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MARKET COMMENTARY

November 2024

Post-Election Recap

Matt Dmytryszyn, CFA®- Chief Investment Officer

With election results showing Donald Trump has been elected President, stocks rallied on November 6th as concerns around an uncertain election outcome were abated. However, the reaction in the bond market was the opposite, with Treasury yields surging due to expectations that Trump's policies are likely to be more inflationary.

An added factor fueling the post-election rally in stocks had to do with technical positioning. Given the uncertainty of outcomes heading into November 5th, there was a surge in interest in put option contracts, which give holders the ability to sell assets at a pre-defined price. Investors purchased put options as a hedge against a potential downside reaction in stock prices post-election. Now that the outcome of the election is clearer than some had feared, it's likely that many of these put option contracts are being closed out, resulting in additional buying activity in stocks. The initial gains stemming from the post-election rally could propel further gains for stocks in the days ahead should investors get a sugar rush and interpret the November 6th market reaction as a reason to follow the short-term trend.

The consensus view among investors is that Trump's policies would likely have a greater impact on sectors that were deemed to be more economically cyclical. For instance, the financial sector could benefit from a pledge for less regulation, the energy sector might see a boost from a desire for more drilling activity, and aspirations to bring manufacturing back to the United States would offer a boost to the industrial sector. These expectations are reasonable, with the initial market reaction showing investors repositioning toward these segments of the market. As is often the case, investors initially act with broad-based repositioning; however, over time these trades become more refined as expectations recalibrate toward policy specifics and implementation timelines.

One outcome stemming from the election that's not as readily discussed is the greater likelihood of "higher for longer" interest rates. Since the Federal Reserve's decision to start cutting interest rates on September 18th, Treasury bond yields initially fell, offering relief to borrowers. However, since that decision, yields on Treasury bonds are up roughly three-quarters of a percent (0.75%) with some variation depending on the maturity.[1] This creates higher lending costs, with 30-year mortgages moving back closer to 7%, after reaching a low of 6.1% in mid-September. We believe, and the market seems to agree, that the combination of lower tax rates, the prospect of additional tariffs, and tighter immigration policies pose a risk of being inflationary. Our base assumption is that the inflationary impacts will be moderate, however, we believe inflationary pressures will materialize and prevent the Fed from being too aggressive in cutting rates. A "higher for longer" interest rate policy is likely to constrain economic growth, but not impair it. This will, however, constrain segments of the economy that rely more on debt such as utilities and real estate.

Regardless of which side of the aisle you may sit on, we urge you to differentiate the political impacts from the economic impacts. Politics has more of an influence on sentiment than it does economics. Long-term, it's the economics – like growth in earnings and cash flows – that ultimately drive asset returns. A pointed example is the energy sector. Following President Biden's victory in 2020, expectations were that his administration would negatively impact the energy sector. Instead, attractive economics stemming from higher oil prices and moderating drilling costs led to a surge in production, with the U.S. becoming the largest producer of oil in the world. This resulted in returns for the energy sector doubling those of the S&P 500 since Joe Biden's inauguration.[2]

While the economy and market expectations are front and center following the election, we believe that is only part of the bigger picture. With the upcoming expiration of the 2017 Tax Cut and Jobs Act, and the likelihood that tax policies contained within it will evolve in some manner, evaluating the entirety of your financial strategy, including financial planning, tax management and estate planning, is imperative. We remain committed to guiding our clients toward achieving their financial objectives and enjoy the opportunity to discuss any questions you may have following the election.

[1] Bloomberg, U.S. Treasury Yield Curve, 9/18/24-11/6/24
[2] Bloomberg, Standard & Poors. Based on performance of S&P 500 Energy Sector and S&P 500 Index, 1/20/20-11/5/24

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