FINANCIAL MARKET
INSIGHT
VANN EQUITY MANAGEMENT

HIGHLIGHTS

- Why the Bullish Thesis Got Stronger
- **Market Preview**: Does the S&P 500 Breakthrough 6,000?
- **Economic**: What you need to know in English
- What the Trump/Republican Victory Means for Markets
- What the Fed Rate Cut Means for Markets

STOCKS

S&P 500

- Technical View: The medium-term trend in the S&P 500 turned bullish in late September as the broad-based stock index hit new record highs.
- Dow Theory: Bullish (since the week of July 10, 2023)
- Key Resistance Levels: 6012, 6045, 6070
- Key Support Levels: 5929, 5833, 5705

"Stocks surged following more Goldilocks economic data and following the Republican sweep in the election, which will result in more pro-growth economic policies."

SOURCE: Factset and Vann Equity Management Research Team

- ✓ **What is Outperforming**: Defensive sector, minimum volatility, and sectors linked to higher rates have relatively outperformed recently as markets have become more volatile.
- ✓ **What is Underperforming**: Tech/growth and high valuation stocks have lagged as yields have risen.

Why the Bullish Thesis is Stronger Now

Just over two weeks ago, we and other market strategists on the street cautioned that the 2024 rally would be tested in virtually every way as we would get critical updates on growth, earnings, Fed rate cuts and the future of Washington.

"The market passed all those tests and the momentum in this rally remains definitively to the upside; and a move through 6,000 in the S&P 500 is likely a question of when, not if."

More specifically, each of the underlying supports for this market passed their tests.

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Soft Landing (Solid Growth):

The major economic reports of the past two weeks were solid. The October jobs report, when adjusted for all the one-time impacts (Hurricanes, strikes, etc.) was in the low 100k, signaling a stable but not hot labor market. The ISM[1] PMIs remained mixed with manufacturing solidly under 50 (showing contraction) but the ISM Services over 50 (showing expansion). September retail sales were solid, and jobless claims have dropped back to recent lows. **The economic reports of the past two weeks, in aggregate, were Goldilocks and 1) Imply a soft landing is still likely and 2) Give the Fed room to cut rates.**

Fed Rate Cuts:

As the Fed showed us last Thursday, it remains committed to cutting rates and we likely will get another cut in December and the cutting cycle will continue in 2025. Neither the election results nor the recent economic data (inflation or growth) dissuaded the Fed from remaining committed to gradual cuts (a positive for the economy and markets).

Earnings:

The Q3 earnings season was more mixed than excellent, but in aggregate the 2025 S&P 500 earnings estimates remain around $275 and as such, the valuation issues facing this market did **NOT** get worse. Additionally, with the new administration there may be policy tailwinds on future earnings, potentially boosting 2025 expectations.

Politically:

Republicans swept the election and have large enough majorities in the House and Senate to likely push through pro-growth legislative changes.

Bottom line: "The bullish thesis for 2024 of 1) Soft landing, 2) Fed rate cuts and 3) Solid earnings growth was tested and not only did it hold up to that test, but the Republican sweep also made the bullish thesis stronger!"

To that point of a stronger rally, timing matters. The S&P 500 is up 25.7% YTD. There are seven trading weeks left in the year. No one wants to see these gains reversed and as such, investors will likely take a very positive view of all of the past two weeks' events and a continued rally into year-end (Santa Clause rally) would **NOT** be a surprise.

However, while the bullish thesis passed the tests of the past two weeks, **do not confuse this with a market that cannot go down. There are real risks to this rally that we cannot ignore over the medium to longer term, between now and year-end.**

[1] ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at manufacturing firms nationwide. PMIs use a monthly questionnaire survey of selected companies which provide an advance indication of the performance of the private sector. It achieves this result by tracking changes in variables such as output, new orders, and prices across the manufacturing, construction, retail, and service sectors. It is considered to be a key indicator of the state of the U.S. economy.

Specifically, while growth is solid, it is still slowing. Everyone assumes the October jobs report was an anomaly. What if it was not? Clearly job creation is slowing. If that continues, it will turn to job subtraction in early 2025. The point being the economy looks like it is in a soft landing, but that does **NOT** mean growth cannot slow more than expected.

Politically, while investors are embracing the virtue of a Republican sweep, there are risks to the pro-growth agenda and trade policies. The "bond vigilantes" are back and if the Republican's pro-growth plan busts the deficit, (even more than it already is) then rising yields will inject volatility into this market, regardless of growth. Pro-growth tailwinds may cause the Fed to slow rate cuts, undermining an important reason behind the 2024 rally.

Geopolitically, things can get much worse! Obviously trade volatility and trade wars are a real possibility in 2025. Meanwhile, the world remains a tinderbox and Trump's foreign policy will differ materially from the last four years. There are no guarantees things do not get worse!

The positive events of the past two weeks plus very strong seasonals mean the path of least resistance is higher, and a move to 6,200 on the S&P 500 before year-end is entirely possible (that is 22* 2025 S&P 500 EPS of $273, plus some additional rally for momentum/chasing). However, do not confuse those moves for a "perfect" market set up, because this market still has risks, it still has problems, and stocks can indeed still go down in 2025 if those risks materialize (now there is virtually zero room for disappointment).

Economic Data (What You Need to Know in Plain English)

In the start to the month, last week's economic data was Goldilocks, and the Fed decision met expectations and as such, both solid growth and Fed policy remain important, positive supports for this powerful YTD rally.

Starting with the Fed, they cut another 25 bps as expected (fed funds is now 4.625%) and, most importantly, signaled that nothing with the election results or recent data (which has been, on balance, better than expected) changed the fact that the Fed is in a rate cutting cycle. The practical result of that is December rate cut expectations remain elevated (just about 70% according to Fed fund futures).

<u>**Bottom line**</u>: The Fed reiterated that it is still in a rate-cutting cycle, meeting market expectations and further supporting the bullish thesis on the market.

Turning to growth, there have been only two notable reports this month, but they were both Goldilocks and further pointed to an economic soft landing. First, the October ISM Services PMI rose to 56.0 vs. 53.5. That headline reading is a bit "hot" but what made this report more Goldilocks were the details, specifically that New Orders, the leading indicator in the report, declined to 57.4 from 59.4 while prices slipped to 58.1 from 59.4. In sum and taken in context with the soft ISM Manufacturing PMI from two weeks ago, the number was Goldilocks enough to not imply the economy was re-accelerating.

It was a similar message from the other notable economic report last week, weekly jobless claims. Claims rose to 221k and met expectations, a slight increase but still very low. However, Continuing Claims rose to a three-year high at 1.89 million. Practically, the data continues to reinforce this reality in the labor market: Firms are not hiring, but they are not laying off, either.

Bottom line: Throughout 2024 the combination of expected (and realized) Fed rate cuts and resilient economic growth have powered stocks higher and that remained the case last week.

COMMODITIES, CURRENCIES & BONDS

Gold

- Technical View: The 2024 gold rally took a breather amid profit taking after the 2024 election results; however, the long-term uptrend remains intact.
- Primary Trend: Bullish (since the week of November 27, 2023)
- Key Resistance Levels: $2729, $2753, $2787
- Key Support Levels: $2668, $2626, $2547

"Commodities were mixed last week as oil rallied modestly amid the post-election, risk-on money flows while the metals sank amidst the pressure of a stronger dollar. Gold logged as the dollar strength, rising yields, and spike in Inflation expectations all weighed on the precious metal."

SOURCE: Factset and Vann Equity Management Research Team

After a volatile start to the month of November, commodities ended last week mixed as energy futures eked out gains and industrial metals relatively outperformed precious varieties; but still ended the week lower thanks to the headwinds of a stronger dollar and firming interest rates.

Gold has been the worst performer in the commodity complex to kick off the month. On the charts, gold has recently dipped below established support at $2,750 and decidedly below the uptrend line dating back to the July breakout to new record highs.

Looking ahead, the path forward for gold depends on whether the knee-jerk reactions higher by the dollar and rates cool, or continue to the upside, as both would be core fundamental headwinds for gold prices. On the charts, $2,665/oz. is initial support to watch, $2,750 will offer initial resistance.

Copper plunged more than 5% in the wake of the election due to demand fears linked to the threat of tariffs by the second Trump administration. Looking ahead, whether copper breaks out above $4.50 or below $4.20, last week's price extremes offer insight as to trader sentiment towards the macro environment.

Special Reports and Editorial

What the Trump/Republican Victory Means for Markets

Donald Trump became the second President to win two non-consecutive terms (the other was Grover Cleveland) after he soundly defeated Kamala Harris. Republicans also flipped the Senate while the House of Representatives remains officially undecided. However, with Trump's sizeable margin of victory and broad Republican outperformance in the Senate, it is likely the Republicans will win the House as well, ultimately creating a Republican sweep and meeting our "Good" scenario analysis.

Is this a bullish gamechanger?

Not really, because markets are up so much already YTD and trading at stretched valuations. That said, the election results should spur a rally into the year-end, barring any other major surprises. Markets will price in a future pro-growth policy agenda; and price in a likely full extension (and possible increase) of the Tax Cuts and Jobs Act (TCJA). In 2016, the Republican sweep led to a 4.5% rally into year-end and given the currently positive macroeconomic backdrop of solid growth, falling inflation and looming Fed rate cuts, a rally through 6,000 in the S&P 500 before year-end is entirely possible.

What should Outperform and Underperform?

The Republican agenda is characterized by: Pro-growth policies (tax cuts), deregulation, focus on domestic industries and negotiating better trade relationships. The likely market winners from this policy stance are Value, Small-Caps, cyclical sectors, and domestically focused sectors such as Industrials, Defense, Energy/Materials/Commodities, and Transports, Banks/Financials/Insurance.

The relative "losers" (which should underperform, but still rally) from this policy stance are global trades, Large-Cap growth, China/Emerging Markets, defensive sectors, and large importers. Essentially, this should continue the broadening of the rally we have all witnessed since July where the "rest of the market" catches up with (and outperforms) mega-cap tech and growth factors.

What are the risks we need to watch going forward?

> **Risk 1: Treasury yields**. Correct or not, the market views Republican control of Washington as negative for the debt and deficits. As a result, Treasury yields will rise and continue to be elevated until such time as Republicans calm fears of rising debt and deficits.
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> **Risk 2: Trade wars**. It is not correct that Trump has unchecked powers to levy tariffs. What is correct is that once his administration meets a burden of proof to "green light" tariffs against a country, then he has broad and unchecked powers. So, with China, he does have broad powers. With other countries, especially trade partners with whom we have a legal treaty (Mexico and others) he does not have broad powers. Nonetheless, clearly there will be increased trade volatility and looking past the fiction for fact will be difficult and as a result, it is reasonable to expect trade-related volatility going forward.

Bullish/Bearish: Stocks: Bullish. Treasuries: Bearish. Gold: Neutral. Dollar: Bullish.

What is Next: The results for the House of Representatives are the next major data points as they are needed to complete the Republican sweep (again that is likely given Republican performance but not guaranteed). Beyond the final election results, the next major events will be cabinet appointments, and, at that time, we will all get a better picture of the actual policies the new administration and government want to pursue (and we all will have a better idea how that will impact markets).

Bottom line: This likely "green lights" a solid year-end rally, as long as, growth and the Fed perform as expected. The market will likely view this outcome favorably into year-end and as such, focus will turn back towards the Fed (continued rate cuts?) and growth (still stable). As in 2016, markets will likely look past some of Trump's commentary and as such, do not expect trade volatility or fiscal concerns to impact markets until 2025, but it is reasonable we all brace for a more volatile market in 2025 than we have had in 2024.

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What the Fed Rate Cut Means for Markets

The Fed cut interest rates another 25 basis points on Thursday, meeting market expectations. Most importantly, they also kept expectations elevated for another rate cut in December and additional rate cuts in 2025.

While that December rate cut is not guaranteed, the Fed cut and statement (and Powell press conference) kept the "status quo" intact, meaning that markets believe the Fed is in the midst of a rate-cutting cycle and keeping that important macroeconomic positive in place.

Bottom line: Is that expected Fed rate cuts are an important support for the market and while the Fed did not give the market more than it expected, it most importantly reinforced nothing in the election or recent data has changed the fact that it is still in a cutting cycle and that means an important tailwind on stocks remains.