ACIMA PRIVATE WEALTH

ECONOMIC & INVESTMENT PERSPECTIVES

November 1, 2024

OCTOBER: MORE TRICK THAN TREAT
ELECTIONS, MARKETS & THE ECONOMY

Figure 1: 10/31/2024 Returns (source: Bloomberg)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-2.5%	1.9%	10.5%	-3.5%	6.7%
Investment Grade Corp Bonds	LQD	-3.2%	1.8%	14.8%	-4.5%	9.8%
U.S. Treasury Bonds	GOVT	-2.4%	1.4%	8.3%	-3.7%	5.1%
U.S. 20+ YR Treasuries	TLT	-5.5%	-3.7%	15.0%	-9.0%	10.0%
Muni Bonds	MUB	-1.2%	1.0%	9.1%	-1.6%	6.2%
US High Yield	HYG	-1.0%	7.1%	15.9%	-1.5%	9.5%
Non-US Corp Bonds	IBND	-2.8%	1.0%	11.2%	-5.5%	10.3%
Emerging Markets Bond LC	EMLC	-4.5%	-0.3%	8.3%	-5.6%	2.5%
Global Equity						
ACWI Global Equity	ACWI	-2.1%	16.0%	32.4%	-3.2%	29.9%
ACWI Global Equity ex US	ACWX	-4.6%	8.5%	23.3%	-5.9%	19.8%
International Developed	EFA	-5.3%	7.0%	22.0%	-6.3%	18.4%
Emerging Markets	EEM	-3.1%	11.3%	24.3%	-6.3%	21.3%
Global Equity by Region						
United States	VTI	-0.8%	19.7%	37.9%	-3.0%	35.8%
Europe	IEUR	-6.0%	6.3%	23.0%	-7.3%	19.6%
Asia ex-Japan	AAXJ	-3.2%	14.5%	26.3%	-7.7%	24.1%
China	MCHI	-3.3%	21.4%	21.3%	-17.6%	38.4%
Japan	BBJP	-5.0%	7.3%	18.1%	-7.1%	13.7%
Latin America	ILF	-5.1%	-13.1%	4.9%	-17.5%	9.3%
US Equity						
US S&P 500	IVV	-1.0%	20.8%	38.0%	-3.0%	35.9%
NASDAQ 100 QQQ	QQQ	-0.9%	18.7%	38.8%	-3.9%	37.7%
US Large Growth	IWF	-0.4%	23.8%	43.5%	-3.6%	42.5%
US Large Value	IWD	-1.1%	15.2%	30.7%	-3.1%	28.5%
US Eqwt S&P 500	RSP	-1.6%	13.1%	31.9%	-3.3%	30.4%
US Mid Cap	IJH	-0.7%	12.7%	33.0%	-3.4%	32.2%
US Small Cap	VTWO	-1.5%	9.5%	34.1%	-4.7%	33.5%

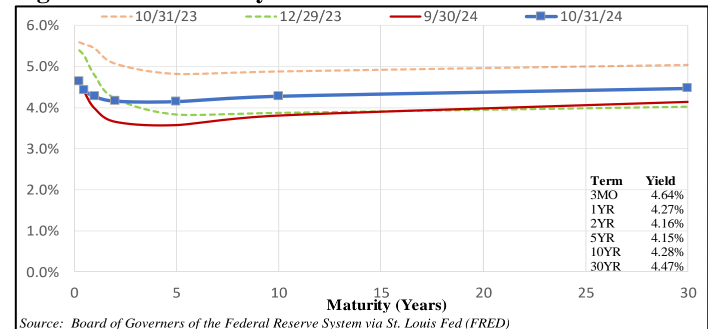
Stocks and bonds were down in October as investors tempered their enthusiasm regarding the magnitude and pace of future interest rate cuts after recent data pointed to resilient economic growth, job market strength and sticky inflation. Performance highlights for the month and year-to-date (YTD) are below.

- Bonds: The US Aggregate index (AGG) lost 2.5% this month (+1.9% YTD) as yields rose. Long-term Treasuries (TLT), which are very sensitive to interest rates, fell 5.5% (-3.7% YTD). Corporate bonds (LQD) were down 3.2% (+1.8% YTD), and high yield bonds (HYG) fell 1.0% (+7.1% YTD). Non-US bonds under-performed as the US dollar strengthened.
- Global equity (ACWI): -2.1% in October (+16.0% YTD).
- US Equity: The broad market (VTI) fell 0.8% (+19.7% YTD), and the S&P 500 (IVV) lost 1.0% (+20.8% YTD). Small stocks (VTWO) were down 1.5% this month (+9.5% YTD). Most sectors posted losses this month, but solid earnings reports led to gains in Financials (XLF), Communications (XLC) and Energy (XLE) stocks on average; Health Care (XLV) was the worst performing sector, down 4.6% (+8.9% YTD).
- Non-US Equity: Non-US stocks under-performed this month, largely due to currency weakness versus the US dollar. Developed markets (EFA) fell 5.3% this month (+7.0% YTD), with sizable losses in Europe (IEUR), Japan (BBJP) and Latin America (ILF). Emerging market stocks (EEM) fell 3.1% (+11.3% YTD), with notably weak returns in India (INDA -6.3%, +12.3% YTD) and Korea (EWY -6.3%, -8.6% YTD).

Interest Rates and the Economy

The yield curve (Figure 2) plots the interest rates (vertical axis) for various US Treasury maturities (horizontal axis). Yields rose notably this month after stronger-than-expected economic data led to tempered expectations for future Fed interest rate cuts. CPI inflation fell to 2.4% year-over-year, the lowest since February 2021, but a strong jobs report (+254k jobs in September) and a resilient economy (Q3 real GDP +2.8% annualized) may give the Fed pause when they meet next week and in December. Investors continue to focus on incoming economic data to calibrate expectations for future cuts. US 10-year Treasuries now yield 4.28%.

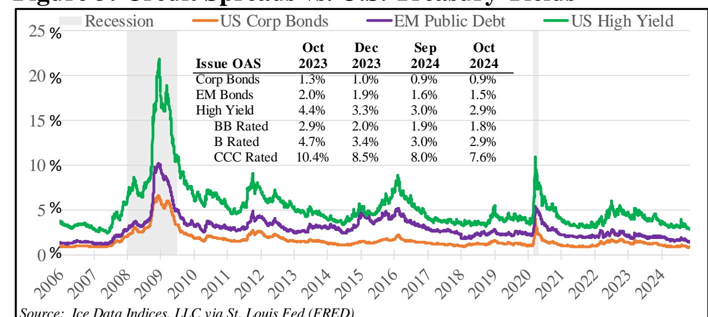
Figure 2: US Treasury Yield Curve



For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between their yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism, while high or widening spreads signal fear. Spreads continued to narrow in October and are very tight by historical standards.

- Investment grade corporate bond spreads were steady at +0.9% but are significantly tighter than the +1.3% spreads a year ago.
- High yield (non-investment grade) spreads have narrowed to +2.9% versus +3.0% last month and +4.4% a year ago. Spreads of the riskiest bonds (rated CCC & below) narrowed measurably to +7.6%, signaling investors' strong appetite for risk.
- Emerging market spreads narrowed to +1.5% and have tightened over the past year; investors see low risk in EM debt.

Figure 3: Credit Spreads vs. U.S. Treasury Yields

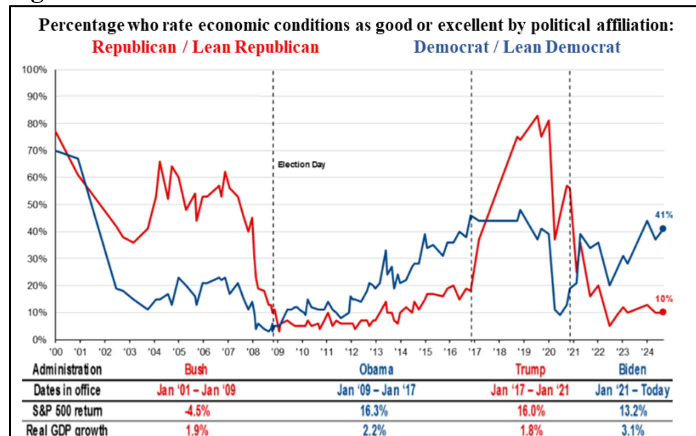


Elections, Markets & The Economy

As we approach the final days of a contentious election cycle, many Americans on either side of the political divide are concerned about the future. Setting aside ideological differences, we explore the historical economic and market impact of various election outcomes. Please note that it is not our intention to present bias in favor of or against any candidate or party. Our goal is to explain why we believe that the economy and stock market will be fine in the long run, regardless of the election results.

We must recognize that our political views color our economic outlook. Figure 4 illustrates how political affiliation has affected economic confidence across four presidential administrations since 2000. The red line tracks the percentage of Republicans (and those who lean Republican) who rated economic conditions as good or excellent; the blue line tracks the same percentage for Democrats (and those who lean Democrat). It is clear that political affiliation is a key driver of an individual's economic outlook: Republican-leaning voters tend to be more optimistic during Republican administrations and pessimistic during Democratic administrations; the opposite is true for those who lean Democrat.

Figure 4: Political Affiliation Colors Our Economic Outlook



Source: JP Morgan

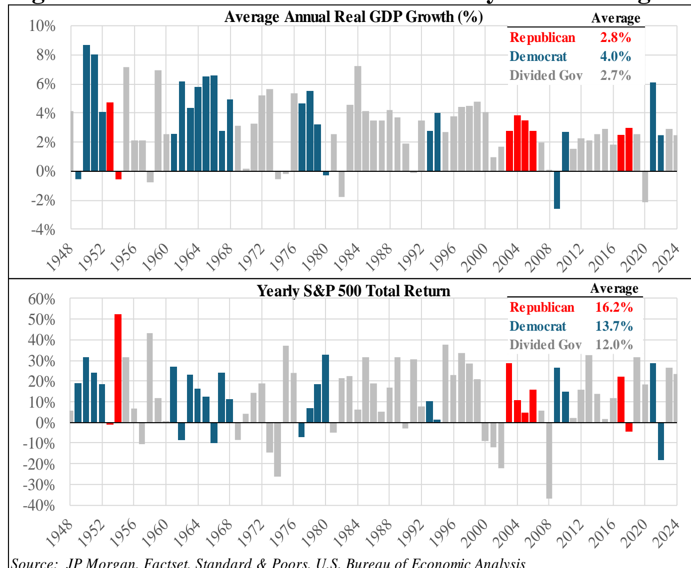
Interestingly, these opinion shifts are not supported by the actual data. Economic growth has been solid across administrations (as measured by Real Gross Domestic Product, the value of all final goods and services produced in the U.S., net of inflation), and the stock market has logged double-digit annual returns since 2009 on average. We note that stock returns were weak during the Bush administration, which was bookended by two crises: the dot-com bubble implosion 2000-2 and the Great Financial Crisis 2008-9.

While the race for president tends to garner the most attention, control of Congress is also at stake in this election. We make no predictions but note that there are three possible outcomes:

- Republican sweep: Republicans win the White House as well as control of the Senate and House of Representatives.
- Democrat sweep: Democrats win the White House as well as control of the Senate and House of Representatives.
- Divided Government: Neither party controls all three entities (presidency, Senate and House of Representatives).

Figure 5 plots historical economic (Real GDP) and stock market (S&P 500) growth rates under these various regimes since World War II. Red bars denote years when Republicans controlled the presidency, Senate and House of Representatives, while the blue bars mark periods when Democrats controlled all three; gray bars denote periods of divided government control. Average annual growth rates are summarized in each panel and in Figure 6.

Figure 5: Real GDP & S&P 500 Growth by Political Regime



Source: JP Morgan, Factset, Standard & Poors, U.S. Bureau of Economic Analysis

Since 1948, economic growth (Real GDP) has been somewhat stronger in periods when Democrats controlled the White House and Congress, while stock returns (S&P 500) have been somewhat higher under Republicans, but results have been consistently strong regardless of the political regime. Key takeaways include:

- Divided government is the norm (48 out of the last 78 years).
- Economic growth has been strong regardless of political control, with Real GDP growth in 67 of the last 78 years (86% of the time, ranging from 85-88% of years under each regime).
- The stock market has been consistently strong, with each political regime enjoying double-digit average annual returns; the S&P 500 has gained in 62 of the last 78 years (79% of the time, ranging from 75-82% of years under each political regime).
- Negative economic growth and stock returns tend to occur during crises: COVID and inflation (2020-2), GFC (2008-9), dot-com bubble (2000-2), OPEC embargo (early 1970s), etc.

Figure 6: Real GDP & S&P 500 Growth by Political Regime

		Economic Growth (Real GDP)			Stock Market Growth (S&P 500)		
Political Regime	#Years	Real GDP%	#Positive Years	%Positive Years	S&P 500 Total Rtn	#Positive Years	%Positive Years
Republican	8	2.8%	7	88%	16.2%	6	75%
Democrat	22	4.0%	19	86%	13.7%	18	82%
Divided Gov	48	2.7%	41	85%	12.0%	38	79%
Total	*78*	*3.1%*	*67*	*86%*	*12.9%*	*62*	*79%*

Source: JP Morgan, Factset, Standard & Poors, U.S. Bureau of Economic Analysis

Bottom Line

Investors continue to focus on incoming economic data to gauge expectations for the pace and magnitude of Fed interest rate cuts. Yields rose in October (pushing bonds and stocks lower) as strong growth, employment and inflation data led investors to expect fewer rate cuts in the near term. This morning's weak jobs report adds to the confusion (impacted by hurricanes and strikes).

Election jitters may have played a part in the recent volatility, which may continue as votes are counted next week, but history tells us that elections have a limited impact on markets and the economy in the long term. Stay diversified, and stay invested!

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