Market commentary notes

Monthly call notes
Monday, November 4, 2024

Wealth Management

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Key issues summary:

Jobs — Friday's jobs report was unexpectedly poor with only 12,000 new jobs recorded. On top of that, estates for the prior two months were reduced by a total of 112,000. One possibility is that the Boeing strike and hurricanes in the South contributed to the poor job growth. Payroll increases came from government and health care, which seems to support that idea. Also, 200,000 people dropped out of the labor force, which could be due to people going back to school.

Finally, average hours worked were unchanged and wages were up 0.4% for the month, both suggesting that the poor jobs number might just be a blip. The idea that the Fed will reduce rates by at least 25 bp this week is pretty much baked into expectations. [https://www.bls.gov/news.release/empsit.nr0.htm, November 2, 2024].

What's been happening to consumer spending trends? — The Bureau of Labor Statistics (BLS) reported that in September consumer spending was up 0.5%. That makes 1.7% over the last four months and about 5% in 12 months. That's a pretty strong performance and is a reason to expect "no landing" or at worst, "soft landing" as the economy adjusts to lower interest rates. [https://www.bea.gov/data/consumer-spending/main, November 2, 2024].

GDP estimate — The Advance (first) GDP estimate for 3Q was issued last week and showed 2.8% annualized real GDP growth. That's a little ahead of my guess, which had been 2.5% or a little lower. For the last two years, the quarterly numbers have ranged from 2% to 4%, so this is entirely in keeping with recent experience. Incidentally, it also indicates that while the Fed's interest rate increases might have changed the composition of GDP—for instance reducing real estate transactions and reducing exports while increasing imports—it hasn't had a noticeable impact on overall growth. By the same token, that calls into question whether it had much impact on the inflation rate trends either. Incomes went up by $221 billion or a little more than $1,600 per household. [https://www.bea.gov/news/2024/gross-domestic-product-third-quarter-2024-advance-estimate, November 2, 2024].

The Fed — First, the latest Beige Book report that surveys how the country's economy is doing by Fed region. Most recently (Oct. 23) two of the 12 Districts reported better growth. However, most reported manufacturing declines. Housing activity held steady. Hurricanes paused business activity and tourism in the Southeast. Half the Districts reported increasing labor demand with the other half indicating no changes. [https://www.federalreserve.gov/monetarypolicy/files/BeigeBook_20241023.pdf, November 2, 2024].

The Fed FOMC meets again this week to decide whether to change short-term rates and purchases of longer-term bonds. My guess is that they will reduce rates by another 25 bp, though 50 bp may also be on the table. Longer-term interest rates have been edging up, with 10-year Treasuries around 4.37% on Friday, which is back to where it was in June but still 35 bp below where it was in April. Consequently, I expect that they won't change their bond buying quite yet. Once the economy stabilizes with lower short-term rates, they may cut back purchases as well.

October surprise — Historically, Septembers have been on average the weakest stock market month of the year. However, this year, September racked up positive returns while October was negative in most categories. The S&P 500 was down 91 bp while small caps were down more at -2.6%. REITs also dipped by 3.6% and international stocks were down even more at -4.9% for developed countries.

Bonds were down too, with the Agg down nearly 2%.

Earnings — We're early in the 3Q earnings season but what's it looking like so far? According to FactSet's latest Earnings Insight report, the blended earnings growth rate for Q3 S&P 500 EPS currently stands at 5.1% with 70% of the companies reporting. This compares to the 4.3% expected at the end of the quarter. The blended revenue growth rate is 5.2%. Both are pretty healthy results and should be supportive of the stock market going forward. The S&P 500 forward 12-month estimated PE is 21.3. [FactSet, Street Account Scorecard, 1 November 2024].

Of 324 companies that held earnings calls, 116 or 36% referred to the elections as a factor in their earnings forecasts. Nearly half the companies in Industrials, Consumer Discretionary and Financials referred to the elections. Of the 116 companies that talked about elections, 38 said that they were related to a business slowdown but they expected better activity after the election.

Most companies apart from Communications are reeling in 4Q expectations, with Energy sector companies reducing earnings forecasts by an average of 8.5%. Materials, Consumer Discretionary, Industrials and Health Care were also cautious on earnings and revenues in the upcoming quarter. Overall, the projected earnings growth for 2025 is +15% and revenues of +5.7%. [https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_110124.pdf, November 1, 2024].

Comparing the cautious forward estimates to what we saw in 2024, there does seem to be an ongoing relationship. Earnings growth for 2024 was weak for energy, materials, industrials. Health care was the only one of the four with better than average 2024 earnings growth. Communications was among the biggest earnings growers in 2024 and estimates indicate that it may repeat in 2025.

Global stock indexes

Total index	Oct %	YTD %	1 yr %	2023 Est PE trailing/ projected
S&P 500	-0.91	20.97	38.01	23.27/21.76
S&P MidCap	-0.71	12.74	32.99	18.25/16.49
S&P SmallCap	-2.64	6.45	30.00	26.69/16.44
FTSE all REIT	-3.61	10.11	34.09	
MSCI all country xU.S.	-4.91	8.61	24.33	
MSCI emerg mkt	-4.45	11.66	25.32	

Source: Morningstar as of October 31, 2024. Estimated PE's are 12 month values from S&P Dow Jones Indices. Trailing PE's are as of September 29, 2023. Projected PE's are as of December 29, 2023. Figures are provided for comparisons over time.

Fixed income and alternatives

Total return index	Oct %	YTD %	1 yr %
Bloom Agg Intermed	-1.98	2.56	9.28
ICE BofA US Convertibles	1.04	8.53	20.89
S&P GSCI	0.46	5.71	-1.51
Bloom US Corp HY	-0.54	7.42	16.47

Source: Morningstar as of October 31, 2024.

Sector performance — In October, the best sectors were Consumer Discretionary, Financials and Communications Services. This is similar to last month with Utilities replaced by Financials. October's worst three were Real Estate, Materials and Health Care—with only Health Care repeating from the previous month. On a YTD basis, Communications, IT and financials topped the chart. Real Estate, Energy and Health Care brought up the rear. [https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-us.pdf, November 2, 2024]. [https://digital.fidelity.com/prgw/digital/research/sector, November 2, 2024].

Commodities

Commodity and food price changes, current month and YoY

Total index	Oct %	YoY %
Copper	-6.0%	17.7%
Lumber	4.9%	11.7%
Cotton	-0.6%	-11.8%
Sugar	-5.0%	-20.6%
Coffee	-4.5%	42.0%
Wheat	-7.8%	-4.3%
Corn	-4.1%	-14.5%
Oil	-0.9%	-15.4%
NatGas	-7.7%	-29.0%

Source: https://tradingeconomics.com/commodities, November 2, 2024.

In October, eight of our nine major commodities experienced price declines, versus none in September. That's encouraging for inflation moderation. On a one-year basis six saw price declines from a year ago. For these nine, the average one-year price change was a decline of 2.7%. That's a better picture than we had last month.

Looking more broadly at commodities, when we look at 22 categories of agricultural commodities and 26 categories of industrial commodities, 29 of the 48 saw price declines in October, up from 15 last month. Twenty-two saw lower prices than a year ago; same as last month.

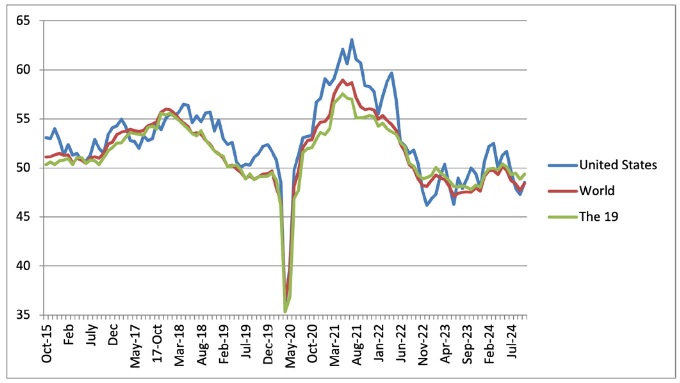
U.S. Economy

U.S. PMI statistics — The U.S. Manufacturing PMI came in at 48.5—slightly below 50, where it has been since June. On the other hand, the services PMI, about 80% of our economy is a strong 55.3. Overall, that signals continued decent growth in the U.S. economy. Should we be worried about the low manufacturing number? I suspect some of the decline is due to a weaker export market because of economic weakness in the EU and China. That is probably exacerbated by the rising value of the U.S. dollar, making our exports more expensive. If that's so, then we should see at least a little improvement in 2025. [Trading Economics, PMI statistics https://tradingeconomics.com/country-list/manufacturing-production, November 2, 2024]. [Trading Economics, https://tradingeconomics.com/country-list/services-pmi November 2, 2024].

International

Manufacturing PMI — Every month, I look at global Purchasing Managers Index (PMI) statistics. The October numbers improved from last month's 13 of 38 with growing manufacturing. In October, we were at 17. Our global index rose to 48.4. Still down but not by much. The Eurozone is still in the mid-40's, as is France. Germany remains in the low 40's, looking like a manufacturing recession. Spain, Sweden and Switzerland are all doing relatively well. From a services standpoint, all of Europe appears to be right at the mid-line of plus or minus 50, with the exception of Spain at 57. [https://tradingeconomics.com/country-list/services-pmi, November 2, 2024].

Here's our updated graph of Manufacturing PMIs:



Source: Author's calculations based on published PMI statistics, as of November 2, 2024

Table summary

Region	Manu PMI	Last month	12 mo. ago
U.S.	48.5	47.3	50
19 majors	49.4	48.9	47.8
38 world	48.4	47.8	47.5
EU	45.9	45	43.1
China	50.3	49.3	49.5

Source: Author's calculations based on published PMI statistics, November 2, 2024

For two years, since Oct. 2022, the manufacturing PMIs have been holding more or less steady at just below 50, meaning manufacturing worldwide has been slowing.

What does that mean in terms of central bank policy and markets? First, I think we can expect short term interest rates to keep coming down in most of the world. The exceptions may be Japan and U.K. The U.S. is also likely to be slower than Europe.

So that means:

1. The U.S. dollar may appreciate against the major currencies, except perhaps the British pound and the Yen.

2. Services seem to be growing at a moderate pace and U.S. earnings appear to be increasing. (A rough relationship is that earnings tend to rise about three times as fast as revenues.)
3. China will probably continue to stimulate their economy, but it may not help much and might not help profits there.
4. On a related note, global trade is currently staging a bit of a come-back, but whether that lasts probably depends on U.S. tariff policy.
5. Bonds are likely to do better, meaning deliver their yields with little capital appreciation.

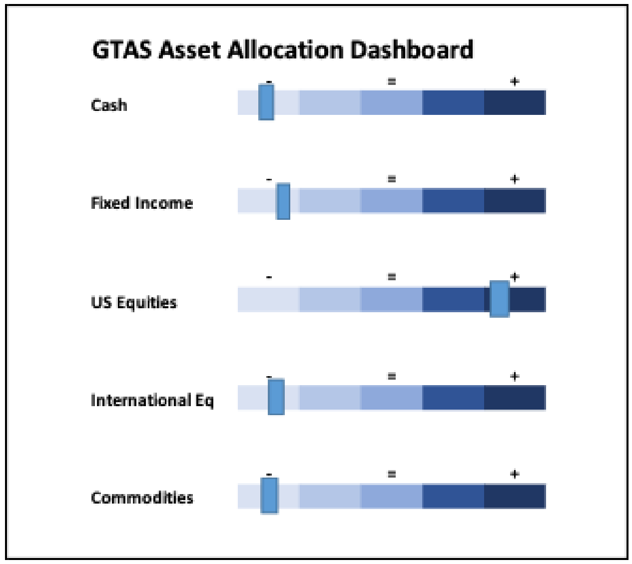
Investment strategy

The next week or so is likely to be volatile—meaning ups and downs. That makes it a risky time to change strategies. Once things settle down and we can assess policy directions—which depend on the make-up of Congress and not just the White House, we can make decisions. In the meantime, earnings look to be intact although PE multiples could decline with people's perceptions of increasing risk.

The dollar could dip temporarily for the same reason, but once again, interest rate differences are likely to dominate over the course of weeks or months.

Whether bonds sell off (prices down, yields up) or the opposite seems like a kind of jump ball question at the moment and depends as much on the narrative as anything.

GTAS Allocation chart



(+/=/-) represents our group's views over a 6- to 18-month time horizon concerning tilts relative to our strategic positions.

+ implies an overweight in that asset class.

= implies a weighting similar to our strategic weight.

- implies an underweight.

Index definitions

Past performance is no guarantee of future results. You cannot invest directly in an index.

Bar Agg Intermed – Bloomberg Barclays U.S. Aggregate Intermediate Total Return index is composed of the BarCap Government/Credit Index, the Mortgage-Backed Securities Index and the Asset-Backed Securities Index. The returns for the index are total returns, which includes the daily reinvestment of dividends.

Bar U.S. Corp HY – Bloomberg Barclays U.S. Corporate High Yield Total Return index includes all fixed income securities having a maximum quality rating from Moody's Investor Service of Ba1, a minimum amount outstanding of $100 million and at least one year to maturity.

FTSE All REIT – FTSE Nareit All Equity REITs Total Return index is an index of publicly traded Real Estate Investment Trusts (REITs) that own commercial property. All tax-qualified REITs with common shares traded on the NYSE, AMSE or NASDAQ National Market List are eligible. Additionally, each company must be valued at more than $100MM USD at the date of the annual review.

ICE BofA US Convertibles – ICE BofA US Convertible Bonds Total Return index tracks the returns of U.S.-traded convertible debt issued by companies with a significant presence in the United States. The index is composed of various combinations of convertible structure and credit quality, e.g. it includes investment-grade, speculative-grade and non-rated issues. The returns for the index are total returns, which include reinvestment of dividends.

MSCI All Country xU.S. – MSCI All Country World Index Ex USA NR is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The index consists of 48 developed and emerging market country indices. The returns for the index are total returns, which include reinvestment of dividends.

MSCI Emerg Mkt – MSCI Emerging Markets NR index consists of 26 developing economies including Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

S&P 500 – S&P 500 Total Return index is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the U.S.; it's often used as a proxy for the U.S. stock market. Total Return (TR) indexes include daily reinvestment of dividends.

S&P GSCI – S&P GSCI Total Return index is a composite index of the commodity futures. It represents unleveraged, long only investments in commodity futures that are broadly diversified.

S&P Mid Cap – S&P MidCap 400 Total Return index is comprised of stocks in the middle-capitalization range and includes approximately 10% of the capitalization of U.S. equity securities. Total Return (TR) indexes include daily reinvestment of dividends.

S&P Small Cap – S&P SmallCap 600 Total Return index consists of 600 domestic stocks chosen for market size, liquidity and industry group representation. Total Return (TR) indexes include daily reinvestment of dividends.

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24-NF-03585 (11/24)