Seeing Red

November, 2024

Summary

- U.S. equities rallied post-election. Large-cap stocks rose 6%, and small-cap stocks increased by 11% in November. International equities lagged and ended the month in negative territory.
- The Federal Reserve cut rates by 0.25% in November, and another 0.25% reduction is expected in December. Inflation edged higher in October, primarily due to rising housing costs.
- Donald Trump won the 2024 presidential election and the Republican Party gained control of the both the House of Representatives and the Senate.
- The appointment of Scott Bessent as Treasury Secretary brings a renewed focus on deficit reduction and the Fed's policy of growing the U.S. economy out of debt.

Overview

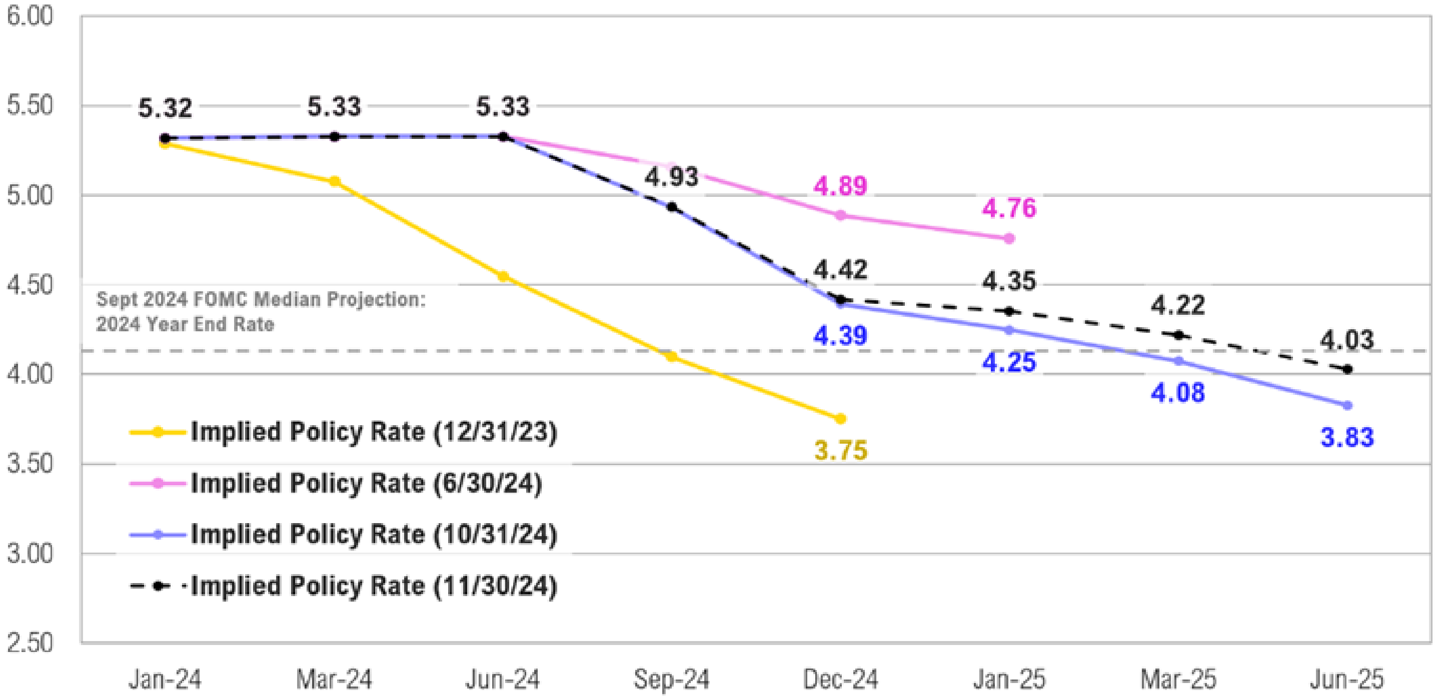
Markets posted mixed returns in November. U.S. large-cap stocks, represented by the S&P 500 index, ended the month up 5.9%, while the small cap Russell 2000 index ended the month up 11.0%. In contrast, international equities underperformed their U.S. counterparts and ended the month in the red. International developed market large cap stocks declined 0.6%, and emerging market stocks ended November down 3.6%. U.S. intermediate-term bonds, as represented by the Bloomberg U.S. Aggregate Bond Index, ended the month up 1.1%.

GDP estimates show the U.S. economy growing at an annualized rate of 2.8% quarter-over-quarter, supported by robust consumer and government spending. Consumer spending posted its best quarter so far this year as it increased by 3.5%, while government spending increased by 5.0%. The services sector of the economy continues to expand, with the ISM Services PMI registering 52.1 in November.

Although notably lower than its June 2022 peak of 9.0%, year-over-year inflation, as measured by CPI, remains stubbornly above the Fed's stated target of 2%. In October, headline inflation increased slightly to 2.6%, while core inflation remained at 3.3%, and has averaged 3.5% throughout 2024. Housing inflation continues to be the main driver of higher inflation, as the shelter component of inflation rose by 0.4% month-over-month (accounting for over half of the monthly increase) and 4.9% year-over-year.

Rate Cut Expectations for 2025 Have Declined

Implied Fed Funds Rate, %



Source: Bloomberg

October marked the start of the U.S. government's 2025 fiscal year, and the budget deficit has already reached \$257 billion—the second-largest October deficit since 1981, surpassed only by October 2020. The Congressional Budget Office projects the fiscal 2025 deficit will closely align with 2024 levels, hitting approximately \$1.9 trillion. Net interest payments remain a substantial component of federal outlays at 14%. As widely anticipated, the Federal Reserve cut interest rates by 0.25% at the November Federal Open Market Committee (FOMC) meeting. Another 0.25% rate reduction is expected at the December FOMC meeting. This would bring the total rate reduction for the year to 1.0%. Given strong economic growth and sticky inflation, one 0.25% rate cut has been priced out for 2025, and markets now expect the equivalent of three 0.25% cuts next year. On November 14, at a speech in Dallas, Fed Chair Jerome Powell stated that the Fed isn't in a hurry to cut rates:

"I expect inflation to continue to come down toward our 2% objective, albeit on a sometimes-bumpy path… The economy is not sending any signals that we need to be in a hurry to lower rates."

Over 95% of S&P 500 companies have reported third-quarter earnings results. Earnings growth estimates improved over the quarter, increasing from 4.2% to 5.8%, primarily driven by a handful of mega-cap technology companies and select market sectors such as communication services (+23%), consumer discretionary (+9%), and financials (+7%). Full-year earnings growth for the S&P 500 in 2024 is projected to reach 9.4% due to significant contributions from the communication services, financials, and consumer discretionary sectors. Earnings growth estimates for 2025 are currently expected to be 15.0%, which would be the best growth rate since 2021, when it was over 35%. As of the end of November, the S&P 500's price-to-earnings (P/E) ratio was at 22.5x, compared to 30.1x at the peak of the tech bubble. However, the top 10 S&P 500 companies account for 34.8% of the Index, compared to 25% at the tech bubble peak.

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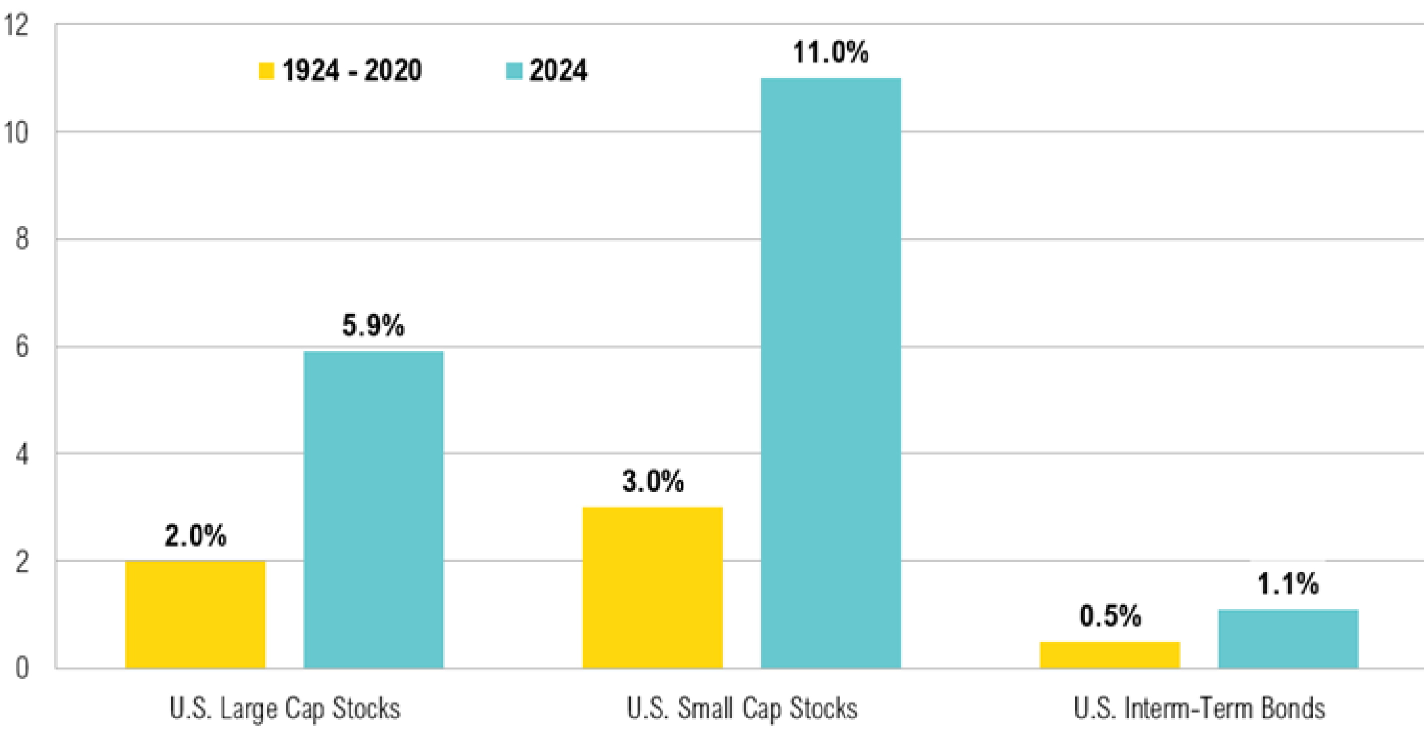
On November 6, with 277 of the 270 required electoral college votes, Donald Trump was announced the winner of the 2024 presidential election. By the final count on November 10, Trump amassed 312 electoral votes to Kamala Harris's 226. The Republican party has also kept control of the House and gained a majority in the Senate. Trump won each of the seven swing states, and the race in Pennsylvania—widely considered the key determinant. Exit polls showed that for the first time in at least twenty years, self-identified independents accounted for a larger share of voters (34%) than Democrats (32%) and were tied with Republicans (34%). Trump is also the first Republican president to win the popular vote in twenty years.

Historically, markets tend to rally following elections, and 2024 has proven no different. In fact, 2024 market returns are above average: between 1924 and 2020, U.S. large cap stocks have increased 2% during the month in which an election was held, while U.S. small cap stocks have increased 3%. In 2024, U.S. large-cap stocks gained 5.9% during the election month, while U.S. small-cap stocks gained an impressive 11.0%. U.S. intermediate-term bonds also outperformed historical norms, rising 1.1% over the election month compared to the historical average gain of 0.5%.

While U.S. small-cap stocks have outperformed large-cap peers by 4.1% since Election Day, they lag by an annualized 6.4% over the past three years. A similar pattern occurred when President Trump won the election in 2016, with small-cap stocks outperforming large-cap stocks by 7.6%. Historical precedent aside, small-cap stocks could benefit from contained interest rates, onshoring initiatives, and deregulation under the new administration. By the end of November, full-year 2025 earnings growth estimates for the Russell 2000 stood at 41%, compared to 15% for the S&P 500.

2024 Election Month Returns Were Above Historical Averages

Average Returns During Election Month, %



Source: Bloomberg

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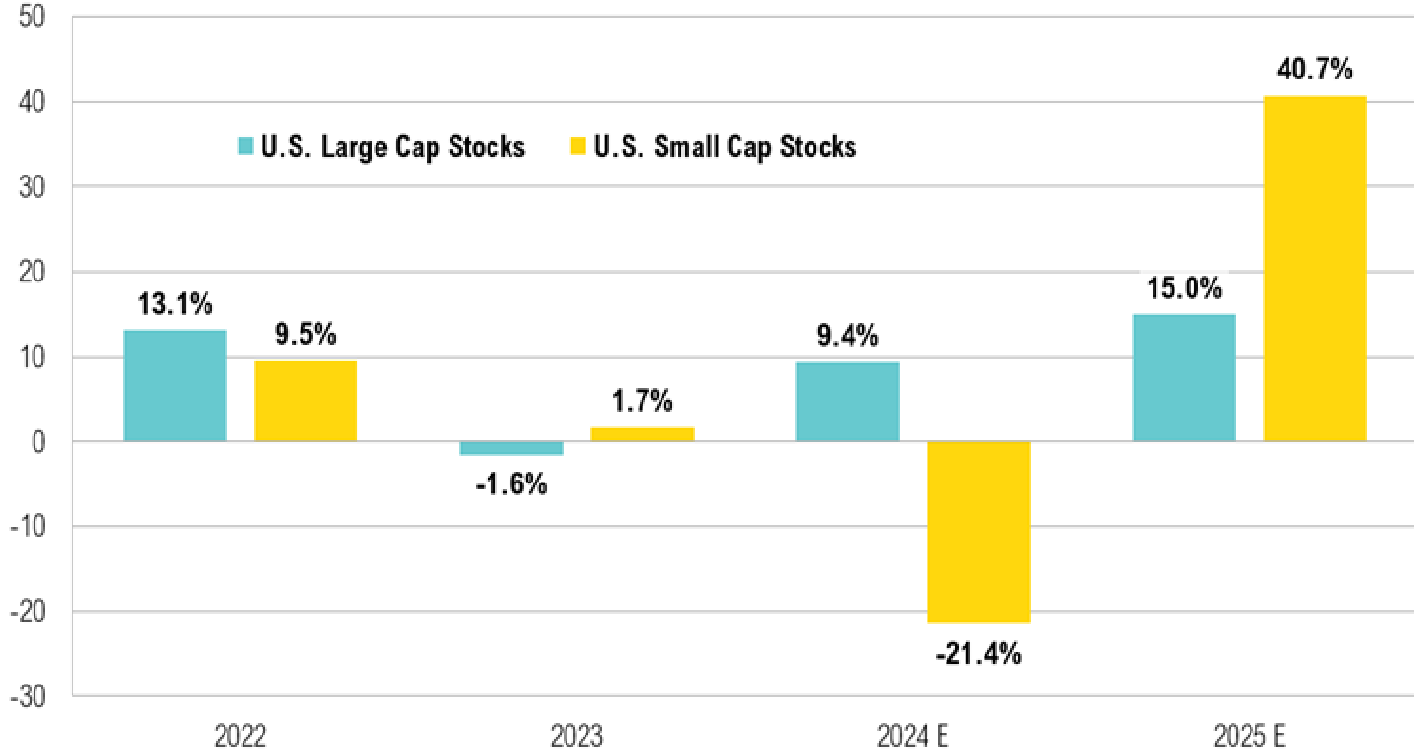
Despite 2024's Low Base, Small Cap Earnings Are Expected to Accelerate in 2025

Earnings Per Share Growth, Y/Y %



Source: Bloomberg

Long-term Treasury yields declined in November. After peaking at 4.5% on November 13, the 10-year Treasury yield ended the month at 4.2%. The bond market appeared to respond positively to the nomination of Scott Bessent as U.S. Treasury Secretary. Bessent has a decades-long career in finance, including his role as a partner at Soros Fund Management and as the founder of Key Square Group, both global macro hedge funds. His platform includes advocating for tax cuts, reducing government spending (and deficits), strong national defense, targeted and gradual tariffs, and a focus on lowering inflation. Bessent has proposed a "3-3-3" target, aiming to achieve 3% economic growth, a 3% reduction in the deficit by 2028, and a 3 million barrel increase in daily oil production (which is a 20% increase from current levels). When asked about his decision to accept the nomination, Bessent remarked:

"This election cycle is the last chance for the U.S. to grow our way out of this mountain of debt…"

The new administration will usher in a more supportive regulatory regime for digital assets. Both Trump and Vice President-Elect J.D. Vance have expressed strong support for cryptocurrencies and digital assets. Bitcoin surged 39% in November and is up 119% year-to-date. With a pro-cryptocurrency and pro-blockchain administration taking office in 2025, expectations are rising for eased regulations on exchange-traded funds for cryptocurrencies, as well as digital assets in general. There is also speculation about the establishment of a U.S. strategic bitcoin reserve. Regulatory clarity introduced by the new administration could pave the way for broader institutional and advisory adoption of digital assets and blockchain technology. This perspective is best captured by incoming Charles Schwab CEO, Rick Wurster, who recently stated that:

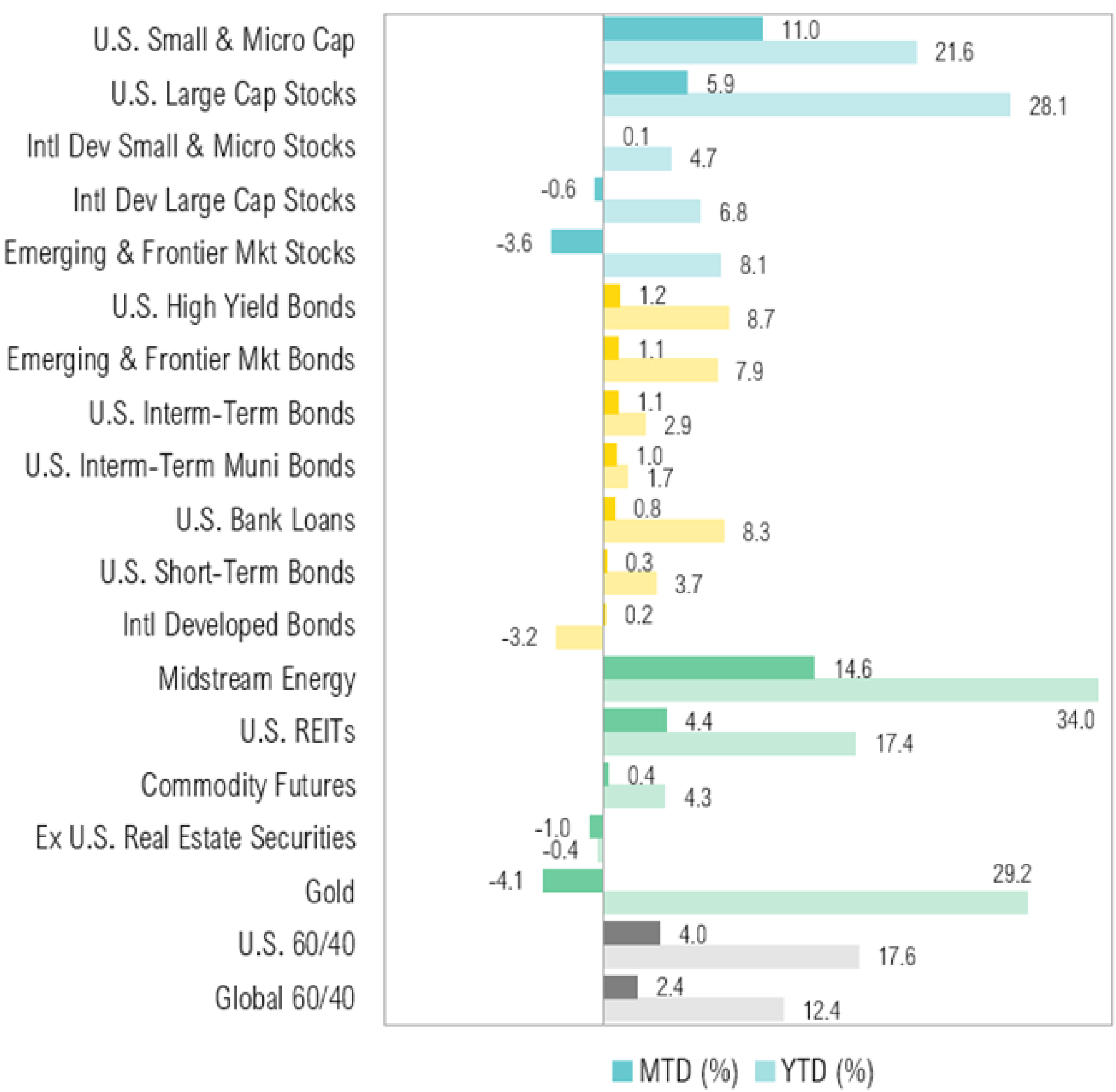
"We will get into spot crypto when the regulatory environment changes, and we do anticipate that it will change, and we're getting ready for that eventuality."

Markets

U.S. equity markets fared significantly better than their international counterparts in November. U.S. large-cap stocks ended the month up 5.9%, while international developed large-cap stocks ended the month down -0.6%. Similarly, U.S. small-cap stocks ended the month up 11.0%, while international developed small-cap stocks ended the month up 0.1%. Emerging market stocks ended November down -3.6%, driven by declines in Brazil, South Korea, and Taiwan. A similar pattern occurred in fixed income markets where U.S. intermediate-term bonds gained 1.1%, but international developed bonds ended November up only 0.2%.

In geopolitical developments, on November 17 President Biden approved Ukraine's use of U.S. missiles on Russian territory. In response, Russian President Vladimir Putin signed a new doctrine on November 20, lowering the threshold for deploying nuclear weapons. After climbing to $72.50 per barrel on November 5, West Texas Intermediate (WTI) crude ended the month $4 lower on news of a ceasefire between Israel and Hezbollah in Lebanon, which came into effect on November 27. By early December, the ceasefire was in a precarious state due to exchanges of fire from both sides.

November 2024 Key Market Total Returns



Source: Bloomberg

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Looking Forward

With a decisive red sweep in the November presidential election, market participants now have more clarity on the direction of U.S. policy. Most importantly, the appointment of Scott Bessent to the Treasury brings a renewed focus on the deficit and better alignment with the Fed's policy of trying to grow the U.S. out of its massive deficit. This could keep long-term interest rates contained, which would not only help support elevated equity valuations, but also buy time for policy implementation. Given this landscape, we maintain that a well diversified portfolio continues to be a great hedge against potential policy shifts and the risk of purchasing power erosion.

As always, if you have any questions or would like to schedule a meeting with one of our investment professionals, please don't hesitate to call us at 508-693-8850.

Sincerely,

Luke Murphy
Managing Director,
Martha's Vineyard Investment Advisors

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Learn more: Visit www.mvinvestmentadvisors.com

Martha's Vineyard Investment Advisors

496 State Road
West Tisbury, MA 02575
(508) 693-8850
www.mvinvestmentadvisors.com

Performance Disclosures

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Citations

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