MH & ASSOCIATES • SECURITIES MANAGEMENT CORPORATION

Happy New Year

INVESTMENT VIEWS

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DECEMBER 31, 2024

2024 IS GOING OUT WITH A BANG!

The US stock markets finished with a strong performance for 2024, even a weak December could not keep the indices from closing the year with solid double-digit gains. Though somewhat volatile, markets rallied all through the year as inflation concerns faded and along with that came the anticipation that the Federal Reserve would begin cutting interest rates in order to avoid being too restrictive to a growing U.S. economy.

Profit Taking Expected

With such strong returns, there is a certain urge to take profits, to which we attribute the recent market volatility. Many investors want to wait until New Years, as taxes will not be paid until April 2026 and some are deciding to do so early, taking profits into the close of the year. This dynamic certainly has been in play since the beginning of December and will likely continue into early 2025. Thus we continue to expect the market to have a weak start for the year.

Market Bifurcation

We note that though stocks markets have had a banner year, the rally has been somewhat narrow as we discussed in previous newsletters. Many sectors and stocks have not experienced the returns of the big indices, with some 33% of S&P 500 stocks and 77% of all stocks down on a Year-To-Date basis. A narrow rally indeed. Dour as this sounds, this does leave the market somewhat bifurcated, as “hot” names are clearly overvalued, while those who have not participated are also relatively inexpensive. Cap weighted indices are being dominated by only a handful of stocks and the adjustment process could be painful and money may not immediately shift to the lower market cap securities.

Economic Uncertainty

Economically, the U.S. seems to be on somewhat shaky footing, with several gauges, including cautious commentary from the Fed and weak revised employment numbers, weighing on investors’ minds. Auto loan and credit card defaults are also rising. On the positive side, business confidence and planned capital expenditures have strengthened over the past few months, possibly a sign of stronger growth ahead. Globally, many areas of the world have been in either a recession or stagnant and may be on the right footing for a rebound towards growth in the coming year.

Setting The Stage For 2025

All said, our current stance is one of caution in the equity and bond markets. The major investment themes that have played out over 2024, like artificial intelligence and a rebirth of nuclear power, seem to be moving to the next phase where the market will expect to see a payoff from all the investments made. The interest rate hiking cycle seems to have peaked, however the cutting cycle investors were counting on appears to have fizzled as inflation remains sticky. Thus the Fed will remain data dependant and markets should remain volatile as it awaits new economic information. For 2025 to be a positive stock market year, there needs to be either a new catalyst or the proof that last years catalysts are bearing fruit. For bond investors, inflation needs to be stamped out before any traction can be made. We anticipate a period of cost cutting from corporations as well as government, brought on by some deregulation as well economic need. This can certainly help on the inflation side, but will cause disruptions corporately in the immediate term.

With 2024 going out with a bang, it is also likely that 2025 may begin with a bang as investors cash in some of their 2024 profits. Beyond that, the year ahead promises to be interesting for investors with new dynamics in politics and economics.

INTEREST RATES THREATENING EVERYTHING

We have written before on the crucial place that interest rates hold in financial markets. Interest rates can be thought of as the price of money (i.e. higher interest rates means money is more expensive and vice versa). Recalling 2022, interest rates began a steep climb that hurt most stocks and bonds (bond prices and interest rates are completely inverse to each other), making for a tough year.

Recently, the yield on longer dated US Treasuries have been climbing, threatening to break out higher beyond what we observed earlier this year. The chart below is for the 10-Year US Treasury yield, which shows it approaching 4.75%, the prior high this year. If it were to move higher from there, markets would have a problem.

Interest rates matter because they are seen as an alternative to every other asset, including stocks, commodities and real estate. If yields do end up moving higher, the marginal investor will be drawn away from stocks to now higher yielding securities. Markets anticipate this, which leads to unfavorable conditions for stock investors, as witnessed in 2022.

For now, this is a data point we are watching closely and while we are far from being confident in longer dated yield moving higher, we also are not dismissing the possibility either. Caution is warranted until investors get a clearer signal.

HINDENBURG OMEN

To add to the caution we are feeling about the market comes an indicator that is as ominous as it sounds, the Hindenburg Omen. It's a combination of several data points that, when triggered several times within a month, indicate an imminent market top. The last time it was triggered marked the late 2021 top and before that was right before the COVID top. This indicator was hit again in mid-December and the attempts at a Santa Claus rally last week have been thwarted. Before we get too over-bearish, this indicator does give some false readings and the running joke is that it has called ten of the last four corrections. That said, it is certainly a red flag and focuses us on looking for signs of distribution and be diligent in protecting capital.

A LUMP OF COAL

The Santa Claus Rally has so far failed to show up this year and some of it can be blamed on people taking some losses to offset gains taken earlier in the year. Another factor was the lump of coal that Chairman Powell left in the stockings of investors who were looking for a more dovish view going into 2025. The rally period is specifically the last five trading days of December and the first two trading days in January. While not confirmed, it looks like this will be a failed Santa Claus rally and these tend to precede bear markets to start the New Year. Since 1950 there have been 16 years in which Santa did not materialize and in nine of those periods a bear market ensued. On the positive side, in five of those nine bear market years, the market was ended up for the year, but only after a period of heavy selling. History shows though, that we should definitely tamper our expectations for the coming year. Failed rallies have produced and average return of +6.4% for the S&P in those sixteen attempts and remember that last years rally was also a failed one and the market did just fine in 2024.

Recommendation List: A list of all previous specific investment discussions published over the past 12 months will be provided upon request. Please email lara@mhandassociates.com or call our office for this list.

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