year over year, which implies that corporations in general are protecting, but not expanding, profit margins.
- Estimates for full-year 2024 are being reined in slightly but are still pointing to a solid year of nearly 10% growth. Estimates for 2025 are holding out for an additional 15% earnings growth. Most of the burden for meeting these estimates will fall on expanding profit margins. As we dig into Q3 results, we are looking for clues into the feasibility of this assumption. If these earnings estimates are possible, elevated valuations at the headline level may be appropriate.
- Earnings for the all-important mega-cap tech cohort have largely been adequate, although market reactions have been mixed. The so-called hyperscalers continue to spend heavily on the infrastructure buildouts they will need to facilitate their transformative artificial intelligence technologies. Investors still seem optimistic that these capital expenditures will bear fruit, but they will want to see signs of a return on investment in the coming quarters.
- We saw continued signs of leadership rotation in October, with financials ending the month as the S&P 500's best-performing sector. However, large-cap stocks did outperform small-cap stocks in the month. Bifurcation between the earnings backdrop for large and small companies continues to be a theme in public markets as well as the small business landscape. An earnings recovery for small caps appears to be further delayed, but we still believe better days are ahead as we get further into an easing cycle. A trough in earnings paired with attractive valuations can be a powerful combination, particularly if investors decide to hunt for value given elevated valuations in the large-cap space.

Bond Markets

- Ironically, Treasury yields have been climbing since the Federal Reserve (Fed) cut interest rates in mid-September. Part of this move was surely an attempt by investors to get ahead of a possible "Trump trade" as polls moved slightly in the favor of the former president over the course of October. Trump is seen by some as the higher-deficit and higher-inflation candidate due to his proposed tax cuts and tariff policies. His surprise election in 2016 was met with a rally in interest rates, and it is possible that markets were attempting to get ahead of a similar move as odds shifted marginally. But another explanation is simply that domestic economic data has also improved markedly. Despite pockets of weakness, strong consumption still powered real GDP growth of 2.8% in Q3, while the labor market appears to be stabilizing, and disinflationary trends remain intact. In such an environment, we would have expected Treasury yields to rise.
- We had felt that the 10-year U.S. Treasury was pricing in too much economic pessimism in mid-September when it got as low as 3.63%. While rising rates can be painful for existing investors who see prices of their holdings fall, we feel that this new general range is more appropriate given our optimistic economic outlook. Credit spreads remain anchored near historical lows, which indicates that investors are not seeing risk to corporate fundamentals.

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Monetary Policy

- Given recent economic strength, expectations for the pace of rate cuts have fallen more in line with the most recent projections in the Fed's Summary of Economic Projections. As the soft-landing scenario continues to play out as we expect, the need for substantial rate cuts will be limited. We expect policymakers to follow a slow and cautious path of easing that will likely not be completed until 2026.

Commodities and Currencies

- Despite a volatile geopolitical situation in the Middle East, crude oil prices remain near their lowest levels of the year, with West Texas Intermediate crude oil ending the month below $70 a barrel. Excess capacity from OPEC countries is still being met with limited demand from industrial economies like China. As a reminder, we aren't convinced that Chinese stimulus efforts will lead to a sustained reacceleration in economic activity. However, we are watching for signs of reacceleration elsewhere in the world as central banks begin to ease. And of course, geopolitics remains the key "wild card." At the moment, energy prices do not appear to be a source of inflation pressure.
- The U.S. dollar had a strong month in October, driven by solid economic growth relative to most other countries as well as increasing odds of former President Trump's re-election, whose policies are seen by some as supportive of interest rates. Now that the election has been resolved in Trump's favor, the new administration's trade negotiations with both friendly and competitive nations will be a key driver of currency markets.

What This Means for Investors

- The economic backdrop for the United States remains supportive, especially when compared with other global economies. Domestic output continues to power along near trend, while disinflationary trends persist, and the labor market approaches equilibrium. Earnings expectations for domestic companies are optimistic (small caps are a notable exception where the bar is much lower). Given the benign economic environment and steady policy easing, we believe such earnings growth is possible, though time will tell if the expectations are realistic. Regardless, equity markets tend to have good seasonality in the last two months of the year, particularly when the first 10 months have been as good as they have been in 2024. From our research, election outcomes do not tend to get in the way of this momentum. Fixed-income markets have repriced to reflect a more sanguine economic environment. Going forward, we will be watching the Trump administration 2.0 for any potential impacts of its policies to economic growth, inflation, and the fiscal situation.

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