



## “Invincible”

### Market Commentary – January 2025

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**The third 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 3.1% in the third quarter of 2024.** This is higher than the advance and second estimates of 2.8% and the 3.0% reading in 2024 Q2. On December 18, the Federal Reserve updated its economic projections that were last released in September. It now sees GDP growth of 2.5% in 2024, 2.1% in 2025, 2.0% in 2026, 1.9% in 2027, and 1.8% in the “longer run” (beyond 2027). The Fed sees unemployment at 4.2% in 2024, 4.3% in 2025, 4.3% in 2026, 4.3% in 2027, and 4.2% in the longer run, while it forecasts inflation at 2.4% in 2024, 2.5% in 2025, 2.1% in 2026, 2.0% in 2027, and 2.0% in the longer run. Overall, inflation is running a tad hotter than expected, while unemployment is a bit lower.

**On December 18, the Federal Open Market Committee (FOMC) lowered the target range for the federal funds rate by 0.25% to a new range of 4.25% to 4.5%.** However, it reined in the number of cuts they expect in 2025. The Fed now sees the federal funds rate at 3.75%–4.0% by the end of 2025, implying two more 0.25% cuts. Total cuts as of December 18 are 1.0%. The Fed’s balance sheet had \$6.886 trillion in assets on December 25, down \$19 billion from November 27 (less than the Fed’s reduction commitment of \$60 billion per month). The next FOMC announcement on monetary policy is scheduled for January 29.

**Technical factors of the market are bearish (more supply than demand), while fundamentals are fairly priced – therefore, we are mildly bearish on the market.** The Standard & Poor’s forecast for S&P 500 operating earnings per share (EPS) through December 31, 2025 is \$271.27, which implies a price-to-earnings (P/E) ratio of 21.7 with the S&P 500 at 5,882. The earnings yield (E/P) of 4.61% represents fair value relative to the 10-year U.S. Treasury note yield of 4.58%. The yield spread is 0.03%. The seven largest companies in the S&P 500 make up \$17.6 trillion of the \$52.2 trillion index market capitalization with a weighted P/E of 36.8. If 33.7% of the index has a P/E of 36.8, then 66.3% of the index has a P/E of 14.0 for the overall P/E to be 21.7. A P/E of 14.0 is an E/P of 7.14%, which is attractively priced compared to the 10-year Treasury note yield of 4.58% (a yield spread of 2.56%).

**The S&P 500 ran into resistance at 6,100, but a look under the hood reveals something more disturbing.** December saw the index retrace some gains, closing down 2.5% for the month (without dividends). It is resting at a support level near the October 2024 high (5,865), with lower support levels including the 200-day moving average (5,552), the September 2024 low (5,400), and the August 2024 low (5,200). What is troubling about the December decline is that the equal-weighted S&P 500 fell 6.4%. Both versions of the S&P 500 have the same companies, including the bubbly mega-cap tech stocks. Most stocks in the S&P 500 are struggling, while investors blindly “buy the index” (market cap-weighted).

**The mania that is driving prices of the mega-cap tech stocks to the moon is causing investors to feel invincible.** Recall that the Nasdaq 100 peaked in March 2000 at 4,705 and then fell 82.9% to 804 by October 2002. Put another way, \$1 million turned into \$171,000. An investor may point out that if you held through that, the same Nasdaq 100 is now 21,000. All you need to do is hold on and it comes back...it *always* comes back, right? Not necessarily. Moreover, investors should consider that it may take *decades* to recover. In Japan, the Nikkei 225 index peaked in 1989 just below 39,000, before falling to near 7,000 by 2009. It did not surpass 39,000 until 2024 – 35 years later! In another example, recall that the Dow Jones Industrial Average rallied from a low of 64 in 1921 to a peak of 381 in September 1929 after a period dubbed “The Roaring 20’s”. This was a nearly 500% rally in the DJIA! And then the bottom fell out. The DJIA hit a low of 41 in July 1932 (down 89%). Eventually, the DJIA did surpass 381, but not until 1954 (25 years later). It seems that we are in another Roaring 20’s period, although it is 100 years later. The arrogance of the financial media and investors today is fascinating (Exhibit A: “The Magnificent 7”). Will the same lessons of the past ultimately be relearned? As Julius Caesar said, “Experience is the best teacher.”