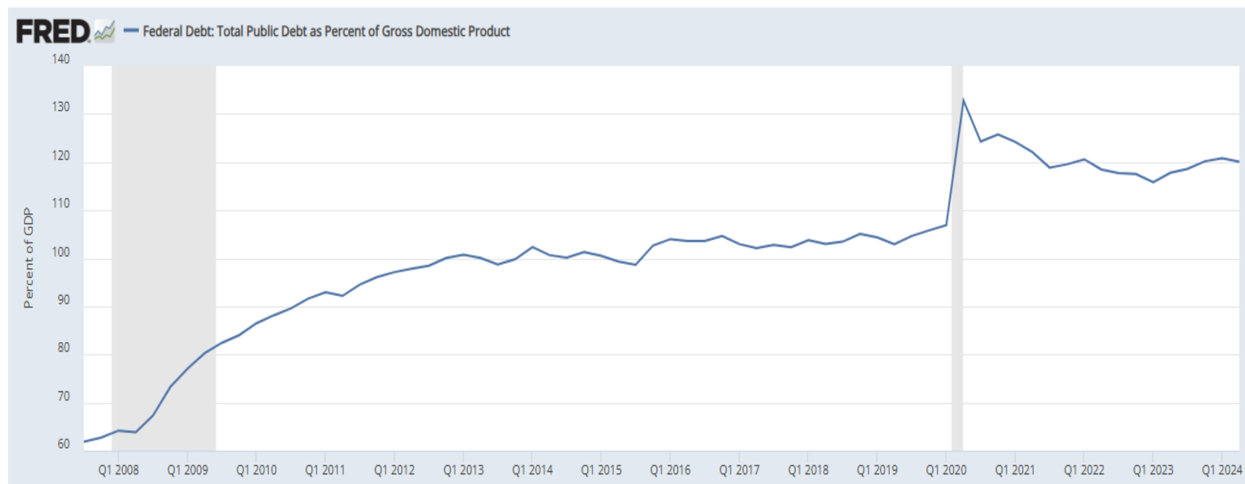
TJT CAPITAL GROUP
REGISTERED INVESTMENT ADVISOR

On Our Radar – November 2024

As we enter a pivotal election season, volatility in the U.S. stock and bond markets has notably increased. In October, the S&P 500 index dropped by just under 1 percent, interest rates generally rose, gold reached a new record high, and oil prices have bounced up and down depending on news out of the Middle East.

In the bond market, the yield on the 10-year U.S. Treasury dropped to 3.63 percent following a recent interest rate cut by the Federal Reserve on September 16, 2024. However, by November 1, 2024, this yield climbed to 4.37 percent, marking a 0.74 percent increase. This upward trend reflects market concerns about the significant rise in government debt and uncertainty surrounding the fiscal policies of the next administration.

U.S. federal debt as a percentage of Gross Domestic Product (GDP) now stands at over 120 percent, down from the COVID-era peak of 132 percent but still nearly double the level before the 2008 financial crisis. The annual interest expense on the roughly $36 trillion federal debt has risen to over $1.1 trillion - almost double the pre-COVID level and approaching 25 percent of annual tax receipts. In fact, this interest expense now surpasses every budget line item except Social Security.



TJT Capital Group's InVEST Risk Model ® has helped our clients participate in bull markets and protect capital from the devastation of bear markets by focusing on 5 indicators that really matter when it comes to determining the health and direction of markets. The following is the most recent update.

Interest Rates (Monetary Policy)

In September, the Federal Reserve cut interest rates by 0.50 percent in response to a "recalibration" of inflation and labor market dynamics. However, most interest rates actually rose. The upcoming elections have raised concerns about future inflation due to different spending plans, while a lack of a clear, cohesive monetary policy framework is also putting pressure on the bond market.

The Fed's approach to inflation has been inconsistent, shifting both its theories on the causes of inflation and the way it measures it. For a time, the Fed's preferred inflation measure was Core PCE (Personal Consumption Expenditures), which ran at around 1.7 percent. The Fed believed that was too low, and then adjusted policy to target 2 percent, eventually adopting an inflation "makeup strategy." This shift contributed to inflation reaching a 40-year high before the Fed responded with a 0.25 percent interest rate increase.

Core PCE remains elevated—up 2.7 percent year-over-year in the latest report. Over the years, Fed Chair Jerome Powell turned to several new metrics including "core services less housing," which recently showed a more than 4.0 percent increase, among other benchmarks. In September, the Fed decided to adjust its monetary policy once again, which has intensified concerns about a framework that seems subject to frequent changes.

The Fed's approach has also created a credibility issue. After implementing the inflation "makeup strategy" and stating that it would act if inflation exceeded 2 percent, the Fed waited until inflation hit a 40-year high to raise rates by just 0.25 percent. Additionally, by keeping rates near zero for over a decade and purchasing billions in bonds, expanding its balance sheet to nearly $9 trillion, the Fed may have indirectly encouraged Congress to continue to increase spending.

The Federal Open Market Committee (FOMC) is scheduled to meet again on November 6-7, 2024.

Valuation

As year-end approaches, S&P 500 earnings estimates for 2024 have been revised downward to $235.50, a modest decrease from earlier projections of over $240. However, the Federal Reserve's newly accommodative interest rate stance has more than offset this decline.

Looking ahead to 2025, estimates suggest S&P 500 earnings will reach $275, potentially providing a significant tailwind for the markets, assuming interest rates and inflation remain under control.

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Economic Cycle

The U.S. economy grew at an annual rate of 2.8 percent in the third quarter, slightly down from the 3.0 percent growth in the second quarter. Non-farm payrolls saw a modest increase of 12,000 jobs in October, impacted by a strike at Boeing and ongoing effects from Hurricane Helene. However, labor market data, which heavily influences the Federal Reserve's interest rate decisions, remains highly unreliable due to frequent, substantial revisions.

The Leading Economic Index (LEI), Industrial Production, and the Institute for Supply Management (ISM) Manufacturing Survey all declined in October. Additionally, existing home sales in September fell to their lowest rate since 2010, driven by rising mortgage rates. On a more positive note, retail sales rose by 0.4 percent month-over-month, and the Consumer Confidence Index posted its largest monthly gain since March 2021, reaching 108.7. Nonetheless, confidence remains well below the pre-COVID level of around 140.

Sentiment

Following early September's market selloff, bullish sentiment jumped 15 percentage points, driven by expected Federal Reserve rate cuts and solid corporate earnings. The Fed has essentially preannounced interest rate cuts based on their "forward guidance," despite claiming they are "data dependent."

Yet, some larger funds have reportedly hedged their positions ahead of the election, so markets may be primed for larger swings should a surprise emerge and those hedges removed.

Technical Factors

The market has been a bit choppy with the percentage of stocks trading above their 50-day moving averages dropping to 55 percent from 76 percent just weeks ago. As the earnings season unfolds, corporate revenues, earnings, and fourth-quarter guidance, become pivotal catalysts influencing stock prices.

In the near term, the market's direction hinges on the outcome of the election, as well as companies' ability to meet or surpass Wall Street analysts' estimates.

Outlook

Globally, the European Central Bank (ECB) reduced interest rates by 0.25 percent for the third time this year as inflation eased, while Germany—Europe's largest economy—lowered its 2024 growth forecast to minus 0.2 percent.

In the UK, newly appointed Treasury chief Rachel Reeves introduced a budget featuring approximately $52 billion in tax increases aimed at addressing a public finance deficit and supporting new spending initiatives. Following this announcement, interest rates on 10-year UK government bonds climbed above 4.40 percent, marking their highest level in nearly a year.

In currency markets, the Japanese yen traded at around 153 per U.S. dollar at the end of October. Earlier, in August, the yen had weakened to about 160 before the Bank of Japan (BOJ) raised interest rates, which strengthened the yen to roughly 140 and triggered a significant global market selloff in early August.

China's economy expanded by 4.6 percent in the third quarter of 2024, and the government increased efforts to stimulate growth by lowering interest rates, especially to support its struggling real estate sector. As part of its largest stimulus package since the pandemic, the People's Bank of China (PBOC) also reduced the reserve requirement by 50 basis points (0.50%), freeing up around $140 billion for new lending.

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Rising geopolitical tensions, fiscal uncertainty, and heightened election-related concerns have led to significant market volatility. Iran has threatened to respond to Israel with "all available tools," North Korean troops are reportedly in Russia, and China's military has rehearsed naval blockades around Taiwan.

On the fiscal side, Modern Monetary Theory (MMT)—the idea that the U.S. government can sustain large budget deficits without severe consequences because it can print its currency—has yet to be truly tested. Meanwhile, election-related lawsuits have already reached the Supreme Court, further adding to uncertainty.

Amid these pressures, the NASDAQ Composite recently dropped by 2.7 percent in a single day, U.S. high-yield bond spreads over Treasury securities are at their lowest since mid-2007, and mutual fund cash levels are reportedly at historic lows. While this doesn't necessarily signal immediate danger, it highlights that when untested economic theories are pushed to extremes, as with subprime mortgages or inflation “makeup strategies,” risks can accumulate, and unexpected challenges may arise.

In response, the U.S. Treasury has announced plans to purchase up to $30 billion of older Treasury securities to provide “liquidity support.” For the government to stabilize debt-to-GDP in the long term, it may need to pursue growth strategies that minimize inflation’s impact. Successfully navigating this path will require careful coordination between the U.S. government and the Federal Reserve, balancing inflationary pressures without letting them spiral out of control.

Ultimately, any of these risks—along with the policies of the next administration—could greatly impact the markets. Given this environment, we remain vigilant, prepared to adapt as circumstances evolve. (11.4.24)

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