



“When The Tide Goes Out” Market Commentary – March 2025

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The second estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.3% in the fourth quarter of 2024. This equals the advance estimate. From 2023 Q1 to 2024 Q4, GDP has ranged from 1.6% to 4.4%, with an average of 2.85%. Seen in this light, GDP is on the cooler side, made more pronounced relative to 3.0% in 2024 Q2 and 3.1% in 2024 Q3. Political uncertainty surrounding the election likely weighed on 2024 Q4. GDP should bounce back in 2025 Q1, although concerns about the effects of tariffs (real or perceived) may weigh on growth. Inflation is trending higher while unemployment is low and stable. The Consumer Price Index (CPI), which measures inflation in consumer prices, was 3.0% in January. While up from 2.4% in September 2024, it is still far below the cycle’s peak of 9.0% in June 2022. Unemployment was 4.0% in January, compared with a range of 3.9% to 4.2% over the past 12 months. The economy continues to show pockets of strength and weakness.

When the Federal Open Market Committee (FOMC) announces its next decision on monetary policy on March 19, futures markets expect the target range for the federal funds rate to remain at 4.25% to 4.5%. The Fed is still in cutting mode, however, as futures markets see 0.25% cuts by each of the following dates: July 2025, October 2025, February 2026, and December 2026. Note that this is a total of 1.0% in additional cuts, which is 0.25% more than was expected one month ago. This is likely in response to concerns echoed in the financial media about tariffs. Meanwhile, the Fed continues to shrink its balance sheet (quantitative tightening). On February 26, the Fed showed \$6.766 trillion in assets, down \$52 billion from January 29 (close to the Fed’s reduction commitment of \$60 billion per month). Quantitative tightening creates headwinds for the economy in the short run, but it also gives the Fed the ability to lean on quantitative easing once again should another financial crisis occur.

Technical factors of the market are bullish (more demand than supply), while fundamentals are fairly priced – therefore, we are mildly bullish on the market. The Standard & Poor’s forecast for S&P 500 operating earnings per share (EPS) through December 31, 2025 is \$268.04, which implies a price-to-earnings (P/E) ratio of 22.2 with the S&P 500 at 5,955. The earnings yield (E/P) of 4.50% represents fair value relative to the 10-year U.S. Treasury note yield of 4.24%. The yield spread flipped positive again to 0.26%, making stocks more attractive than one month ago. Seven of the nine largest companies in the S&P 500 make up \$16.6 trillion of the \$52.9 trillion index market capitalization with a weighted P/E of 30.9. If 31.5% of the index has a P/E of 30.9, then 68.5% of the index has a P/E of 18.2 for the overall P/E to be 22.2. A P/E of 18.2 is an E/P of 5.48%, which is fairly priced compared to the 10-year Treasury note yield of 4.24% (a yield spread of 1.24%).

Just when the S&P 500 appears to be caving in, it manages to find some strength. After closing at an all-time high of 6,144 on February 19, the S&P 500 pulled back 4.6% on increasing volume. And then suddenly, a rally took hold on February 28 on even higher volume, thus offsetting the negativity of the prior sessions. The index is sandwiched between its 200-day moving average at 5,720 and its 50-day moving average at 5,999. A break below the 200-day moving average would likely trigger a round of selling. Until then, however, our hypothesis is that the market may trade to the higher end of its recent range.

The shift away from the “Magnificent 7” mega-cap technology stocks became more defined in February. Overall, large cap is better than mid cap, and mid cap is better than small cap. Moreover, value is better than growth, except in the small cap space. Index returns (total returns) in 2025 year-to-date tell the story: S&P 500 Large Cap -0.2% (value +2.0%, growth -2.1%); S&P 400 Mid Cap -1.7% (value -0.2%, growth -3.1%); and S&P 600 Small Cap -3.8% (value -4.5%, growth -3.2%). Investors whose portfolios rely heavily on the Magnificent 7, knowingly or unknowingly, may ultimately prove Warren Buffett’s observation that “only when the tide goes out do you discover who’s been swimming naked”.