INVESTMENT PERSPECTIVES

DECEMBER 2024

Key Takeaways —

- Sectors that stand to benefit post-election.
- Tax-loss harvesting opportunities in December.
- Market prospects continue to be encouraging.

POST-ELECTION PORTFOLIO POSITIONING

Mark Luschini, Chief Investment Strategist

A politically unified government under Republican control establishes a cohesive framework for what we are likely to see evolve over the coming months and quarters, derived from the policies under which President-elect Trump campaigned. Generally, the Republican platform includes deregulation, less stringent antitrust enforcement, tax cuts, tariffs, and immigration curbs. Market participants initially reacted positively to the outcome. The melt-up in stock prices, especially those representing some of the riskier corners of the market, was rational if a bit exuberant. Subsequent market action has naturally been a bit choppier as investors digest those gains delivered so rapidly and position or rebalance for the next move.

Only two days after the election, the Federal Reserve (the Fed) eased monetary policy a further 0.25% to 4 5/8%, the lowest level since March 2023, which reinforced expectations that further disinflation will allow the Fed to loosen in subsequent meetings and continue to foster the solid pace of growth experienced this year into next. The Fed is becoming less restrictive as it has gained confidence that inflation will return to the central bank's target of 2%. Indeed, Chair Jay Powell communicated that the Fed remains on an easing path, but admitted the pace and ultimate endpoint of that easing will be determined over time, based on incoming data. What seems clear is that the Fed's onus has shifted from triaging inflation to unemployment. Since the job market is key for promoting consumption, the primary driver of the economy, steady employment, and positive real wage growth will have to be sustained to avoid an economic downturn. The good news is although labor conditions have cooled, the job market is still performing well enough to keep employment levels firm.

Investors have positively embraced the potential for corporate taxes to remain the same or possibly move lower, for a much lighter regulatory hand, and for increased capital markets activity via an active merger and acquisition (M&A) calendar. For the time being, worries about the possible negative impulse on trade and economic consequences of tariffs being imposed on allies and adversaries alike, seem to be pushed aside. In fact, similar to eight years ago when Trump "45" was elected, cyclical and small company stocks have led the post-election surge on expectations of pro-business, domestic-facing policies, and the revival of "animal spirits," expecting "all of the above" to stoke the economy and boost profits. Ultimately, it will be necessary for those profits to follow as the jump in equity prices has pushed the stock market to a rather demanding valuation.

Holistically, one must also at least consider a few of the endogenous risks that investors face. For instance, bonds are considered competition for stocks, so yields on fixed-income alternatives are of paramount importance. The yield on the bellwether 10-year Treasury bond has moved significantly higher since the Fed first reduced rates in September but remains well below its cyclical peak of 5% reached in October 2023, a level that caused some indigestion for equity investors. So long as yields don't rise rapidly toward that height, and instead adjust to a stable range reflecting benign inflation and non-recessionary growth, they should not interfere with the equity market's advance. The other variable investors face is handicapping the economic consequences, if any, from the implications of trade wars and immigration curbs. Pass-through costs on import price tariffs, or inflation-inducing labor shortages caused by modified migration policies, could weigh on households and sap spending, especially among those cohorts that are already struggling with high living costs.

Much will depend on the sequencing of Trump's priorities, but these matters could come with growth-draining complications. In addition, tax cuts without a commensurate offset in spending or revenue will likely widen the budget deficit, which is already on a deleterious trajectory, and may create inflationary pressures over time and pinch parts of government spending that are intrinsic to our society.

In sum, a few sectors that should stand to benefit under the new political landscape include: 1) Banks, as pro-growth policies should help loan demand, while deregulation and a merger-friendly FTC may lead to increased M&A; 2) Utilities, since a deregulatory agenda covers building out more power-generation capabilities to secure and advance the buildout of nuclear and data centers in support of the development of artificial intelligence which comes with massive energy needs; and 3) Industrials, as Trump's America First agenda promotes onshoring and domestic manufacturing. Separately, small company stocks, those proxied by the Russell 2000 index, had been under pressure for most of the year but have risen sharply since the election on hopes of lower taxes, lower interest rates, and regulatory relief. Further gains are warranted if next year's forecasts for much better profit growth come to fruition. We expect all of this to coalesce during the first few months of 2025 providing a window into the new administration's policy initiatives and their likely market impact. Stay tuned. ■

TAX-LOSS HARVESTING

Guy LeBas, Chief Fixed Income Strategist

Tax-efficient trading is one of the lower-risk ways to improve after-tax investment returns. Within the fixed income markets, the most common version of tax-efficient trading is tax-loss harvesting—selling a bond or bonds to realize a capital loss and reinvesting the proceeds in a similar bond or bonds to maintain the same sort of interest rate, credit, and sector exposures. As of early December 2024, bond market returns based on the Aggregate Bond Market index and many sub-indices are positive. Most of that return is from coupon payments, as interest rates are higher than they were at the beginning of the year and bond prices slightly lower, in contrast to 2023. That situation opens a limited number of tax-loss harvesting opportunities in the final days of the trading year. Here's where loss harvesting works in the bond markets—and where it does not.

Chart 1: Muni Market Total Market Losses are Small in 2024, But Some Tax Harvesting Opportunites Remain

Source: Bloomberg Indices; Janney ISG

In simple terms, the idea behind harvesting losses is to sell a bond that is trading at a price lower than its cost basis (i.e., adjusted purchase price), thereby generating a capital loss. In order to maintain ongoing investment in the bond markets overall, an investor will usually take the proceeds from that sale and reinvest in a similar though slightly different bond. By definition, if the sold bond is at a loss, the new bond will have a lower price and a higher yield than the old one. The key part, however, is that our hypothetical investor can then net the realized loss against gains elsewhere in the portfolio as well as up to $3,000 of ordinary income, thereby reducing tax bills come April 2025. Selling a bond at a tax loss and reinvesting simultaneously is a "tax swap."

There are a few important caveats. The biggest is that selling a bond (at a loss) and buying the exact same bond will trigger the IRS's "wash sale rule," and invalidate the realized loss. To avoid this rule, the reinvestment should have a different issuer, coupon, and/or maturity date. Official IRS guidance is vague on the matter, but historical precedent indicates any of these changes will ensure that the reinvestment is not "substantially identical" to the sold one. Given that there are usually dozens of bonds with similar characteristics, it is typically straightforward to shift reinvestment in that manner.

Within the category of tax swaps, there is usually some form of give-up. For example, the swap may require the reinvestment to be a lower-yielding bond or require a slightly riskier bond in order to match the yield of the bond sold. This give-up in either yield (or quality) is mostly the result of the natural bid/ask spread that dealers require to purchase a bond. One common tradeoff in municipals is to, for example, sell a 5% 10-year bond and reinvest the proceeds in a similar quality 4% 10-year bond. Since 4% coupon municipals typically trade at a higher yield than 5% coupon municipals, this swap negates some of the bid/ask spread and "earns" it back with a higher yield.

Table 1: Sample Tax Swap 5% Coupon w/6% Market Loss into Similar 4% Coupon

Action	Amt.	Bond	Coupon	Matur.	Price	Yield	Unreal. Loss	Proc.	Ann. Coupon
Sell	$50,000	Aa1/AA+ City GO	5%	6/15/34	$115.13	3.15%	($3,454)	$57,565	$2,500
Buy	$55,000	Aa2/AA City GO	4%	3/1/35	$107.66	3.12%	0	($59,213)	$2,200

Source: Janney ISG

First, a good rule of thumb is that any tax loss in an individual bond should be $1,000 or more and 5% of a bond's market value. Losses smaller than $1,000 or 5% are less efficient as transaction costs will eat up much of the benefit. Second, fixed income tax harvesting makes sense with municipals, but rarely with taxable bonds such as corporates. For taxable bonds, while selling bonds at a loss will generate tax savings in the current tax year (at capital gains rates), the reinvestment will be at a higher yield, and the forward-looking income (taxed as ordinary income) will overwhelm the tax benefits over time. There are cases when it may make sense, but those cases are the exception, not the rule.

December is a key period for tax-loss harvesting. While there are fewer losses today than in many recent years, there are still some opportunities for tax-efficient trading in the final few weeks of 2024. As always, before considering any transactions that could affect your tax bill, please speak with your tax professional for personalized advice.

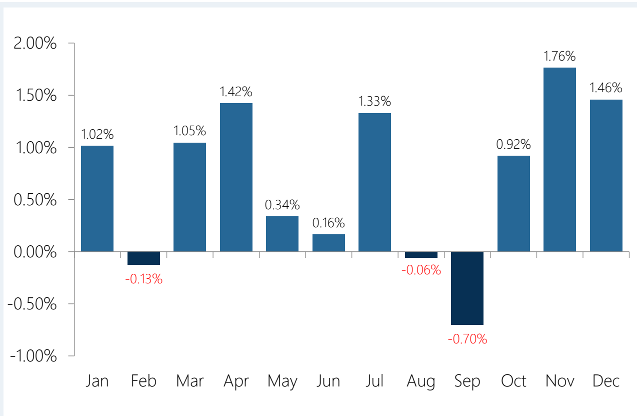
ALMOST A WRAP

Gregory M. Drahuschak, Market Strategist

As November ended, the S&P 500 was on pace for the best annual monthly average in 74 years while setting 53 new closing highs.

A December gain in the S&P 500 would be the tenth monthly gain this year and make this year one of only 11 years when the S&P ended with gains in 10 or more months (1954, 1958, 1964, 1972, 1974, 1995, 1996, 2006, 2013, 2017, and 2019). The closest to monthly perfection was in 1958, 2006, and 2017, when the S&P had gains in 11 months. No year had all months lower. Losses in 11 months happened only once in 1974 when the year ended with an S&P 500 at a 9.72% loss.

Chart 2: Average Monthly Percentage Results—S&P 500 1950-2024



Source: Thomson Financial; Janney Investment Strategy Group

This year holds a distinction in that it is only the third time since 1950 that the S&P 500 has had back-to-back annual gains of 20% or more. The first time the index achieved this feat was in 1954 and 1955, when it increased by 45.02% and 26.40%, respectively. It was not until 1995 that another string of 20% or more consecutive gains was reached, but the S&P did not stop at two years. Instead, it logged four straight 20%-plus gains in 1995 through 1998 of 34.11%, 20.26%, 31.01%, and 26.67%, respectively.

Resiliency has been one of the market's outstanding characteristics this year.

There was no Santa Claus rally this year, and the first five days of 2024 saw a small loss. However, January rekindled hope that the cliché "as goes January, so goes the year" might be relevant this year, as the S&P 500 ended January with a 1.59% gain.

Despite historically having an average loss, the S&P's 5.17% gain was the seventh-best February result in the last 75 years. The S&P 500 3.1% gain in March was significantly better than the average for the month.

A rally that began in mid-April temporarily allowed the S&P 500 to recover roughly half of the early April loss before ending the month with the fifth-worst April result since 1950. On the other hand, the month of May began with many press outlets recanting the "sell in May and go away" adage. Investors who chose to sell May 1 missed what turned out to be the eighth best result for the month since 1950 as the S&P 500 rose 4.8%.

After topping 5,500, June ended with a 3.47% gain as the cap-weighted S&P 500 continued to widen its already substantial performance gap relative to an equally weighted version of the S&P 500.

Thanks to an upward thrust led by semiconductors, July ended with a 1.13% gain, and the Russell 2000 ended July up 10.10%.

And then came August, which eventually produced the best trading opportunity in several years.

In a relatively rare event, on August 5, a fraction more than 92% of all stocks traded on the New York Stock Exchange were down. Instead of producing a loss for the month, the S&P 500 embarked on a sharp upswing that, by the high on August 29, had the S&P 500 10.3% above the August 5 intraday low, before ending the month only 0.38% below its then all-time high of 5,669.67. September, October, and November, on balance, continued the positive bias that by the end of November had the S&P 500 17.84% above the August low.

December has a strong seasonal bias, but on average, results for November are better. However, December has a greater frequency of gains as the S&P 500 has ended the month higher in 57 of the previous 74 possible months compared with 49 in November. In the 24 years from 2000 through 2023, the S&P 500 has ended December higher 17 times.

The technically overbought status for the S&P 500, as November ended, might inhibit the index at times this month, but market prospects heading toward 2025 continue to be encouraging.

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