OUTLOOKS

December 2024

ECONOMIC OUTLOOK

Summary

Consumer spending remained robust this holiday season, supported by evolving shopping trends and technological innovation. Black Friday online sales grew by more than 10% year-over-year, reaching approximately $10.8 billion, according to Adobe Analytics. Generative artificial intelligence (AI) played a role by streamlining the shopping experience and making it easier to find relevant deals and check out, particularly on mobile devices, which accounted for nearly 55% of all online sales. With e-commerce surging, in-store foot traffic declined, reflecting a broader shift in consumer preferences. This could be driven in part by fewer in-person "doorbuster" promotions which may be diminishing the appeal of traditional in-store holiday shopping.

The recent data showcases the strength in consumer spending. The Atlanta Fed's GDPNow model currently estimates fourth-quarter GDP growth at 3.3%, pointing to steady economic momentum through the end of the year. Consumers continue to show resilience despite the Federal Funds rate remaining at what most consider to be restrictive levels.

Additionally, the outlook for business investment has become increasingly optimistic. Economic surveys showed a sharp decline in expectations for future capital expenditures leading up to the presidential election. However, confidence has rebounded with more political certainty, raising the possibility of increased business spending in the coming months. Any additional business investment could complement consumer spending and provide an additional boost to the economy.

The economy is likely to follow its typical seasonal pattern of strong fourth-quarter performance driven by holiday activity, with a modest slowdown in the first quarter. Consumers may exhibit spending fatigue after the holidays, while improved business investment prospects could offset this seasonal dip. The combination of a resilient consumer coupled with optimistic business leaders offers a promising outlook as we move toward 2025.

Positives

Initial jobless claims remained stable in November, averaging 218k per week

Conference Board Consumer Confidence Index reached its highest level since July '23 (111.7)

Retail sales (October) beat expectations (0.4% vs. 0.3% est.)

Negatives

Headline CPI moved higher year-over-year for the first time since March (2.6%)

ISM services PMI missed expectations, dropping to its lowest level in 4 months (52.1)

Durable goods orders missed expectations by 0.3% (0.2% vs. 0.5% est.)

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OUTLOOKS

December 2024

EQUITY OUTLOOK

Summary

U.S. equity markets have responded positively following the results of the presidential and congressional elections in early November. The S&P 500 Index climbed 5.9% during the month and participation in the rally was fairly broad. The Russell 1000 Growth Index rise of 6.5% was in line with the 6.4% increase in the Russell 1000 Value Index. The Russell Midcap Index and small-cap Russell 2000 Index gained 8.8% and 11.0% respectively. International markets did not fare as well with the developed MSCI EAFE Index falling 0.5% and the MSCI Emerging Markets Index dropping 3.6%.

Domestic stock indexes have been buoyed partly by improving consumer sentiment, pent-up demand, as well as fear of missing out on the rally. The potential for the incoming administration to reduce regulation and possibly cut the corporate tax rate is generally seen as positive for equity investors. It is also worth reminding investors December has historically been one of the best performing months for stocks.

As we move into the final month of 2024 it is important to point out the S&P 500 is now up 28.1%. This follows a year in which this index rose 26.3%. The path has certainly been higher, but the equity markets are likely overdue for a pullback. Some of the catalysts that could upset the market's upward momentum are elevated stock valuations, geopolitical tensions, threats of tariffs and retaliation, and forced fiscal restraint to name a few. Still, none of these issues are absolutely imminent in terms of creating negative market reactions. The response to these specific matters could happen sooner, later, or never.

So, as we look to close out the year and look ahead to 2025, it is important to be thankful for the prosperity over the past years and to be mindful of the possibilities ahead. We will continue to remain vigilant in our equity processes and weighing both opportunities and risks. Happy Holidays!

Positives

Consumer, labor markets and other economic factors remain favorable

Federal Reserve policy becoming less restrictive

Trump's pro-business policy agenda

Negatives

Elevated trade war risk

Stretched valuations

Geopolitical tensions

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FIXED INCOME OUTLOOK

Summary

Following the bond market's poor returns in October yields continued to move higher in the first weeks of November. Starting in mid-September, as Trump and the Republicans gained in the polls, investors surmised that a "red sweep" would lead to higher economic growth, deficits and inflation. Yields peaked in mid-November, then eased back following decent inflation reports combined with a soft retail sales report. By the end of the month, yields dropped below the month's starting levels. The 2-year Treasury note declined 2 basis points (bps) to end at 4.15% while the 10-year eased by 12 bps to end at 4.17%. After finally "un-inverting" back in September, the 2 to 10-year curve briefly inverted again and is now barely holding on to a few bps of upward slope.

Corporate bond spreads narrowed again with strong demand from managed funds and slightly less new issuance. For the second consecutive month, new issuance was below $100 billion, whereas the previous nine months were above that level. November's issuance was about 5% lower than the average for previous Novembers over the past few years (excluding 2020). The average credit spread on intermediate-maturity corporate bonds declined by 7 bps to end at 67 bps according to Bloomberg index data. This is the tightest level since year-end 2021 when Treasury yields were less than a third of today's levels. The only other comparable period when credit spreads were this tight was back in the early 2000s, before the Great Financial Crisis started in 2007. Year to date, credit spreads have declined 23 bps for the same index leading intermediate corporate bonds to return nearly 5% whereas intermediate Treasury notes have delivered about 3%.

The recent release of the November payroll report should solidify another 25 bp rate cut this month by the Federal Reserve's Open Market Committee (FOMC). The six-month average increase in non-farm payrolls of job gains dropped to 143k from a rate of 236k six months ago. With a December cut, the Fed will have lowered the overnight rate by 100 bps since mid-September, just as forecasted by the average of the FOMC committee members at that meeting. But at the same meeting, their average forecast also projected an additional 100 bps of rate cuts for 2025. We believe this forecast is less likely to be accurate. The outlook for cuts going forward has become increasingly opaque since as progress towards a 2% inflation target has been stymied, financial conditions have eased and growth estimates increased. Barring an unforeseen economic or geopolitical black swan type of event, we believe two rate cuts of 25 bps may be more likely for the coming year. Even so, we think yields are attractive at current levels and continue to recommend maintaining a duration position similar to the benchmarks. While credit spreads are unlikely to repeat this year's performance, high-quality corporate bonds still offer incremental yield with little reason to fear a significant deterioration in credit quality. We continue to have a higher allocation to corporate bonds but have tempered our "duration-adjusted" exposure so portfolios can absorb a modest increase in spreads, should it occur.

Positives

- Yields have moved sharply since the first Fed rate cut
- Inflation continues to trend towards 2% target along a bumpy path
- Fed to continue lowering the overnight borrowing rate

Negatives

- Fed is likely to adjust the outlook for rate cuts to less than four
- Republican control is feared to create larger federal budget deficits

Unknowns

- Ability of the new administration to end Israeli conflict and Russia/Ukraine war
- Forthcoming tax policies and ability of DOGE to cut spending

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