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Market Commentary 12/17/24

An Oxford Harriman & Company Market Commentary

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The past two years have been strong for investors, with the S&P 500 posting back-to-back gains of over 20 percent. At the start of this year, the S&P 500's previous all-time high was set in January 2022 (4,796 on the first trading day of 2022). It took over two years to reclaim the prior high, but once the index broke through in late January 2024, it set more than 50 new highs this year.

The number of all-time highs illustrates the current bull market's strength and persistence, which could continue with further new highs by year-end. Large-cap technology stocks have posted strong returns and played a major role in driving the index's gains. The S&P 500's record-setting performance is part of a broader cross-asset rally that has lifted stocks, bonds, and commodities this year.

In our opinion, the stock market's steady climb speaks to investors' growing confidence. We believe investors are optimistic about the artificial intelligence industry's growth potential. The economy has outperformed expectations, driven by strong consumer spending, growing at an above-trend rate during the past two quarters despite high interest rates. After the November election, the stock market rally intensified as investors focused on the incoming administration's policy agenda. Expectations for tax cuts, deregulation, and energy production are fueling hopes for stronger economic growth. The bond market echoes this confidence in the economy, as high-yield credit spread tightness is at levels not seen since 2007.

Many wonder if this momentum will continue into 2025. The S&P 500 currently trades at over twenty-two times its next 12-month earnings estimate, a level not seen outside of periods like the late-1990s tech boom and the post-COVID recovery. Investors have shown a willingness to pay higher multiples, but with valuations at extremes, earnings are likely to play an important role in determining the stock market's next move.

The current bull market, which started in October 2022, is now in its third year, and it's common to see investors shift focus to fundamentals as a bull market matures. We believe 2025 will likely be a year where earnings come into focus and companies will need to deliver on investors' expectations to justify their high prices. With the SP 500's consensus earnings growth estimate of 15% for 2025 (an increase from the 9% growth estimate for 2024), there is room for the earnings multiple to contract and still have the market move higher.

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Jobs

Last month's job report provided mixed signals for investors, offering both encouraging trends and areas of concern. On the one hand, unemployment inched up from 4.1% to 4.2% after a period of steady declines. This uptick was driven by workers reentering the job market as well as new entrants into the labor market, offset by permanent job losers and job leavers. However, a positive sign emerged as the number of workers on temporary layoffs declined for the second consecutive month, signaling that businesses are actively recalling employees to workplaces and production lines.

Despite the slight rise in unemployment, job creation surged. Nonfarm payrolls increased by a robust 227,000 in November, following an upward revision of 36,000 in October. Additionally, job gains for the prior two months were revised upwards by a combined 56,000, pushing the 3-month average to 173,000. We believe these revisions highlight stronger-than-expected hiring momentum, a reassuring metric for assessing economic recovery.

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However, the sustainability of this level of job growth remains uncertain, particularly given the slowdown observed during the summer months. Understanding these employment trends is crucial for evaluating the broader economic outlook and making informed investment decisions. Investors will be closely monitoring whether this recent rebound in job growth can persist as the economy adapts to evolving labor market dynamics.

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The Federal Reserve's final FOMC meeting of the year occurs this week, and all eyes are on the central bank's next move. With the November job market and inflation data aligning to give the Fed a signal to act, a 0.25% interest rate cut is widely expected. Current market projections show overwhelming confidence in this outcome, with a 96% probability of a rate cut at this meeting.

Looking ahead to January, market forecasts shift noticeably. There's a 75% probability of the Fed holding interest rates steady following a cut in December, and only a 25% likelihood of another reduction. This anticipated pause stems from recent data indicating slower-than-expected progress toward the Fed's 2% inflation target. This has also tempered earlier expectations of significant Fed rate cuts in 2025. Indeed, only 3 further rate cuts are now expected, versus 6 cuts that were anticipated prior to the election.

Markets are looking closely for potential adjustments to the Fed's neutral rate estimate. We expect the Fed to revise this estimate upward, signaling to markets that rate cuts may be less aggressive and slower than previously anticipated.

An important part of this week's meeting is the release of the updated Summary of Economic Projections. Markets are looking closely for potential adjustments to the Fed's neutral rate estimate. We expect the Fed to revise this estimate upward, signaling to markets that rate cuts may be less aggressive and slower than previously anticipated. Broadly speaking, this suggests a more cautious monetary easing cycle amidst persistent inflationary concerns.

We will be monitoring the FOMC's commentary and projections, as they will undoubtedly shape expectations and strategies moving into the new year. While Fed actions have taken center stage over the past few years, and will continue to remain important, the new presidential administration in Washington will also be closely monitored. Areas of focus include tariffs, tax rates and easing of regulations, with tax policy and regulatory environment providing tailwinds for the economy and the market.

Have a good rest of the week,

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S&P 500 Index: The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

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