Marketline December 2024

Stocks:

December marked a "back to business" attitude in the stock market. With the election in the rearview mirror, participants spent the month re-focusing on interest rates, economic figures, and what scant earnings remained in the reporting queue. Of the three, interest rates gave us the most trouble, rising substantially during the month to near the highest levels of the year. Many of you have heard me say that opinions about stock values gyrate between an obsession over earnings, and an obsession over interest rates, with sentiment playing only bit role most of the time. Rising rates are not good for stock prices. Consequently, the Dow fell 5.3% and the S&P sank 2.5%. The Nasdaq managed to eke out a positive price increase of 0.5%.

Meanwhile, overseas, other countries fell in line with our domestic stock-market malaise. Several European countries are flirting with recession. The FTSE index of large European companies was down 1.4% last month. Mexico is confronting trade challenges. Even stalwart Canada is mired in political turmoil that has affected its economy. Its market declined 3.6%.

While the vaunted "Santa Claus rally" didn't show up – or if you want to view it this way, showed up early (in November) – the year was incontrovertibly strong despite the drag of a month here and there. Stocks have now posted high returns two years in a row – certainly not unheard of, in fact, history is full of "runs" of great stock returns. However, from the perspective of how much we pay for assets these days, high prices are a formidable barrier to successful investing. Selling is easier, but we can't saturate portfolios with cash – that's not profitable either. Fortunately, we did find one new technology stock, which is winding its way through our due diligence process now and will likely find its way into portfolios as appropriate. Stay tuned!

Bonds:

The respite in rates that November brought didn't last long. After a downward foray, yields rose in December and this time, levels came close to the highs for the year. The long bond surged from 4.36% to 4.78%. The ten year – which influences mortgage rates – rose from 4.17% to 4.57%. This action came despite the Fed's decision to cut rates in December. The fact that the entire market went the opposite direction (except the very shortest end) means investors are expecting higher inflation, stronger growth, and perhaps more intransigence around the budget deficit than they were just a month ago. It's possible we will see only one more rate cut – or none at all.

The consequence of these rising rates was another year of low returns from bond portfolios, though at least the results were better than in 2022 when bonds across the entire > 1 year maturity spectrum showed losses. This year was largely positive, albeit nominally so.

This month, we'll highlight corporate bonds to explain more about why we have preferred this segment of the market for the bulk of retirement portfolio (except where municipal bonds are a better prospect). Like all non-government bonds, corporate bond yields have a known, historical relationship to other bonds, particularly Treasuries in a similar maturity. For instance, a ten-year corporate might have a yield of 5.2% while the ten-year Treasury sits at 4.5%. That differential of 0.7% is either high, low, or on the dot relative to where that bond usually trades. If it's high, the bond might provide an exceptional return, though of course fundamental research is required to confirm that thesis. At Cascade, we developed a theory over the last few years that corporate spreads will remain narrow, and even break historical norms to narrow further. Our basis for this theory is profoundly simple – sophomoric, really:

- We think corporations on average manage their balance sheets better than the government.
- Most companies are devoid of the drama of shutdowns due to political disagreements
- While the government must borrow every week no matter the level of rates, companies can borrow when it's best for their financial outcome

In fact, corporate bond spreads are as narrow as they've been in modern history, giving great returns as expected. Now we'll need a new theory!

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