QUARTERLY TRADING REPORT

Q4 2024

RESEARCH

Volatility returns

U.S. equities finished a strong year on a solid note in the fourth quarter, with the S&P 500 Index gaining 2% in the quarter and closing above 6,000 for the first time ever in early December. However, as the quarter wound to a close, rising bond yields began to pressure equity markets—a trend that has continued through much of January.

The uptick in government bond yields unleashed a round of volatility in fixed income markets as bond investors grew concerned over the rising fiscal deficit and the potential for inflation to reaccelerate, which could mean fewer Federal Reserve (Fed) rate cuts than expected.

The foreign exchange (FX) market in Q4 was driven by rising U.S. Treasury yields and Donald Trump's presidential election victory. The U.S. Dollar Index rallied 7.7%, while Trump's proposed tariffs pressured a basket of currencies. Investor flows shifted decisively toward long U.S. dollar (USD) positions, with market uncertainty around the new administration's trade policies expected to influence FX movements going forward.

Volatility also returned to derivatives markets, where U.S. equity index futures traded at historic premiums to fair value into the quarterly roll cycle, only to decline by 100 basis points (bps) as December came to an end.

At Russell Investments, our 87 years of experience executing trades for a broad range of institutional clients gives us unique and valuable insights into the latest market trends and insights. Each year, we facilitate approximately $2.2 trillion in trades through our multi-venue trading platform and operate a 24-hour global trading desk, providing access to over 100 countries and all asset classes. Below, we share our key observations from the fourth quarter of 2024 and our outlook for the months ahead.

EQUITIES

Overview

The end of the fourth quarter capped an extraordinary year for markets, with the S&P 500 Index setting 57 new highs during 2024—about 23% of the trading days.

The Russell Investments trading desk saw very strong equity flows throughout the year that continued during the final quarter. Trading activity from institutional investors was driven by asset reallocations, rotating global exposure, and changing investment strategies, all of which played a part in the robust trading.

U.S. exceptionalism was on the top of investors' minds during 2024, with the S&P 500 Index up 23% and the Nasdaq 100 Index up 28%, respectively, making for the best two-year period of index returns since 1997-98. Dissecting the returns even further, the Magnificent Seven group of stocks (Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla) was up an impressive 67% last year.

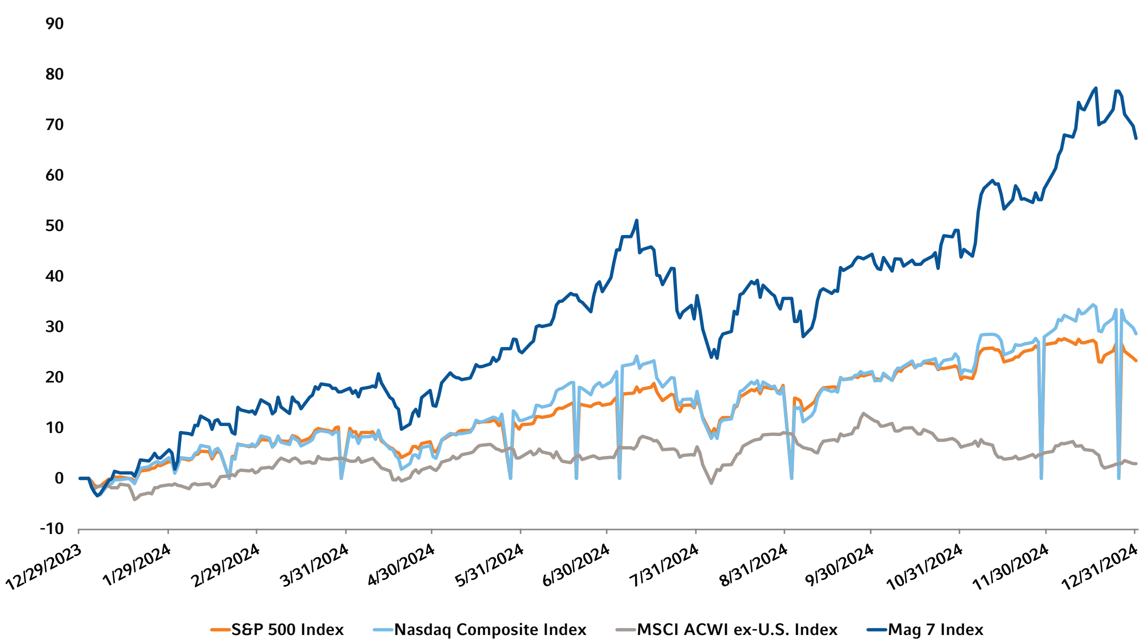
In Asia, Taiwan was the best-performing major market, with a yearly gain of 28%, driven by semiconductor, artificial intelligence (AI), and robot-themed companies.

In Europe, the Euro Stoxx 50 Index closed the year with a more modest 8% return, reflecting steady but slower growth compared to the U.S. and Asia.

Looking at Q4 trading data in the U.S., it was the most active quarter based on average daily volume of shares (13.4 billion) and average daily turnover ($600.9 billion). The U.S. market also saw an uptick in auction closing volumes, hitting a yearly high of 16% in December due to quarter- and year-end passive allocations.

As we move deeper into 2025, market participants are closely watching for potential trends and opportunities. While the strong performance in 2024 set a positive tone, investors will need to remain vigilant about macroeconomic factors, geopolitical developments, and sector-specific dynamics. We stand ready to trade in whatever investment environment might prevail.

EQUITY RETURNS IN 2024 BY INDEX



Source: S&P 500 Index, Nasdaq Composite Index, MSCI ACWI ex-U.S. Index, Bloomberg Magnificent 7 Total Return Index

FIXED INCOME

The U.S. elections were undoubtedly the main event for fixed income markets during the fourth quarter of 2024. Markets and risk tone grinded higher into the election, with the *Trump Trade 2.0* helping lift equity markets to all-time highs. In U.S. Treasuries, positioning whipsawed from max short in October to net long in early November (just prior to the elections), only to claw back slightly into year-end.

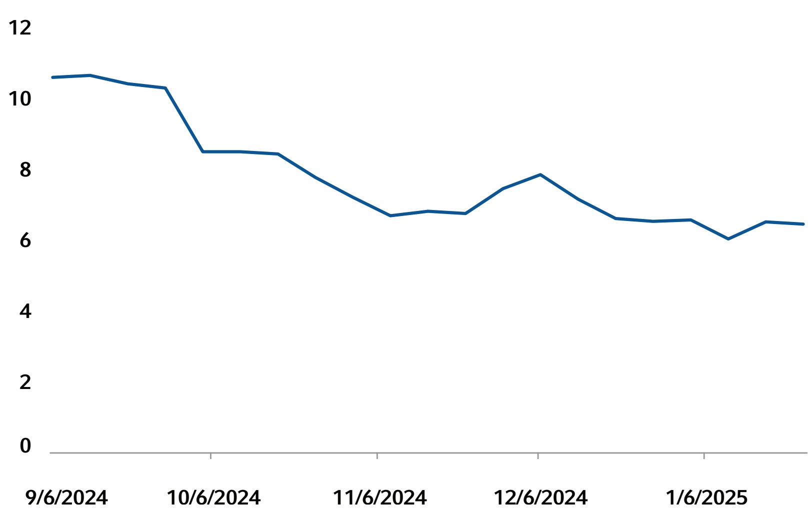
The U.S. Treasury yield curve started off the quarter on the wrong foot, with the 10-year yield peaking at 4.45% in mid-November due to the inflation narrative, a more hawkish Fed, and a murky growth outlook coming into play. Treasuries then rallied on the nomination of Scott Bessent, a Wall Street veteran, for Treasury Secretary. However, the bounce was ultimately short-lived, with the looming fiscal debt level posing uncertainty for the road ahead. The MOVE Index (a measure of bond market volatility) peaked in November—coinciding with the elections—then quickly reverted to the year's average and a level consistent with years past.

Anecdotally, the Fed released its Financial Accounts (Z.1) report, highlighting that foreign investors posted their strongest quarter of buying on record in Q3, representing $252 billion of demand (almost double that of historical numbers).

U.S. money market funds also broke a new record in November, surpassing $7 trillion in assets under management. While rates backed up in unison from the start, Treasury yield curve trades oscillated by 32 bps in the spread between the 2-year yield and the 10-year yield (2s/10s) and 36 bps in the spread between the 2-year yield and the 30-year yield (2s/30s), reflecting an overall steepening bias.

With the Fed implementing one last cut at its December meeting, questions surrounding future cuts came more into focus, with markets no longer pricing in a potential cut until March. Auctions held up reasonably well during the fourth quarter, tracking in line with historical averages (the most recent 30-year auction in December tailed ~1 bp and had a somewhat muted bid/cover of 2.39). These numbers aren't alarming by historical means, but nonetheless signal that investors are wary to add duration at this stage. In credit, volumes averaged just north of $1 trillion per month over the quarter, with the peak volume of the year hitting in October.

IMPLIED U.S. FEDERAL RESERVE RATE CUTS



Source: LSEG Eikon

Liquidity conditions improved, with bid/ask spreads tightening 2 bps in investment grade credit and 3 bps in high yield versus the year-to-date average, prior to widening back out in December as the holiday season kicked off. Credit spreads remained firmly contained, as yield buyers remained supportive, keeping spreads rangebound in an 75-80 bps option-adjusted spread (OAS) range in investment grade. 2024 capped off a busy year on the supply front, coming in at $1.5 trillion (second only to 2020 at $1.8 trillion). Bonds issued in Q4 tightened an average ~10 bps and were well covered at 3.6x, reflecting the strong demand backdrop that remained a theme throughout the year.

Elsewhere in the world, France's political instability reached a boiling point in early December after Prime Minister Michel Barnier was ousted in a no-confidence vote, significantly widening the spread of 10-year OATs-Bunds (a measure of the risk premium of French government debt over German government debt) to 88 bps. In spite of the election drama, European corporates finished the year strong, tightening 16 bps to end the year at an OAS of 100 bps.

FOREIGN EXCHANGE

The divergence between U.S. monetary policy and Treasury yields, along with the U.S. presidential election, were key drivers of the FX market in the fourth quarter.

Late in Q3, U.S. Treasury yields unexpectedly surged on the same day the Federal Open Market Committee (FOMC) delivered a surprise 50-bps rate cut at its September meeting. This trend extended into Q4, as the FOMC delivered two additional quarter-point rate cuts in November and December, even as Treasury yields continued to rise. This steady increase in yields fueled a 7.7% rally in the U.S. Dollar Index (DXY), which climbed from 100.70 to 108.48 during the quarter.

The widening interest rate differential between U.S. 10-year yields and foreign equivalents also had a significant impact on currency pairs like USD/JPY (U.S. dollar to Japanese yen). After marking its lows at the start of Q4, the USD/JPY rallied approximately 9.5% by year-end.

Donald Trump's victory in the November presidential election further bolstered the dollar. Markets priced in expectations of a stronger dollar, driven by the new administration's proposed tariffs, a larger U.S. fiscal deficit, higher inflation, and a potentially elevated terminal interest rate. The EUR/USD (euro to U.S. dollar) exchange rate, which had traded within a 1.05–1.12 range for most of 2023 and 2024, broke below its lower bound in Q4, declining from 1.1135 to 1.0335. Similarly, the GBP/USD (British pound to U.S. dollar) exchange rate fell 6.4%, from 1.3375 to 1.2476.

In the wake of President Trump's election victory, the potential for tariffs on Canada and Mexico over cross-border drug flows impacted their respective currencies. The USD/CAD (U.S. dollar to Canadian dollar) exchange rate surged above 1.40, nearing March 2020 highs, while the USD/MXN (U.S. dollar to Mexican peso) extended its Q4 rally by 6.5%. Additionally, the suggestion of a 10% tariff increase on Chinese imports pushed the USD/CNH (U.S. dollar to Chinese yuan) to retest its 2022–2023 highs.

Looking ahead, FX flows suggest a significant shift toward long USD positioning with the Trump administration now in office, with elevated levels sustained through year-end. The heightened uncertainty surrounding the new administration's tariff policies, which are expected to become clearer in the coming months, is likely to remain a major driver of FX market movements.

DERIVATIVES TRADING

Near the end of December, Congress passed a law to keep the government funded until mid-March 2025. This capped a quarter filled with anticipation and expectations surrounding the U.S. presidential election and FOMC decisions in November and December. Derivatives provide a way to express views or hedge such announcements and activity.

There was no shortage of activity as the CME Group reported record annual average daily trading volume in 2024, and record Q4 activity in the U.S. Treasury futures complex. Rates may very well be rangebound as we move deeper into the first half of 2025.

As the U.S. elections approached, the U.S. equity volatility risk premium traded rich as investors utilized options to hedge political uncertainty. This premium collapsed quickly after the elections. Downside skew has remained elevated even at lower levels of implied volatility. This suggests that there is continued demand for far-downside protection.

The premiums in U.S. equity index futures in the first three quarters of 2024 were driven by strong demand for long exposure by asset managers and limited ability by dealers to provide supply to the market due to ongoing regulatory constraints. This imbalance continued through much of the fourth quarter but was exacerbated by the strong rally in U.S. equities after the November elections. This caused equity index futures to trade at historic premiums to fair value.

That premium in S&P 500 futures moved lower as the December futures expiration arrived and the March 2025 contract continued to cheapen aggressively over the remaining days of 2024. By Dec. 31, S&P 500 futures were trading at a 75-bps premium to fair value, which was a decline of 100 bps in just under two weeks. The same factors that drove mispricing higher contributed to this collapse in funding costs at the end of the year.

In Europe, equity returns since the September futures expiration were mixed, with Germany's DAX Index up 6.5%, while the UK FTSE 100 Index, the French CAC Index, and the Euro Stoxx 50 Index were all flat to lower. Futures premiums were elevated, but not to the same extreme as seen in the U.S. Meanwhile, Japan's Topix equity benchmark resumed its richening trend after trading closer to fair value in the previous quarter.

THE BOTTOM LINE

The ups and downs witnessed throughout the fourth quarter of 2024 may be a precursor of what lies ahead for much of 2025. As the year unfolds, we anticipate the potential for more volatility as markets balance expected economic growth against U.S. policy uncertainty. Amid this backdrop, we believe partnering with an experienced and agile investment solutions provider that can manage risk and move money expeditiously will be critical to achieving investment success.

At Russell Investments, our 87 years of experience in trading makes us well equipped to do both, no matter the market environment. We combat low volume with significant market depth through 400+ dealers to assist our clients with improved performance and minimal impact. Please reach out if you have any questions.

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