Weekly Market Insights

October 14, 2024

The Sun Also Rises!

Financial Markets

This past week was an excellent one for equity markets and investors. The S&P 500 set a new high, and the other major equity indices also advanced.

	Total Return (%)		
Index	**Prior Week**	**Year-to-Date**	**1-Year**
S&P 500	1.13	23.25	34.80
S&P 500 Equal Weighted	0.77	15.63	28.67
Dow Jones Industrial Average	1.21	15.42	29.32
NASDAQ Composite	1.13	22.89	35.30

Some may be surprised to learn that the reason we borrowed Hemingway's famous title is not because of recent market gains. But if not for that reason, then why? Of course, nothing is certain, but the economy appears strong, inflation is seemingly under control, and the Federal Reserve looks poised to follow its desired path to lower interest rates. We will spend more time on this later in the economics section.

The reason for optimism is that when the market made significant gains in the past, it was due to one of two reasons. Positive corporate earnings reports have been one reason. However, even strong earnings have sometimes not led to market gains. The reason is that if stronger earnings spelled too strong an economy, then it would become less likely that the Federal Reserve would ease its monetary policy stance. This leads us to the other seemingly contradictory reason investors have bought equities. If the economy is settling into a path of moderate growth, slowing inflation, and a more accommodative Fed, then "the sun also rises." Of course, no one knows what the future holds, but this is as close as we have come to a balanced economy for a long time. Now, perhaps the election will take the spotlight.

Economics

At least this past week, the stars aligned for those betting on a soft landing or no landing. But, of course, that ignores the problems the economy faces in the immediate future. The damage caused by hurricanes Helene and Milton will result in a short-term hit to growth; however, in the scheme of the national economy, the damage isn't devastating in the long term. That being said, it most certainly is for the people and businesses involved.

Markets are often ruled by emotion, at least in the short run. Therefore, investors' reactions to political developments can have future implications. The market hasn't revealed anything quite yet, but it bears watching.

Regardless of election outcomes, leaders must focus on the country's large and growing deficit. It is unreasonable to think that, as some do, the country can grow its way out of its problems. It doesn't make sense to us to think, as the Modern Monetary Theorists do, that deficits do not matter. Compounding the problem is that there are two distinct deficits—the budget deficit and the Social Security/Medicare deficit. Each is unique and needs its own solution. Fortunately, there may be help on the way. We have written about the enormous investments in technology occurring at the present and the rapid advances in new technologies like A.I. As these advances come to fruition, they should spur significant returns to capital and labor and, ultimately, to corporate profits. Fortunately for the federal government, these profits will be taxable and add significantly to tax receipts. This would go a long way in helping repair the country's fiscal situation, but the plan must be put in place now.

Conclusion

We began this paper with an allegorical ray of sunshine and are ending with serious thoughts about the ever-increasing budget deficit. Both are important, and neither cancels the other out, but one helps solve the other.

At the risk of sounding like a broken record, the United States has been and continues to be the strongest economy in the world. The rest of the world is generally improving, while China is probably facing the most difficult recovery.

Although we ended today's letter with our concern about deficits, they are a problem for the future. While above-average valuations are notable, long-term investors should not be hesitant about investing in U.S. markets.

As always, vigilance is essential as markets go higher and investor exuberance rises.

Yield Curve Update

The Treasury yield curve experienced a "bear steepening" move this past week—when yields at the long end of the curve rise faster than yields at the short end. The 2-year yield rose 3 basis points, while the 10-year rose 13 basis points, increasing the 2-year/10-year yield spread by 9 basis points to +0.14%.

This type of movement typically signals rising inflation expectations, with rising long-term interest rates reflecting eventual rate hikes to combat future inflation. Thursday's higher-than-expected Consumer Price Index (CPI) reading spurred the move higher, although a week-over-week spike in unemployment claims helped to offset stronger inflation data. To be clear, the Fed remains on an easing path, and despite the higher-than-expected inflation print, the general disinflationary trend remains intact. Furthermore, with the Fed's renewed focus on the labor market, any signs of employment weakness keep rate cuts on the table.

The market has adjusted accordingly, with Fed Funds futures now pricing in a 0% chance of another 50 basis point cut in November. A 25 basis point cut remains the expectation. As we regularly warn readers, a lot can change before the Federal Reserve meets for its next policy-setting meeting on November 6 and 7, with the incoming economic data continuing to guide the Fed's policy decisions. Next week, we will receive updates on Retail Sales, Industrial Production, and unemployment claims for more insight on U.S. economic growth and the labor market.

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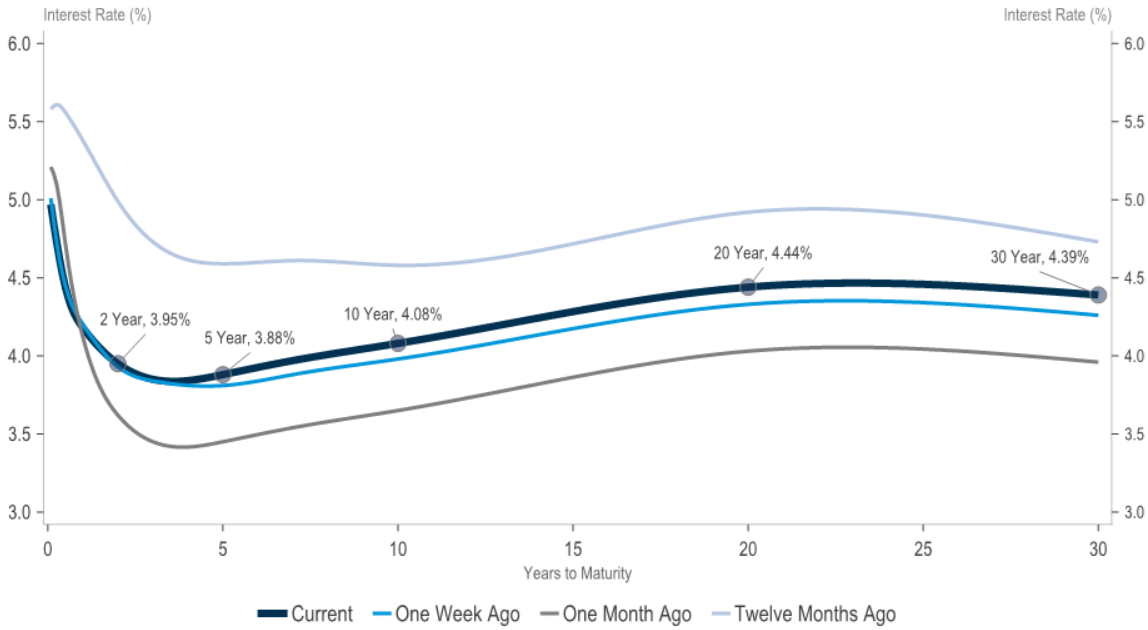
Yield Curve

Interest Rates for U.S. Treasury Securities by Maturity Date



U.S. Department of Treasury, Daily Treasury Bill Rates Data
Data as of 10/11/2024

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