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Wealth Advisory Market Update

December 6, 2024

Equity Markets:

The market, as measured by the S&P 500, had its best performing month of the year. The performance can be attributed to election euphoria moving the market as investors see less regulation in the future as beneficial for companies. This was most noticeable among the Russell 2000 index, which tracks smaller capitalization companies, as it rose by 10.8% for the month. Smaller companies would benefit the most from deregulation and lower taxes and lower rates.

Investors have begun shuffling their portfolios to fit a Republican-led agenda. That was evident by the strong performance in Financials and Energy for the month. These indices rose by 10.2% and 6.3% respectively. The prospect of pullbacks in regulation, as well as a ramp up in domestic oil production, sent these stocks higher. Out of the seventy-two stocks in the financial sector, approximately 95% of them recorded gains for the month, with many seeing double digit increases. Conversely, Healthcare was the laggard of all sectors, as it rose by just 0.1%. The new administration's cabinet picks could affect the healthcare sector going forward. This could be done through price controls on drugs and health insurance changes. RFK Jr. was very outspoken on this leading up to the election.

Earnings season has nearly come to an end. Messaging from retailers continues to suggest a consumer that is struggling. For instance, Target saw their biggest earnings miss in over two years and issued negative guidance going forward. Their CEO mentioned a deceleration in discretionary spending. Home improvement companies Lowes and Home Depot reiterated that there is slow demand for Do-It-Yourself projects as the consumer wrestles with elevated interest rates and prices that are still not coming down.

Equity markets overall remain expensive. Relative to history, we are in one of the most expensive markets in history. Concentration is the main driver. If we look at the market, most sectors and companies remain fairly valued. However, the largest segment of the index by market cap (information technology) is extremely stretched. In our opinion, this is more of a concentration bubble than an overall equity market bubble. The top 10 stocks in the S&P 500 now make up nearly 35% of the market and trade at an average multiple of 52x earnings.

Economic Indicators and Monetary Policy:

All eyes continue to follow the Federal Open Market Committee (FOMC) and look for any insight into rate cuts in December. The market is currently pricing in a 75% chance of a 25-basis point cut this month. FOMC members have implied that they can continue to cut rates, as it is of their opinion that policy is still restrictive. The Fed will continue to digest new data points that come out over the next few weeks before making their decision.

Our view continues to be that the economy is headed for a slowdown. The Fed must have a reason for the continued reduction of rates, even though they have said that the economy remains strong and the labor market is solid. When looking into the data of the Bureau of Labor Statistics (BLS), it continues to show some concerning trends. For example, the spread between private and total payrolls has been negative for nineteen consecutive months. Coupled with credit card delinquencies that have reached levels not seen since 2012, as well as credit card debt at all-time highs, this data hints at a slowdown. This leads to a consumer who is heavily burdened by debt and the interest burden on that debt. This will lead to a slowdown in consumer spending over the coming 6-12 months. The Fed may not let on to this, but we believe they are making decisions based on this data.

As we know, there are lag effects on the economy when it comes to injecting liquidity into the market, as well as when you remove said liquidity. M2 is showing signs of slowing as covid money has been drawn down and bank lending is steadily slowing, especially as commercial real estate continues to be a headwind for midsized banks. The consumer savings rate is back at lows, not leaving dry powder left for the consumer. At the same time, we have an inverted yield curve and business hiring slowing dramatically. The fact is that recessions happen after the Fed cuts rates, not before. Historically, these indicators point to a slowdown sooner rather than later. We are positioned for an economic slowdown and falling interest rates.

Strategy:

With a new administration set to begin next year, we will monitor the effect of any new policies that are implemented. However, our discipline does not change. Our opinion is that fundamentals will begin to take hold as many managers have strayed from their investment philosophy and have chased returns. As a result, valuations have become stretched to levels not seen since the DotCom bubble. That is why we focus on companies with robust free cash flow and market dominant positions. We target sectors that have historically shown the ability to withstand an economic slowdown.

Interest rates have pulled back from the levels they've reached earlier in the month. . Short term rates continue to head lower because of the Fed lowering the federal funds rate. The middle and end of the yield curve have risen from the continued deficit spending we are witnessing. Remaining short when rates were low has allowed us the opportunity to extend duration and take advantage of the higher yields. With credit spreads still tight, high-quality credits remain favorable. We also see rates coming down over the next year as the economy slows, so locking in rates now in the belly of the curve offers a good risk/return profile.

As we navigate this challenging environment, we appreciate the opportunity to collaborate with you in achieving your financial goals.

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