OBSERVATIONS

- Markets traded lower last week as interest rates rose; the S&P 500 lost -1.9% and small caps (Russell 2000) lost -3.5%, while the yield on the 10-year Treasury climbed +16 basis points to end the week at 4.76%.[1]
- The US Services PMI increased to 54.1 in December, which was 2 percentage-points higher than in November. The Services PMI has been above 50—any reading above 50 denotes expanding activity—for 52 of the past 55 months beginning in June-2020.[1]
- The Job Openings and Labor Turnover Survey (JOLTS) showed that job openings increased to 8.1 million in November (latest data available), which was +350k more jobs than in October. However, the number of quits—a useful measure of people's confidence in the labor market—declined to 3.1 million, which was the lowest number of monthly quits since mid-2020.[1]
- Initial unemployment claims remained low, registering only 201k new claims in the first week of 2025.[1]
- Consistent with the increase in job postings in November and the low number of unemployment claims, the December jobs report showed that 256k new jobs—well above expectations—were created in December and the unemployment rate ticked down to 4.1%.[1]
- The Michigan consumer sentiment index weakened in January to 73.2 from December's 74 level as people became more pessimistic about future economic conditions and expectations for inflation 1-year from now increased from 2.8% the month prior to 3.3%.[1]

EXPECTATIONS

- Fed minutes showed that many Fed officials "expected that inflation would continue to move toward two percent, although they noted that recent higher-than-expected readings on inflation, and the effects of potential changes in trade and immigration policy, suggested that the process could take longer than previously anticipated." The release of these Fed minutes along with President-elect Trump's press conference detailing some of his administration's plans to lower taxes helped push the yield on the 10-year Treasury higher last week.[2]
- As Q4-2024 earning season is about to kick-off, it is worth noting that industry analysts have collectively lowered their estimates for Q4 by -2.7%, which is below the typical downgrade of -3.4% that usually takes place in the run-up to an earnings season. This less than average earnings downgrade comes despite 71 firms issuing negative guidance for Q4, which is above the 5-year average for the number of firms issuing negative guidance. At this point, analysts expect Q4 earnings to grow by +11.9% year-over-year.[3]

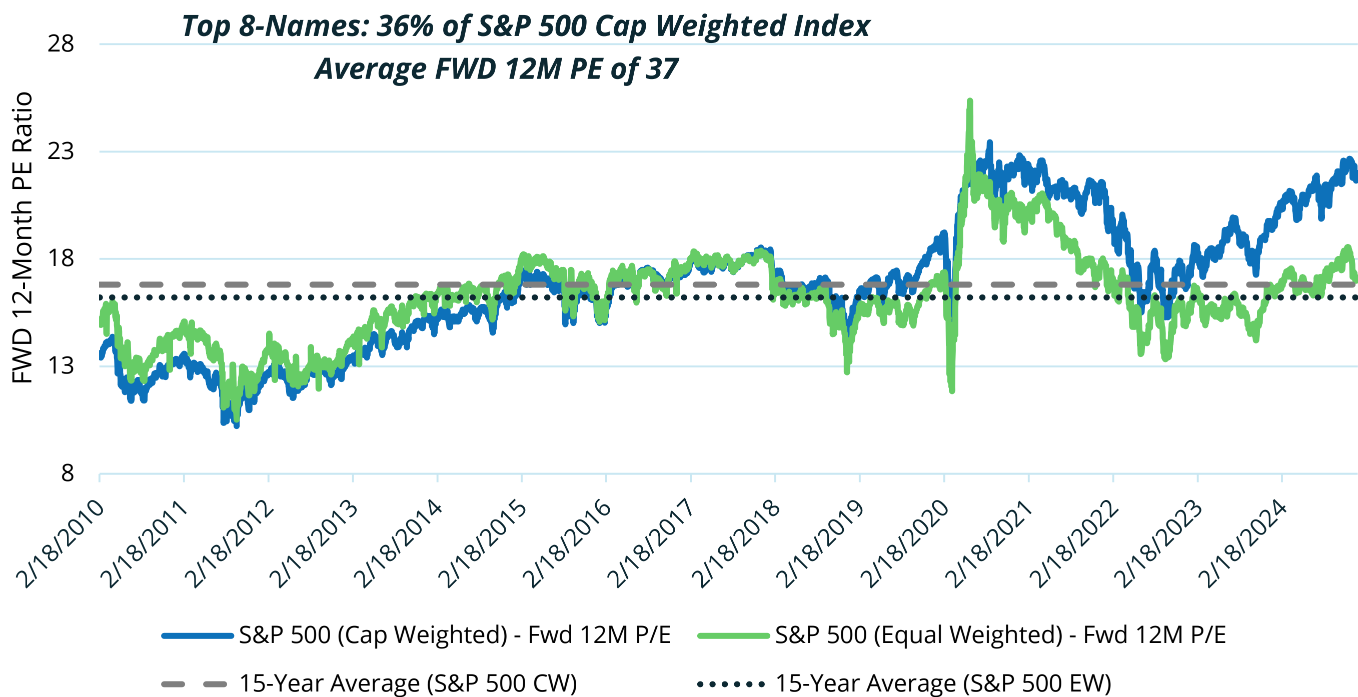
ONE MORE THOUGHT: Valuations are High, but Narrowly So[1]

As we closed out 2024, the S&P 500 returned 25.0% (total return). This was the second straight year of returns over 20%, which has not happened since the 1998-1999 period. While 2024 returns were robust—they were in the top 1/3 of best returns over the past 80-years—they came largely due to multiple expansion. This is to say the S&P 500 closed out 2024 at nearly 5,882 and divided by the expectations for 2025 S&P 500's earnings (≈$272) this yielded a Price-to-Earnings (P/E) ratio of 21.7. This is well above the long-run average for the forward-looking P/E ratio for the S&P 500 which is approximately 16.8 over the past 15 years—see Chart of the Week. However, this elevated P/E ratio for the S&P 500 is being driven by a relatively small number of mega-cap stocks which have increasingly been

[1] *Blomberg LP, 1/10/2025*
[2] *https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm*
[3] *https://insight.factset.com/how-much-did-analysts-cut-eps-estimates-for-sp-500-companies-for-q4*

the focus of investors' attention. These so called "Big 8"—Apple, NVIDIA, Microsoft, Amazon, Meta (Facebook), Tesla, Alphabet (Google), and Broadcom—represent over 36% of the S&P 500 by market capitalization and have an average P/E ratio of about 37. Meanwhile, the P/E ratio for the median company in the S&P 500 is just over 18.5. Similarly, if you look at the forward-looking P/E ratio for an equal weighted S&P 500 Index—which counts every stock in the S&P 500 as an equal part—it is just slightly elevated above its long-run average (17.0 vs. 16.2). While there is reason to be cautious as investors when P/E ratios drift well above their long-run average, it is equally worth understanding the reasons for this drift. In the late 1990s, when P/E ratios also became very high relative to their long-run average, these elevated P/E ratios extended to much of the index rather than a narrow cohort of stocks. In contrast, today many of the S&P 500 constituents have a P/E ratio in-line with historical averages, but the largest components of the index are very expensive and skewing the results for the index as a whole. This suggests that if multiples normalize in the coming year, the brunt will likely be felt by those few stocks at the top of the index.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP 12/31/2024

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