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Market Stats & Commentary

Market Vital Signs as of 12/31/2024

Stock Indexes	December	YTD	1 Year
S&P 500	-2.38%	25.02%	25.02%
Dow Jones Industrial Average	-5.13%	14.99%	14.99%
NASDAQ Composite	0.48%	28.64%	28.64%
Russell Mid Cap Index	-7.04%	15.34%	15.34%
Russell 2000 Small Cap Index	-8.26%	11.54%	11.54%
MSCI EAFE Developed Int'l Index	-2.27%	3.82%	3.82%
MSCI Emerging Markets Index	-0.14%	7.50%	7.50%
Bond Indexes			
BBgBarc US Aggregate Bond Index	-1.64%	1.25%	1.25%
BBgBarc US Corp High Yield Bond Index	-0.43%	8.05%	8.05%
Interest Rates	12/31/24	12/31/23	12/31/23
Fed Funds Target Range	4.25%-4.50%	5.25%-5.50%	5.25%-5.50%
10 Yr U.S. Treasury Rate	4.57%	4.35%	4.35%

December was a tough month for both bonds and stocks, with the exception of a handful of large tech companies. Of course, these numbers come after outsized gains in November, so they are not exactly surprising.

What was surprising is how the returns were dispersed. For most of 2024, gains in the S&P 500 had once again been driven by a handful of large tech companies (same handful referenced above). This began to change in the fall and gains broadened out to the rest of the market, which is a healthy thing. Then in December markets narrowed again, with leadership being concentrated in that same handful of names. My hope is that January sees a return to the broadening out seen in the fall, as the current level of concentration in the S&P 500 is worrisome to say the least.

Bonds also had a negative month, driven by the continued march higher of long-term interest rate. The Fed cut the overnight rate again in December, now down a full 1% since September, but signaled that there would probably be fewer cuts in 2025 than expected earlier in the fall. So, long term rates rose, and bonds prices took a hit.

Outlook for 2025

It's January, so the question de jour is "what is your outlook for this year?". I will do my best to lay out the landscape as I see it and some thoughts going forward.

Couple points to make first:

- Constructing a price target is fairly simple math, you multiply a P/E ratio and an earnings estimate. The problem is that both those numbers are "best guesses" at this point in the year. So, I used consensus estimates for the S&P 500, then +/- a percentage to create a range of estimates for earnings. Creating a range of expected P/E values is basically a historical exercise, using existing levels and historical norms. You then create a table based off the ranges established and voila, you have yourself a midpoint price target with upside and downside ranges.

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Now that the methodology is out of the way, here are the numbers and ranges for 2025…

Input Data

Current Consensus Estimate for CY 2025 S&P 500 EPS	$273.63
S&P 500 close on 12/31/2023	5881.63

Data Source: Factset

Earnings +/- 2% Range	**$268.16**	to	**$279.10**
Expected P/E Range	**21**	to	**27**
Implied S&P 500 Targets	**5631**	to	**7536**
	Midpoint	**6584**	

Implied S&P 500 Returns

Lower Range	**-4.26%**
Mid Point	**11.93%**
Upper Range	**28.12%**

Range of Expectations Table

	S&P 500 P/E Ratio									
S&P 500 EPS Estimates	**19**	**20**	**21**	**22**	**23**	**24**	**25**	**26**	**27**	**28**
245	4655	4900	5145	5390	5635	5880	6125	6370	6615	6860
250	4750	5000	5250	5500	5750	6000	6250	6500	6750	7000
255	4845	5100	5355	5610	5865	6120	6375	6630	6885	7140
260	4940	5200	5460	5720	5980	6240	6500	6760	7020	7280
265	5035	5300	5565	5830	6095	6360	6625	6890	7155	7420
270	5130	5400	5670	5940	6210	6480	6750	7020	7290	7560
273	5187	5460	5733	6006	6279	6552	6825	7098	7371	7644
275	5225	5500	5775	6050	6325	6600	6875	7150	7425	7700
280	5320	5600	5880	6160	6440	6720	7000	7280	7560	7840
285	5415	5700	5985	6270	6555	6840	7125	7410	7695	7980
290	5510	5800	6090	6380	6670	6960	7250	7540	7830	8120
295	5605	5900	6195	6490	6785	7080	7375	7670	7965	8260
300	5700	6000	6300	6600	6900	7200	7500	7800	8100	8400
305	5795	6100	6405	6710	7015	7320	7625	7930	8235	8540

Data Source: Factset

Using current EPS estimates and a midpoint P/E ratio, you get a price target of 6,584 for the S&P 500, which implies a return of 11.93%. If by some miracle the market is able to maintain a 27 P/E and beat estimates, 2025 looks to be a great year. If earnings miss by 2% and P/E ratios contract to 21, I would expect a slightly negative year, but nothing like 2022.

Couple of important points to keep in mind:

- The midpoint of the P/E range I used is 24. The current P/E is approximately 27. However, the P/E at the start of the year was around 23.
- Historically, 27 is a VERY HIGH P/E ratio. The P/E of the S&P 500 at the end of 1999 was 29.7 and we all know how that ended. My assumption is that the market will do well just to maintain its current P/E, so I used that as the upper limit. I derived the lower P/E range of 21 by charting P/E data post COVID to now.

My Thoughts on The Numbers

- The S&P 500 has become heavily concentrated in a handful of giant technology companies, and this is driving the abnormally high current P/E. Once you get away from that handful, the rest of the index is much more reasonably valued. The current P/E on the S&P 500 Equal Weight Index is currently 21.7 – far more reasonable than 27
- That handful of stocks I mentioned above seems far more vulnerable to a pullback in P/E levels than the average stock in the index
- There is potential for a bit of leadership change and broadening out of gains over the course of 2025. This started at the beginning of Q4 2024 and seems to be continuing as I write this. This is a good thing and would lead to a healthier overall market.
- Valuations matter! Getting the P/E ratio right is more important than getting the earnings estimates right. Take a look at the chart and notice that going from a 28 P/E to a 19 P/E is far more painful than going from $305 to $245 in earnings per share.

I actually think the 11.93% is about as good an estimate as one can make a rational case for. It lines up with what I have heard from various fund management companies and industry chatter. **But be mindful of the P/E ratio**. I downloaded the daily P/E ratios for the S&P 500 since January 3, 2000 (4,650 data points) and ran mean and median formulas. The mean P/E over the time period is 17.67 and the median came in at 17.00. Going back to those numbers from where we are now would inflict some real pain, particularly on those handful of stocks with high double digit P/E ratios.

David

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Disclosures, Disclaimers & Other Assorted Compliance Fun

Index Descriptions

S&P 500: Representing approximately 80% of the investable U.S. equity market, the S&P 500 measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested.

Dow Jones Industrial Average Total Return: The Dow Jones Industrial Average is a composite of 30 stocks spread among a wide variety of industries, such as financial services, industrials, consumer services, technology, health care, oil & gas, consumer goods, telecommunications, and basic materials. The index represents approximately 23.8% of the U.S. market, and is price weighted (component weightings are affected by changes in the stocks' prices). Maintained by the Averages Committee, components are added and deleted on an as-needed basis.

Russell Midcap: A subset of the Russell 1000 index, the Russell Midcap index measures the performance of the mid-cap segment of the U.S. equity universe. Based on a combination of their market cap and current index membership, includes approximately 800 of the smallest securities which represents approximately 31% of the total market capitalization of the Russell 1000 companies. The index is created to provide a full and unbiased indicator of the mid-cap segment.

Russell 2000: Based on a combination of their market cap and current index membership, this index is comprised of approximately 2,000 of the smaller securities from the Russell 3000. Representing approximately 10% of the Russell 3000, the index is created to provide a full and unbiased indicator of the small cap segment.

NASDAQ: The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system.

MSCI EAFE (Europe, Australasia, Far East) Index: A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. As of June 2, 2014, the index consists of 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI Emerging Market Index: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 2, 2014, the index consists of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

Bloomberg Barclays U.S. Aggregate (BCAG): A representation of SEC-registered, taxable, and dollar denominated securities. The index covers the U.S. investment grade fixed rate bond market, with index components for asset-backed securities, government and corporate securities, and mortgage pass-through securities. Must be rated investment grade (Baa3/BBB- or higher) by at least two of the following rating agencies: Moody's, S&P, Fitch; regardless of call features have at least one year to final maturity, and have an outstanding par value amount of at least $250 million.

Bloomberg Barclays U.S. Corporate High Yield: Covers the universe of fixed rate, non-investment grade debt which includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors. The index also includes Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. Must publicly issue, dollar-denominated and non-convertible, fixed rate (may carry a coupon that steps up or changes according to a predetermined schedule), and be rated high-yield (Ba1 or BB+ or lower) by at least two of the following: Moody's, S&P, and Fitch. Also, must have an outstanding par value of at least $150 million and regardless of call features have at least one year to final maturity.

U.S. government bonds and Treasury notes are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury notes are certificates reflecting intermediate term (2-10 years) obligations of the U.S. government. There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices generally rise.

International investing involves special risk, including currency fluctuations, differing financial accounting standards, and possibly political and economic volatility.

Investing in emerging markets can be riskier than investing in well established foreign markets.