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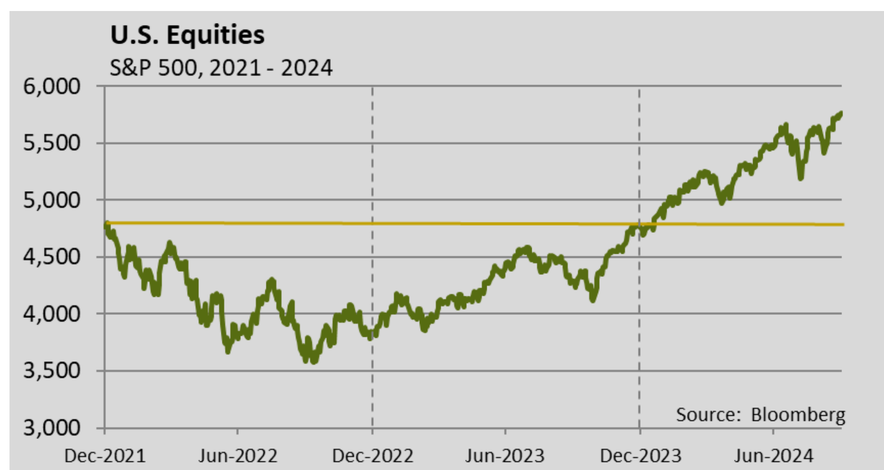
A Likely Soft Landing

October 2024

Summary

After two years of flat markets, the U.S. stock market reached new highs in 2024. Recession worries in 2022 did not materialize, and the economy navigated the highest interest rate environment since 2000. After a bit of summer volatility, the S&P 500 is up over 20% for the year. While plenty of risks remain, the environment is reminiscent of the '90s tech-driven bull market.



In considering the outlook for 2025, there are several aspects of the economy and financial markets that are important to consider:

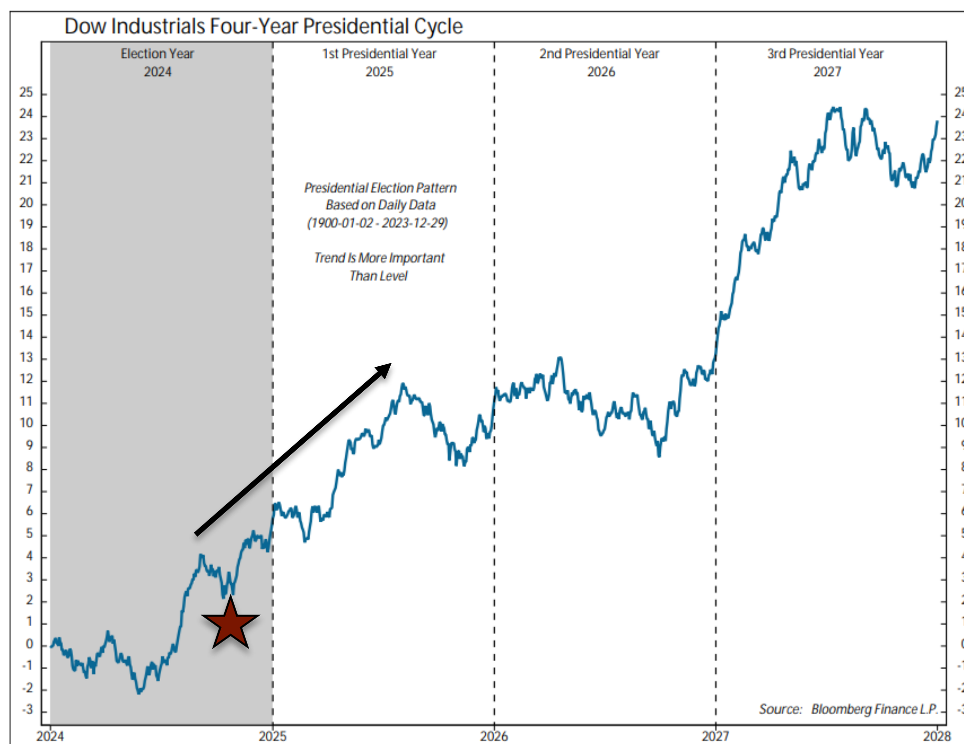
- **The U.S. election is front and center with two weeks to go before election day.** These are important decisions, but specific candidates are not key drivers of stock market returns. The increased clarity that comes post-election tends to be associated with positive stock market returns.
- **The U.S. economy is currently healthy.** GDP growth stabilized at 3% last quarter. Inflation, which had been elevated since the pandemic, has returned to desired levels (September was 2.2%).
- **Unemployment ticked up for the first time in years,** a result of tighter monetary policy. However, the ratio of job openings to unemployed is quite healthy on a historical basis.
- **Friendlier monetary policy is on the horizon.** September saw the first Fed rate cut since 2021, setting expectations for significantly lower interest rates over the next year. The first rate cut has a mixed record in terms of impact on stock market returns. If the economy can avoid a recession in 2025, the first rate cut is correlated with a strong period for stocks.

Accordingly, client portfolios have been moved to the maximum equity positions.

The Election and Presidential Election Cycle

Presidential elections can feel intense and overwhelming, creating a stressful atmosphere. While elections are undoubtedly significant, it is important to remember that the President and members of Congress are not the primary drivers of financial markets.

Many investors believe that Republican administrations foster stronger stock market performance because they are perceived as more "pro-business" and supportive of "free markets." At first glance, this assumption seems logical—business-friendly policies should theoretically lead to better outcomes for companies and higher stock returns. However, a deeper analysis of historical stock market data tells a different story. According to Ned Davis Research, which has analyzed data since 1901, "Looking at just presidents... The real (inflation adjusted) return for [U.S. stocks] under Democrats is 3.7% versus 1.4% under Republicans."



For financial markets, the four-year presidential election cycle (see chart above) is more important than the candidates themselves. Certain patterns emerge around government spending, regulation, and monetary policy. Historically, the stock market tends to weaken in mid-term election years and strengthen in pre-election years, largely influenced by government stimulus and investor sentiment.

The past few years followed the historical pattern relatively closely. Weakness in the mid-term year (2022) was followed by a strong recovery initiated in the pre-presidential election year (2023). The election year (2024) has been strong so far, and the post-election period seems to be promising.

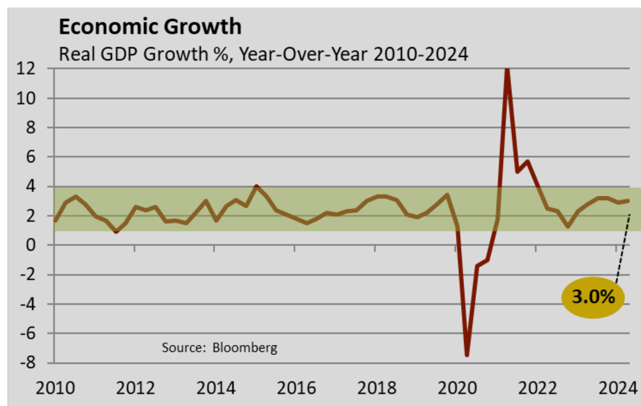
Despite the anxiety that accompanies election decisions, election years are typically more stable for financial markets. The Federal Reserve usually limits its monetary policy changes during this time to avoid accusations of political interference and disrupting the economy ahead of the election. Similarly, legislative and fiscal policy shifts tend to be minimal, as many politicians prefer to wait for a more favorable mix of lawmakers post-election.

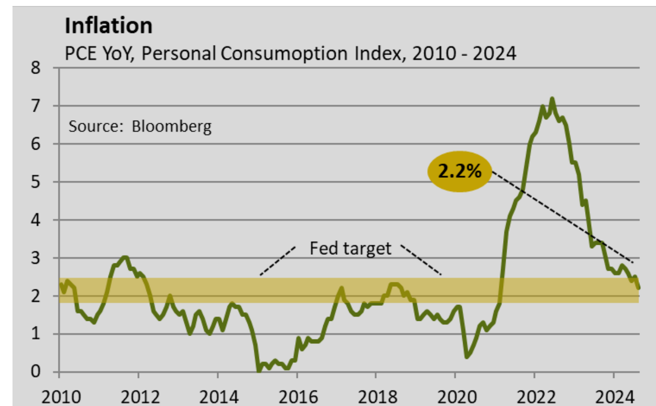
Stability Amidst Uncertainty

Overall, the U.S. economy is healthy. Key indicators, such as GDP growth and inflation, have shown stability throughout the year. Exogenous shocks – such as wars, natural disasters, and pandemics – could disrupt such a stable environment, but such events are inherently unpredictable.

Real economic growth, adjusted for inflation, has returned to 3.0%. This figure reflects the inflation-adjusted value of goods and services produced by U.S. labor and property. Even after accounting for the post-pandemic surge in inflation, the economy continues to grow at a modest pace.

In 2022, there were concerns that declining economic growth would persist, potentially leading to a recession. GDP had slowed for six consecutive quarters, reaching just 1.3% by the end of that year. Fears of recession caused a 25% drawdown in U.S. stocks.





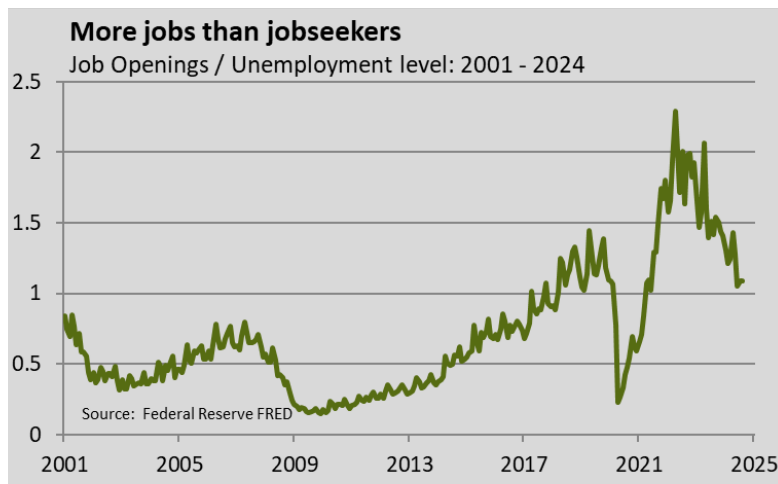
After two years of stubbornly high inflation, most indicators now show that it has returned to more manageable levels. Following a surge in inflation that began in 2021 and peaked at 7.1% in mid-2022, rates have since declined to 2.2% in September. As noted in the 2023 Outlook commentary, inflationary trends often follow a symmetrical pattern. It took roughly 18 months for inflation to peak, and a similar timeframe was needed for rates to normalize.

While much economic data is backward-looking and may not indicate immediate changes in equity markets, it's important to recognize that the current economic environment is stable. This stability could provide a foundation for future growth, despite potential uncertainties on the horizon.

Employment Situation is Mostly Healthy

Labor markets are strong despite recent headwinds, further supporting a solid U.S. economy.

The Federal Reserve has a tough job to curb inflation while not increasing unemployment, but their plan is working. When the Fed began hiking interest rates in 2022, unemployment rates largely remained at all-time lows, reaching just 3.4% in April 2023. Since then, unemployment inched up to 4.3% as of July 2024, mostly due to less job openings and more jobseekers. That makes sense as the economy responded to the one of the fastest rate hikes in U.S. history. The chart below shows how the number of job openings to job seekers has trended over the last 25 years.



Employment looks much better now than recent periods of significant economic distress. During the Great Financial Crisis, there were far fewer jobs than job seekers, and it remained that way for several years. The same was true in 2020 when the U.S. economy grappled with the pandemic. A robust recovery in 2021 created a labor market with more than 2.0 job openings per job seeker, which dropped as the Federal Reserve raised interest rates to curb economic growth, and by extension, job creation. While job openings continued to fall in 2024, the 1.1 job openings per job seeker as of August is well above the level during more painful economic environments.

Two areas of labor markets remain watch points. Hiring rates declined to 3.3% in August from 3.4% in July, as companies hired 5.3 million employees. There were 3.1 million resignations in August, slightly less than July. While fewer voluntary departures could be a positive signal, it could also represent decreased confidence in labor markets.

Despite recent headwinds, labor markets have improved. Unemployment dipped to 4.2% in August and eased further to 4.1% in September, thanks to a surprise increase in job openings. The Bureau of Labor Statistics reported 8.0 million open jobs in August compared to 7.7 million in July. Openings increased the most in the construction industry, and small businesses reported the most open jobs, compared to medium- and large-sized firms. Another positive sign was a modest decrease in layoffs. The layoff rate dropped to 1.0% in August versus 1.1% in July. Employers of all sizes reported fewer layoffs.

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Stock Market Tendencies After First Fed Cuts

With inflation slowing and a steady job market, the Fed lowered interest rates in September for the first time since 2020. What comes next for stocks tends to depend on whether the economy encounters a recession. If the economy is weakening rapidly and the Fed cuts quickly, stock market returns tend to be varied and relatively weak. If the economy avoids a recession and is slowing in such a fashion the Fed can lower rates more gradually, stock market returns tend to be positive.

First cut date	Size of first cut	Total change in rates over cycle	Recession or No Recession	S&P 500 3 months later	S&P 500 6 months later	S&P 500 12 months later
February 1954	0.25%	0.50%	Recession	8.9%	15.5%	40.5%
November 1957	0.50%	1.75%	Recession	1.8%	7.4%	31.5%
June 1960	0.50%	1.00%	Recession	-3.2%	-2.3%	13.5%
April 1967	0.50%	0.50%	No recession	2.6%	8.2%	6.3%
August 1968	0.25%	0.25%	No recession	8.2%	0.7%	-3.4%
November 1970	0.25%	1.75%	Recession	18.3%	20.8%	10.5%
November 1971	0.25%	0.50%	No recession	14.9%	19.0%	26.1%
December 1974	0.25%	2.75%	Recession	28.6%	37.9%	32.7%
May 1980	1.00%	3.00%	Recession	9.7%	26.3%	19.0%
November 1981	1.00%	5.50%	Recession	-5.0%	-5.4%	9.1%
November 1984	0.50%	3.50%	No recession	9.0%	14.0%	22.4%
June 1989	0.25%	6.81%	No recession	8.7%	8.4%	13.1%
July 1995	0.25%	0.75%	No recession	5.0%	11.5%	21.4%
September 1998	0.25%	0.75%	No recession	18.4%	22.6%	20.9%
January 2001	0.50%	5.50%	Recession	-18.1%	-9.5%	-14.3%
September 2007	0.50%	5.13%	Recession	-4.9%	-14.6%	-23.9%
July 2019	0.25%	2.25%	Recession	1.9%	10.2%	8.9%
September 2024	0.50%	TBD	TBD	TBD	TBD	TBD

Source: Ned Davis Research

Percent positive	Cases	3 mo	6 mo	12 mo
No recession	7	100%	100%	86%
Recession	10	60%	60%	70%

Median Returns	3 mo	6 mo	12 mo
No recession	8.7%	11.5%	20.9%
Recession	1.9%	8.8%	12.0%

Whether the economy enters a recession in 2025 is unclear, but the economy seems stable considering resilient labor markets, stabilized inflation, and other forward-looking indicators. While more cases of Fed cutting cycles lead to a recession (10 out of 17), the cases where no recession occurs tend to be positive. In the 7 cases without a recession, the stock market was positive six months later in all 7 cases and incurred limited drawdowns along the way. Also notable is 4 of the 10 recession cases saw positive stock returns.

Given the job and inflation data, the Fed has substantial room to maneuver. At the September Fed meeting, chairman Jerome Powell announced expectations of continued rate cuts in 2024 and 2025. While plans can change, falling short-term interest rates seem likely over the next year. If the employment situation begins to weaken, the Fed can move more quickly. If inflation re-emerges, the Fed can move more slowly while maintaining a downward trajectory.

Echoes of the Mid-1990s

There's a saying that "history doesn't repeat itself, but it often rhymes." This is especially relevant when we look at the current economic environment and compare it to the mid-1990s. Both eras share notable characteristics: a booming technology sector, economic stabilization, declining interest rates, and low consumer confidence.

In the mid-1990s, the economy experienced a significant tech boom driven by the internet revolution, which greatly enhanced productivity. Today, the stock market is similarly buoyed by advancements in artificial intelligence and machine learning. Both technological developments sparked substantial stock market rallies.

From a monetary policy perspective, the Federal Reserve raised the Fed Funds rate to 6% in 1995, then paused before gradually lowering rates over the following years. During this time, GDP growth and inflation remained steady, even as consumer confidence was relatively low. While it's too soon to predict whether our current macroeconomic environment will mirror the '90s, early indicators are encouraging. For more insights on the current state of consumer confidence, refer to the January commentary titled "The Vibecession."

The '90s also featured a remarkable period of positive stock market returns, including a decade without a 10% market correction. While such stability may be unlikely to repeat, it highlights the benefits of a consistent growth environment. The potential for a similar economic soft landing today remains an intriguing possibility.

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