Marketline January 2025

Stocks:

January's stock price patterns benefitted from a relatively stable interest rate environment and adequate earnings reports. The Dow rose 4.7% while the S&P tacked on 2.7%. In a notable divergence, the Nasdaq posted only a 1.6% price rise, as several tech stocks reacted negatively to the announcement that Deepseek, a Chinese AI model, was able to shortcut its way to results that are very nearly as efficacious as American AI models. Overseas, both Canada and Mexico posted results in the 3.3% area, while Europe outlegged everyone with a 6.1% rise. European stocks have lagged US results for a number of years, pushing valuations down considerably.

While January was interesting, as all months are in their idiosyncratic ways, we will spend our space here discussing 2024 overall. As much divergence as you see in January was also evident during the last year. The international index we follow was up 4.4%. The broad Russell 2000 posted 11.4%. The S&P came in at 25%. Just seven technology stocks comprise 33% of the S&P index; performance from these seven names accounted for 52% of the entire 2024 return. Had you owned the entire S&P but for those seven stocks, your return would have approximated that of the Russell 2000. Value investors were left in the middle of the performance pack: the Russell 2000 value index came in at 8.0%. But ticking over just one month put value into a much better light, as the 1/31/24 to 1/31/25 number rose to 15.5%. The opportunity to buy good companies selling at low prices and engaged in solving margin, earnings, or market position issues remains intact, but the longer-term vision required to wait for improvement has seen more modest rewards lately. Instead, stocks that *have* performed well, *continue* to do well, based largely on inflows to index funds and prior price behavior. These are not fundamental attributes.

Looking forward, we have heard from several clients expressing concern about the political milieu. We are not policy or political analysts; as we explained to one inquiry, our focus is on earnings and interest rates – *which are the two most important determinants of returns in the markets*. The earnings season currently underway has seen its share of challenges – many in the tech sector – and most driven by the very strong US dollar and weakness in orders coming from overseas during the last half of 2024. With 40% of S&P earnings derived from foreign countries, these results are reflective of economies worldwide. The job of companies is to adjust, and adjust they will, as they always have. Meanwhile, a window on the futility of forecasting returns based on politics – or even economics – is evident when we examine returns around the world last year. Argentina's MERVAL produced a 172% return, in the midst of complete upheaval; Pakistan came in with about 75%, thanks to – you won't be surprised – reductions in *interest rates*; and China, despite declining economic growth all year, produced 26%. As one of my mentors used to say, you could know to the basis point what the economy is going to do in the next six months and still be wrong about stocks.

Bonds:

Interest rates were relatively stable last month, changing by only a basis point or two across the curve – a welcome respite after December's flurry upward. That said, when we focus on 2024, bonds dished up another disappointment to investors on a total return basis: the Barclays Government/Corporate Index returned only 1.2% last year. That follows a return of 5.7% the year before, and negative returns in 2022. So fixed income has seen rough going lately. (It's worth a reminder that just because total returns are low, that doesn't mean bonds aren't producing income – cash flows are actually higher than we've seen in the last several years.) Overall, corporate bonds have tended to perform better versus governments and municipals, beginning these periods with the head start of higher yields. We continue to favor this sector, despite slightly widening spreads lately.

Looking ahead at interest rate trends, we can see an argument for rates remaining as is or edging higher if the economy remains strong; and we can see an argument for lower rates if the recessionary trends we're seeing in Germany and the UK infect other economies. The one factor that has mattered less lately is the Fed's decision, though we will be listening to the next pronouncements like everyone else.

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