"Tsunami Of News"

Market Commentary – November 2024

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The advance estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.8% in the third quarter of 2024. This is slightly less than the 3.0% reading in 2024 Q2. The components of the 2024 Q3 GDP number are: consumer spending +2.46 percentage points, investment +0.07 percentage point, net exports -0.56 percentage point, and government spending +0.85 percentage point. The sum of these numbers equals +2.82%. Consumer spending was robust, with nearly equal contributions to GDP growth from goods and services (the two major subcategories). On the other hand, investment was weighed down by weak residential and tepid non-residential spending, high demand for imports hurt GDP, and government spending is not sustainable. Overall, the economy looks decent on paper, but it is a mixed bag.

The Federal Open Market Committee (FOMC) is scheduled to make its next announcement on monetary policy on November 7. The federal funds rate currently sits at a target range of 4.75% to 5.0%. Futures markets have built in a 0.25% rate cut by December 2024 with a 46% probability of a 0.50% cut. They anticipate a total of 1.25% in cuts by November 2025, which would put the target range at 3.5% to 3.75% (much higher than the 2.75% to 3.0% range by 2026 that the Fed telegraphed in its September projections). The Fed's balance sheet had $7.029 trillion in assets on October 23, down $51 billion from September 25 (less than the Fed's reduction commitment of $60 billion per month).

Technical factors of the market are bullish (more demand than supply), while fundamentals are fairly priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) through December 31, 2025 is $273.54, which implies a price-to-earnings (P/E) ratio of 20.9 with the S&P 500 at 5,705. The earnings yield (E/P) of 4.79% represents fair value relative to the 10-year U.S. Treasury note yield of 4.28%. The yield spread is 0.51%. Seven of the eight largest companies in the S&P 500 make up $16.0 trillion of the $50.5 trillion index market capitalization with a weighted P/E of 32.0. If 31.8% of the index has a P/E of 32.0, then 68.2% of the index has a P/E of 15.7 for the overall P/E to be 20.9. A P/E of 15.7 is an E/P of 6.38%, which is attractively priced compared to the 10-year Treasury note yield of 4.28% (a yield spread of 2.10%).

Signs of weakness are creeping into the bullish technical chart pattern of the S&P 500, but the index has had a habit of shrugging off similar signs in recent months. The S&P 500 closed at an all-time high of 5,865 on October 18, but today it experienced a breakaway gap to the downside on increased volume (called a "distribution day"). This could mark a bearish change of character. However, the index has not yet breached its 50-day moving average (5,699) and is comfortably above its 200-day moving average (5,354). Additional major support areas include 5,400 (September 2024 low) and 5,200 (August 2024 low).

A fascinating difference between the S&P 500 market cap weighted index and the S&P 500 equal weighted index has continued to evolve in recent years. From January 2017 through October 2024, the S&P 500 market cap weighted index was up 154.8% (without dividends). In contrast, the S&P 500 equal weighted index was up 103.7%. Both indexes include the same 500 companies! In the market cap weighted version, seven of the 500 stocks are 31.8% of the index. In the equal weighted version, these same seven stocks are only 1.4% of the index. While market cap weighting seemingly leads to "the rich getting richer" on the way up, it can also unwind on the downside in similar, but opposite, fashion. Index investors beware.

There will be a tsunami of news in the coming days as the U.S. general election is held on Tuesday, November 5. It is speculative at best to guess how the election will turn out. If results are not definitive on the evening of November 5, Wall Street may have a tantrum due to the uncertainty. Given the strength of the S&P 500 in recent months, this could evolve into a "buy the rumor, sell the news" event. It may even involve an elusive black swan, for which the market seems ripe.