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Investment Insights Monthly

From the Desk of Bill Hornbarger, Chief Investment Officer

November 2024

What About Bonds?

Stocks are on a tear, with the S&P 500 over 6,000 and making 50* new record highs so far this calendar year. The period immediately following the election was particularly strong, with small-cap stocks, regional banks and more cyclically-oriented stocks outperforming. The initial reaction of the stock market suggests relief from regulatory concerns and reduced concerns over the growth outlook. The U.S. Federal Reserve (Fed) cut rates for the second time (25 basis points [bps]) this year, which also strengthened the soft-landing narrative.

The bond market, on the other hand, has continued to sell off, a move that began with the first Fed rate cut in September. Since September 18 (the date the Fed lowered the target federal funds rate 50 bps) through the day after the election, the 10-year Treasury yield has risen almost 75 bps (from 3.70% to 4.43%). To date, this hasn't created a headwind for the broad stock market averages but could if this trend continues. What is behind the sudden, sharp increase in yields? We think there are three major reasons.

**As of November 11, 2024*

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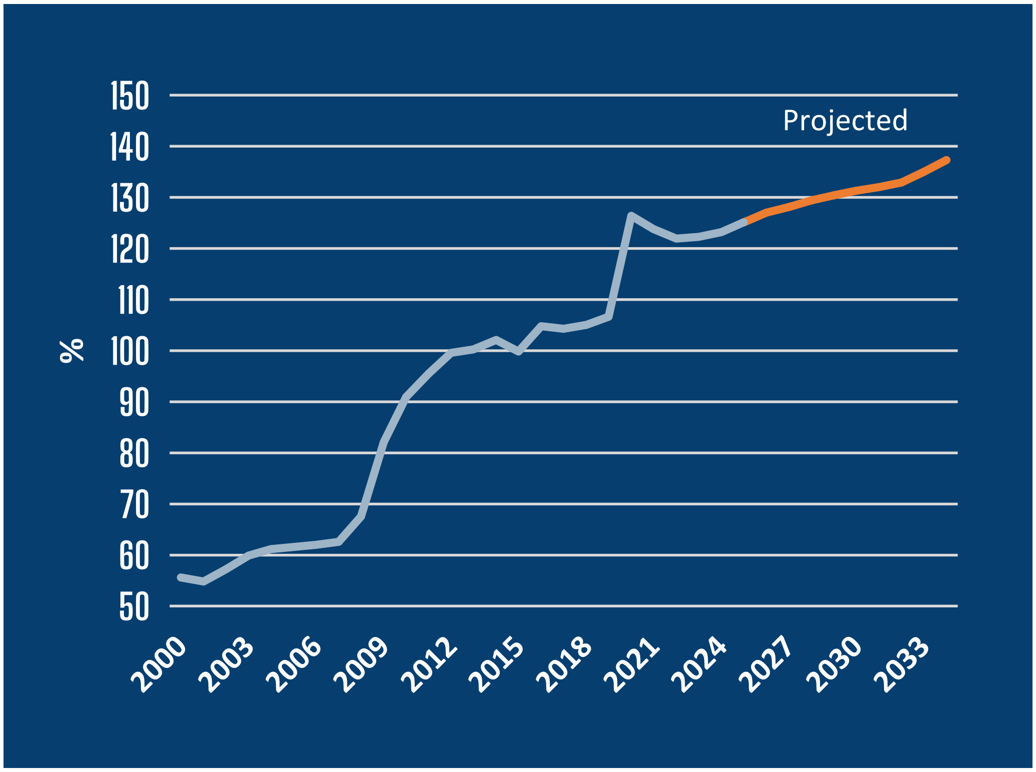
Deficit Concerns

The United States' fiscal stance has continued to deteriorate and is more and more a topic of concern among investors. The deficit rose sharply during the Global Financial Crisis and again during the period surrounding Covid-19 as policymakers wanted to ensure smooth and functioning markets, while also providing relief for businesses and individuals alike (see chart). The proposed policies of both presidential candidates did little to persuade investors that deficits wouldn't continue to expand. Under a Trump Administration, the 2017 tax cuts (set to expire in 2025) will likely be extended, and the proposed corporate tax cuts could be enacted.

Gross Federal Debt as a % of GDP



As of October 31, 2024
Source: Haver

Currently, net interest is the third-largest category for government spending, right behind social security and health, and slightly ahead of Medicare and national defense. In recent interviews, well-known investors Larry Fink, Paul Tudor Jones and Stanley Druckenmiller all made negative comments about bonds, with deficits cited as one of the reasons.

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Inflation

While significant progress has been made on inflation, core inflation remains stubbornly higher than the Fed's stated goal, and inflation expectations remain elevated to where they were pre-Covid. The University of Michigan five-year expected inflation rate was last reported at 3.1% after peaking at 3.2% in late 2023. Service inflation (about two-thirds of the economy) remains at 3.7% and 4.7% in the personal consumption expenditures and consumer price indices, respectively. With President-elect Trump aggressively talking about tariffs, interest rates and inflation will likely remain higher than they would have under a Harris administration.

Fed Policy

The bond market's reaction to this Fed cycle has been different than history would suggest. Historically, the 10-year Treasury yield peaks prior to the last Fed increase and declines as the Fed cuts rates. In this cycle, yields peaked in October 2023 after the last tightening move and, as mentioned previously, have increased since the Fed first cut rates. This suggests that there is some thought that the Fed might have declared victory on inflation too soon and that the "neutral" rate will be higher than previously thought and the Fed might not be cutting much more.

To date, the increase in yields hasn't weighed on stocks, and the 10-year Treasury yield is lower than its 2023 peak. A rising 10-year yield won't necessarily derail a bull market, particularly in a deregulatory environment. Stocks rose in 2023 despite the 10-year touching 5%, and yields remain below that level now. However, the market's views on deficits appear to be shifting and bears watching, in our opinion. Equity investors appear more focused on inflation and earnings growth, but if rates continue to trend higher, it could change how they approach the stock market.

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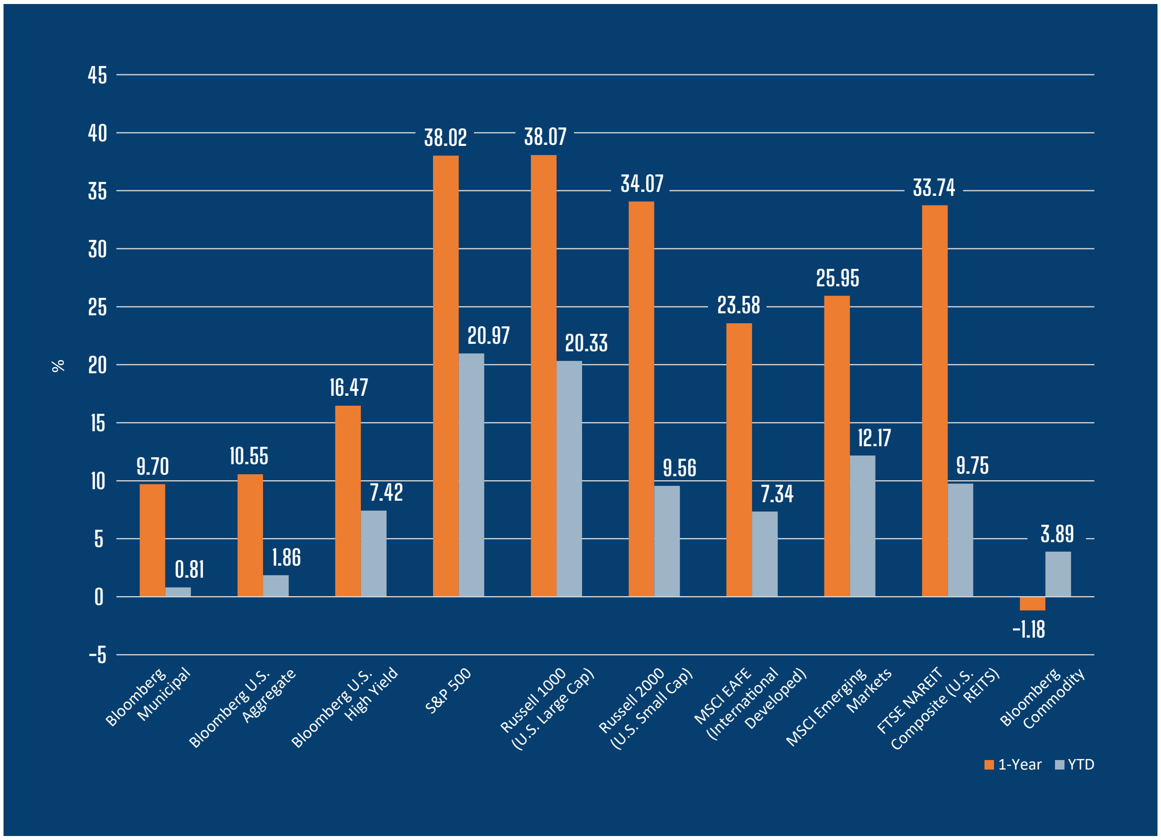
Asset Class Returns

Comparing Recent 1-Year and Year-to-Date Total Returns



As of October 31, 2024
Source: Conway Investment Research

Fixed Income

- Treasury and other sovereign debt yields marched sharply higher in October, leading to broad losses in core fixed income, municipals and global bonds.
- Credit spreads generally tightened in October. Credit held up better due to the higher starting carry and favorable movement in spreads.
- Bonds outside the U.S. were also hit by the stronger U.S. dollar.

Equities

- U.S. equities fell in absolute terms but held up better than non-U.S. equities on a relative basis.
- Large caps beat small caps and growth outpaced value within both large caps and small caps.
- The one-year returns across U.S. equities are pretty astonishing with gains in the 30-45% range.
- Developed markets outside the U.S. exhibited broad weakness last month led primarily by losses in Europe.
- Within EAFE markets, value beat growth and small caps underperformed large caps.
- Emerging market equities held up a bit better than the EAFE, but losses were across all regions, styles and market caps.
- The strong U.S. dollar cost EAFE investors 384 bps of performance in October and 157 bps for emerging market investors.

Alternatives

- REITs struggled in October as rising bond yields provided a significant headwind.
- Commodities, infrastructure, and MLP's, all declined in October as part of a broader risk asset sell-off.

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October 31, 2024	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Bloomberg U.S. Treasury Bill 1-3 Month	0.40%	0.40%	4.49%	5.45%	3.71%	2.38%	1.67%
Bloomberg Municipal	-1.46%	-1.46%	0.81%	9.70%	-0.30%	1.05%	2.30%
Bloomberg US Govt/Credit Intermediate	-0.57%	-0.57%	3.79%	6.25%	1.42%	1.51%	1.56%
Bloomberg U.S. Aggregate	-2.48%	-2.48%	1.86%	10.55%	-2.20%	-0.23%	1.49%
Bloomberg U.S. High Yield	-0.54%	-0.54%	7.42%	16.47%	2.97%	4.55%	4.86%
Bloomberg Global Aggregate	-3.35%	-3.35%	0.12%	9.54%	-4.08%	-1.64%	0.23%
U.S. Equity Indices							
DJ Industrial Average	-1.26%	-1.26%	12.50%	28.85%	7.42%	11.37%	11.65%
S&P 500	-0.91%	-0.91%	20.97%	38.02%	9.08%	15.27%	13.00%
NASDAQ Composite (Price)	-0.52%	-0.52%	20.54%	40.80%	5.30%	16.89%	14.60%
Russell 1000	-0.70%	-0.70%	20.33%	38.07%	8.12%	15.00%	12.75%
Russell 1000 Growth	-0.33%	-0.33%	24.14%	43.77%	8.84%	19.00%	16.18%
Russell 1000 Value	-1.10%	-1.10%	15.40%	30.98%	6.85%	10.14%	8.87%
Russell Mid Cap	-0.54%	-0.54%	14.02%	35.39%	3.55%	10.94%	9.80%
Russell 2500	-0.93%	-0.93%	10.27%	33.08%	1.51%	9.81%	8.92%
Russell 2000	-1.44%	-1.44%	9.56%	34.07%	-0.05%	8.50%	7.94%
Russell 2000 Growth	-1.33%	-1.33%	11.72%	36.49%	-2.30%	7.92%	8.15%
Russell 2000 Value	-1.56%	-1.56%	7.51%	31.77%	1.95%	8.42%	7.33%
Non-U.S. Equity Indices							
MSCI World	-1.96%	-1.96%	16.94%	34.29%	6.90%	12.57%	10.36%
MSCI ACWI	-2.21%	-2.21%	16.44%	33.40%	6.01%	11.61%	9.62%
MSCI ACWI Ex-U.S.	-4.86%	-4.86%	9.13%	24.98%	2.13%	6.29%	5.30%
MSCI EAFE	-5.42%	-5.42%	7.34%	23.58%	3.22%	6.76%	5.78%
MSCI EAFE Growth	-6.17%	-6.17%	5.63%	23.65%	-0.97%	5.97%	6.40%
MSCI EAFE Value	-4.68%	-4.68%	9.16%	23.62%	7.38%	7.17%	4.92%
MSCI Europe	-5.87%	-5.87%	6.75%	23.18%	3.64%	7.55%	5.86%
MSCI Japan	-3.90%	-3.90%	8.32%	22.75%	2.86%	5.68%	6.47%
MSCI AC Asia	-4.26%	-4.26%	13.27%	26.53%	0.43%	5.18%	5.63%
MSCI EAFE Small Cap	-6.26%	-6.26%	4.60%	23.56%	-2.53%	4.54%	6.15%
MSCI ACWI Ex-U.S. Small Cap	-5.21%	-5.21%	6.53%	24.33%	-0.43%	6.68%	6.19%
MSCI Emerging Markets	-4.32%	-4.32%	12.17%	25.95%	-0.99%	4.35%	3.83%
MSCI EM Asia	-4.42%	-4.42%	16.55%	29.55%	-0.76%	5.70%	5.38%
MSCI China	-5.91%	-5.91%	21.94%	22.00%	-8.24%	-1.01%	2.52%
MSCI EM Eastern Europe	-7.29%	-7.29%	0.34%	16.60%	-38.04%	-21.46%	-7.92%
MSCI EM Latin America	-5.13%	-5.13%	-16.72%	2.96%	7.83%	0.57%	0.51%
MSCI EM Small Cap	-4.08%	-4.08%	8.67%	24.51%	4.13%	10.95%	6.01%
MSCI Frontier Markets	-0.55%	-0.55%	10.54%	22.05%	-3.88%	3.43%	1.77%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	-0.36%	-0.36%	6.68%	12.71%	2.57%	3.45%	2.87%
Real Assets Indices							
FTSE NAREIT Composite	-3.68%	-3.68%	9.75%	33.74%	-0.34%	3.73%	6.49%
Alerian MLP	-1.34%	-1.34%	16.97%	22.28%	22.90%	14.66%	2.17%
Bloomberg Commodity	-1.85%	-1.85%	3.89%	-1.18%	2.15%	6.96%	-0.08%
S&P Global Infrastructure	-1.28%	-1.28%	16.51%	33.26%	7.83%	6.27%	6.00%
Other							
CBOE Market Volitility (VIX)	38.43%	38.43%	86.02%	27.67%	12.51%	11.87%	5.14%

Source: Morningstar

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