Westminster
FINANCIAL COMPANIES

Economic & Market Commentary
January 2025

Market Recap – January: The Month 2024 Laggards Outperform

Equity markets added to their 2024 gains in January 2025, with 2024 laggards outperforming the winners during the month. For example, the value-tilted Dow Jones Industrial Average (DJIA) outperformed the tech-heavy NASDAQ, up 4.8% versus 1.7%. Despite some volatility, the large cap S&P 500 gained 2.8% on the month. Meanwhile, the equal-weighted S&P 500 outperformed and climbed 3.5%. In January, market breadth expanded beyond the "Magnificent Seven" names with other segments of the market rising since the end of December[i].

On the sector front, the communication services and healthcare sectors were up 9.1%, and 6.8%, respectively, in January. The laggards were technology and consumer staples down 2.9% and up only 2%, respectively, as the Chinese DeepSeek AI model hit technology, and tariffs, weight-loss drugs, and alcohol warnings impacted staples names[ii].

In the bond market, both Treasury and corporate bonds across the full spectrum of maturity and quality advanced in price year-to-date with longer bonds rallying the most.

The U.S. Aggregate Bond Index is up 1% year-to-date, with Treasury bonds slightly outperforming corporate bonds of comparable maturities. For example, the iShares 10-20 Year Treasury Bond ETF (per proxy ETF ticker: TLH) advanced 2.3%, while the iShares 10+ Year Investment Grade Corporate Bond ETF (per proxy ETF ticker: IGLB) rallied 2.1%[iii]. Overall, the bond market is having a good start to the year with a resumption of the typical negative correlation between stocks and bonds. This is a good development to see for portfolio hedging and diversification purposes as it displays a normalization of market behavior (i.e., bonds providing portfolio defense during periods of stock market turmoil).

Key Interest Rates[iv]	**01/31/25**	**12/31/24**	**01/31/24**
Federal Funds Target Rate	4.50%	4.50%	5.50%
3 Month T-Bill	4.28%	4.31%	5.36%
2-Year T-Note	4.20%	4.24%	4.21%
5-Year T-Note	4.33%	4.38%	3.84%
10-Year T-Note	4.54%	4.57%	3.91 %
30-Year T-Note	4.79%	4.78%	4.17%

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The Economy

The U.S. Economy closed 2024 on a high note. Fourth quarter GDP came in at 2.3% annualized rate, with personal consumption a standout contributor to growth, up at a 4.1% clip, as consumers continued spending through the holiday quarter. 2024's initial figures show inflation-adjusted economic growth was 2.8%, slightly lower than the 2.9% in 2023, but overall, a solid rate relative to the long-term historical average of 2.2%[v].

Topic of Interest: US Manufacturing Sector Recovering

Economic data in January was positive overall. The manufacturing sector has climbed out of a 2-year slump per the Institute of Supply Management's (ISM) Purchasing Manager Index (PMI). The survey crossed the 50 level for the first time since 2022 (a reading above 50 indicates expansion, while below 50 indicates contraction). The January gain was broad, but note it was reported prior to recent tariff threats. New orders rose three points to 55.1, the strongest reading since May 2022. The fifth straight monthly increase in this index, which illustrates a pickup in purchasing demand, led to an increase in production, as seen in figure-1[vi].

Figure 1 - The U.S. Manufacturing sector seems to be recovering, but any enacted tariffs could stall the recovery.

Topic of Interest: Moderating but Still Healthy Job Growth

The January jobs report showed hiring slowing down after a strong November and December, as seen in Figure-2[vii]. January nonfarm payrolls increased by 143,000 after an upwardly revised 307,000 gain in December. The unemployment rate came in at 4.0%, below December's 4.1% print as the labor force participation increased to 62.6%.

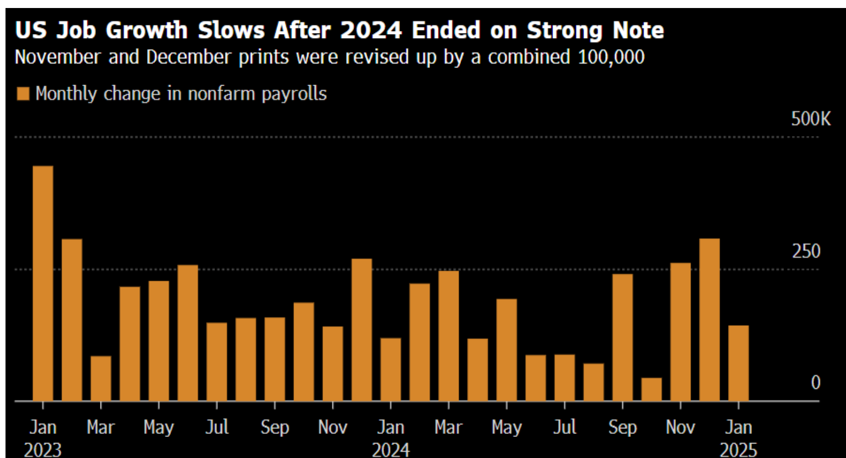

Figure 2 - A Moderating, but Still Healthy Job Growth

However, the downward revisions to 2024 monthly payrolls numbers were significant and showed job growth averaged

166,000 a month last year, a slowdown from the initially reported 186,000 pace as seen below in Figure-3[viii].

January's employment gains and the updated payrolls figures going back to early 2023 show a moderating yet still-healthy labor market that continues to fuel the economy without contributing to inflationary pressures.

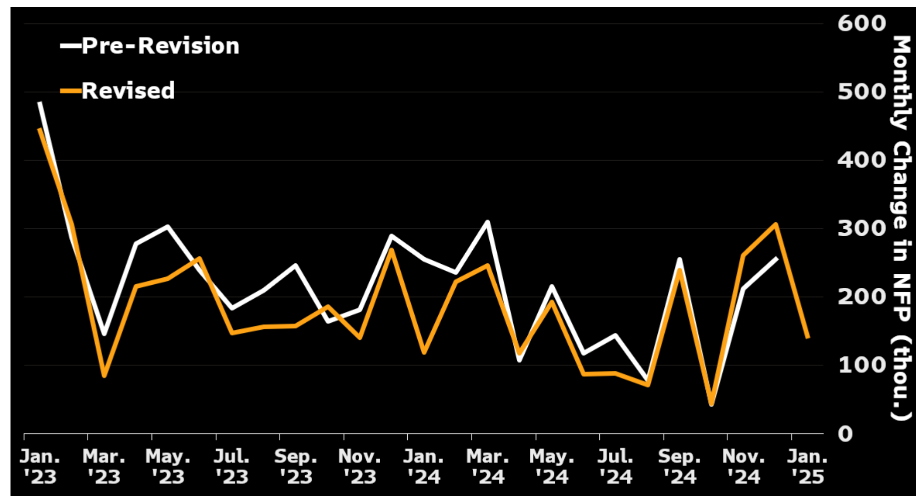

Figure 3 – Monthly Nonfarm Payroll Figures Downward Revisions

Overall, this data reinforces the narrative that the Fed may only cut rates a couple of times this year. However, it may be worth keeping in mind that the direction of the Federal Funds Rate remains lower even though further easing may come more gradually than initially anticipated.

Topic of Interest: Earnings Season

The fourth quarter earnings season is going well with some exceptions. At the time of writing, 62% of S&P 500 companies have reported results, with 77% having beat expectations, equal to the 5-year, but above the 10-year, average beat rates. For Q4 2024, the blended year-over-year earnings growth for the S&P 500 is tracking at 16.4%, which would mark very robust year-over-year quarterly growth. The largest earnings growth is coming from financials and communication services companies (51.2% and 30.2%, respectively), while energy and materials earnings are printing profit declines (-27.5%, and -3.8%, respectively) due to weak energy and commodities prices compared to a year ago[ix].

We highlight two notable takeaways from the earnings season thus far. First, the projected capital spending by the mega-cap cloud providers is expected to increase by 25% to $280 billion this year. Further, Microsoft and Meta reaffirmed their capex guidance even after the Chinese artificial intelligence (AI) company released its claim to have developed a significantly more efficient AI model[x]. Although the validity is still being investigated, the Chinese Deepseek AI model looks more efficient, cheaper to train, and more cost-effective to run. This development has called into question the massive capex plans of the tech companies and whether such investment will be able to generate meaningful returns.

The second takeaway from this earnings season is that the spread between profit growth for the "Magnificent Seven" and the rest of the S&P 500 companies is narrowing. For the fourth quarter of 2024, the "Magnificent Seven" are expected to report an aggregate net income growth rate of~22% year-over-year, which is down from the group's high watermark of ~57% net income growth in 4Q'23. For the fourth quarter of 2024, the remaining S&P companies are anticipated to have grown profits by 5.5%[xi].

Remember, future stock prices are determined by future profit growth. Analysts see both groups with double-digit earnings growth for 2025 and 2026. Note that while the pace of "Magnificent Seven" profit growth is higher, the growth rates between the two groups is converging, as seen in Figure-4[xii].

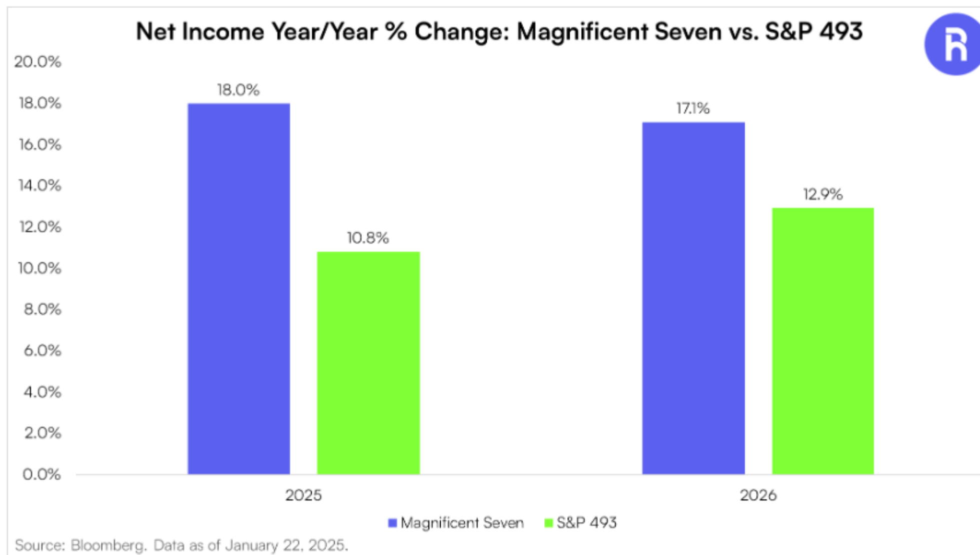

Figure 3 - Mag-7 vs, S&P 493 Earnings Growth 2025 and 2026

Conclusion

As can be seen from the data above, economic growth continues to be supported by resilient consumer spending underpinned by a robust labor market. The disinflation process has stalled in recent months; however, we still see inflation coming down gradually as the economy slows down, barring any major across-the-board tariffs from the current administration.

The new administration's 3-3-3 goal targets are cutting the budget deficit to 3% of GDP, boosting GDP growth to 3% through deregulation and pro-growth policies, and increasing U.S. energy production to the equivalent of an additional three million barrels of oil per day. These goals are ambitious though possible. If achieved, they would make for major economic tailwinds.

However, the market sees tariffs[xiii] as a risk that could be short-term inflationary and an impediment to economic growth longer-term. This was observable in the market reaction during the recent U.S.A-Canada-Mexico trade panic. Stocks were down, but more telling, was the action in the bond market. Short-term treasury yields rose in anticipation that the Fed will not be able to cut interest rates due to tariffs-induced inflation. Furthermore, long-term rates declined as investors feared longer-term economic pain from uncertainty shrouding future global trade. Bond yields decline

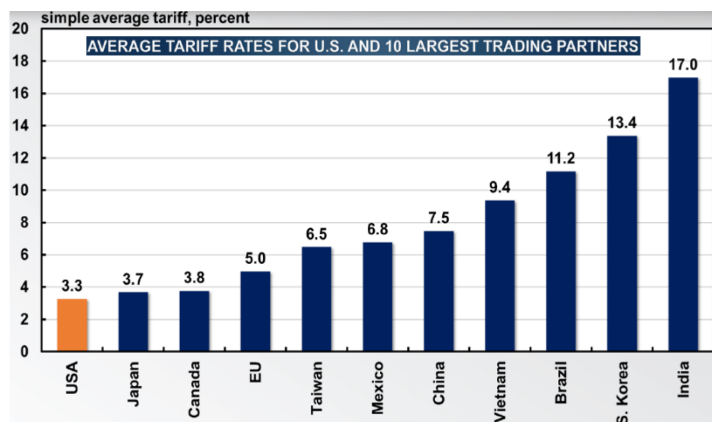

Figure 4 - The USA charges lower tariffs than its major trading partners.

when prices rally. Hence, depending on the scope and duration of any upcoming tariffs, market impacts could be minimal or drastic.

The current period is characterized by numerous uncertainties with so many large and sweeping policy changes proposed. Meanwhile, following heighted returns in recent years, the market is trading at expensive valuations. Thus, investment diversification is key. We recommend staying invested as we are still bullish on stocks long-term. We favor the "broadening-out-theme" this year as market valuations excluding the "Magnificent Seven" are not so rich, with many less-hyped stocks offered at fair prices. However, keeping reasonable exposure to secular growth names still makes sense to serve as an effective ballast to the cyclical value companies at the core of this "broadening-out-theme".

For balanced accounts, having moderate bond portfolio duration and favoring intermediate investment-grade and Treasury bonds could offset the impact of higher volatility in the stock market this year as well as serve as a hedge for worst-case economic scenarios.

As always, please contact us with any questions or needs.

The Westminster Financial Investment Policy Committee

Resources:

[i] Total return figures through Bloomberg
[ii] Total return figures through Bloomberg
[iii] Total return figures through Bloomberg
[iv] US Treasury Department and Bloomberg
[v] US Bureau of Economic Analysis (BEA)
[vi] Institute of Supply Management (ISM), and Bloomberg
[vii] US Bureau of Labor Statistics (BLS), and Bloomberg
[viii] US Bureau of Labor Statistics (BLS), and Bloomberg
[ix] FactSet
[x] UBS Financial Services Inc
[xi] Bloomberg
[xii] RoundHill Investments, Bloomberg
[xiii] First Trust "Coming Back to Reality", World Trade Organization. Data for year 2023.

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