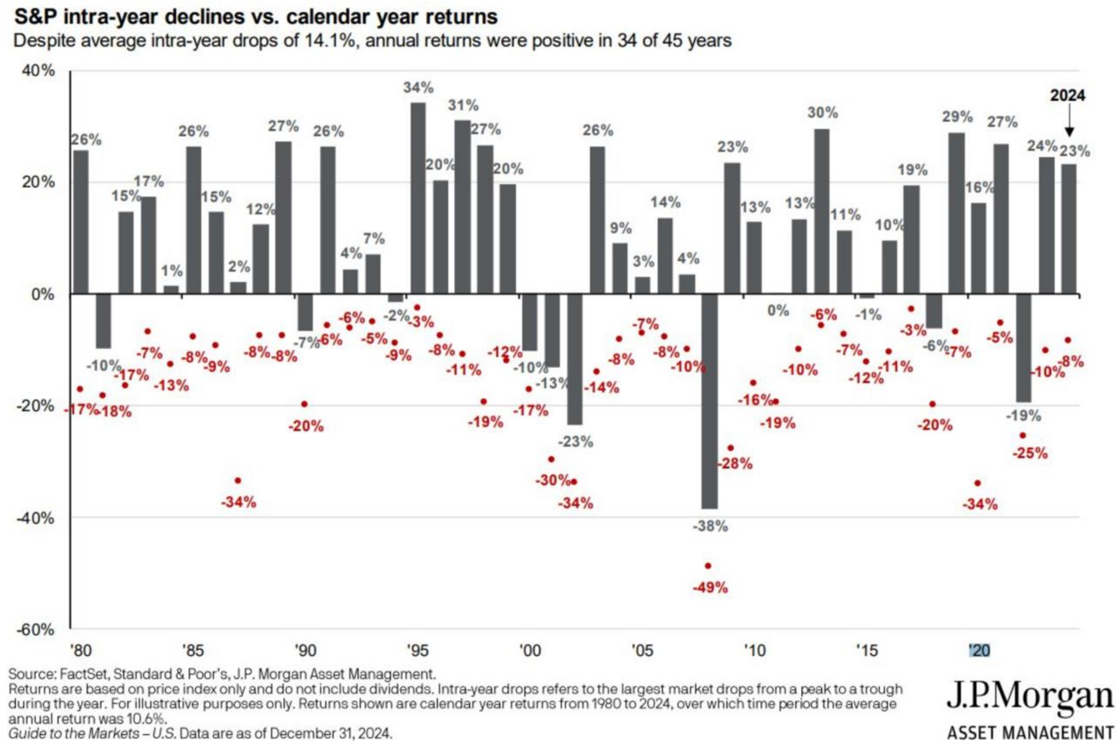
MEDALLION WEALTH MANAGEMENT

January 2025 Market Commentary #2

Walking on Sunshine

"I'll say it, I'll say it, I'll say it again now
And don't you feel good?
I'm walking on sunshine, whoa-oh"
https://www.youtube.com/watch?v=iPUmE-tne5U

Don't you feel good! I mean how can you not. Back-to-back years of +20% gains in the S&P 500 for a combined two-year total return of **57.60%**! That's pretty good.



The S&P 500's current bull market started on October 12, 2022, and has generated a total return of 72.4% through year-end 2024. Before we get into this bull market let's take a quick look at its origin, the bear market of 2022. Now, most bear markets coincide with recessions, but occasionally we have non-recessionary bear markets like 2022.

S&P 500 bear markets and recessions					
Bear market		Duration (days)	S&P 500 % change	Recession	
Start date	End date			Start date	End date
5/29/1946	5/19/1947	355	-28.5%	N/A	N/A
6/15/1948	6/13/1949	363	-20.6%	Nov-48	Oct-49
8/2/1956	10/22/1957	446	-21.6%	Aug-57	Apr-58
12/12/1961	6/26/1962	196	-28.0%	N/A	N/A
2/9/1966	10/7/1966	240	-22.2%	N/A	N/A
11/29/1968	5/26/1970	543	-36.1%	Dec-69	Nov-70
1/11/1973	10/3/1974	630	-48.2%	Nov-73	Mar-75
11/28/1980	8/12/1982	622	-27.1%	Jul-81	Nov-82
8/25/1987	12/4/1987	101	-33.5%	N/A	N/A
7/16/1990	10/11/1990	87	-19.9%	Jul-90	Mar-91
3/24/2000	10/9/2002	929	-49.1%	Mar-01	Nov-01
10/9/2007	3/9/2009	517	-56.8%	Dec-07	Jun-09
2/19/2020	3/23/2020	33	-33.9%	Feb-20	Apr-20
1/3/2022	10/12/2022	282	-25.4%	N/A	N/A

Source: Charles Schwab, Bloomberg, National Bureau of Economic Research.

Bear market defined as 20% or greater drop in S&P 500. Red text indicates periods of recessions. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance is no guarantee of future results.**

The thing about non-recessionary bear markets is that the bull market that follows it is generally shorter lived (33 months) than post-recession bull markets (61 months). Unsurprisingly, that has tended to mean weaker returns for non-recessionary bull markets (40.5%) than post-recessionary bull markets (62.9%).

Again, our current non-recessionary bull markets return of 72.4% is the best ever bull run that hasn't been preceded by a recession. It's also interesting that as measured by the P/E of 24.5x, this was the most expensive bull market when it started in 2022.

The table below shows that year three of a bull market has generally resulted in much more muted returns, with only a few percentage points of improvement above the two-year performance.

S&P 500 bull market performance				
Bull market start date	Two-year % change	Three-year % change	Max drawdown in first three years	5-year normalized P/E at start of bull market
5/19/1947	7.5%	35.7%	-20.5%	14.3
6/13/1949	59.0%	79.9%	-14.0%	10.0
10/22/1957	43.7%	36.8%	-13.5%	13.5
6/26/1962	55.7%	58.8%	-10.5%	17.0
10/7/1966	41.7%	27.2%	-17.4%	18.4
5/26/1970	59.7%	55.8%	-14.5%	13.9
10/3/1974	67.3%	55.3%	-14.1%	11.3
8/12/1982	61.5%	83.9%	-14.3%	8.7
12/4/1987	56.9%	45.7%	-19.9%	16.3
10/11/1990	36.3%	56.0%	-6.2%	15.5
10/9/2002	44.5%	54.0%	-14.7%	20.5
3/9/2009	95.1%	102.6%	-19.3%	11.8
3/23/2020	99.2%	76.5%	-25.4%	20.9
10/12/2022	62.7%	N/A	-10.2%*	24.5
Average (recession)	**62.9%**	**66.8%**	**-15.1%**	**14.0**
Average (no recession)	**40.5%**	**41.9%**	**-17.1%**	**16.5**

Source: Charles Schwab, Bloomberg, The Leuthold Group, as of 10/11/2024.

Bull market defined as 20% or greater rise in S&P 500. *Maximum drawdown only through first two years of bull market. Normalized P/E uses five-year average earnings (18 quarters of historical results combined with two quarters of future estimates). Average does not include 10/12/2022 current bull market. Red text indicates periods of recessions. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. **Past performance is no guarantee of future results.**

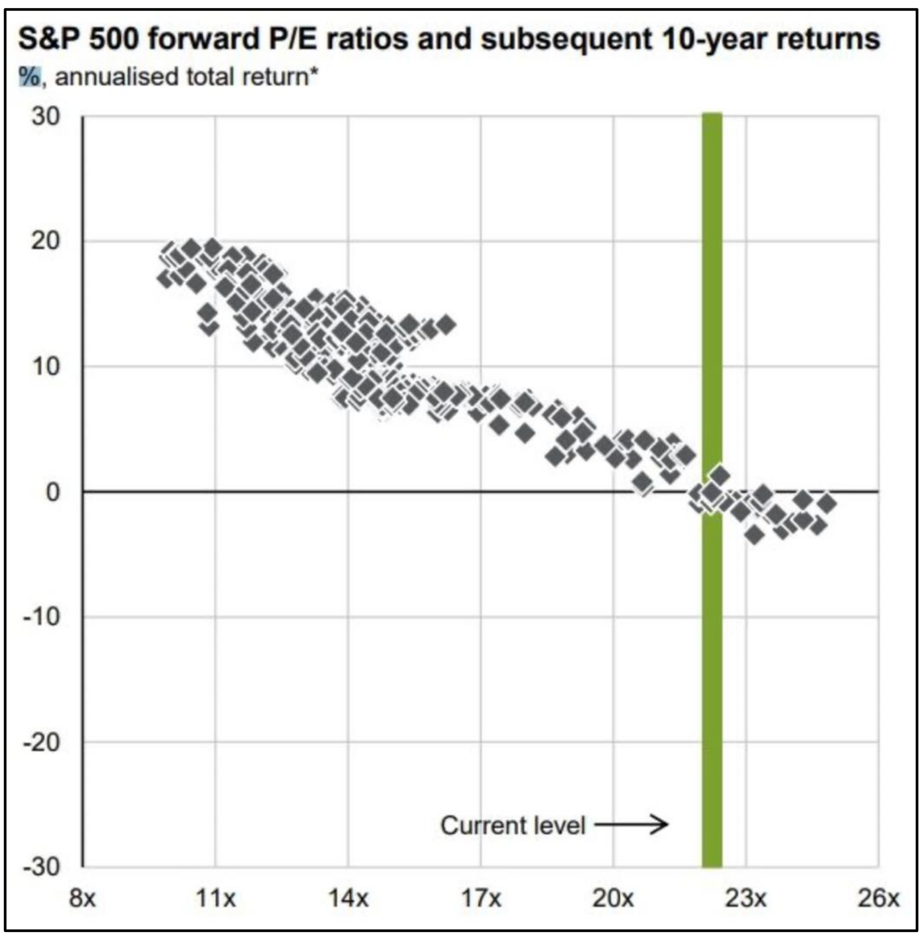
None of this is a forecast, every year is different and every bull and bear market is different, but I find it useful to understand where we are today versus history. There were really three big market moving themes in 2024, that will probably continue to be important into 2025.

- **The Fed and Interest Rates** – Markets entered 2024 expecting at least half-a-dozen Fed rate cuts, but inflation remained stickier than expected and the Fed waited until mid-September to make its first rate cut. This first cut was a bold 50 bps, which the market thought was a bit of an admission that the Fed may have waited too long. The most surprising part of this rate cutting cycle is that while the Fed has now cut 100 bps out of the Fed Funds Rate, interest rates on the 10-year bond have actually gone up by 80 bps. Mr. Market (aka, the Bond Vigilantes) are telling the Fed that our runaway government spending and deficits will lead to very sticky inflation well above the Feds stated 2% target, therefore further rate cuts may be perversely met with higher interest rates.
- **AI & Quantum Computing –** 2024 continued the massive capital spending push into all thing's artificial intelligence. Capital spending by the top five tech firms in 2023 was $110 billion, and grew by 50% to $165 billion in 2024. And it's expected that spending will increase to over $200 billion in 2025. This arms race in capex spending has led to a market bifurcated into the haves and have-nots. We have a handful of mega-cap companies that have the profitability and market-cap to take advantage of these new technologies, and then we have everyone else. Will 2025 be the year that we start to see

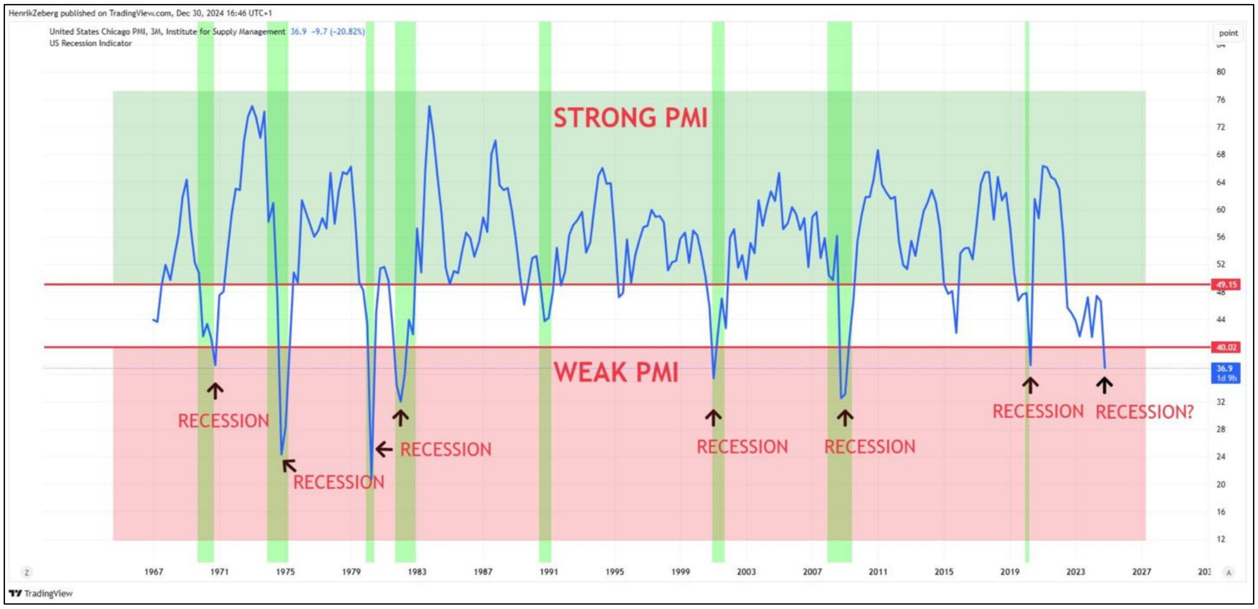
the fruits of this capital spending boom begin to trickle down to everyone else? Will we be able to generate enough electricity to meet this voracious demand for energy?

- **The Election –** The final market-moving theme of 2024 was clearly the election. The race was back and forth for much of the year, but after the failed assassination attempt on former President Trump odds began shifting decidedly towards the republicans. It all came to a head in November with a republican sweep that led to a rally in Trump-related sectors and a sell-off in anything Harris related. There are a lot of moving pieces in the new incoming administration; taxes/tariffs, immigration, DOGE, etc. I think it is fair to say that there will be some surprises and some volatility, only time will tell if its upside or downside volatility.

While I'm enjoying my brief walk on sunshine, I just want to point out a couple of clouds on the horizon. First are those pesky valuations. While valuations are horrible market timing tools, they do a pretty good job of foreshadowing future ten-year returns. And our current S&P 500 forward P/E ratio of 21.6x would leave you to believe that muted returns may be in our future for a while.



There are also some signs that our economy may not be as strong as believed. The Chicago PMI (Purchasing Managers Index) a measure of economic activity in the heartland recently came in at a reading of 36.9. Readings under 50 are signs of economic contraction, and readings under 40 have always presaged a recession. Again, doesn't mean it will happen this time.



So, as we enter 2025, let's count our blessings and embrace the uncertainty we will always face, confident that we have a pretty good financial plan that will weather a storm.

Finally, I'd like to leave you with a poem that I reread every year, the **Desiderata**:

> ***Go placidly*** *amid the noise and the haste, and remember what peace there may be in silence. As far as possible, without surrender, be on good terms with all persons.*
>
> *Speak your truth quietly and clearly; and listen to others, even to the dull and the ignorant; they too have their story.*
>
> *Avoid loud and aggressive persons; they are vexatious to the spirit. If you compare yourself with others, you may become vain or bitter, for always there will be greater and lesser persons than yourself.*
>
> *Enjoy your achievements as well as your plans. Keep interested in your own career, however humble; it is a real possession in the changing fortunes of time.*
>
> *Exercise caution in your business affairs, for the world is full of trickery. But let this not blind you to what virtue there is; many persons strive for high ideals, and everywhere life is full of heroism.*

Be yourself. Especially do not feign affection. Neither be cynical about love; for in the face of all aridity and disenchantment, it is as perennial as the grass.

Take kindly the counsel of the years, gracefully surrendering the things of youth.

Nurture strength of spirit to shield you in sudden misfortune. But do not distress yourself with dark imaginings. Many fears are born of fatigue and loneliness.

Beyond a wholesome discipline, be gentle with yourself. You are a child of the universe no less than the trees and the stars; you have a right to be here.

And whether or not it is clear to you, no doubt the universe is unfolding as it should. Therefore, be at peace with God, whatever you conceive Him to be. And whatever your labors and aspirations, in the noisy confusion of life, keep peace in your soul. With all its sham, drudgery and broken dreams, it is still a beautiful world. Be cheerful. Strive to be happy.

by Max Ehrmann ©1927

As always, be careful out there.

Chris Wiles, CFA

Where trust is Earned