



Basis Points | November 8, 2024

Riding the Waves

1. Election Uncertainty Becomes Policy Uncertainty

Financial markets have priced President-elect Trump's decisive victory and the apparent Republican sweep of Congress. In the first trading day after the election, US equity indices were up across the board, led by small-cap stocks, with the S&P 500 and Russell 3000 up by 2.5% and 2.8%, respectively. Bond yields and the dollar also moved higher – as did inflation expectations – as investors appear to be pricing in greater chances of a higher-growth, higher-inflation outcome.

A clear election outcome has afforded markets some clarity. But in coming weeks, months, and quarters election uncertainty will likely give way to policy uncertainty as the new government grapples with taxes, international trade, and other important economic policy factors.

2. Fundamental Matters

Economic and market data have beaten expectations at almost every turn this year. Corporate earnings grew 5.1% in Q3, and analysts expect this to rise to 15.1% in 2025.¹ Real GDP growth was 2.8% in Q3, above estimates of the longer-term trend. The services sector refuses to slow down as consumer spending remains upbeat, buttressed by sustained income growth and apparently decent job gains despite several months of mixed employment data. **Even if policy uncertainty rises from here, we think markets will pay more attention to strong economic and market fundamentals.**

3. New Normal?

Inflation recently has leveled off at around 2.5%, close to but still materially above the Federal Reserve's 2% target. **Consumers and investors see the inflation fight as not yet finished:** 5-year inflation swaps have risen to 2.6%, up from 2.5% before Election Day and 2.3% in September. What has driven this change in sentiment? First, more optimism on US economic conditions. Second, investors may have priced a higher likelihood of elevated budget deficits and the potential for trade policies that could contribute to inflation.

4. Bear Steepening

The move in Treasury yields since mid-September has been unusually large, especially [considering the Fed has cut the overnight rate](#) by 0.75%. On September 16th, the 10-year Treasury yield bottomed at 3.62%; as of this writing, the 10-year yields 4.30%. Economic data has outperformed, and yields rose in October as markets viewed a Republican sweep on Election Day as a real possibility. **Elevated yields offer an attractive entry point for fixed**

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¹ Year over year growth. Source: FactSet.



income investors. But the higher yields may also pose a challenge to borrowers, as seen by the 0.6% increase in the 30-year mortgage rate since its recent low in September.

5. Small Caps Rally

The broadening of equity market returns into small cap stocks was significant in the days leading up to and following the election. Since October 31st, the Russell 2000 has risen 8.5%, while the S&P 500 is up 4.7%. Notably, this outperformance has been in an environment of rising interest rates—small caps typically outperform when yields fall due to their greater reliance on credit. Investor enthusiasm over a potentially easier regulatory environment, focus on domestic production, and increased M&A activity appears to have outweighed concern over increased borrowing costs. Since mid-year the equal-weighted S&P 500 has rallied 12.0% while the widely cited market cap-weighted index has rallied 9.9%.

Near-term volatility is likely, but we continue to see potential for broadening outside of the largest US equities. We recently increased our 12-month forward S&P 500 price target to 6,200 and remain constructive on equity markets.



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