November 2024 – Post-Election Rally Takes Hold

The S&P 500 soared to a record high in November, delivering its strongest monthly performance of the year, notching a 5.7% gain. Treasury yields, which had climbed steadily over the past three months, retreated in late November amid optimism that President-elect Trump may moderate his trade and tariff policies. The benchmark ten-year yield ended the month at 4.18%, down 10 bps from the end of October.

Market Benchmarks

	YE-2023	Oct-24	Nov-24	1-Month Change Δ	% Δ
Fed Funds	5.33%	4.83%	4.58%	-0.25%	-5.18%
1-Month SOFR	5.34%	4.81%	4.57%	-0.24%	-4.99%
10-Yr Treasury	3.87%	4.28%	4.18%	-0.10%	-2.34%
S&P 500	4,769.83	5,705.45	6,032.38	326.93	5.73%
REIT Index[1]	29.71	31.28	32.58	1.30	4.16%
VIX	12.45	23.16	13.51	(9.65)	-41.67%

1. Vangaurd Real Estate Index Fund tracks the MSCI U.S. REIT Index

The Federal Open Market Committee (FOMC) delivered its anticipated 25-basis-point rate cut in November, but inflation remains a concern. October Year-over-Year Core-PCE climbed to 2.80%, up from 2.65% in September, suggesting inflationary pressures could stall further cuts. Meeting minutes from the FOMC's session revealed cautious sentiment, dampening the market-implied probability of the Fed Funds rate falling to 3.5% or lower by June 2025—from 68% to 15% over the past month. These uncertainties, combined with mixed inflationary and deflationary proposals from the incoming Trump administration, are clouding the rate outlook.

"Double Default" Risk & Market Capitulation

The absence of significant foreclosures and loan defaults throughout the recent real estate downcycle has surprised many market participants. One of the key drivers has been "extend and pretend" tactics, whereby lenders extended loan maturities in hopes that declining rates would stabilize troubled assets. However, two critical developments have changed this dynamic:

1. **Acceptance of Elevated Treasury Yields:** The market has gradually come to the realization that medium and long-term yields are not likely to drop materially, leaving assets over-levered.

2. **Impending Loan Maturities:** Loans previously extended during the downcycle are approaching new maturities, amplifying the risk of "double defaults."

These pressures have escalated urgency among distressed property owners. In recent weeks, brokers have reported increased activity from sellers willing to accept losses, signaling a potential wave of market capitulation.

Policy Impacts on Commercial Real Estate Markets

The policy landscape under the Trump administration introduces both opportunities and challenges for the CRE sector. Key proposals can be categorized into **positive**, **negative**, and **uncertain** impacts.

Positive

- **Housing Production:** Trump has indicated a desire to streamline housing regulations and unlock federal land for development. If successful, these measures could increase housing supply, especially in areas where demand is outpacing availability. However, the administration's influence is limited by the fact that it is state and local – i.e. not federal – zoning and permitting regulations that dictate what, where and how quickly we can build. It's also unclear how much federal land really impedes housing development in most metro areas, as much of the federal land in question is in rural regions far from areas with acute housing shortages.

- Tax Reforms:
  - **Certainty that no cap will be placed on 1031 exchange benefits:** This would allow property investors to continue deferring capital gains when reinvesting into commensurate properties, encouraging greater transaction volume.
  - **Expansion of the Qualified Opportunity Zone (QOZ) program:** This could potentially attract more capital to underdeveloped regions by incenting investments in economically distressed areas.
  - **Re-establishment of bonus depreciation:** Bonus depreciation allows investors to deduct a sizable percentage of the cost of certain property improvements immediately rather than over time. Restoring this policy could encourage faster renovations and upgrades, enhancing asset quality across CRE markets.

Uncertain

- **Banking Regulation:** While Fed chair Powell has signaled his intent to remain in office, new OCC and FDIC leadership may adjust capital requirements under the Basel III Endgame framework. This could influence lending activity and liquidity in CRE markets.
  - These rules propose higher capital requirements for banks, which could limit their ability to lend aggressively to CRE projects. If adopted without modification, tighter banking regulations could reduce liquidity in the CRE market, making it more difficult for developers and investors to secure financing.
  - On the other hand, adjustments to these proposals could ease capital requirements, preserving access to credit.

Negative

- **Tariffs:** Economists widely agree that tariffs are generally inflationary, potentially leading to higher rates and creating additional headwinds for the CRE industry.
  - Increased costs for steel, lumber, and other building materials will raise development expenses, reducing profit margins for developers and potentially delaying or halting projects.
  - Accelerating inflation will make it much more difficult for the Fed to continue lowering interest rates and could even lead to future rate hikes.
- **Immigration Restrictions and Deportation:** Proposed restrictions on immigration, including deportation policies, could negatively affect the construction industry, which relies heavily on immigrant labor.
  - A reduced labor force would drive up wages and extend project timelines, further increasing construction costs.
  - Additionally, a decline in immigration could reduce demand for housing in certain markets, particularly those with high concentrations of immigrant communities, potentially weakening rental growth and property valuations.

At Caisson Capital Partners, we are committed to closely monitoring the evolving policy landscape to protect and grow our investors' capital. While opportunities like tax reforms and housing production initiatives show promise, challenges such as tariffs and immigration restrictions add complexity. Our team is actively tracking these developments and will continue providing timely updates and insights to help navigate risks and seize opportunities in this dynamic market.