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MARKET UPDATE – Q4

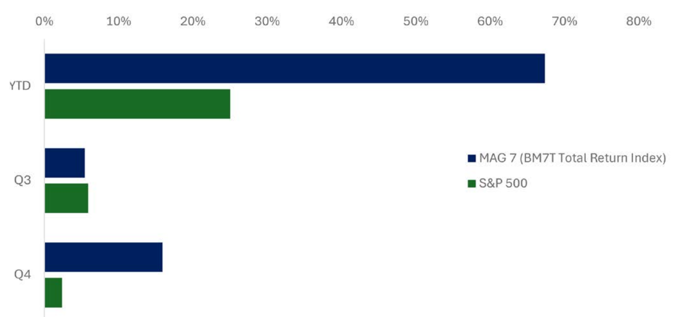
Trump Trade Shakes Up Status Quo in Equity Markets, Rates Rise 60 Basis Points (bps) as Fed Cuts

Financials and the Magnificent 7 (Mag 7) Dominate Returns in Weak Q4

Despite a historic post-election rally and multiple record highs for the S&P 500, the index returned +2.39% in its weakest quarter of 2024, ending the year with a selloff across multiple sectors. Mag 7 stocks (housed in Consumer Discretionary, Communication Services, and Information Technology sectors) and Financials (+7.06% Q4) found strength while other sectors declined, led by Materials (-12.42% Q4) and Healthcare (-10.30% Q4).

Mag 7 stocks leading the index is nothing new for 2024, but it's a stark contrast to Q3, whose top performer was Utilities (+19.37% Q3).

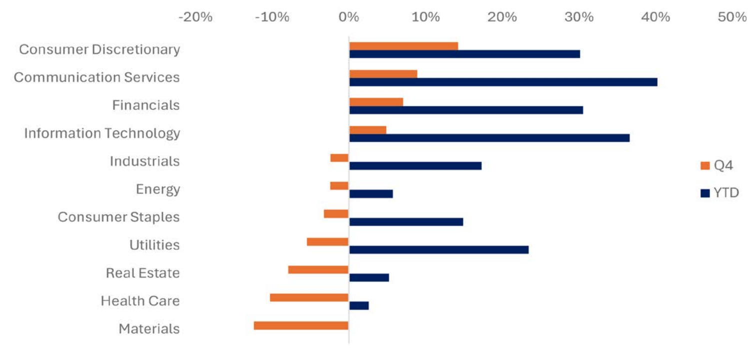
MAG 7 vs. S&P 500 Returns



Source: Bloomberg

In part, the outperformance in Financials and Consumer Discretionary (which houses TSLA +54.36% Q4) and underperformance in Energy (-2.44% Q4), Healthcare (-10.30% Q4) and Utilities (-5.51% Q4) can be attributed to a sentiment shift coined as the "Trump Trade." The shift has been characterized by outperformance in Financials and Crypto (BTC +46.97% Q4) on deregulation hopes, a stronger US Dollar (Bloomberg US Dollar Spot Index +7.10% Q4), rising US Treasury yields (2Y +60bps Q4) on expectations of a tough US trade stance, and underperformance in Healthcare and Energy on Robert F. Kennedy's appointment to Secretary of the Department of Health and Human Services (HHS) and potential increases in domestic oil supply.

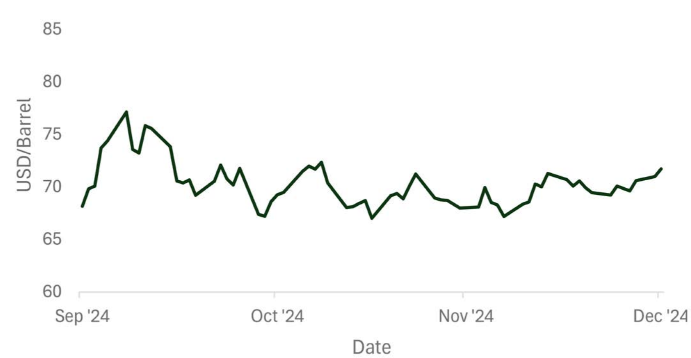
S&P 500 Returns by Sector



Source: Bloomberg

These sectors declined amidst a lack of fundamentals / underlying commodity price movement to justify the moves. Energy declined despite West Texas Intermediate (WTI) Crude futures trading sideways over the quarter (mean price 70.29 σ±2.12). Healthcare sunk despite a constructive earnings backdrop, with 87% of S&P 500 companies in the Healthcare sector beating earnings from October through December. Utilities (71% of which in the S&P 500 beat earnings over the same time period), typically viewed as a defensive play and sensitive to rates declined alongside a sharp sell-off in interest rates over the quarter. Although the Federal Reserve cut rates 50bps in Q4, rates increased on fears of inflationary impacts of trade policies, making fixed income an attractive alternative to defensive stocks and ratcheting up borrowing costs.

WTI Crude Futures Price Q4



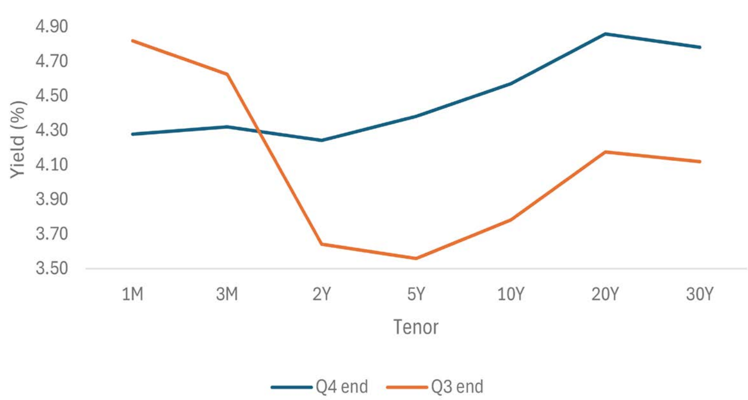
Source: Bloomberg

Despite outperformance and a constructive earnings backdrop in Tech (87% of S&P 500 companies Technology Sector beat earnings from October through December), geopolitical tension remains a risk to the sector. During Q4, the US and China exchanged blows, with China launching an antitrust probe into NVDA, the Biden administration upholding a law that could ban Tik Tok in the US, and Trump's tariff rhetoric harshly targeting China.

Fed Signals Pause After Cutting Rates 1% in 2024, Rates Rise, Equities Sell Off

Despite a dovish Fed to start the quarter and 50bps of rate cuts, yields drifted materially higher across the curve (2Y +60bps, 5Y + 82bps, 10Y +79bps), defying forward rate expectations at the end of Q3 (3M forward rates were 2Y -16bps, 5Y -4bps, 10Y ~flat). The data backdrop shifted – with both inflation and the labor market showing resilience in Q4 vs. the weakness that had characterized Q3 and served as a catalyst for the Fed's 50bp rate cut in September.

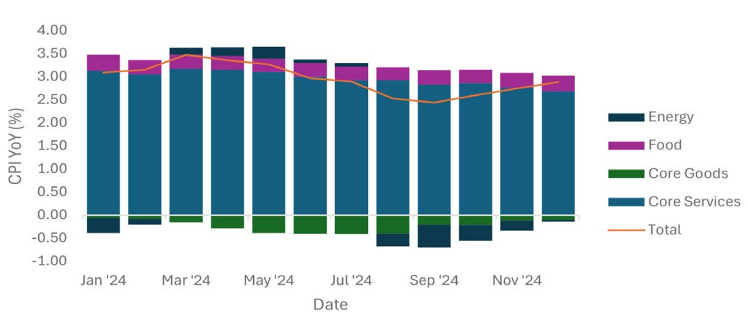
US Treasury Yield Curve



Source: Bloomberg

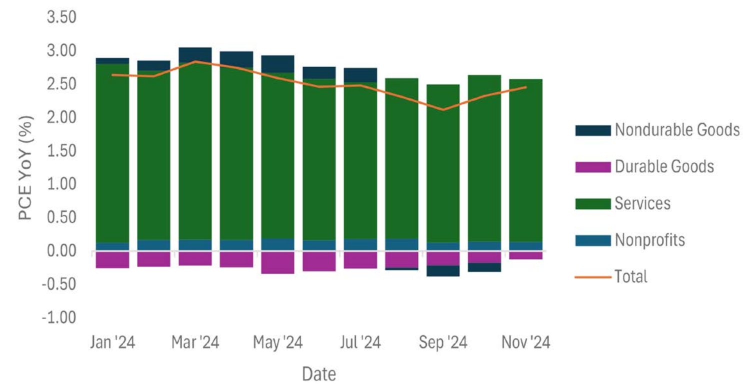
Led by price strength in Services (by both Consumer Price Index or CPI and Personal Consumption Expenditures or PCE measures), inflation was sticky in Q4, with the Year over Year (YoY) headline number trending higher (YoY CPI 2.9%, YoY PCE 2.4%). With the Fed's preferred measure of inflation being PCE, the 2.4% figure is meaningfully above the 2% target, and up from a 2.1% headline number in September.

CPI YoY



Source: Bloomberg

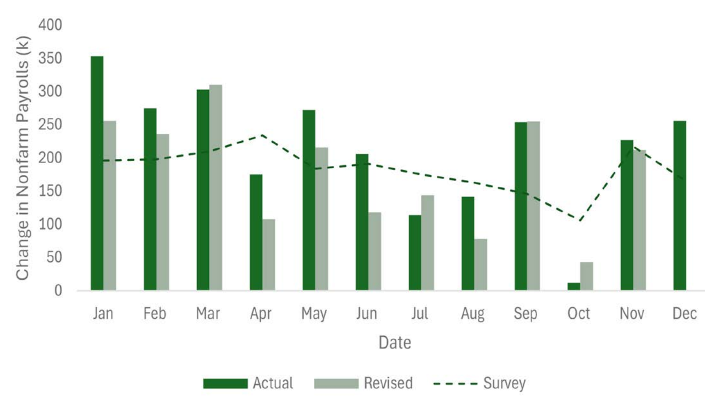
PCE YoY



Source: Bloomberg

Q3 was also characterized by weakening in the labor market, with July / August prints shocking to the downside and revisions of previous months making a meaningful downward impact on the full year employment figure. With the exception of the October print, which the Fed acknowledged was noisy due to natural disasters and strikes, Q4 was a different narrative. The prints from September showed strength in the labor market, shocking to the upside of analyst estimates.

Change in Nonfarm Payrolls 2024



Source: Bloomberg

For a data driven Fed, this was enough to lead to a pivot in policy after the 50bps of additional cuts over Q4. At the December meeting, following a 25bp cut, Powell hawkishly signaled a policy recalibration, impressing that the Fed would be "cautious with future cuts." Equities sold off sharply (SPX -2.95%) that day, making it the S&P 500's worst Fed day since March 2020. At Q4 end, Fed Funds Futures implied roughly four fewer cuts in 2025 than they did at the start of the quarter.