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Mitch on the Markets

Portfolio Manager Investing Insights

Can the Post-Election Rally Last to the End of the Year?

At the outset of 2024, most large banks were forecasting the S&P 500 Index to finish around 5,200, which would have implied a roughly 10% gain for the year. U.S. stocks had different plans.

Bolstered by stronger-than-appreciated U.S. consumer spending, steady economic and earnings growth, declining inflation, and the Federal Reserve's pivot to looser monetary policy, U.S. stocks have delivered a rally over double the magnitude of most expectations.[1]

The U.S. presidential election seems to have catalyzed the momentum. In the week following the election, the S&P 500 Index jumped +4.7% – the strongest week since October 2022. I've argued before that the 'removal of uncertainty' was a key driver of this short-term market strength, but I also think it's fair to say the market was pricing-in hopes for lower taxes and lighter regulation, both of which could promote growth.

The question for investors is, *can this post-election rally continue through the end of the year?*

I think it can.

The first factor I'd consider is seasonal. Looking back to 1950, December ranks as the second-best performance month for the S&P 500, with an average gain of 1.3%. But December is also *the most consistently positive* month, with the highest frequency of advances of any month with the lowest volatility (based on data since 1950). On average, gains have been broad-based, but small- and mid-caps have tended to outperform historically.

Strong gains leading up to December have also ushered in a strong close to the year. In the last ten instances when the S&P 500 Index entered December up more than +20%, the final month saw an average gain of +2.4%. In this historical context, strong gains beget more strong gains.

ABOUT MITCH ZACKS

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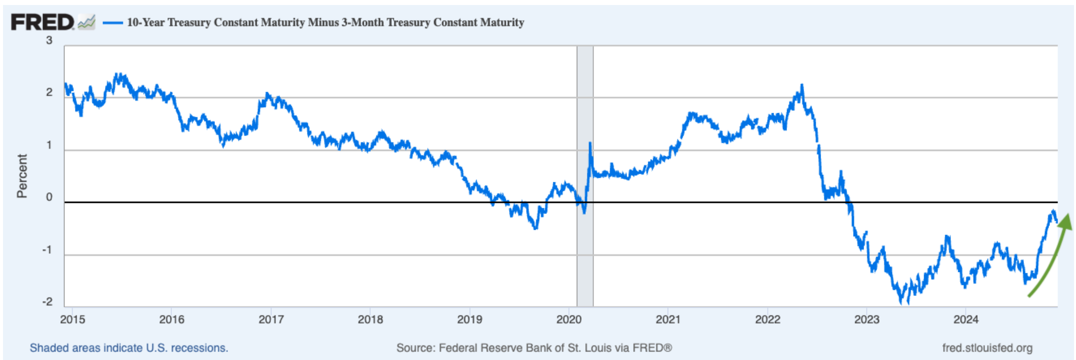
Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

I also think the market could keep pricing-in major policy shifts as the new administration's agenda comes into clearer focus. The prospect of sizable fiscal stimulus (tax cuts) into an economy that's already growing roughly 2.5% to 3% could be a significant catalyst to growth, and it could also mean adding to an already historically large U.S. fiscal deficit. In my view, this could put upward pressure on long-duration U.S. Treasuries, which could finally un-invert and eventually steepen the yield curve (Fed rate cuts would also help). A steeper yield curve would arguably help Financials while also having the potential to stimulate more lending, an economic positive.

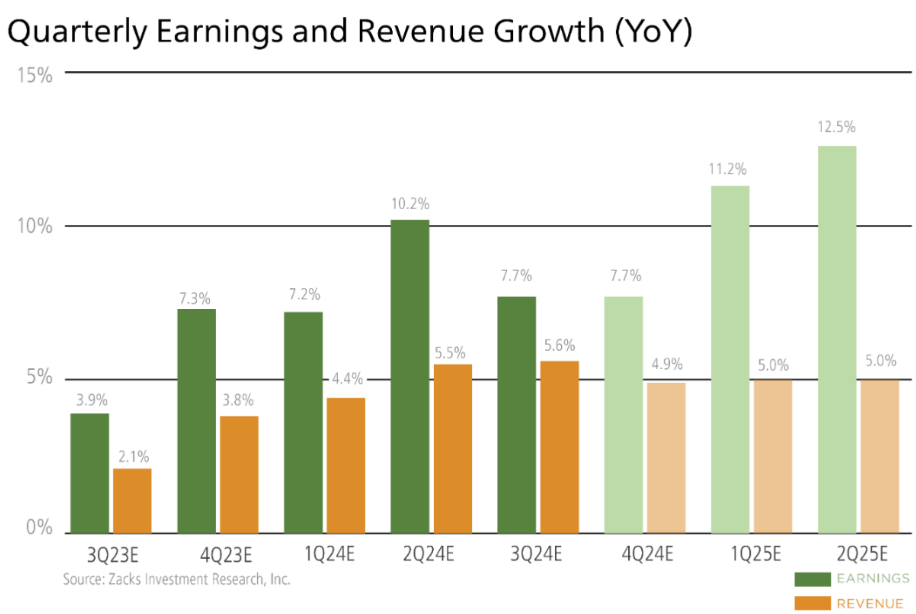
The Yield Curve Could Steepen with Further Fed Cuts and Rising Long-Duration Treasury Yields



Source: Federal Reserve Bank of St. Louis[2]

Finally, no commentary about the potential for more stock market appreciation would be complete without talking about earnings.[3]

For the third quarter, total earnings for the S&P 500 index are expected to be up +8.1% from the same period last year on +5.7% higher revenues. If we exclude the volatile Energy sector, whose Q3 earnings were down -22.9% from the same period last year on -2.7% lower revenues, then earnings would have been up +10.6% on +6.3% higher revenues. This level of solid earnings growth has been present throughout 2024, and as seen on the chart below, is expected to accelerate in the new year:



A final point to make on earnings is that unlike the unusually high magnitude of estimate cuts we had seen ahead of the Q3 earnings season, estimates for Q4 are holding up a lot better, as the chart below shows. Heading into the final stretch, companies are feeling more confident about sales and earnings than they were previously.

BOTTOM LINE FOR INVESTORS

I want to be clear that while I think stocks *can* continue to rally into the end of the year and early next, based on the factors laid out above, I am not suggesting they *will* rally. No one can truly predict what stocks will do in the short term, and downside volatility and/or a correction can occur at any time and for any reason.

Thinking further ahead, I do think economic fundamentals remain supportive of higher equity prices, and earnings and economic growth could benefit from lower taxes and looser regulation. In other words, the ingredients for more equity market gains are present, it's just a matter of whether the realities of those policies and growth will meet and/or exceed expectations. For now, I think they can.

The risks I see in the market today go the other way, i.e., the risk of economic overheating. Major tax cuts and efforts to deregulate in an otherwise strong economy could cause an acceleration of investment and activity, which could in turn tip investor sentiment into the realm of too optimistic. These are all just possibilities, however—we need to see actual policy before making any forecasts or projections. And we're not there yet.

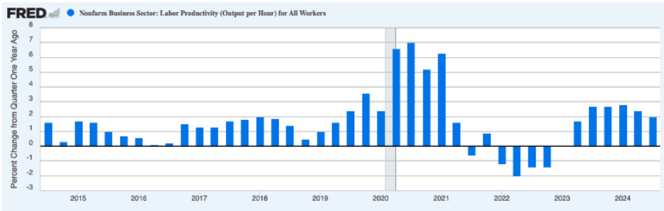
[1] Black Rock. November 20, 2024. https://www.blackrock.com/us/individual/insights/election-rally
[2] Fred Economic Data. December 3, 2024. https://fred.stlouisfed.org/seriesBeta/T10Y3M#
[3] Zacks.com. November 22, 2024. https://www.zacks.com/commentary/2374310/taking-stock-of-the-earnings-picture

STEADY INVESTOR WEEK

- **The U.S. economy shows exceptional growth**
- **China escalates trade tensions**
- **October labor report reveals mixed signals**

Productivity Growth in the U.S. Sees Steady Increase

Job growth has slowed in the U.S. over the past several months, while economic growth has picked up. A key feature explaining how this divergence is possible is rising productivity. In 2024, quarterly productivity has grown by at least 2% year-over-year, with productivity gains notched over the past five quarters. As seen in the chart below, the steady gains in productivity are consistently higher than what's been experienced in the previous decade, excluding the immediate post-pandemic rebound—when low productivity jobs like food service were slow to come back online.



Source: Federal Reserve Bank of St. Louis

The productivity gains in the U.S. are notable for their contrast to other developed economies like Europe and Canada, where productivity has grown by less than 1% on average over the last decade. Productivity gains are crucial for driving healthy long-run economic growth, because the productive capacity of the economy can expand without too much overheating in the labor market. By some accounts, rising productivity in the U.S. has happened out of necessity, as companies face a tight talent pool and have turned to other measures—like investment in technology—to get more productive output out of each worker.

China Bans the Export of Rare Earth Metals to the U.S.

Many investors and market watchers were alarmed this week when China announced it was outright banning the export of rare earth metals gallium, germanium, antimony, and superhard materials to the U.S. These metals are essential components of semiconductors, satellites, night-vision goggles, and other high-tech, often military applications. China is the world's top supplier of these metals, which had some investors concerned about short- and long-term implications. But a closer look at the issue reveals some key insights. For one, the U.S. has not imported *any* gallium and germanium in 2024, and the business community has indicated that ample supplies exist in inventory, with alternative sources available to explore as well. China's move appears to be more posturing than anything else, in response to the Biden Administration's decision to place more export controls on high-bandwidth memory chips.[2]

What the Latest U.S. Jobs Report Tells Us About Potential Fed Policy

The Labor Department delivered the latest JOLTS (Job Openings and Labor Turnover Survey) report last week, which showed further loosening in the labor market. Job openings increased by 372,000 from September, bringing the total for October to 7.74 million. A higher level of job openings tends to ease pressure on wage growth, which can factor as a positive for inflation data. The ratio of job openings as a percent of the total labor force increased from 4.4% to 4.6%. All told, there is about one open job for every unemployed American, which as seen on the chart below is a balance last achieved in 2018.[3]

Job Openings (blue line) and Unemployment Level, Persons (green dotted line)

Source: Federal Reserve Bank of St. Louis[4]

In our view, this data points to a normalization in the labor market, which reinforces the idea that the Fed can focus almost universally on inflation data in determining the path of rates.

[1] Wall Street Journal. December 5, 2024. https://www.wsj.com/economy/u-s-economy-is-doing-what-few-others-are-getting-more-productive-4c2116f5?mod=economy_lead_story

[2] Yahoo Finance. December 3, 2024. https://www.yahoo.com/news/china-targets-critical-metals-tit-102821740.html

[3] CNBC. November 3, 2024. https://www.cnbc.com/2024/12/03/job-openings-jumped-and-hiring-slumped-in-october-key-labor-report-for-the-fed-shows.html

[4] Fred Economic Data. December 3, 2024.

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