

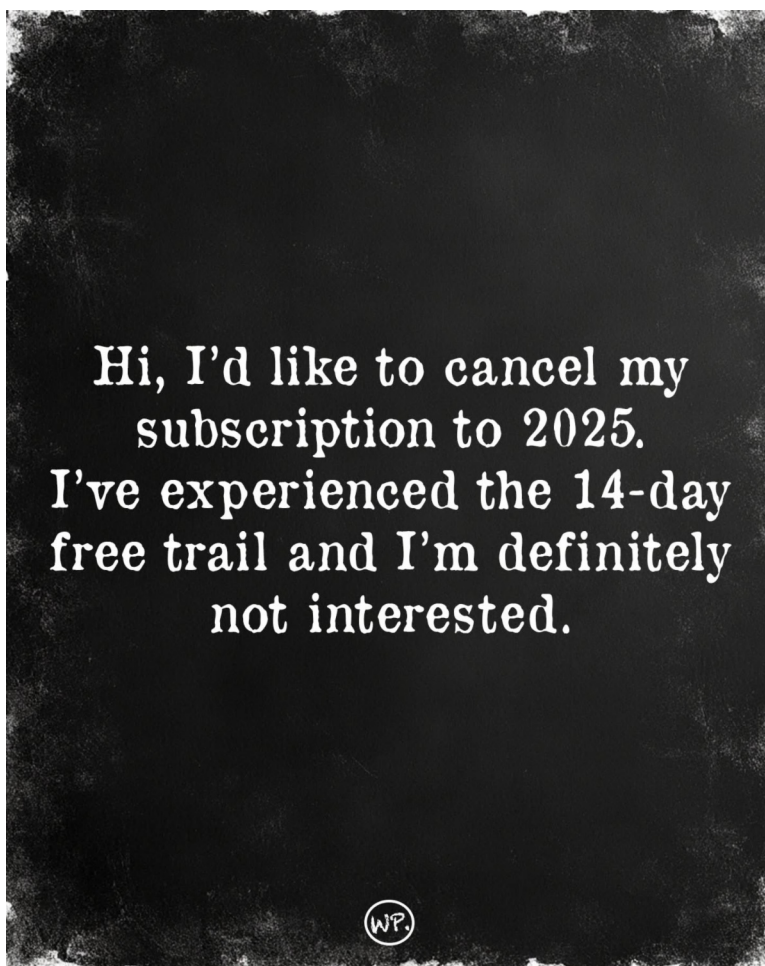


Wealth Management Monthly | *McClure Investment Management*

the big picture



happy (?) new year



First off, my heart goes out to those of you who lost their homes or had to be evacuated. We were without electricity for a couple days but suffered no real difficulties due to the fire. With memories of the 2014 Colby Fire, just a couple blocks north of us, firmly etched in my memory, we kept a close eye on the news reports. Here's to hoping the worst is over.

Let's jump into what's going on, what we're planning to do and a brief personal note.

Stocks

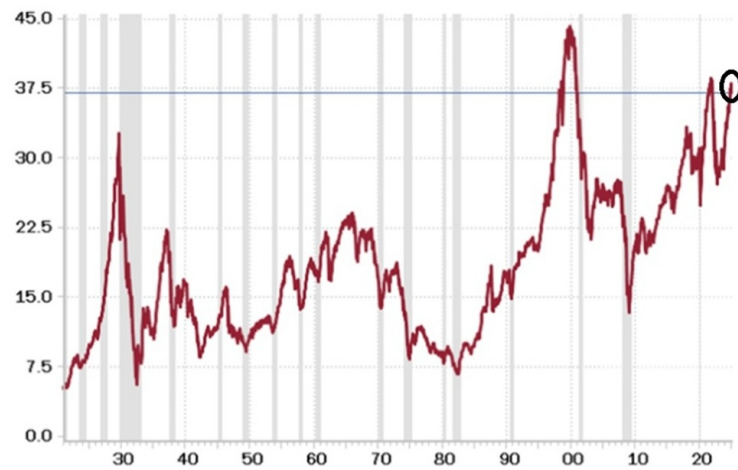
For starters, let's discuss where the market's valuation is

now. (Spoiler alert, it's high. Really high.) Let's look at a few – six, to be precise - measures of the market's current valuation:

(1) The **CAPE** (Cyclically Adjusted Price Earnings) Ratio is currently sitting at right around 37. That's **high**.

S&P 500 CAPE Multiple

United States
(ratio)



Shading indicates recession

Source: Haver Analytics, Robert Shiller, Rosenberg Research

The Higher the CAPE, the Lower the Expected Forward S&P 500 Return Potential

United States

	<10	10-20	20-30	30-35	35+
3-Year Forward Return (Annualized)	14.0%	6.9%	5.2%	7.2%	-3.3%
5-Year Forward Return (Annualized)	13.9%	6.1%	5.4%	3.6%	-3.0%
10-Year Forward Return (Annualized)	7.6%	7.3%	4.5%	1.4%	-1.8%

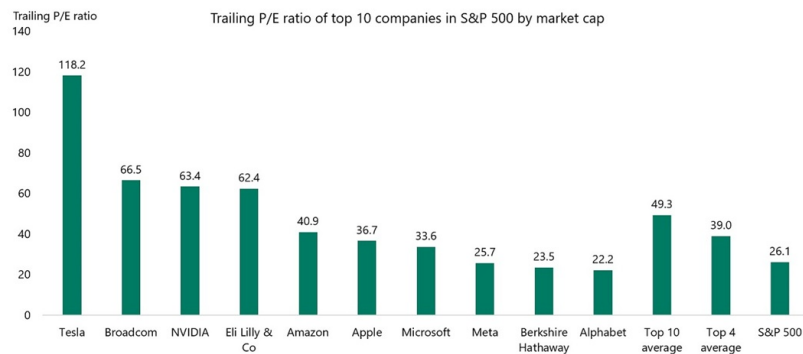
Source: Bloomberg, Bloomberg Research

A 37 CAPE is high enough to indicate the average annual *expected* return for the S&P 500 for the next 3-, 5- and 10-year periods is *negative*.

(2) The P/E Ratio for the 10 largest companies of the S&P 500 is just under 50. That's **high**.

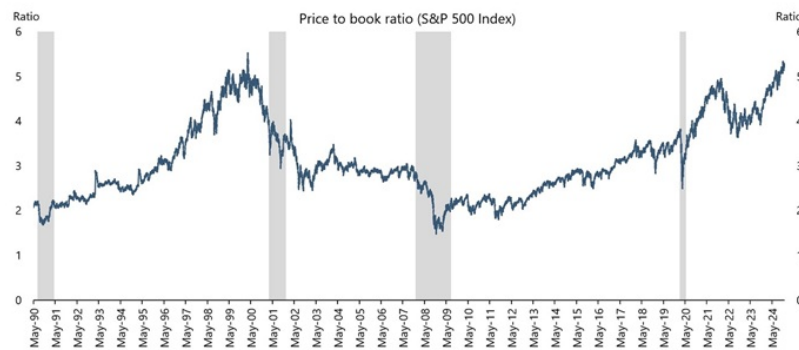
The average P/E ratio of the top 10 companies in the S&P 500 is almost 50

APOLLO

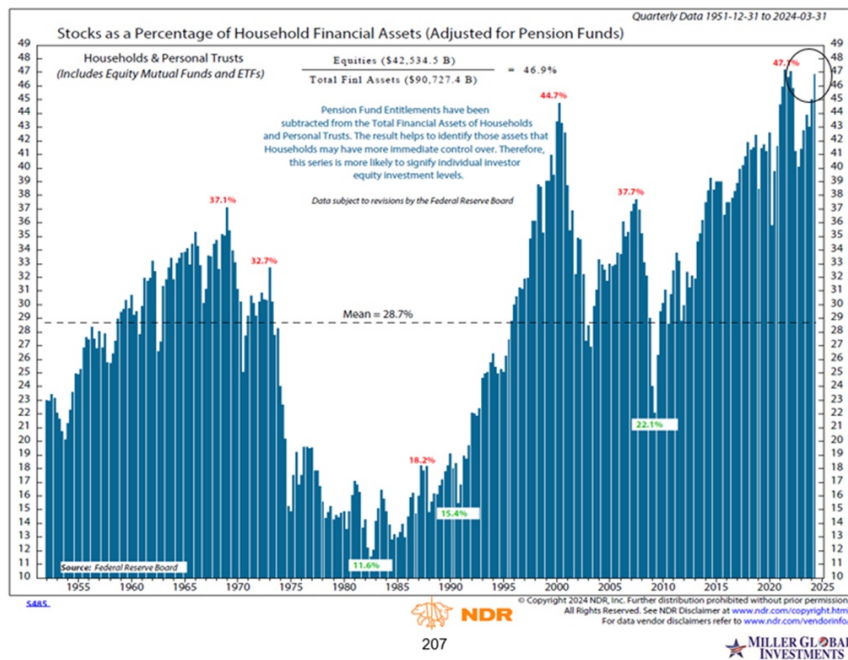


(3) The Price to Book Ratio for the S&P 500 has ***never been higher. Ever.***

Price-to-book ratio for the S&P 500 at record-high levels

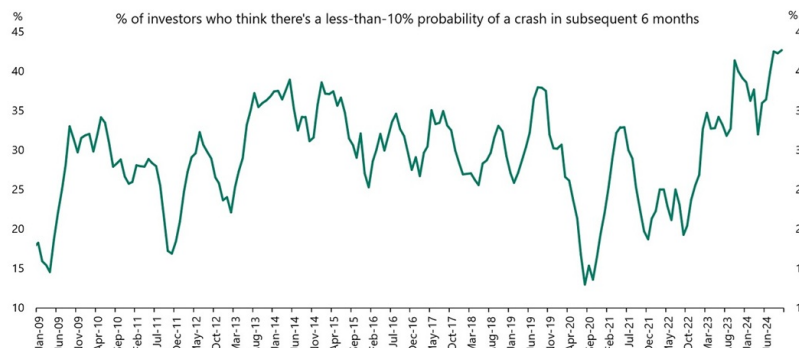


(4) Stocks as a percentage of household assets are at an all-time high.

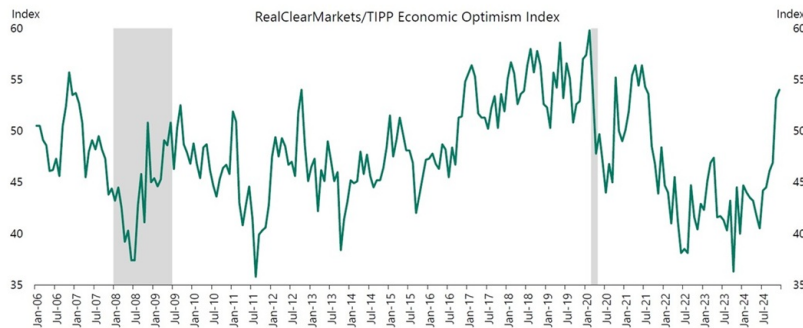


(5) Investor sentiment is very **high**. Traditionally, investor sentiment is a strong contrary indicator of the market's next move.

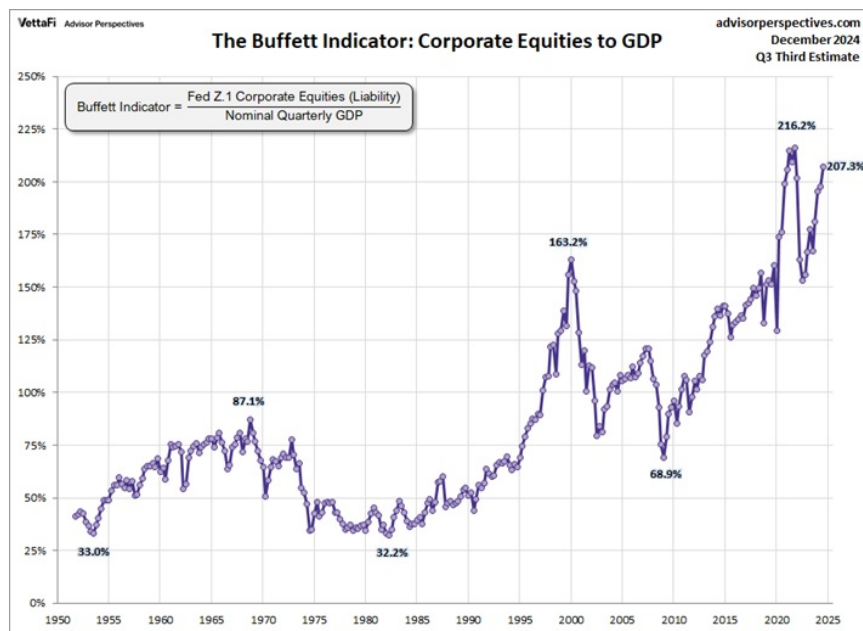
A record-high share of investors think there is less than 10% probability of a crash in the stock market



And...



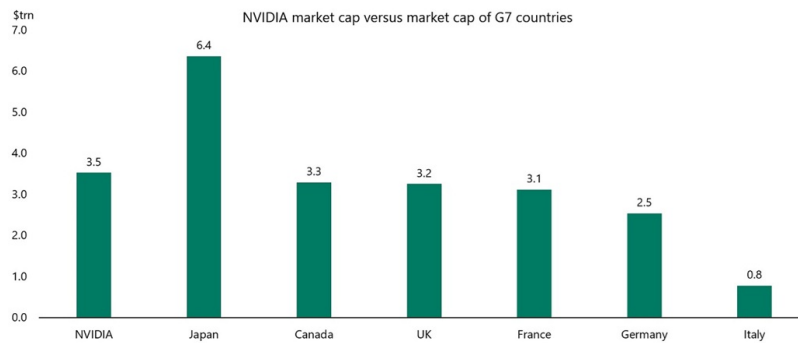
(6) And last, but not least, the Buffett Indicator, which he discussed in detail in a 2001 issue of Fortune magazine (You can access the article [here](#)), compares the value of stocks to US GDP (Gross Domestic Product). The current ratio of 207.3% is really **high**.



Quoting Buffett from that 2001 article, "The message from the chart is this: If the percentage relationship falls to the 70% or 80% area, buying stocks is likely to work very well for you. If the ratio approaches 200% - as it did in 1999 and part of 2000 – you are playing with fire."

With that ratio now *above* 200%, the all too real concept of playing with fire really hits home.

So, why the sky-high valuations? As I've mentioned a few times, the 10 largest tech stocks now make up over 1/3 of the S&P 500's value. Nvidia itself is worth more than the entire Canadian stock market. In fact, it's worth more than each of the G7 nations apart from Japan:



And for those of you disappointed that one US company isn't bigger than Japan's market capitalization, rest easy. All we need to do is add Apple (or Microsoft to Nvidia) to get a bigger market cap than Japan.

Of course, the engine driving these valuations is Artificial Intelligence. Nvidia, Apple, Microsoft, Amazon and others are trading at valuations I haven't seen since 1999-2000 run up in tech stocks. And we know how that ended. My biggest concern with the AI driven stocks is that AI has yet to do anything close to what many folks expect AI to do. Rather than torture you with more graphs about ridiculous valuations, please do yourself a favor and read any (or all!) of the following articles by Gary Smith and/or Jeffrey Funk. They're written in user-friendly prose and pose practical questions of logic and math to various AI programs.

- If you're a fan of the daily NY Times game, Connections, have a look at how AI did in [one of last week's puzzles](#).
- In this article, several AI programs [attempt to solve a fairly easy financial calculation](#).
- This third article features a few AI chatbots trying to solve the old [puzzle of a man, a boat, a wolf and a goat](#). The problem is ferrying the man, goat and wolf across the river in a boat that's too small to take all three at the same time while bearing in mind the goat and wolf can't be left together. However, in this case the number of variables is reduced to give AI a fighting chance.

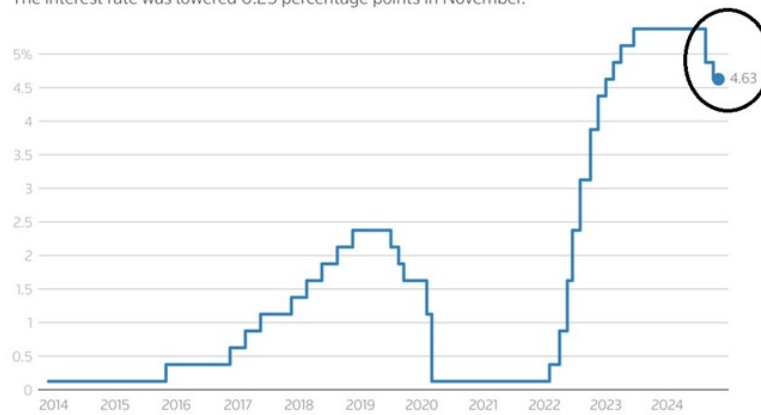
Inflation

Inflation is definitely not under control yet. The market has told the Fed, very decisively, that reducing rates isn't working.

Since September, the Fed has cut rates 100 bps (100 basis points or 1%):

US federal funds target rate

The interest rate was lowered 0.25 percentage points in November.



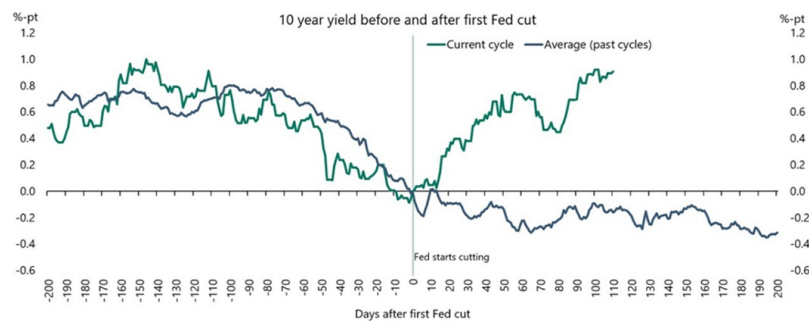
Data is the midpoint of the federal funds target range. Published November 7, 2024 at 8:00 PM GMT

By Reuters • Sources: Federal Reserve, LSEG

A line chart titled "US federal funds target rate" that tracks the metric over time. The interest rate was lowered 0.25 percentage points in November.

But since then, the 10-year Treasury Bond has *risen* 1%. The exact opposite of the Fed's intention:

Very unusual behavior in long rates after the Fed started cutting in September 2024



While the Fed has a great deal of influence on short-term rates, longer-term bonds, like the above-mentioned 10-year treasury, are entirely driven by market forces. In this case the bond market is stating the fed, in lowering rates, has gotten it wrong. Rates seem to be headed higher for longer.

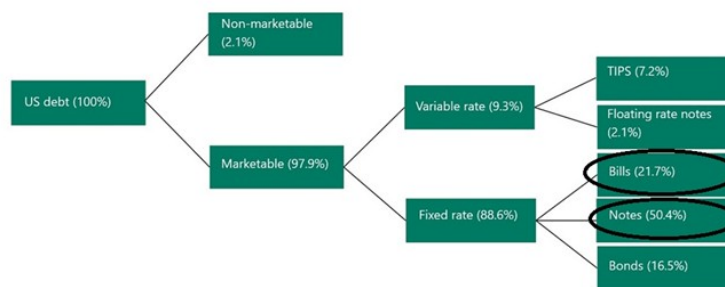
To compound the inflation problem, we're heading into a new administration with several policies that'll add to the inflationary backdrop. Let's discuss three of them.

1. Tariffs. During his first term, Trump imposed tariffs on Chinese goods between 7.5% to 25%. This time around the proposed rate is as high as 60%. As happened in his first term, these new tariffs, which will also extend to Canada, Mexico and other countries, will result in higher prices being passed on to American consumers and companies. Additionally, our trading partners may impose retaliatory tariffs in goods they import from the U.S. thus increasing the inflationary effect.
2. Immigration. The planned deportation of millions of workers will probably create a labor shortage. The food processing, agricultural, hospitality and construction industries are all liable to see either reduced output and/or higher labor costs. This may well result in lower or non-existent profit margins, reduced output and higher prices for consumers.
3. Tax cuts. The Trump Administration passed the 2017 Tax Cuts and Jobs Act and many of the provisions of that Act are set to expire in 2025. Assuming these tax cuts are extended or renewed, the resulting increased disposable income will,

unsurprisingly, tend to be inflationary.

*Please note none of these observations are meant to be political in nature. My only aim is to find investment opportunities that offer decent returns with acceptable levels of risk. Here ends the disclaimer.

One last bit about inflation. With just over \$36 trillion in debt, interest expense is now a bigger budget item than the defense budget. For the last couple years, T-Bills (debt that has 1 year or less from the time they're issued) have been paying over 4% interest. They make up just over 21% of government debt. The more concerning issue to me is the government's T-Notes, with maturities ranging from 2-10 years. As previously issued T-Notes - sporting interest payments under 1% - come due, they will be refinanced with interest rates higher than 4% or maybe 5%. That's going to add substantially to interest expense as T-Notes currently make up 50% of all government debt.



What now?

Well, with the market, as measured by the S&P 500, priced so high, we will continue to take money off the table, especially in some of our more expensive names. We believe much more attractive entry points await. There are several that I like at current prices, but I am pretty sure we'll have the opportunity in 2025 to buy them cheaper. Please give me a call or send me an e-mail if you'd like to discuss any of them or this strategy.

I know we've missed out on a good portion of the market's 2024 move. The fact is most investors aren't doing that well unless they own that small handful of stocks that have made a huge run up in the AI fueled hysteria that currently grips the market. In fact, the concentration of the S&P 500 has never been greater:



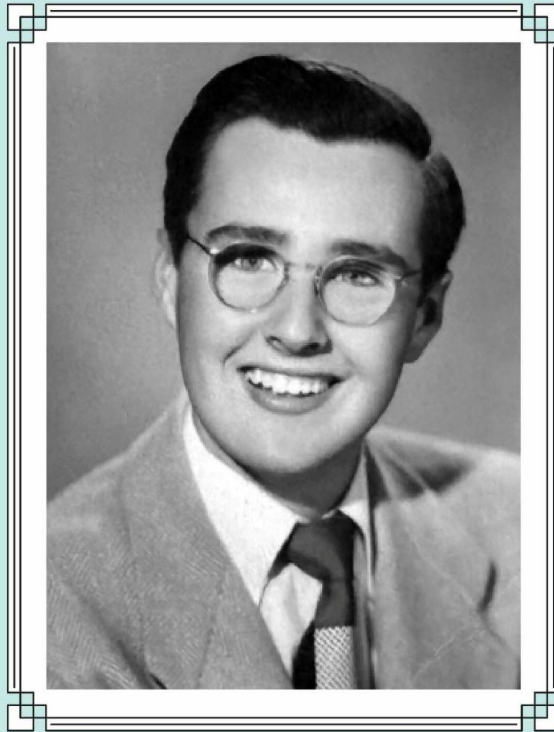
For 2025, we'll try and stick to Charlie Munger's philosophy, "extreme patience followed by extreme decisiveness." This seems to be a year where that will pay off handsomely.

One Last Thing

The last part of 2024 was rough. My November included a couple bouts with food poisoning/flu - I'm still not sure which. Then January began with wildfires that destroyed the houses of many friends and a couple clients.

But the worst part was in between those two events. My 90 year-old father, who had been in declining health for the last year, fell and broke a hip on December 6th. He wasn't able to overcome the complications and passed away on December 22nd.

He was a great father, grandfather, great grandfather and husband. His ability to twist the English language into never before heard - yet often understandable - phrases was unmatched. He had a tremendous work ethic and, even though he was fairly tone deaf, a boundless love for music. We were blessed to have him live 13 years after my mother passed which is substantially longer than any of us expected.



David Gregory McClure

January 24, 1934 – December 22, 2024

So, 2024 didn't end in a great way but we're determined to make 2025 great year. We have someone joining the McClure Investment Management team that I'm very excited about. It'll definitely free up time for more client meetings and communications (like this one) but will also bring some fresh insight to the operation. More about that in the months ahead.

But for now, I'd like to thank you for your faith in me and our ability to navigate a challenging investment landscape. We're looking forward to a challenging - and rewarding - 2025.

Bob McClure

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