Weekly Market Flash

Four Things On Our Radar

January 3, 2025

Markets are trying to find their footing as the year gets underway, so far without much success. The S&P 500 is slightly lower in morning trading today after losing ground in each of the last five trading sessions, stretching back into the December holiday period. No Santa Claus rally this year, kids. But – so far, anyway – nothing too much out of the ordinary for a standard-issue pullback following a furious rally. Stocks rose more or less nonstop after the November election, reaching a peak in early December. Since its last record high on December 6, the S&P 500 has lost around 3.6 percent, well within the norm for these types of things. Markets don't reach a technical "correction" until they have fallen at least ten percent from the previous high.

Nonetheless, we are always attentive to things that could go wrong. Here are four items to which we are paying particular attention in these early days of 2025.

The US Consumer

Our economy lives and breathes on the strength of the determined, doughty American consumer. Consumer spending makes up around 70 percent of our gross domestic product (GDP). The persistent strength of household spending over the past two years helped the US economy defy the predictions of most mainstream economists (ourselves included) who foresaw a recession two years ago. Back then, one piece of data that had us concerned was a sharp decline in household savings rates, as the cushion of income from the pandemic-era stimulus checks wore off. Our concern was arguably premature – households kept on spending throughout 2023 and 2024, but they did so increasingly thanks to credit card and other consumer debt. So we were not happy to see a recent report that credit card defaults among US individuals are at their highest level since 2010. We will be paying close attention to what banks and other financial institutions have to say about their credit card receivables and nonperforming loans when they start to report Q4 earnings in a few days.

Valuations

Item number two on our list is the concern one always has when markets have been going gangbusters; namely, nosebleed valuations. The forward 12-month price-to-earnings (P/E) ratio for the S&P 500 is currently around 22 times – not a record high by any means, but comfortably above the 10-year average of 18.5 times. Of course, some multiples are higher than others. The S&P 500 technology sector sits around 40 times, while that of AI chip leader Nvidia is at 54. Tesla, which appears to be losing ever more ground to Chinese rival BYD in the volume of electric vehicles produced, sits at a jaw-dropping 103 times earnings. Of course, the high-flying tech sector was also expensive a year ago, and a year before that, and those who dumped all their Magnificent Seven holdings back then are probably regretting having done so. There is no particular reason why 2025 should be the year when the tall poppies get lopped back to earth, but that doesn't make the concern go away. Earnings and sales, earnings and sales. It will be a year for maintaining a hawklike eye on corporate earnings.

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Rest of the World

We keep looking for reasons to be even slightly excited about investment opportunities outside the US, and we keep coming up shorthanded. The year is just two trading days underway, and already the euro and the British pound are under water against the dollar. A euro buys a scant $1.02 today, while a pound sterling gets you just $1.24. Good times for American holidaymakers abroad, bad times for owning assets in non-dollar denominated currencies. High on our list of international problems are two very powerful economies: Germany and China. The Eurozone's leading economy has been in, or close to, recession for the past two years and is also showing increasing signs of political instability. China is flirting with deflation, and its leaders know this but seem unable to do anything meaningful about it. Other problem spots include France and South Korea, also beset by myriad political and economic dislocations.

Inflation

We would have hoped to cross this one off our list of worries sometime last year, but if anything, our concerns about price levels are higher now than they were six months ago. There was a nice reprieve from recent bad news on the inflation front with the Personal Consumption Expenditures (PCE) index report late last week – finally, a month-over-month increase that was less than what economists had forecast. But Fed chair Powell himself was pretty blunt about the inflation problem during the post-FOMC press conference last month, and the guidance provided by his colleagues in their Summary Economic Projections reflected a belief that prices will take longer to come down than previously expected. So, therefore, will interest rates. And that closes the circle with Concern Number One expressed above. If interest rates stay higher for longer, then consumers' credit problems are likelier to persist as well, and that in turn feeds back into growth prospects for the economy and for corporate earnings. Which, in turn, could make those valuations even more expensive. And that's all just within the US, which is still supposed to be far outpacing the situation elsewhere in the world.

All of which may mean a great deal, or nothing at all, for equity markets. Even during the 30-odd minutes it has taken to write this commentary, stock prices have turned from negative to positive this morning. Yesterday they turned from positive to negative. As the old Wall Street saw goes, the market can stay irrational for longer than you can stay solvent. Neither too far one way, nor too far the other, but reasonably positioned for both growth and downside protection is, in our opinion, the right way to start off the New Year.

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