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WEALTH MANAGEMENT

Markets Surge on Trump Victory

Equity and bond prices surged following Donald Trump's resounding victory in the 2024 U.S. presidential election. President Trump version 2 (Trump 2) will be inaugurated on January 20, 2025, becoming just the second U.S. president ever elected to a second term after leaving office. Although hardly an underdog due to leading in many pre-election polls, Trump 2 nonetheless completed an impressive comeback since leaving office in 2021 with many question marks. Election results delivered a potential "red wave" as Republicans flipped control of the U.S. Senate and could also retain control of the House of Representatives (final results still pending, as of 11/8/24). The S&P 500 equity index surged +2.5% post-election (11/6/24), its best one-day return in nearly two years, and saw a 3-day post-election gain of +3.7%. On day 1 post-election, the index closed above 5,900 for the first time and after briefly trading above 6,000 on day 3, the S&P 500 closed the week (11/8/24) at 5,995. Within the S&P 500, all 11 industry sectors (as defined by MSCI's Global Industry Classification Standards, GICS) traded higher post-election, reflecting broad participation and surging investor sentiment. In other indices, small-company stocks, as measured by the Russell 2000 index, surged +6.1%. Equity markets appeared to predict a Trump win in early October as prices rose, but pulled back a bit the past two weeks prior to Election Day. Once results were official, the bulls returned as investors' immediate reaction has focused on the potential for economic stimulus provided by campaign promises of lower regulation, smaller government, and lower taxes.

Over multiple election cycles, including 2024, we have shared our view that investors should take a top-down, big picture view of election impacts on portfolios. We conclude that most investors are best served to minimize the influence of election predictions, adhere to their long-term investment roadmap, and resist making broad portfolio changes due to election results alone. Our view is informed by historical data discussed in our recent report: 2024 Election: A Two-Month Sprint to the Finish. When factoring in political party control/affiliation of the president, the Senate, and the House of Representatives (House), since 1945, equity market returns (as measured by the S&P 500's average annual price return) have been virtually identical when Republicans have majority control compared to when Democrats have majority control. In addition, while investors often will comment that "Wall Street loves divided government," suggesting that one-party control is bad for markets, the data suggests that average annual returns under those conditions have also been very positive. Even in the recent past, when President Trump won the election in 2016, it was a Republican sweep (red wave) and the S&P had its best return in four years in 2017. When President Biden won in 2020, the Democrats swept (blue wave) and in 2021, the S&P 500 delivered the best year of the Biden term. Not to say, there won't be market volatility and some winners and losers post-election, but major changes and trading calls are not advised for long-term investors. Stay the course. We will have more to say as the new administration comes together but below are a few thoughts on the week's market activity and what we see ahead.

We attribute the post-election equity market gains to a view that initial Trump 2 policies will be economically stimulative and add fuel to an economy that has already exceeded expectations. Amid some concern that the labor market is slowing, an extra economic kindling could delay the slowdown and allow the U.S. to avoid a recession. At least initially, investors appear less concerned about the impact of Trump 2 tariffs, which are more of a wildcard. Markets also appear to assume that a better economic growth outlook will create more interest rate pressure, either due to the return of inflation pressure or a more cautious Federal Reserve Bank (Fed). This week, the Fed lowered its overnight fed funds target by 0.25% to a new range of 4.50% to 4.75%. Since the Fed's September 2024 meeting, the central bank has lowered the fed funds target by 0.75%, yet the market-traded 10-year Treasury yield has moved higher to 4.33% from 3.72% over that time. This suggests to us that bond investors perhaps see some resistance to the Fed's plan to gradually lower rates at successive future meetings (the Fed meets every six weeks except for a summer break). In 2016, after the Trump 1 election, the S&P 500 gained +4.6% from Election Day to year-end (almost two months). Gains were led by Financials, Communications Services, Energy, and Industrials. Technology was positive, but underperformed the market, while Consumer Staples and Utilities declined. But from year-end 2016 through April 2017, Technology and Consumer Discretionary both rallied more than +10%, and Financials, Communications Services, and Energy lagged. While the overall market remained positive six-months post-election, leadership changed quite a bit after the initial rally and is a reminder to remain diversified in quality companies. Below are current thoughts post-Trump 2 victory.

- Renewed "animal spirits" will stoke economic optimism, which should favor cyclical sectors such as Financials, Industrials, and Materials. This could also help drive small-company stocks higher. Recent mixed performance in Consumer Discretionary stocks could improve.
- If interest rates remain higher than expected, this makes sectors that typically trade at higher dividend yields relatively less attractive. This includes Real Estate and Utilities. Traditionally "defensive" sectors (which typically perform better in a weaker environment) could underperform. This includes Consumer Staples, Utilities, and Health Care.
- Fundamentals in the Technology sector should remain very positive as spending on generative artificial intelligence, cloud services, and data centers is not dependent on political outcomes, in our view.
- We believe that investors will pay close attention to earnings growth in 2025, and we like companies with solid earnings and cash flow visibility. When comparing sector valuations to expected earnings growth over the next three years, four sectors trade at a discount to the S&P valuation compared to estimated growth. Those sectors are Communications Services, Financials, Health Care, and Technology. Although Health Care screens well on some of these parameters, there is, at least initially, some concern about how Trump 2 will address the pharmaceuticals and managed care industries. We like exposure to this group but await more details on specific proposals before becoming more aggressive.
- Valuations are elevated, and we continue to believe this limits the market upside in 2025. But we could be wrong, especially if the economy surges and earnings growth accelerates. However, we believe the "average" stock can outperform and we want to remain diversified across sectors. For now, a solid economic outlook reduces the chances for widespread earnings disappointment that could erode confidence.
- The market and Trump 2 are not without risks, and this includes a pickup in inflation, a continuing jobs growth slowdown, and investor concern over Trump 2 initiatives (government layoffs, deportations of illegals, tariffs, etc.). In addition, the new administration faces 2025 budget challenges as the Trump 1 tax cuts expire and the federal debt ceiling must be raised amid higher federal debt and interest expense. Most of these risks remain on the back burner for many investors.

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The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity. The 11 sectors are: Communication Services, Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, and Utilities.

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet consensus refers to the aggregate of all analysts' estimates from firms that submit estimates to FactSet for a given financial metric.

S&P 500 earnings growth reflects the year-over-year change in operating earnings on a per share basis. Earnings data are aggregated for all S&P 500 constituents and are measured according to the relative market capitalization weights for each company. Estimated earnings are the combined FactSet estimates of analysts covering each company included in the index.

The forward S&P 500 price-to-earnings ratio (P/E) is a valuation measure, calculated by dividing the price of the S&P 500 index over the weighted average earnings per share (EPS) estimate of each company in the index. Earnings are based on "forward" consensus estimates expected over the next 12 months (NTM), using quarterly analyst estimates as provided by FactSet.

U.S. economic growth: Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. The most recent GDP report can be found at www.bea.gov. It is reported by the U.S. Bureau of Economic Analysis (BEA). The most recent BEA GDP reports, quarterly growth is reported inflation-adjusted, annualized growth from the previous quarter, include: Third quarter 2024 (3Q24) +2.8%, 2Q24 +3.0%, 1Q24 +1.6%, 4Q23 +3.2%, 3Q23 +4.4%, 2Q23 +2.4%, 1Q23 +2.8%.

2024 election day was 11/5/24. On the national level, voters selected the next president of the U.S. and state elections determined the party control (Democratic or Republican) of Congress, both the U.S. House of Representatives and the U.S. Senate. As of 11/5/26, the House of Representative votes were still being counted with still no clear party control determined.

The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury securities, indicating the relationship between the interest rate and the time ("term") to maturity. The yields of the 2-year and 10-year U.S. Treasury notes are widely followed barometers of the current U.S. interest rate environment. Treasury security data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet.

We define a bull market as an index that has gained 20% or more from its most recent closing price low. Growth stocks are generally categorized as companies that are expected to sustain growth rates (in earnings and cash flow) above the overall market, or S&P 500 index.

The Federal Reserve Bank's Open Market Committee (FOMC) consists of twelve members – the seven members of the Board of Governors of the Federal Reserve System, the president of the Federal Reserve Bank of New York, and four of the remaining eleven Federal Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth. The most recent available FOMC meeting transcript is here. The Federal Reserve Act mandates that the Federal Reserve conduct monetary policy "so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Even though the act lists three distinct goals of monetary policy, the Fed's mandate for monetary policy is commonly known as the dual mandate. The Federal Reserve influences the demand for, and supply of, balances that depository institutions hold at Federal Reserve Banks and, in this way, alters the federal funds rate. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight. As of 11/8/24, the fed funds target range was 4.50% to 4.75%.

The National Bureau of Economic Research (NBER) is a private non-profit research organization. The NBER is widely used as an organization that analyzes U.S. economic data and the business cycle, and determines the start dates and end dates of economic recessions. The NBER defines recession as "a significant decline in economic activity that is spread across the economy and that lasts more than a few months" and also looks at the depth, diffusion, and duration of the downturn.

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We define an economic "soft-landing" that continues to grow, but at a rate that is below long-term averages. In the current environment a soft landing would be GDP growth that continues at annual inflation-adjusted growth rate below 2.0%.

The consumer price index (CPI) is a measure of average change, over time, in the prices paid by urban consumers for a market basket of goods and services. It is reported monthly by the U.S. Bureau of Labor Statistics.

We define 'Defensive' stocks or sectors as companies in sectors that tend to be less tied the cyclicality of the economy. These reflect products and services that often are necessities that consumers will continue to purchase even when the economy slows.