Richard Rose Wealth Management January 6, 2025

WEEKLY COMMENTARY **Richard Rose AIF®**

Good morning,

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What's in this week's Report:

- Why Have Stocks Dropped?
- Weekly Market Preview: Can Goldilocks Data Fuel A Rebound?
- Weekly Economic Cheat Sheet: Friday's Jobs Report is the First Big Report of 2025.
- Are H-1B Visas the Reason for this Pullback?
- Important Events as We Start 2025
- Are Credit Spreads Confirming Equity Market Weakness?

Futures are extending Friday's rally thanks to a rebound in political optimism and despite more mixed global economic data.

Mike Johnson was relatively easily re-elected Speaker of the House on Friday, providing a needed positive political event for markets and boosting pro-growth policy hopes.

Economically, global data remained lackluster as the UK Services PMI missed expectations (51.1 vs. (E) 51.4.).

Today's focus will turn back to data with Factory Orders (E: -0.3%) and the December Services PMI (E: 58.5) and the more Goldilocks the readings, the more they'll fuel this early bounce. There is also one Fed speaker, Cook (9:15 a.m. ET), but she shouldn't move markets.

Market	Level	Change	% Change
S&P 500 Futures	6,035.25	45.75	0.76%
U.S. Dollar (DXY)	107.87	-1.08	-0.99%
Gold	2,660.61	5.91	0.22%
WTI	74.53	0.57	0.77%
10 Year	4.585%	-0.010	-0.22%

Stocks

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

U.S. equity markets remained volatile last week thanks to mixed global economic data and dual headwinds from rising Treasury yields and a strengthening dollar at the start of 2025. The S&P 500 fell 0.48% for the week.

Stocks gapped lower last Monday with big tech names leading the way as investors booked profits on some of 2024's best-performing companies. No negative fundamental headlines were driving the broader indexes lower, however, and news that President-elect Trump endorsed current House Speaker Johnson helped the market turn higher and end off session lows. The S&P 500 still fell 1.07%.

The market opened unchanged Tuesday, the final trading session for 2024, as investors took a soft Chinese Manufacturing PMI in stride as the data seemed to shore up optimism for aggressive stimulus measures from the Chinese government in 2025. However, a rise in bond yields, which accelerated midday after the Treasury announced sizeable auctions planned for early January, saw stocks turn lower, with the S&P 500 closing down 0.43%.

After being closed for the New Year holiday on Wednesday, stocks opened Thursday with tentative gains amid less-hawkish money flows after disappointing global Manufacturing PMI data (China and EU reports both missed estimates). However, strong domestic jobless claims data and a better-than-feared U.S. Manufacturing PMI sent yields back toward the December highs and stocks turned lower with the S&P 500 falling to two-month lows. Stocks enjoyed a late-day relief rally and ended off the lows with the S&P 500 down 0.22%.

Stocks gapped higher on Friday as there were bullish follow-through money flows in the wake of Thursday's late-day relief rally. A strong ISM Manufacturing Index sparked slightly hawkish money flows which saw the market turn sideways early but optimism surrounding House Speaker Johnson's reelection helped power the S&P 500 with the index ending higher by a solid 1.26%.

Why Have Stocks Dropped?

Stocks started the new year the same way they ended 2024, with declines as the pullback reached a third week and the peak-to-trough decline in the S&P 500 from the highs near 6,100 reached nearly 5%.

While most of this selloff has been downplayed as just year-end rebalancing and positioning, and to a true point, there are also legitimate reasons that stocks have declined since mid-December and I'd caution investors against totally dismissing the uptick in volatility.

There are two main reasons this has occurred: First, the Fed. Second, politics.

Starting with the Fed, the December FOMC meeting was important and the impacts of it are still being felt. The FOMC reduced the number of expected rate cuts in 2025 to two from four. That's less dovish than what was expected. But the bigger issue has been the language changes and Fed commentary that has, intentionally or not, birthed the idea in some investors' minds that the Fed may be done with rate cuts and that they've "paused" and the rest of the market just doesn't realize it yet. At a minimum, it's made the markets very sensitive to any economic data that doesn't warrant additional rate cuts (as we saw again this past week). Put more plainly, until that December meeting, solid economic data was seen as reinforcing a soft landing (so positive for stocks). Now, solid data is seen as bolstering the case for a Fed pause (not a market positive).

Turning to politics, the S&P 500 had surrendered virtually all of the post-election gains at last week's lows and the reason is simple: Unforced communication errors and typical Trump-related headline volatility have undermined confidence that Republicans can execute a pro-growth agenda of deregulation and tax cuts. Starting with the Gaetz AG nomination, followed by predictable tweeted tariff threats against Mexico, Canada, China, and the BRICs, which were then followed by threats about seizing the Panama Canal and, finally, the last-minute government shutdown drama have all combined to chip away at post-election enthusiasm. Friday's relatively easy election of Johnson as Speaker will

reduce some of the policy anxiety but the coming month has a lot of early tests for Republican cohesiveness (including cabinet confirmation hearings) and it's going to take more than quickly electing a Speaker before markets become more confident in the actual implementation of the pro-growth agenda.

The bottom line, part of this late-year/start-of-year market dip is due to positioning and rebalancing but it's also due to negative events. To be clear, these are not the type of events that would derail the rally, but they are the type that makes investors paying 22X forward earnings re-think those choices, as the near-term outlook has become legitimately less positive.

So, for this to stop, we need to see 1) The Fed re-instill confidence in the markets that it wants to cut rates (and isn't about to pause) and 2) Republicans and the Trump administration stop the distracting drama, act cohesively and give the market confidence they'll be able to quickly execute on a pro-growth agenda. Until those two things happen, we should expect the road higher in stocks to be a tougher climb than we saw in 2024.

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

Last Week

Economic data was sparse last week, but what data we got, including the first big economic report for December, was solid and won't ease any investor anxiety that the Fed may pause rate cuts in 2025.

The key report last week was the ISM Manufacturing PMI and it was slightly better than expected. The PMI rose to 49.3 vs. (E) 48.2 and the details of the report were also better than expected as New Orders rose solidly above 50 to 52.5 from 50.4. While this report wouldn't be considered "Too Hot" because it's still under 50, the bottom line is that it was better than expected and as a result, investors that were nervous about the Fed potentially cutting fewer than twice in 2025 (or even not at all) will stay that way as the PMI won't make the Fed any more dovish.

The other notable report was jobless claims came in slightly "hot" as they fell to an eight-month low at 211k vs. (E) 223k and that did weigh on markets and boost the dollar and Treasury yields last Thursday. However, that one-week reading needs to be taken with a rather large grain of trading salt as claims are especially "noisy" during the holiday period with temp hires and students home from college, although if claims stay this low for several weeks that will increase anxiety the Fed may be done with rate cuts (as claims that low imply a tight labor market).

Bottom line, none of last week's data provided any substantial surprises but at the same time it didn't do anything to alleviate concerns that the Fed may be close to pausing the rate-cutting cycle and as a result, this solid data did weigh a bit on stocks.

Important Economic Data This Week

This is the first "real" week of the new year from a data standpoint and it's potentially important because the data and events this week will either 1) Increase worries that the Fed may pause rate cuts (which would be an additional market negative and keep pressure on stocks) or 2) Calm fears that the Fed may be done with rate cuts (which would be a relief for investors and likely spur a solid bounce back rally).

The key report this week is Friday's jobs report and it's going to directly influence those Fed expectations. The bottom line is an in-line to slightly weak number with no substantial drop in the unemployment rate is the best-case scenario for stocks. As is typically the case, it's basically "jobs week" as we'll get several measures of employment before Friday's jobs report including 1) JOLTS on Tuesday, ADP on Wednesday, and jobless claims on Thursday. While all those will

ultimately be overshadowed by the jobs report, the more Goldilocks the data (meaning it meets or slightly misses expectations) the better for stocks.

Because the Fed is really at the heart of this recent market dip (remember it all started when the Fed dots showed just two rate cuts in 2025) that makes the FOMC minutes on Wednesday more important than they otherwise would normally be. These are the minutes from the December meeting and if they imply numerous Fed officials are considering just another cut or even a pause, that will increase investor anxiety that the Fed may be ending its rate-cutting cycle much sooner than previously thought.

The final potentially market-moving piece of data this week comes tomorrow via the ISM Services PMI. This number needs to 1) Stay above 50 because dropping below 50 would be a potential economic warning sign and 2) Can't bounce substantially higher (like it did in November) because if it does, that will increase anxiety that the Fed is done with rate cuts already.

Bottom line, the most pressing issue for this market right now is anxiety that the Fed may be done (or almost done) with rate cuts, and if data this week reinforces that fear, then Treasury yields will rise and stocks will (likely) continue to decline. For this market dip to stop, investors need to get more confident that the Fed isn't done cutting rates yet (and that at least two more rate cuts are coming in 2025).

Special Reports and Editorial

Are H-1B Visas the Reason for this Pullback?

I've learned over the years in this business that anything, regardless of how seemingly disconnected, can impact markets and I believe we're seeing that yet again as an internal Republican spat over H-1B visas is likely contributing to the declines we've seen in markets the past few days (and in particular the declines in tech). Now, before I go into why, I do want to make clear that year-end positioning and lack of adequate liquidity volume are major contributors to this uptick in volatility. But I think those factors are exacerbating legitimate anxiety that's being driven by the H-1B visa argument.

For those that haven't been following along, late last week media reports surfaced of an intense disagreement in the Republican party over the benefits of H-1B visas, with the more hard right portion of the party (which includes Steve Bannon who has been vocal on this issue) butting heads on the topic with DOGE heads Elon Musk and Vivek Ramaswamy. For background, H-1B visas are non-immigrant visas for foreign nationals who have a bachelor's degree or higher and work in a specialty field such as engineering, math, medicine, or education. There are 85,000 of these visas granted annually and they are used extensively by the tech industry (and, notably, both Musk and Ramaswamy worked under these visas when they came to the U.S.).

The fight has erupted as some of the hard right in the Republican Party (and in this disagreement represented by Mr. Bannon) want to limit the issuance of H-1B visas due to several reasons (including past examples of abuses and claims it allows companies to import cheaper skilled labor instead of hiring Americans). Musk and Ramaswamy pushed back hard against those claims and it's created the latest rift in the Republican Party.

This latest episode of Republican infighting has impacted the markets in two ways. First, it's yet another example of the chaos and infighting that threatens to derail the pro-growth Republican agenda. Trump has been president-elect for less than two months and this is the fourth time some Republican-attached political drama has weighed on equity prices: First, there were the unorthodox cabinet nominations in mid-November, then the threats of 25% tariffs on major trading partners Canada, Mexico and China. Next was the last-minute government shutdown drama from two weeks ago and,

most recently, the H-1B visa drama. None of these events are big enough to derail this market, but they are a near-constant reminder of the drama Trump can manufacture (either directly or indirectly) on seemingly mundane functions of the government.

This matters because the Republicans have a miniscule majority in the House and a small majority in the Senate and this drama is increasing concern that pro-growth initiatives will be derailed by this infighting and the longer these types of episodes occur, the more markets will begin to doubt the realization of pro-growth hopes.

Second, the tech industry benefits tremendously from the H-1B visa program and it helps make the U.S. tech sector the destination for the world's best tech minds. That gives U.S. tech companies a huge competitive advantage over the rest of the world. Altering or reducing the H-1B visa program reflects further isolationism that investors fear would hurt the U.S. tech industry in the long run. And while that fear is a bit of a stretch, amidst large tech outperformance and thin volumes into year-end, it's creating another reason to book profits.

Here's the bottom line. The H-1B drama isn't going to end this bull market and it won't derail tech leadership, but it is another stark reminder of the chaos and dysfunction that can come out of left field during a Trump administration. And in a low-volume/liquidity environment, that's pressuring stocks. It's also a warning that while Republicans may (and probably will) eventually enact pro-growth policies including tax cuts and deregulation, it's not likely going to be as smooth a ride as markets assume at these levels.

Important Events as We Start 2025

2024 was a historically positive year in markets (the late-year swoon notwithstanding) as the S&P 500 completed the best two-year performance since 1997-1998, while other assets including gold had their best year since 2010 and Bitcoin more than doubled. Even bonds logged a modestly positive return in what was, mostly, a banner year for investors.

And these gains were legitimate, as 2024 saw a near-perfect resolution of numerous market unknowns. The economy achieved, for now, an elusive soft landing as growth has been stable but soft enough to allow the Fed to cut rates. Inflation fell sharply back close to the Fed's 2% target, further clearing the way for Fed rate cuts. And the Fed obliged, unleashing 100 bps of rate cuts in just over five months to ease pressure on the economy. Meanwhile, AI optimism remained rampant, and surging earnings growth from tech companies kept the rise in stocks at least justifiable on a valuation basis while all other tangential risks to markets, including geopolitical and political, never materialized. Given that reality, it's not a surprise the S&P 500 rose more than 23% in 2024!

As we start 2025, those positive factors remain broadly in force (despite the late-year dip). Yet unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Instead, everything is "good" right now for stocks and for the rally to keep going, things are going to have to stay good and get even better.

Given that, I wanted to identify several of the important events looming in the coming month that will offer insight into whether things are going to stay good or if we're in for mild disappointment that could further this pullback.

1) Jobs Report. Friday, January 10. *Why this matters*: Markets are complacent to a growth scare and if we get one, stocks will drop like they did in August. On the other hand, with the Fed showing less desire to cut rates, if the jobs report is really strong it'll reduce rate cut expectations and boost yields. *Positive if*: We get a Goldilocks job adds number (so in line with expectations or slightly soft) and the unemployment rate stays in the low-4% range (so more than 4.0% and less than 4.5%. *Negative If*: The jobs report is very strong or very weak as that will reduce rate cut expectations or give markets a growth scare.

2) Earnings Season. Begins on Monday, January 13. *Why this matters*: The only way valuations for this market aren't prohibitive is if we get substantial earnings growth. The consensus for 2025 EPS growth is close to 15%, more than double the historical average. If earnings season offers warning signs on earnings growth, especially from the Mag 7 and AI names, it'll exacerbate the valuation issue with this market. *Positive if*: Earnings season contains strong results and positive corporate commentary and earnings growth from the Mag 7 beats estimates. *Negative if*: Mag 7 earnings guidance disappoints markets, increasing fears that earnings growth estimates are too aggressive and market valuations are unsustainable.

3) CPI. Wednesday, January 15. *Why this matters*: The Fed guided to fewer rate cuts in 2025 because of the bounce in inflation metrics. Everyone (including the Fed) thinks that bounce is "transitory" but the data needs to confirm that and soon in 2025. *Positive if*: CPI is below expectations and confirms expectations that inflation will fall back towards the Fed's 2% target, increasing rate cut expectations. *Negative if*: CPI is hotter than expected and implies inflation is bouncing back, which will further reduce rate cut expectations and send yields higher (and stocks lower most likely).

4) Fed Decision. Wednesday, January 29. *Why it matters*: The Fed continuing to cut rates (even if it's slowly) is a critical piece of this bull market and if the Fed hints it may pause cutting rates at this meeting that will be a substantial negative. *Positive if*: The Fed signals it's still committed to cutting rates in 2025 (no one expects the Fed to cut rates at this meeting). *Negative if*: The Fed (and Powell specifically) implies the Fed may have "paused" its rate-cutting cycle.

The bottom line, the fundamentals for this market are good as we start 2025, but there are also great expectations, and meeting those expectations starts right away. These are the key events that will likely determine if those positive expectations are met (and stocks start 2025 with gains) or if we see a continuation of the declines of the past two weeks.

Are Credit Spreads Confirming Equity Market Weakness?

Stocks limped into the end of 2024 and then started trading in 2025 with an ugly reversal, as markets started solidly higher but promptly faded and closed lower on the day. So far, most analysts have dismissed this recent uptick in volatility as little more than year-end positioning and rebalancing and not something that implies the market is deteriorating. But do bond markets agree with that assessment?

Often, I'll look for "confirmation" of moves in the stock market from different assets or indicators, whether it be bonds, economic data, currencies, Fed expectations, or credit spreads. The confirmation (or lack thereof) can tell us if a move truly has "legs" or whether it's likely just positioning/rebalancing or short-term "noise."

Positively, so far credit spreads, which are an important part of the bond market, are not confirming this recent weakness in stocks.

For a refresher, credit spreads are the difference in yields between two bonds with the same (or similar) maturities but different credit qualities. For instance, the difference between the yield on a 10-year Treasury (which is still viewed in corporate finance as the "risk-free" rate) and the yield on a 10-year corporate bond, or more realistically, an index of corporate bonds with a maturity of around 10 years. Analysts look at credit spreads because they tell us bond investors' view of future economic growth.

Again, positively, credit spreads are still signaling that bond investors are not worried about a near-term economic slowdown and they are not "confirming" this recent dip in stocks, as credit spreads remain very low. Currently, the Baa spread is 1.43%, which is historically low, close to the lows for the year, and down solidly from the recent high of 1.85% that was hit in early August when stocks dropped on the soft jobs report.

If we start to see this credit spread rise consistently while stocks are declining, that will be at least partial confirmation that something else (and potentially bigger) is going on other than just short-term positioning and year-end/beginning-of-year rebalancing. Should the Baa over Treasuries credit spread rise above 2.00% consistently, that would be a much more negative signal that investors are legitimately acknowledging a hard landing isn't just possible but becoming more likely. At that point, and depending on what's driving it, we'd need to make sure we have a defensive plan in place and be ready to act on it. For now, credit spreads are not confirming this decline in stocks and are also not signaling bond investors are worried about an economic slowdown (and that's good).

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