A Year-End Stock Market Rally!

November 25, 2024

Here we are, a few days before the Thanksgiving Day celebration, and financial markets are in "rally" mode. The major stock market averages hit new highs during the fourth quarter. While the first half of the year was characterized by a narrow market leadership among the seven major companies known as the "Magnificent Seven," the second half of the year has witnessed a wide broadening out of the stock market and both the mid-cap and small-cap indices have also rallied. For example, the small-cap S&P 600 is up 18% year to date, while the NASDAQ 100 is up over 23%. As of this writing, earnings per share details for the third quarter are higher than forecasted for 70% of those companies that have reported.

On the fixed-income side, results have not been as positive as expected. One broad gauge of this activity is the S&P U.S. Aggregate Bond Index. That index is up a total of 2% on a total return basis, indicating that, after interest payments, that index is down for the year. Once the Federal Reserve began to lower short-term interest rates (targeting the Fed funds rate), long-term interest rates began to climb. The reason for this divergence is the likelihood that the U.S. economy will grow faster than anticipated and that the demand for funds will accelerate. As we had mentioned earlier, a better-than-expected economic outlook may be discouraging the Fed from lowering interest rates as much as economists had expected. For now, interest rates may be in a holding pattern until fixed-income market participants get a better handle on the new administration's economic policies.

For investors in U.S. financial markets, government policies are likely to favor capitalism over big government. As a result, inflation is likely to be lower even though there are few forecasters expecting higher inflation due to the probability of tariffs weighing on the cost of imported goods. The big question is whether the new administration will be using the tariff "hammer" as a bargaining tool to level the global trading environment. The strong dollar of late should put downward pressure on import prices, buffering the impact of some tariffs. Even though China is a significant exporter to the U.S., Mexico and Canada are our two largest trading partners. Unfortunately, Europe is under continuing economic pressure, with the German economy on the brink of recession, which could be antagonized by government efforts to lower deficits by cutting spending. Recently, the new labor government in Britain passed a major tax increase to reduce the budget deficit, a decision that might lead to even greater economic problems.

One big surprise of the year is the continued equity market gains in the face of two major global wars and the possibility of further escalation as each side employs new technology to gain an advantage on the battlefield. Once again, the change in government should bring a different perspective on how to achieve peace in these conflicts. For the time being, financial markets are getting an early taste of the Christmas spirit.