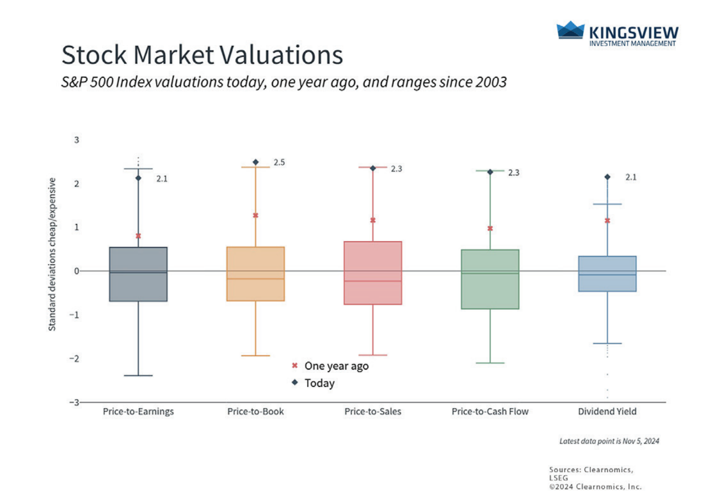
INVESTMENT MANAGEMENT

# Portfolio Manager Insights

*What the Trump Trade Means for Long-Term Investors*
Weekly Investor Commentary | November 13, 2024
Investment Committee

## VALUATIONS ARE ABOVE HISTORICAL AVERAGES




While the political world will focus on the election for some time, financial markets have already shifted their attention to the next administration's policies, Federal Reserve rate cuts, and the underlying economy.

In the remainder of the week following election day, the S&P 500 gained 3.7%, the Dow 4.2%, and the Russell 2000 index of small cap stocks surged 6.1%. Bitcoin also rose above $80,000 for the first time. Even though this sudden jump in markets is positive for portfolios, it's always important to stay disciplined by maintaining a long-term perspective and focusing on fundamentals.

Putting politics aside, chances are that the next administration will inherit strong economic tailwinds. While it's clear that voters struggled with inflation over the past few years, rising prices were the result of both supply chain disruptions during the pandemic and the significant government stimulus that followed. These shocks to the system have faded as inflation has fallen back toward 2%, prompting the Fed to cut rates, which supports the economy.

At the same time, the bull market rally since late 2022 means that valuations across an array of asset classes are well above average, suggesting that many investments are no longer as attractive. The post-election rally in recent days has only pushed valuations higher. The price-to-earnings of the S&P 500, for instance, is nearing post-pandemic highs and is only a few points away from its historic dot-com bubble peak.

History shows that markets can move back and forth between extremes as investors overreact to positive and negative events. This occurred after the 2016 election as well. Markets rallied throughout 2017 before facing a market correction in early 2018, which ended the year negative for the first time in a decade. Markets then experienced a strong rally in 2019 until it was derailed by the pandemic in early 2020. While the past is no guarantee of the future, this goes to show that the market never moves up in a straight line, despite how positive the situation may seem at the time.

In uncertain situations, a north star that can guide investors is valuations. In the long run, there is nothing more correlated with returns than whether the market is cheap or expensive compared to measures such as corporate earnings. While valuations are not market timing tools – stocks can run well above fundamentals in the short run – they do tell us how to set expectations that reflect long-term trends.

Today, market enthusiasm is the result of the "Trump trade," which refers to investments that benefit from the expected policies of the next administration. This includes lower individual and corporate taxes, tariffs, light regulation, and deficit spending in areas such as infrastructure. This propelled markets for a time after the 2016 election due to optimism in financial markets, the strengthening of the U.S. dollar, and higher bond yields as investors anticipated pro-growth economic policies.

As the famous investor Benjamin Graham observed, "in the short run, the market is a voting machine but in the long run, it is a weighing machine." This is relevant today because many of the investments with stretched valuations, including tech stocks and cryptocurrencies, are especially prone to booms and busts. When things go well, it seems foolish in hindsight to focus on valuations and earnings. However, the reason to do so is exactly because it is difficult to predict the exact winners.

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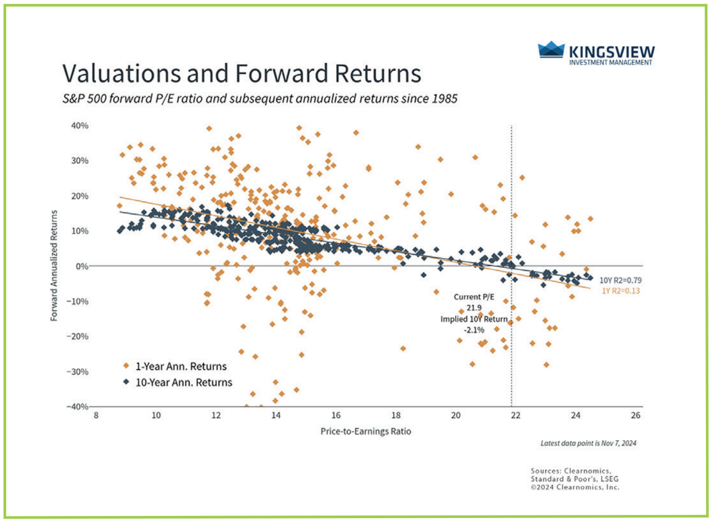
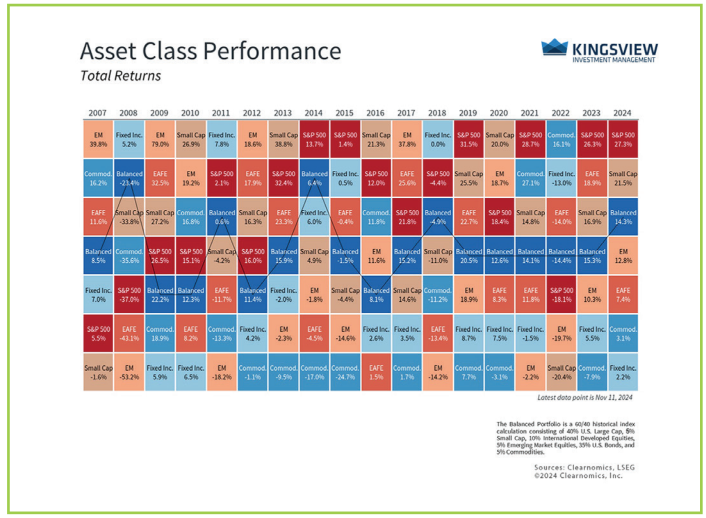
As the accompanying chart shows, elevated valuations have often corresponded to lower or even negative longer run returns. This occurs if those valuations take place later in the business cycle just before a correction. The hope is that this time is different, and the economy continues to grow steadily. But even in that scenario, markets that are rallying ahead of fundamentals could mean that returns are “pulled forward.”

## HIGHER VALUATIONS CORRESPOND TO LOWER EXPECTED RETURNS




## MANY ASSET CLASSES BEYOND U.S. STOCKS HAVE PERFORMED WELL THIS YEAR




High valuations don’t mean we should avoid the stock market. Instead, they suggest we should carefully construct and adjust portfolios in a risk-aware manner, using diversification as a key tool. The accompanying chart shows that while U.S. stocks have performed well this year, many other asset classes have generated positive returns too.

International stocks, for instance, continue to have much more attractive valuations than U.S. stocks. And while bonds have not performed as well recently with rates rising again, they still provide income and diversification benefits, especially in periods of market volatility.

Perhaps most importantly, long-term fundamentals suggest that the trends are still moving in the right direction. Corporate earnings have shown steady growth in recent quarters and GDP figures have been surprisingly strong. The Federal Reserve also implemented its second rate cut of the cycle after the election, lowering the fed funds rate by 25 basis points to a target range of 4.5% to 4.75%.

In its official statement, the central bank acknowledged evolving labor market dynamics, noting that conditions have generally eased while unemployment, though higher, remains at historically low levels. It highlighted that while inflation has eased substantially and the economy remains strong overall, labor market conditions have moderated compared to pre-pandemic levels.

During the post-meeting press conference, Fed Chair Powell presented a balanced view of the economic landscape, emphasizing both progress and continued vigilance. Your portfolio should be viewed in the same manner, balancing progress and vigilance.

**The bottom line?** Slower-moving economic trends are what drive financial success for long-term investors – not the short-term market movements over a few days or weeks. As 2016 to 2020 demonstrates, it’s important for investors to maintain portfolios that can take advantage of market rallies while also protecting against periods of uncertainty.