November Market Commentary

It's Not About the Election—Or Even the Fed

October 30, 2024

What About the Election?

It would not be an election season without the usual debate over whether the U.S. stock market has done better under Democratic or Republican leadership. Here's the short answer—it doesn't matter. Since 1990, there hasn't been a statistically significant difference in stock returns between Democratic and Republican administrations.

Another fan-favorite debate is whether a divided or a unified government is better for stocks—that's a dead end too. There's been little difference in market performance during times when a single party holds the House, Senate and Presidency compared with periods when control is divided.

In short, if you're eager to hit the trade button the moment elections results are known, you may want to reconsider.

What About the Fed?

Monetary policy is on everyone's mind as well, especially now that we have begun a rate-cutting phase. A lower Fed Funds Rate should, in theory, boost asset prices by bringing down the discount rate, making stocks more appealing.

Here's the catch: Equity valuations are generally less tied to the Fed Funds Rate and more about what's happening with longer-term interest rates. In fact, price-to-earnings (P/E)[1] ratios typically have a much closer connection to longer-term yields, such as the 10-year Treasury.

Let's rewind to the pre-quantitative easing era. In the 2000s, the Federal Reserve's real policy rate averaged just over 1%, while core inflation was a shade under 2%. That gave us an average Fed Funds Rate of around 3%, which is pretty much in line with the Fed's long-term target.

From the 1990s through the 2010s, the yield curve had a steady upward slope of about 1.5%, which would translate to a 10-year yield of around 4.5%. With the recent climb in Treasury yields, the 10-year yield may be already in the vicinity of its landing zone. This could indicate that the path of Fed rate cuts may not have much impact on the stock market in the near term.

[1] Price-to-earnings (P/E) shows how much investors are paying for a dollar of a company's earnings. P/E helps to assess the relative value of a company's stock by measuring its share price relative to its earnings. A high P/E could mean that a stock is overvalued.

What Should Investors Be Thinking About?

While the election and the Fed may have less to tell investors than one might think, that should not prompt complacency. Here are three strategies investors may want to consider in the days and months ahead:

ProShares S&P 500 High Income ETF (ISPY)

Powered by a daily covered call strategy[2] and seeking investment results, before fees and expenses, that track the S&P 500 Daily Covered Call Index, ISPY offers the potential to produce a high level of income, to target S&P 500 returns over the long-term, and to capture the returns that monthly covered call strategies may sacrifice.

Why ISPY:

- Covered call strategies have exploded in popularity, but a strong period of stock market returns has revealed the weakness of traditional monthly covered call strategies—they substantially underperformed the market.[3]
- With indications from the Fed that a soft economic landing is seemingly in hand, recently strong corporate earnings reports, and signals from both political parties that they are likely to continue a path of fiscal stimulus, there is potential support for a solid stock market trajectory.
- Common sense might suggest that investors would expect the equity strategies they hold to be structured to behave like equities and produce equity-like returns.

ProShares S&P 500 Dividend Aristocrats ETF (NOBL)

This ETF seeks to track the S&P 500 Dividend Aristocrats Index, before fees and expenses. NOBL consists of an equally weighted portfolio of 66 high-quality stocks that have increased their dividends for a minimum of 25 consecutive years.

Why NOBL:

- Equal weight may not be enough. The U.S. stock market is generally top-heavy. Simply equal-weighting the S&P 500 elevates all the constituents—not all of whom may deserve that treatment.
- The return on assets of the equal-weighted S&P 500 has been substantially worse than the capitalization-weighted S&P 500. NOBL's return on assets has been materially higher than both.[4]
- NOBL's valuation has been at a discount relative to the S&P 500. Historically this has been a potential buy signal followed by an extended period of outperformance.[5] NOBL has outperformed both the cap-weighted and equal-weighted versions of the S&P 500 since the end of the second quarter.[6] Click here for NOBL's standardized returns and performance.

[2] ISPY gains exposure to the sale of daily call options using swap agreements and does not trade options.

[3] Source: Bloomberg. Monthly returns of the S&P 500 vs the CBOE S&P 500 BuyWrite Index from 12/31/13 to 9/30/24. Index returns are for illustrative purposes only and do not represent actual fund performance. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged, and one cannot invest directly in an index. Past performance does not guarantee future results.

[4] Source: Bloomberg. "Return on assets" is determined as of 9/30/24, calculated by dividing each individual underlying index constituent's net income by its average total assets, as reported by each constituent at its most recent fiscal reporting period. Past performance does not guarantee future results.

[5] Source: Bloomberg and ProShares. Data from 6/30/05 to 6/30/24 represents 3- and 5-year outperformance of S&P 500 Dividend Aristocrats vs. S&P 500 when the Aristocrats have been valued at less than 90% of the valuation of the S&P 500.

[6] Source: Morningstar. Data from 7/1/24–10/27/24. Index returns are for illustrative purposes only and do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged, and one cannot invest directly in an index. Past performance does not guarantee future results.

ProShares S&P 500 Ex-Energy ETF (SPXE)

This ETF seeks to track, before fees and expenses, the performance of the S&P 500 Ex-Energy Index, which focuses on S&P 500 companies excluding those in the energy sector.

Why SPXE:

- Energy prices are low and expectations for energy stock fundamentals are high. Bloomberg consensus estimates project gross margins for the sector materially higher than 2024 estimates, which are already roughly 50% higher than 2023.[7]
- One hopeful thought that might be bad for the energy sector: The post-election period could inspire movement on diplomatic fronts that may be in “wait-and-see” mode now. The energy sector is the one place where there is not a “peace dividend.”[8]

The Takeaway

It’s not necessarily about the election, or even the Fed. Elections always loom large in the public consciousness—and for good reason. But when it comes to positioning your portfolio, investors may want to consider skipping the rhetoric and partisanship and focus on the economic fundamentals.

[7] Source: Bloomberg. Data as of 10/26/24.

[8] A “peace dividend” refers to potential long-term economic benefits as spending is reallocated after the end of major military conflicts.

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The S&P 500 Daily Covered Call Index replicates the performance of a covered call investment strategy that combines a long position in the S&P 500 with a short position in S&P 500 call options. In particular, the index is designed to replicate a daily covered call strategy that sells call options with one day to expiration each day. The Fund intends to make distributions each month of an amount that reflects the dividends and call premium income earned by a daily S&P 500 covered call strategy (net of expenses). There can be no guarantee that the Fund will make such distributions and the amount of such distributions, if any, may vary significantly from month to month. A significant portion of such distributions may be characterized as a return of capital.

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