Wellington Shields

January 2025

Quarterly Market Strategy Report

CHANGE IS EVERYWHERE

Equities were more volatile in the second half of December after Federal Reserve FOMC meeting. Fed Chair Jerome Powell cut the fed funds rate 25-basis points, which was expected, but lowered the number of expected 2025 rate cuts to two, which was a negative surprise. In response, the S&P 500 Composite fell nearly 3%, the worst daily performance in months. In our view, this extreme reaction to less Fed stimulus is a sign that speculators, which had been boosting share prices in 2024, were becoming a bit more cautious.

Nonetheless, it was a good year for stockholders. In 2024, the Dow Jones Industrial Average gained 12.9%, the S&P 500 gained 23.3%, the Nasdaq Composite inked a gain of 28.6%, and the Russell 2000 index rose 10.0%.

What made 2024 significant is that it was the second time in a row in which all three popular indices closed with double-digit gains for the year. This is a fairly rare occurrence. There have been times when all three indices had an additional third year of double-digit gains, such as in: 1943-1945, 1949-1951, and 1995-1999. The bad news is that each of these occurrences was followed by a significant bear market. The most memorable advance was seen in 1995-1999 (five years of double-digit gains), and it was followed by a major bear market that resulted in substantial annual losses for three consecutive years.

Double-digit gains for only two years in a row are more common and have been seen in: 1954-1955, 1975-1976, 1982-1983, 1988-1989, 2009-2010, and 2016-2017. Still, each of these occurrences was followed by negative or negligible annual gains in the subsequent year. In short, two years of double-digit gains does not tell us much about 2025. It could be a weak year or another year of double-digit gains, but it does suggest that 2025 could be an important and pivotal time for investors.

January tends to be an important month for equities and the Wall Street adage "As goes January, so goes the year" could have special meaning this year. The reason January tends to be significant is that liquidity is strong early in the year due to IRA and pension funding. Therefore, a

Summary

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Our assumptions for 2025 include GDP growth of 3.2% YOY, S&P Composite earnings growth of 15%, a possible 25 to 50 basis point decrease in the fed funds rate, inflation to remain sticky at 2.75%, Treasury bill yields to fall to 4.1% and Treasury bond yields to ease to 4.3%.

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weak January performance is ominous and suggests investors are avoiding equities.

At the end of 2024 Change appeared Everywhere

Political change appeared everywhere in 2024, particularly as the year ended. On December 8, 2024, President Bashar al-Assad of Syria fled to Russia after six decades of his family's autocratic rule. This overthrow could be a major turning point in the Middle East, and it was an obvious blow to both Russia and Iran who backed Bashar al-Assad. According to Reuters, Senior US diplomats met with Syria's de-facto new ruler Ahmed al-Sharaa, and after a "good" and "very productive" meeting about Syria's political transition, the US removed an existing bounty on his head. At this early stage the transformation in Syria appears to hold great promise for positive, and potentially peaceful change in the Middle East.

Change is also impacting America's allies. French President Emmanuel Macron is under extreme political pressure to rein in France's fiscal deficit. German Chancellor Olaf Scholz is not expected to survive a February 2025 vote. The UK had a series of Conservative Party Prime Ministers after the pandemic, including Boris Johnson, Liz Truss, and Rishi Sunak, before a Labor Party upset brought the current Prime Minister Keir Starmer to power. The Conservative Party's newly elected leader is Kemi Badenoch, a right-wing politician who opposes identity politics and state spending. She is also the Tories' first black female leader. And in Canada, Justin Trudeau, is expected to face a formal motion of no-confidence in the House of Commons early this year.

Change is what also re-elected Donald J. Trump in November and won not only a majority in both the House and the Senate but a majority of all voters. This election was greeted with both jubilation and trepidation, domestically and abroad. Trump, the disruptor, has cobbled together a Cabinet full of potential disruptors who promise to bring transparency and common sense change to the federal government. However, change will not be easy to achieve in Washington DC or be pleasant for everyone, so we would expect some pushback.

The appointment of Elon Musk and Vivek Ramaswamy to head the newly created Department of Government Efficiency (DOGE), is a unique experiment. In our opinion, the effort to bring efficiency to government may be Elon Musk's greatest challenge to date. Nevertheless, the result of the November presidential election is a renewed focus on growing jobs in America, removing government regulations that hinder corporate growth, and controlling budget deficits. Each of these will require profound change and is what could make this year a time of both promise and potential turbulence.

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Our 2025 Forecasts

Our assumptions for 2025 include GDP growth of 3.2% YOY, a 15% increase in SPX earnings, a maximum of two fed funds rate cuts, Treasury bill yields falling to 4.1%, Treasury bond yields at 4.3%, and inflation remaining sticky at 2.75%. This combination results in our valuation model generating a predicted PE of 17.3 times and an SPX target of 5372 based on our 2026 earnings estimate. In short, the stock market is 40% overvalued by this benchmark. However, we must point out that at the end of 2021, 2022, and 2023 the market was also 30% or more overvalued by this benchmark, yet the market continued to climb higher. Liquidity and momentum have been overriding valuation in recent years and stock prices have been boosted by stocks benefiting or expected to benefit from the adoption of artificial intelligence. Moreover, household liquidity remains favorable and offsetting the risk in valuation are the fact that the US economy remains the global engine of growth, US is the home of many, or most of the companies benefiting from the future of artificial intelligence, and global liquidity remains high due to the sizeable global monetary and fiscal stimulus seen in the post-Covid era.

Conclusion

All in all, economic activity should remain relatively healthy in 2025 due in large part to the support given to the energy sector which will help to lower energy prices. This in turn lowers expenses for the household sector and improves margins in the corporate sector -- a combination that potentially increases both consumption and corporate earnings. The incoming business-friendly administration is also expected to improve the growth path for the small business sector which is the source of over 45% of all jobs in America. Prior to his inauguration, President-elect Trump has already proven that he can get foreign companies to invest in the US, and that too, increases jobs which improves household income.

Overall, we expect top line revenue growth next year will lead to at least a 15% increase in S&P earnings and this should support further gains in the equity market. However, much of this was priced in during the November rally, and we would not be surprised if stock prices were flat to lower in the first quarter of 2025.

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