Weekly Market Insights

December 9, 2024

A New Beginning

Financial Markets

Equity markets put in a mixed performance last week. Led by big tech, the S&P 500 still managed to finish in the green for a third straight week. Although the incoming economic reports were largely positive, markets reacted in lackluster fashion.

	Total Return (%)		
Index	**Prior Week**	**Year-to-Date**	**1-Year**
S&P 500	0.99	29.34	35.75
S&P 500 Equal Weighted	-1.23	19.08	26.34
Dow Jones Industrial Average	-0.60	20.57	26.10
NASDAQ Composite	3.36	33.19	41.40

Investors were encouraged by this past week's jobs report. While November's payroll gains were solid, the unemployment rate unexpectedly increased to 4.2%. It appears that the Federal Reserve will likely accommodate investors with another 25-basis point cut next week.[1] We may see some market volatility next week when the Federal Reserve announces its next interest rate move. It will be interesting to see if investors begin to pull in their horns and wait for the inauguration.

Economics

At the risk of sounding like a broken record, the United States economy remains the healthiest in the developed world. And now it looks like it will stay that way for the foreseeable future. Are there dangers lurking in the future? Certainly. We must wait to learn more about the incoming president's plans, but there is one obvious danger—a second wave of inflation. Some analysts are concerned about the economy's strength and the potential reacceleration of inflation. As it stands now, we are comfortable with the current trajectory and believe the Fed will remain vigilant in its fight to promote price stability.

Structurally, the economy looks remarkably strong relative to the rest of the developed world. We, and seemingly everyone else, have written about China's struggles. The country remains in limbo, while the European Union and U.K. stay in a minor rut. Scholars have argued different reasons why the United States has stood out, but what makes sense is what has made sense since the days of Adam Smith and David Ricardo. Both argued that productivity boosts can help to counter inflation and promote economic growth and efficiency. As we have written, businesses and governments in the United States have been investing heavily in capital and infrastructure, effectively adding new productive capacity.

Capital investment is vital to both productivity and progress. The world is starting on a journey that has the capacity to lift society and the economy to new and greater heights. Of course, we are alluding to AI and quantum computing. Both inspire a degree of fear and loathing in some, but they should also inspire hope and excitement. We have written positively about these developments in the past, believing we are in the

[1] One basis point is one-hundredth of a percentage point.

early innings of another industrial revolution. Yes, it will cause some pain and plenty of anxiety, but both technologies can do great things for society. The United States and China are leaders in the race and are in fierce competition to be the winners. Therefore, both private industry and governments must cooperate in this competition. The winner will reap great rewards. We will have much more to say on this topic in the future.

Yield Curve Update

Yields moved higher in the days following the election, peaking about one week after the results were known. Yields have declined since, driven primarily by post-election political developments and the incoming economic data. Relative to the day before the election, the 2-year Treasury yield has dropped 6 basis points, and the 10-year yield has declined 13 basis points. Since the post-election peak, the 2-year yield is down 18 basis points, while the 10-year yield is down 30. The current 2-year/10-year spread sits at +0.05%, modestly flatter than pre-election at 0.12%.

We saw a significant decline in yields, particularly in longer-dated notes and bonds, after President-elect Trump nominated Scott Bessent as Treasury Secretary. While climbing government debt levels and persistent deficit spending remain open issues, Bessent's more conservative fiscal policy stance has helped to alleviate investor concerns about unchecked government borrowing. Bessent, a seasoned Wall Street hedge fund manager, is focusing on his "3-3-3" policy—reducing the budget deficit to 3% of GDP by 2028, driving 3% real GDP growth, and increasing domestic oil production by 3 million barrels a day. Bessent's agenda aims to address the U.S. national debt problem, stimulate economic development, and ensure low energy prices. In addition to Bessent's nomination, the newly established Department of Government Efficiency (DOGE) is another reflection of the incoming administration's apparent commitment to greater fiscal responsibility. While we have yet to see how these policies will play out, investor optimism surrounding the potential for fiscal reform has manifested itself in the form of lower yields.

The incoming economic data has been generally consistent with a continued "soft landing"—gradual labor market cooling, slowing but stable economic growth, and continued disinflation. This past Friday, November nonfarm payrolls grew by 227,000, slightly higher than estimates and significantly above October's weather and strike-impacted 36,000 print. The unemployment rate ticked higher to 4.2%, while the labor force participation rate declined 0.1 percentage point to 62.5%. Earlier in the week, the ISM Manufacturing Index improved to its highest level since April, with the New Orders component (a leading indicator of economic activity) moving into expansion territory for the first time in 8 months. The Atlanta Fed's real-time estimate of GDP increased to 3.3% on the heels of the latest data. On the inflation front, the latest PCE Deflator index readings were reported to be in line with expectations, and inflation expectations remain in check, as evidenced by the latest University of Michigan's consumer sentiment survey results.

Overall, the economic data has supported the case for a 25-basis point cut at the Fed's FOMC meeting next week. Should the economy continue on its current trajectory, the Fed will likely be able to continue on its easing path and conclude its balance sheet reduction[2] in the months ahead. However, much can happen between now and then. Later this week, we will receive the November CPI report, which will impact the Fed's decision on the 18th. As always, we will keep readers updated on what develops.

[2] Quantitative Tightening (QT) is a monetary policy in which the Federal Reserve reduces the size of its balance sheet, allowing securities to mature without reinvesting the proceeds.

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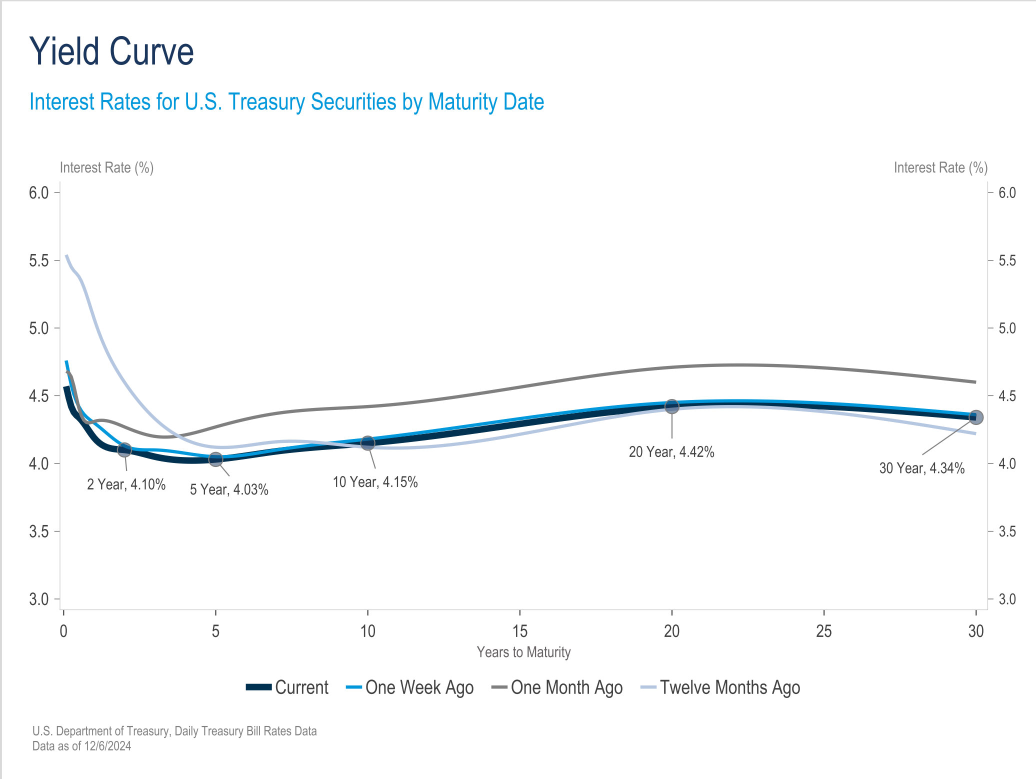
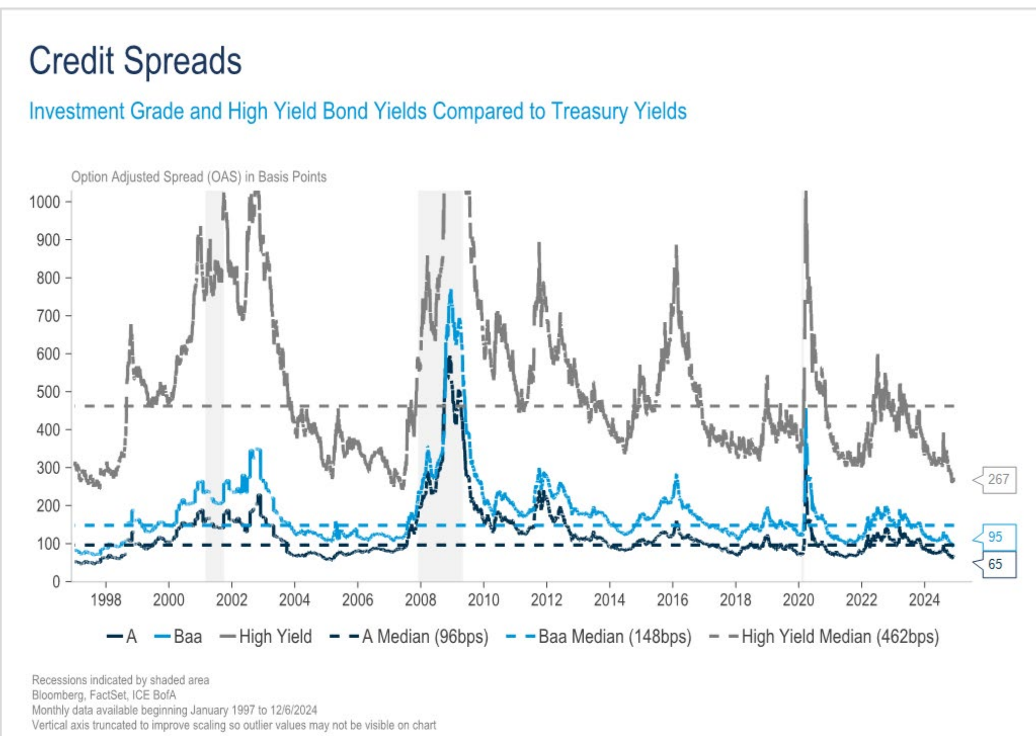


Conclusion

There isn't an easy way to conclude this week's letter. As we wrote earlier, we are a bit suspended in time awaiting the incoming president's actual proposals on trade and taxes. Overall, the United States economy looks very good. It is growing but not overheating, and the Federal Reserve appears to have won the day.



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