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January 27, 2025 – Investment Commentary

Last week, stocks experienced a slight pause near record highs, but the market still secured its strongest start to a presidential term since Ronald Reagan took office in 1985. In addition, On Friday, the S&P 500 slipped 0.3%, the Nasdaq 100 dropped 0.6%, and the Dow Jones Industrial Average declined 0.3%. A Bloomberg Index tracking the "Magnificent Seven" Mega-Cap stocks fell 0.4%, while the Russell 2000 retreated 0.3%. Despite a sell-off in chipmakers impacting Friday's session, the S&P 500 managed to post a 1.7% gain for the week. This rally came after President Donald Trump promoted policies aimed at stimulating economic growth and reducing taxes while signaling a softer stance on tariffs against China— although he maintained threats of broader action.

Meanwhile, the MOVE Index, which measures expected Treasury volatility, fell to its lowest level since mid-December. This week, the focus shifts to the kickoff of big-tech earnings season (4 of 7 Mag), a key test for the market's risk-on sentiment. Investors are keen to see if demand for artificial intelligence meets lofty expectations. Last week, optimism in the sector was fueled by a $100 billion joint venture formed by SoftBank Group Corp., OpenAI, and Oracle Corp. to invest in AI infrastructure. Ahead of next week’s Federal Reserve decision, bonds rallied, supported by data showing a decline in U.S. consumer sentiment and a slight slowdown in business activity growth. Despite this, companies remained optimistic about their outlook. The yield on 10-year Treasuries eased by two basis points to 4.62%.

Equities

The S&P 500 returned 1.8% for the week and made a new all-time high as President Trump seemed to strike a better-than-feared tone on global trade. Lower tariff concerns particularly helped stocks in Europe and Japan. All sectors in the S&P 500 posted positive returns except energy (-2.9%), communication services (+4.0%), and healthcare (+3.0%) were the best-,performing sectors. EAFE markets returned +3.2%, with gains in Europe (+3.4%) and Japan (+3.2%). EM markets returned +1.9%, with China (+3.0%) and Brazil (+3.1%) leading the index higher, while India (-0.9%) underperformed.

From a valuation perspective, U.S. markets (other than midcaps) trade above +1 standard deviation based on historical forward P/E ratios as the S&P 500 is at +2.2, the NASDAQ is at +1.2, and U.S. small caps are at +1.2. For the next 12 months, EPS growth for S&P 500 is expected to be 10.4% (vs. 6.9% annualized over the last 20 years). For the next 12 months, EPS growth for NASDAQ is expected to be 19.0% (vs. 10.7% annualized over the last 20 years). For the next 12 months, EPS growth for the Russell 2000 is expected to be 8.9% (vs. 6.3% annualized over the last 20 years). All U.S. indices, including the S&P 500 (US Large Cap), NASDAQ, Russell Midcap (US Midcap), and the Russell 2000 (US Small Cap) trade at or above their 20-year averages based on forward P/E ratios while the MSCI EAFE (Non-US Developed Market Equities) and MSCI EM (EM Equities) are inline.

Fixed Income

Investment grade fixed income sectors posted positive returns as rates were mostly unchanged across the curve, but spreads were compressed. Municipals returned +0.4%, U.S. AGG returned +0.1% and U.S. IG returned +0.3%. HY bonds returned +0.3% as the spread compressed 6bps, while bank loans returned 0.2%. EM debt returned +0.5% as the U.S. dollar fell -1.7%.

Rates

Rates were mostly unchanged across the curve. The recession-watch 3M-10Y spread compressed 2bps to +31bps. The 2Y-10Y spread compressed 1bp to +33. Rates rose slightly in other developed markets other than the U.K. The BTP-Bund spread is at 1.09%, its lowest level since 2021. 5-year breakeven inflation expectations rose 1bp to 2.55% - their highest level since April 2024 (vs. low of 1.88% on Sept 10); 10-year breakeven inflation expectations fell 1bps to 2.42% (vs. recent low of 2.03% on Sept 10); the 10Y real yield was unchanged at 2.20%. The market now expects between two cuts in 2025 vs the Fed's guidance of two cuts. At year-end 2025, the market expects the Fed Funds rate to be 3.8% vs. the Fed's guidance of 3.75%-4.00%.

Currencies/Commodities

The dollar fell -1.7%, its worst week since November 2023. The commodities complex fell 1.1% as energy prices fell 3.0% for the week. Brent prices fell 2.8% to $79/bbl. U.S. natural gas prices rose 2.0%, while European gas rose 8.2% due to weather.

Market monitors

Volatility fell for equities and for bonds (VIX = 15, MOVE = 87); the 10-year average for each is VIX=18, MOVE = 78. Market sentiment (at midweek) showed a strong rebound, rising from -15 to +14 as investors grew more optimistic with the President's first week in office.