Richard Rose Wealth Management December 23, 2024

WEEKLY COMMENTARY **Richard Rose AIF®**

Good morning,

What's in this week's Report:

- Was Last Week A Preview of 2025?
- Weekly Market Preview: Can the Santa Rally Re-start?
- Weekly Economic Cheat Sheet: A Quiet Week, But Claims Thursday Matter
- Why Markets Fell So Hard Following the Fed Decision
- Can the Trump Trade Outperform in 2025?

Futures are slightly weaker following a quiet weekend of news and ahead of the holiday-shortened trading week.

Economically, the only notable number overnight was UK GDP which was slightly weaker than expected, rising 0.9% vs. (E) 1.0%.

Politically, a U.S. government shutdown was averted as Congress passed a bill to fund the government but only through March, which adds complication to Republican plans to pass aggressive pro-growth legislation.

Today the only notable economic report is Consumer Confidence (E: 113.0) and barring a major surprise, it shouldn't move markets.

Market	Level	Change	% Change
S&P 500 Futures	6,009.00	7.25	0.12%
U.S. Dollar (DXY)	108.17	0.55	0.51%
Gold	2,629.11	-15.99	-0.60%
WTI	69.11	-0.35	-0.50%
10 Year	4.548%	0.024	0.53%

Stocks

Last Week (Needed Context as We Start a New Week)

Market volatility surged last week, shattering the expectation for a Santa rally into year-end following the Fed's hawkish rate cut and surprise near-government shutdown. The S&P 500 dropped 1.99% last week.

Stocks began last week with a modest Monday rally as investors shrugged off more soft Chinese economic data and instead focused on the combination of a weak Empire State Manufacturing index and upbeat U.S. Composite PMI Flash, which were viewed as Goldilocks. The S&P 500 gained 0.38% on the day.

Market jitters started to appear on Tuesday as a “hot” UK wage number sent Gilt yields higher and Treasury yields rose in sympathy. Stocks pulled back in early trade as investors assessed a strong Retail Sales report but a weak Industrial Production print. Ultimately the rise in yields moderated, allowing stocks to stabilize but the S&P 500 ended with a loss of 0.39% ahead of the Fed.

The tape was muted ahead of the Fed Wednesday but that changed promptly at 2:00 p.m. as the market reacted to language changes to the FOMC’s forward guidance, upwardly revised inflation forecasts, and fewer rate cuts in 2025. Powell’s press conference confirmed the combination of resilient economic growth and the threat of a rebound in inflation were “cause for a pause” in the cutting cycle and stocks effectively went no-bid with the S&P 500 falling more than 200 points peak-to-trough to end down 2.95%.

Stocks attempted to initiate a relief rally early on Thursday thanks to a dovish-leaning BoE meeting announcement, however, a strong Q3 GDP report and meaningful retreat in weekly jobless claims saw yields break to new highs above 4.50% for the first time since May, a move that held for the balance of the day and the headwind of higher yields amidst fragile sentiment saw the market rollover and the S&P ended down a slight 0.09%.

Stocks were near-term oversold coming into Friday’s session, but the selling pressure started to ease early as the headline and Core PCE price indexes were cooler than expected while there was reported progress on a short-term funding bill that would avoid a government shutdown. Those headlines sparked a relief rally that sent the S&P 500 rebounding a solid 1.09%.

Was Last Week A Preview of 2025?

Stocks dropped last week on hawkish commentary from the Fed and political dysfunction, and I think it’s fair for investors to view last week as a potential preview of the market in 2025. Now, to be clear, I don’t mean investors should look at last week’s decline in the S&P 500 as a preview of 2025 and I’m not saying I expect the market to decline next year.

Instead, I think last week was a preview of 2025 because it was a realization of what I have been warning about: Namely that uncertainty around the key drivers of this bull market is going to rise and we saw that last week with two of the drivers of the rally, expectations for Fed rate cuts and pro-growth policies.

The key to navigating this market in 2025 will be knowing the difference, in real-time, between news that’s just a minor negative and news that legitimately jeopardizes the reasons for the rally. Look at last week: The Fed cut rates but reduced forward guidance and some investors jumped to think the changes meant the Fed won’t cut rates anymore. However, it’s still more than likely the Fed rate-cutting cycle is in place, just at a slower (for now) pace. Bottom line, last week’s Fed news was negative but doesn’t invalidate that the Fed is still in a rate-cutting cycle.

Turning to politics, last week’s government shutdown drama is a very clear reminder that politics will be volatile and will impact markets (positively and negatively). Last week’s theatrics did spook markets about pro-growth policies being derailed in Washington despite upcoming Republican control. However, despite the drama, the government didn’t practically shut down and as so often happens in Washington, what needed to get done did get done at the absolute last minute.

Here's my point. Last week we saw bad news around Fed rate cuts and pro-growth policy expectations and stocks dropped in response. But in the end, none of the negative headlines are strong enough to 1) Tell us the Fed is done cutting rates or 2) That pro-growth policies won't be passed in 2025. So, last week's volatility should be viewed as causing an unpleasant pullback (that may not be over) but not derailing the bull market.

Telling the difference between unfortunate negative news that causes pullbacks and data/news that invalidates bullish factors such as 1) Economic soft landing, 2) Ongoing Fed rate cuts, 3) Inflation trending lower, or 4) Pro-growth policies from Washington will be the key to navigating 2025.

Economic Data (What You Need to Know in Plain English)

Last Week

Last week was eventful for markets mainly because of the Fed, which cut rates but also gave more hawkish-than-expected guidance by signaling just two rate cuts in 2025 (vs. three) and altered the statement to reflect fewer rate cuts in the future. Additionally, some investors interpreted that statement change to mean the Fed may pause rate cuts going forward (I don't agree with that view but it's the main reason stocks dropped so hard on Wednesday following the decision).

One of the main reasons the Fed gave more hawkish-than-expected guidance was because inflation hasn't progressed as quickly towards its 2% goal as they expected. Given that reality and the Fed's hawkish guidance, that made Friday's Core PCE Price Index the most important economic report last week, and thankfully for the bulls it was better than expected (this was the main reason stocks rallied on Friday).

The Core PCE Price Index, the Fed's preferred measure of inflation, rose 0.1% vs. (0.2%) m/m and 2.4% vs. (E) 2.5% y/y and, most importantly, showed a small increase in core services prices (just 0.2%, the smallest monthly increase in a while). While one good Core PCE Price Index report won't resolve concerns about the Fed pausing or cutting less than expected, it was an important reminder that inflation is still trending lower (even if it's going slower than the Fed would have preferred).

Turning to growth data, it stayed, on balance, mostly Goldilocks. The key growth report was the November Retail Sales report and it showed solid activity as the "Control" reading rose 0.4% and met expectations and importantly bounced back from a negative October reading. That implies consumer spending is steady (although not great) but that's characteristic of an economic soft landing.

Other economic data also was Goldilocks, as the December flash composite PMIs were 56.6 vs. (E) 54.6 and implied the status quo (which is a soft landing). The manufacturing PMI remained in contraction territory (although barely so) while the service sector PMI rose and implied solid activity. That gap was mostly confirmed by the Empire and Philly Fed manufacturing surveys which both fell below expectations. Empire saw a large drop and fell back to flat at 0.2 and New Orders, the leading indicator in the report, showed a similar decline to 6.1 from the previous 22.0. Philly Fed, meanwhile, saw a larger drop and fell sharply to -16.4 and New Orders fell into negative territory at 4.3. However, before we get too worried about this reading, we have to remember these regional surveys have been very volatile for well over a year and unless these negative readings persist or are accompanied by a sudden drop in national manufacturing surveys (like the flash PMIs or ISM PMIs), any soft regional readings must be taken with an appropriate grain of salt.

The bottom line, the Fed's guidance spooked markets, the reality is the data this week was stock-positive as we received favorable inflation readings while the major economic reports were still Goldilocks, and that's something to remember amidst last week's volatility.

Important Economic Data This Week

The economic calendar is quiet this holiday week (keep in mind that markets close at 1:00 on Tuesday and are closed on Wednesday) but given last week's anxiety over future Fed rate cuts, the few reports we get this week have the potential to move markets, especially if they are "too hot" and increase that anxiety.

The most important report this week is Thursday's jobless claims, mainly because we don't want to see claims drop sharply and increase concerns that the labor market is getting too tight again (which would make the Fed drift more hawkish). So, an in-line jobless claims number that implies the labor market is solid but not too hot would be welcomed.

The second notable report this week is tomorrow's Durable Goods, which will give us the latest look at business spending and investment. Like retail sales, business spending, and investment have largely plateaued in 2024, but that's ok because it points to an economic soft landing. However, what we don't want to see is this number jump dramatically higher (which would imply business spending and investment are ramping up, which is positive for growth) or a sudden dump lower (which implies businesses are pulling back spending amid caution and increase the possibility growth suddenly slowing in 2025).

There aren't a lot of reports this week but given the Fed's hawkish cut last week, markets will be more sensitive to economic data (especially if it's dramatically too good or too bad), so while history tells us this week should be quiet given the holiday, data has the potential to move markets and we need to keep that in mind (not for just this week, but for the start of 2025).

Special Reports and Editorial

Why Markets Fell So Hard Following the Fed Decision

Markets dropped sharply Wednesday following a Fed decision that met our "Hawkish If" scenario analysis, with the S&P 500 falling nearly 3% and the Russell 2000 dropping the most since 2022!

There are four reasons the market dropped so sharply following the Fed decision, two that are based on positioning and two that are based on fundamentals. First, above 6,000, the S&P 500 was priced for continued perfection and the Fed cutting rates less than expected is not perfection. We and others have been saying this market has been vulnerable to a pullback or "air pocket" should it encounter legitimate disappointment on core issues and that's exactly what happened.

Second, the calendar. The S&P 500 is still up more than 25% YTD. Investors were positioned for a "met expectations" Fed meeting that would clear the path of a year-end melt up. The Fed cutting less than expected was a negative surprise and it likely caused some short-term focused traders to close positions out into year-end to secure gains, which added to the selling pressure.

Now, it's not right to say Wednesday's declines were all trading/positioning driven. There are two fundamental reasons behind the declines, as well. First, the Fed is going to cut rates less than expected in 2025 and that's a legitimate disappointment (essentially the Fed will be a less-powerful bullish force for the markets in 2025).

Second, there was a change in language in the Fed statement that some interpreted as the Fed signaling it may be done with rate cuts (this was the main fundamental reason for the steep drop in stocks). The bottom line, the Fed provided a

legitimately negative surprise, and that combined with extended positioning and the calendar caused a sharp drop in stocks.

Did the Fed Decision Weaken the Bull Market?

No, I do not think so, and here's why.

Expectations and then the realization of the Fed rate-cutting cycle were powerful bullish forces on markets in 2024. And for that to end entirely, markets have to believe the Fed is done with rate cuts. It's not so much the number of rate cuts that matter as much as it is the direction of rates (so as long as they're still falling, the pace isn't that important).

To that point, the main fundamental reason for the drop in stocks was some interpreting the Fed's change to the statement as implying the Fed may be done with rate cuts. I do not think that's what occurred and there are two reasons why:

1) Fed Chair Powell stated, in his press conference, that rates needed to continue to decline.

2) Powell also stated that the FOMC believed rates were still substantially restrictive and the Fed wants to get them to neutral, and that means that rates will have to continue to decline.

Those two statements by the Fed chair are much clearer than the words inserted in the FOMC statement and they speak to the fact that the Fed is still likely in a rate-cutting cycle. Because of that, I do not view the Fed decision as a substantial blow to the bull market.

Put differently, while fewer-than-expected rate cuts are a disappointment near term vs. market expectations, the facts tell me the rate-cutting cycle is still in place, and because of that, Fed policy is still moving in a supportive direction for stocks. It's just less supportive than it was before.

This reinforces the point I've been trying to make about 2025, that we're entering the new year with most positives realized and the key to continued gains in 2025 will be the maintaining of those positive factors, e.g. soft landing, Fed cutting cycle, falling inflation, solid tech earnings. Pro-growth policies will be "kickers" on that positive setup, should they pass. However, this is not going to be the straight-line rally that we saw in 2024 and there will be bouts of doubt and disappointment caused by the Fed and economic data, and we saw that last week.

In sum, the Fed meeting was a legitimate disappointment, but the steep drop in stocks was more a function of the S&P 500 being priced for perfection above 6,000 and not a legitimately negative change to the outlook. That said, we could see this decline continue in the near term if we get a negative surprise in data. But despite the disappointment, the Fed is still likely in a cutting cycle, growth is still solid, inflation is still falling over the medium term and earnings remain solid. Until that changes the medium- and long-term benefit of the doubt remains with the bulls (although it may not be the smoothest of rides).

Can the Trump Trade Outperform in 2025?

Can the Trump trade outperform in 2025? The answer, I believe, is "yes." But before we get into the reasons why, first we need to think about what's going to outperform for the full year, not just the first few weeks. I say that because there could be some short-term policy disappointment when Trump and the Republicans assume power in January, mainly because investors always want instant gratification and if anything is the opposite of that, it's the U.S. government (we're seeing some of that with the drama surrounding a potential government shutdown today). But in the end, I believe the factors supporting a Trump trade are stronger than the factors against it.

First, pro-growth policies are coming in 2025. The Tax Cuts and Jobs Act (TCJA) has to be extended (otherwise the economy will take a proverbial board to the face) and because it has to be done for political advantage, it almost certainly will be done. Additionally, pro-growth deregulation and other policy moves have less of a chance of getting bogged down in Congress and can add to growth. Bottom line, we're likely getting pro-growth policies in 2025, the only questions are "how soon" and "how much" and that should just relate to the amount of cyclical outperformance, not whether it happens.

Second, while no one can argue with the momentum in tech and AI stocks, there remain a lot of very high expectations baked into this sector. And while in December investors focused on strong AI chipmaker earnings, not all reports were good.

Finally, growth remains very solid and that means the pro-growth policies will simply add fuel to the fire, again benefitting "Trump trade" cyclical sectors. Now, I'm as cognizant as anyone of the risks facing the economy, but the simple truth is no major economic indicators are suggesting a slowdown is imminent. We're not seeing it in jobless claims, we're not seeing it in retail sales, we're not seeing it in business spending (Durable Goods), or in the PMIs. Yes, a slowdown absolutely can happen, but they usually don't appear out of thin air and there simply are no signs the economy is losing momentum right now.

Bottom line, I don't expect the Trump trade to outperform every month (or even every quarter) of 2025, but the market set up of 1) Solid growth, 2) Fed still cutting (it's just a question of how much), 3) Looming pro-growth policies (again it's just a question of how much) and 4) Extended tech and AI names implies the Trump trade should outperform markets in 2025 despite this recent underperformance.

Disclaimer: The Weekly Advisory Update is provided to clients and on an informational basis only and is not intended to be considered investment advice or recommendations to buy or sell any security or a solicitation to buy or sell any security. Information contained in The Weekly Advisory Update is compiled from a variety of sources and is not necessarily complete and its accuracy is not guaranteed. Neither the information contained in The Weekly Advisory Update or any opinion expressed in The Weekly Advisory Update constitutes a solicitation for the purchase of any future or security referred to in the Newsletter. The Newsletter is strictly an informational publication and does not provide individual, customized investment or trading advice to its clients. CLIENTS SHOULD VERIFY ALL CLAIMS AND COMPLETE THEIR OWN RESEARCH AND CONSULT A REGISTERED FINANCIAL PROFESSIONAL BEFORE INVESTING IN ANY INVESTMENTS MENTIONED IN THE PUBLICATION. INVESTING IN SECURITIES, OPTIONS AND FUTURES IS SPECULATIVE AND CARRIES A HIGH DEGREE OF RISK, AND SUBSCRIBERS MAY LOSE MONEY TRADING AND INVESTING IN SUCH INVESTMENTS.

REPRESENTATIVES ARE REGISTERED THROUGH, AND SECURITIES ARE SOLD THROUGH NATIONWIDE PLANNING ASSOCIATES, INC., MEMBER FINRA/SIPC, LOCATED AT 32-16 BROADWAY, 2ND FLOOR, FAIR LAWN NJ 07410. INVESTMENT ADVISORY SERVICES ARE OFFERED THROUGH NPA ASSET MANAGEMENT, LLC. INSURANCE SOLD THROUGH LICENSED NPA INSURANCE AGENCY, INC. NON-DEPOSIT INVESTMENT PRODUCTS ARE NOT FEDERALLY INSURED, INVOLVE INVESTMENT RISK, MAY LOSE VALUE, AND ARE NOT OBLIGATIONS OF OR GUARANTEED BY THE BROKER/DEALER. NATIONWIDE PLANNING ASSOCIATES, INC. IS A REGISTERED BROKER/DEALER.

Richard Rose AIF®
917-597-7432
rrose@nationwideplanning.com