# Executive Summary

- The S&P 500 made its 57th new record high this month.
- It is now up 67% from the start of this bull run in 2022.
- Uncertainty before the election has been replaced with optimism.
- Global GDP growth will slow from 3.2% in 2024 to 2.9% in 2025.
- US GDP growth will slow from 2.7% in 2024 to 1.9% in 2025.
- The stock market is pricing in two or three rate cuts in 2025.
- My December 2025 S&P 500 target is 6596.
- I made two changes to the asset allocation model.

## The US Economy

As we approach the midpoint of the decade, the implications of the US election result are a focal point. A key question is whether US political change might extend or end the current bull market. The upside scenario would see lower taxes, deregulation, and trade deals adding to a positive market narrative built on solid growth and continued investment in artificial intelligence. The risk scenario is that trade tariffs, excessive fiscal deficits, and geopolitical strife will contribute to higher inflation, weaker growth, and market volatility.

My base case leans toward the upside scenario. The adaptability of the economy, the power of innovation, and the potential for long-term market growth will likely keep the economy growing, albeit at a slower pace, and therefore avoid a 2025 recession.

Real GDP y/y, in %

|  | 2024E | 2025E | 2026E | 2027E |
|---|---|---|---|---|
| US | 2.7 | 1.9 | 1.6 | 1.8 |
| Canada | 1.1 | 1.6 | 1.9 | 1.7 |
| Japan | -0.2 | 1.1 | 0.6 | 0.6 |
| Eurozone | 0.7 | 0.9 | 1.1 | 1.2 |
| UK | 0.9 | 1.5 | 1.3 | 1.3 |
| Switzerland | 1.4 | 1.3 | 1.6 | 1.6 |
| Australia | 1.2 | 2.0 | 2.2 | 2.1 |
| China | 4.8 | 4.0 | 3.0 | 3.6 |
| India | 6.7 | 6.3 | 6.6 | 6.8 |
| EM | 4.4 | 4.0 | 3.6 | 4.0 |
| World | 3.2 | 2.9 | 2.6 | 3.0 |

Source: Haver, CEIC, National Statistic, Bloomberg, UBS, as of 14 November 2024

| Possible outcomes | Narrative | Probability |
|---|---|---|
| Optimistic | Lower taxes, deregulation, and trade "deals" add to a positive market narrative built on solid economic growth and continued investment in artificial intelligence (AI). | 30% |
| Most Likely | Investors remain optimistic about the prospects for US stocks, anticipating around 10% upside for the S&P 500 by year-end 2025, with AI playing a pivotal role in driving economic and earnings growth. | 50% |
| Pessimistic | Blanket trade tariffs, excessive fiscal deficits, and geopolitical strife contribute to higher inflation, weaker growth, and market volatility. | 20% |

## The U.S. Stock Market

Despite my optimistic outlook for the economy, the stock market is exposed to a barrage of uncertainty in the year ahead. The first is valuation. This is an expensive market, and investors may be reluctant to continue buying at the same pace we've seen in 2023 and 2024. There is precedent for another 20% up year after two years of 20%-plus gains, but it only happened once in the past 100 years. That was the great bull run of 1995-1999. Using Bayesian inference, there is only a 5% chance that 2025 will end with a gain of 20% or more. What's more likely is a gain of 10%, which would give us a price target of roughly 6600 for the S&P 500.

Another source of uncertainty is the prospect of tariff wars with trading partners like China, Mexico, and Canada. If the incoming administration follows through on Trump's tariff threats, it will likely lead to a resurgence of inflation, which in turn would lead to a decline in consumer spending. Under this scenario, corporate earnings would suffer and the stock market would decline along with it.

A third source of uncertainty is the prospect of sharply increasing budget deficits, which would put upward pressure on interest rates. Home builders, auto makers and other companies who rely on consumer credit to finance purchases of big ticket items would see a slackening of demand from already stretched consumers.

Taken together, these uncertainties are bound to create increased volatility in the stock market.

## Consensus forecasts for 2023

The table below shows the consensus forecasts from strategists, asset managers, and economists at the major Wall Street firms. The individual forecasts are widely dispersed but the average has historically been close to the actual closing price.

According to the calls from these forecasters, 2025 will end at 6637, which would represent a 10.6% gain for the year. With the bull market intact and making new highs, these forecasters have been raising their targets. As these forecasts change throughout the year, I will update this table accordingly.

| FIRM | 2025 S&P | % Change |
|---|---|---|
| Oppenheimer | 7100 | 18.3% |
| Wells Fargo | 7007 | 16.8% |
| Yardeni Research | 7000 | 16.7% |
| Deutche Bamk | 7000 | 16.7% |
| SocGen | 6750 | 12.5% |
| HSBC | 6700 | 11.7% |
| BMO Capital Markets | 6700 | 11.7% |
| Bank Of America | 6666 | 11.1% |
| RBC Capital Markets | 6600 | 10.0% |
| Fundstrat | 6600 | 10.0% |
| Barclays | 6600 | 10.0% |
| UBS | 6600 | 10.0% |
| Morgan Stanley | 6500 | 8.3% |
| Goldman Sachs | 6500 | 8.3% |
| JPMorgan | 6500 | 8.3% |
| Citigroup | 6500 | 8.3% |
| Stifel | 5500 | -8.3% |
| **AVERAGE** | **6637** | **10.6%** |

As of 12/26/24

## Sector preferences.

The most favored sectors right now are Technology, Industrials, and Healthcare. Technology, Communication Services, and the market as a whole are still dominated by the so-called Magnificent 7 mega-cap stocks (Apple, Amazon, Alphabet, META, Nvidia, Tesla, and Microsoft). However, I expect market participation to broaden out as the bull market ages.

Least favored are the sectors that are the most vulnerable during an economic slowdown – Energy and Real Estate will likely lag as their upside is limited. Bear in mind that these earnings estimates will change as we move through 2025, and the attractiveness rankings will change accordingly.

These leading and lagging sector forecasts are consistent with an economy that is still expanding but at a slow pace. If we have a recession, which appears less likely, these over- and underweights will become even more valuable from an asset allocation standpoint.

| Sector | 2025 Earnings Growth (Estimate) | 2024 Total Return (Estimate) | 2025 Total Return (Estimate) |
|---|---|---|---|
| Info Tech | 23.2% | 32.6% | 22.3% |
| Industrials | 18.8% | 18.0% | 18.7% |
| Health Care | 20.6% | 3.7% | 18.3% |
| Comm. Svc. | 15.2% | 35.5% | 17.8% |
| Utilities | 9.0% | 23.7% | 15.1% |
| Financials | 9.0% | 30.8% | 14.5% |
| Materials | 17.4% | 1.5% | 14.4% |
| Cons. Discr. | 12.2% | 27.0% | 13.9% |
| Cons. Staples | 5.5% | 14.0% | 8.5% |
| Real Estate | 4.6% | 4.5% | 7.7% |
| Energy | 3.6% | 4.3% | 6.2% |

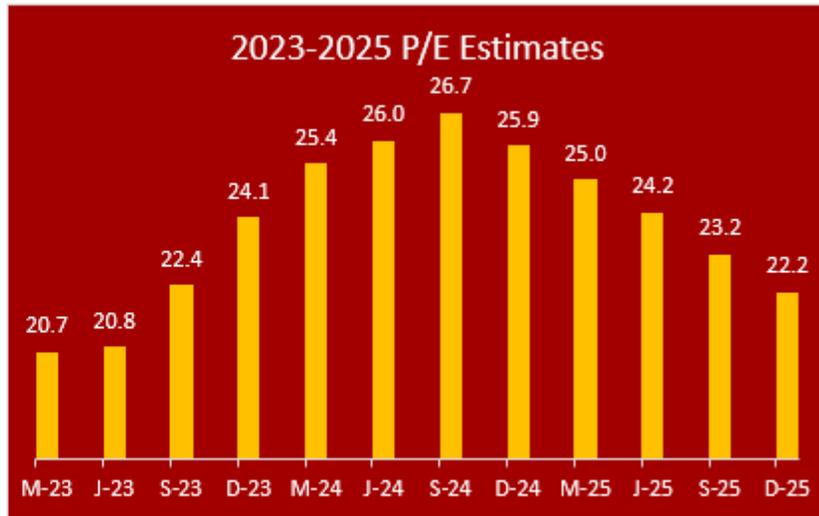*Source: S&P Global; Factset; Zacks Investment Research*

## Earnings

Turning to the earnings outlook for 2024-2025, analyst consensus forecasts have been moving higher for the past few months. Several companies have reported moderate earnings beats for the September quarter but they are also trimming forward guidance. Lowered guidance indicates a more cautious but not necessarily bearish outlook among analysts and the companies they follow.

The S&P 500 (the blue line on the chart below) is well above earnings estimates for the September and December quarters. As a result, valuations are stretched. In order to bring valuations down to a level closer to the historical trend, either earnings estimates must rise or the market must slow down. I think the market will keep rising but at a slower pace than we've become accustomed to.



Looking at the picture from a different angle reveals three quarters of negative earnings growth, followed by reasonably healthy growth through 2025. According to S&P Global, year-over-year earnings growth (operating) is projected to be up by 10.2% in 2024 and up 19.7% in 2025 (left chart). My view is that Wall Street analysts are still too optimistic about the prospects for future earnings. If these optimistic earnings estimates are met or exceeded, and the market trades sideways, the market P/E (on "operating" earnings) will come down from the September 2024 high of 26.7 to 22.2 by the end of next year (right chart). (This assumes a flat market.)

**2023-2025 YoY Earnings Growth Estimates**

| M-23 | J-23 | S-23 | D-23 | M-24 | J-24 | S-24 | D-24 | M-25 | J-25 | S-25 | D-25 |
|------|------|------|------|------|------|------|------|------|------|------|------|
| -10.9% | -5.9% | -1.5% | 10.0% | 8.5% | 8.2% | 8.9% | 10.2% | 14.8% | 16.1% | 19.6% | 19.7% |

**2023-2025 P/E Estimates**

| M-23 | J-23 | S-23 | D-23 | M-24 | J-24 | S-24 | D-24 | M-25 | J-25 | S-25 | D-25 |
|------|------|------|------|------|------|------|------|------|------|------|------|
| 20.7 | 20.8 | 22.4 | 24.1 | 25.4 | 26.0 | 26.7 | 25.9 | 25.0 | 24.2 | 23.2 | 22.2 |

What is more likely to happen is that the market will rise along with earnings, which will keep the P/E ratio close to where it is today. If consensus earnings estimates come down modestly, as I expect, the market P/E will expand. The long-term median P/E based on "operating" earnings is 18.4.

If, on the other hand, earnings estimates should come down more sharply, as some in the financial media expect, it would signal a deeper and longer-lasting recession is ahead of us. That is not my base case, however. I believe that we will have a soft landing, and that the Fed will accelerate its easing if the market declines sharply from here.

# The Models

## Key Market Indicators (KMI)

The KMI traffic lights are designed to give readers a visual sense of how healthy the market is. They cover 4 groups of indicators – Fundamental ones, like revenue and earnings growth; Technical, such as relative strength and on-balance volume; Valuation, like P/E, Price-to-book; and Risk, such as recession threat and volatility. Today we have one green, one red and two yellows. This configuration means that the market is healthy but there are above-average risks. Valuations are  stretched to the 3rd highest reading since 1950.



The **Fundamental** group light is green, reflecting solid earnings growth and expanding profit margins. Analysts expect Q4 earnings to come in 10.2% above the same quarter one year ago, which is very respectable. The ongoing rollout of AI applications are starting to show up in a wide range of businesses. If this trend continues, the fundamental light will likely stay green.

The **Technical** group light flipped from green to yellow this month, mainly due to the narrowing of breadth and leadership, On the plus side, the spread between the 50 day and 200 day moving averages is positive, wider than usual, and expanding. More stocks are above their respective 200 day moving averages compared to last month.

**Valuation** is red, reflecting above trend P/E and P/B ratios. There are signs that analysts are raising their earnings estimates for 2025 and beyond, but there have been some pockets of weakness in sectors like Energy, Consumer Staples, and Real Estaste.

**Risk** is now yellow after being green for several months prior. Despite the long string of new record highs, there are some concerns investors are dealing with. Has the Fed being too timid with its rate reduction program? Is the AI trade losing steam? Will the Middle East conflict turn into a limited nuclear confrontation? And, last but not least, will Chair Powell succeed in bringing inflation under control without tipping the rconomy into a recession?

# Bear Market Probability Gauge

This gauge calculates the likelihood that a new bear market will arrive sometime in the next 4-6 months. It is built on Bayesian inference, where we start with the assumption that the 2025 will see the market rise by 10.6%, which is the long-term average of all years back to 1928. The model then adjusts that assumption based on current data like valuation, projected earnings growth, and market behavior during similar periods.

The probability gauge takes all the measures of market health and assigns a probability to each, based on similar conditions that were present during past bear markets.



As of today, the probability of this bull market ending in the next 4-6 months is **16%.** The low reading is based on solid (but slowing) economic data, a slowing but still robust jobs market, and healthy consumer spending. Personal income has been rising at a faster clip this year as compared to the historical trend.

The gauge is sending a clear signal that this bull market will last for at least the next 4-6 months. However, if inflation reverses its recent trend and begins to move substantially higher, or the economy slips into a mild recession, and the reading on this gauge starts to move higher, I will increase the cash allocation in the asset allocation models shown later in this report.

## Probability of market outcomes for Year End 2024.

It's time to flip the calendar to 2025. In this section of the report I estimate the probabilities of various market outcomes looking out to December 2025. Each market outcome shown in the table on the right has its own Bayesian probability of occurring. This table shows the weighted probability of all the possible outcomes.

The model forecasts a **gain of 9.2%** from the Decembber 24, 2024 closing price of **6040** to the December 2025 estimate of **6596** for the S&P 500. Here are the probabilities for each of the estimated market outcomes:

| % Change for the S&P 500 | Dec 2025 Level | Outcome Likelihood |
|---|---|---|
| up 20% or more | 7,550 | 22% |
| up 10%-20% | 6,946 | 28% |
| up 0%-10% | 6,342 | 32% |
| down 0%-10% | 5,738 | 9% |
| down 10%-20% | 5,134 | 6% |
| down 20% or more | 4,530 | 3% |
| As of 12/26/2024 | | 100% |

There is a **22%** chance that the market will be up by **20%** or more by December 2025.

| 12/24/2024 | 6,040 |
|---|---|
| 12/31/2025 *est* | 6,596 |
| Est. Chg for 2025 | 9.2% |

There is a **28%** chance that the market will be up by **10% - 20%**.

There is an **32%** chance that the market will be up by **0% - 10%**.

There is a **9%** chance that the market will be down by **0%-10%**.

There is a **6%** chance that the market will be down by **10% - 20%**.

The most bearish outcome (**3%** probability) is a decline of **20%** or more in 2025.

This table, when used in conjunction with the stock market traffic lights and the bear market speedometer (both shown above), offers a reasonable, data-driven expectation of where we will end on 12/31/2025. Bear in mind that these forecasts will change as more data comes in and the stock market model makes the necessary adjustments.

# Key Recession Indicators (KRI)

The recession warning lights look at four economic indicators to gauge the health of the economy. Of the four indicators, the Yield Curve is the most prominent, since it has a good track record of predicting recessions.



After spending several quarters in the red (reflecting the inverted yield curve), this light has turned yellow (reflecting the newly positive curve.) With three yellow and one green light, the model indicates caution but it does not yet give a clear warning that a recession is coming.

The **Yield Curve** index flipped from red to yellow this month, reflecting the positive Treasury yield curve. The longer the 10yr rate stays above the Fed Funds rate, the lower the risk of recession.

The **Misery Index** is yellow. The index is at the current level of **6.95**, up from **6.70** last month and up from **6.84** one year ago. The index adds together the inflation rate and the unemployment rate. With easing inflation, this indicator is becoming less negative. Consumers are still getting squeezed by inflation, and real wages have been growing but have not been keeping up. This has forced many consumers to tap into credit cards and home equity lines of credit in order to cover the high and rising cost of living.

The **Consumption** Index is green, reflecting the strong demand for travel and leisure services. Consumers may also be pulling future purchases forward in order to avoid paying even higher prices or getting hit with higher interest rates.

The **Production** Index is yellow. This indicator tanked during the COVID lockdown, then bounced right back to pre-COVID levels. It has since been trending sideways. U.S. factories are building up excess capacity as the demand for manufactured goods has softened. Some businesses are working off excess inventory.

# Recession Probability Gauge

The probability of the US economy slipping into a recession sometime in the next 4-6 months is **20%**. Recent economic data has been better than expected but there is concern about the trend of unemployment. Retail sales are good, but not as robust as they were in the fourth quarter last year.

Some key leading indicators are also trending lower, including consumer confidence and the ISM manufacturing index. My base case is a soft landing for the economy, i.e., inflation moving closer to the Fed's target without a Fed-induced recession. The inflation picture should continue to improve in the coming months, but the ride will be a little bumpy.

The stock and bond markets are trading with above average volatility as investors struggle to formulate their expectations for the economy during 2025. Investors are anticipating lower taxes and loosening regulation on businesses. If implemented, companies – especially small and mid-caps – will benefit. More of their revenue will flow to the bottom line, thus raising earnings per share and creating headroom for price increases.

The Fed is fully focused on its mission to bring inflation under control, regardless of the pain it may cause for consumers, employees, and investors. The risk of a policy error (not cutting rates fast enough) has the potential to send the economy into a recession. If large tariffs are widely imposed, economists think there will be an uptick in inflation and the interruption of some of our supply chains. On the whole, however, economists are guardedly optimistic about the next 2 years. They say that any tariff-related uptick in inflation is likely to be short lived. As far as supply chain interruption goes, the thinking is that we will adapt quickly and avoid the mess we experienced during the pandemic.

# The Zen Triple Cross Moving Average Indicator

This Moving Average Indicator is best utilized as part of a Plan B defensive strategy. As each of the three individual lines cross above or below the Zero line, active investors can increase or reduces risk exposure accordingly. Long term investors should look at this indicator but not be in a rush to make portfolio allocation changes.

A simple example would be a two-asset portfolio that switches between equities (risk) and cash (riskless) as the model indicates. For example, if your normal asset allocation calls for 80% equities and 20% bonds, active investors can use this indicator to adjust that mix. When this indicator begins to turn negative, you might reduce your equity exposure from 80% to 70%. If it continues to become even more negative, you might reduce your equity exposure to 60%, and so on.

Here is a chart of the last 90 days. Only the long term line is in positive territory, indicating a "risk off" asset allocation. The Triple Cross Indicator presents a narrow view of the market, as it is a technical indicator based solely on price movement. It is designed to give the reader a sense of where the market may be headed in the near term.
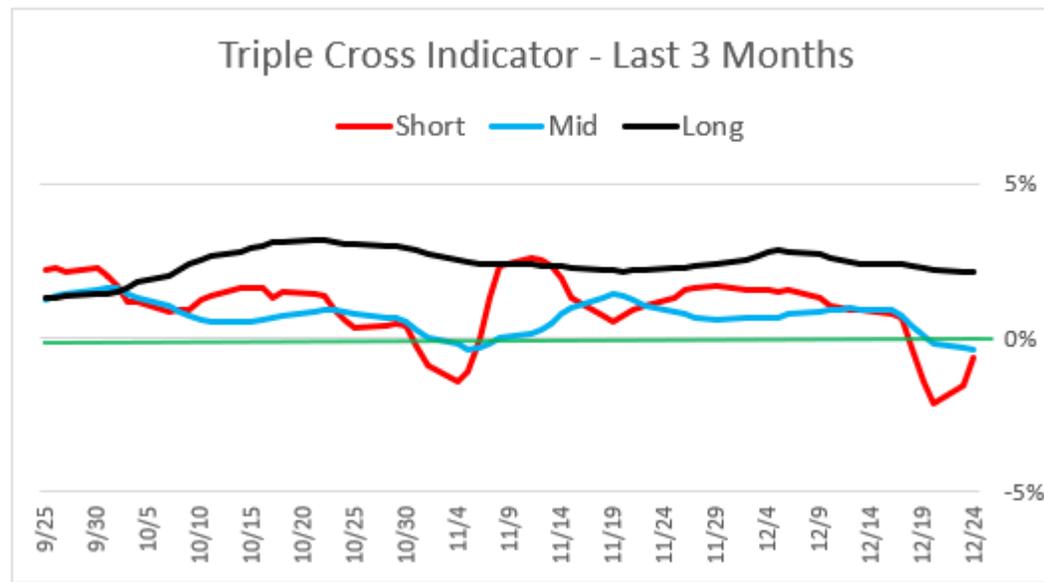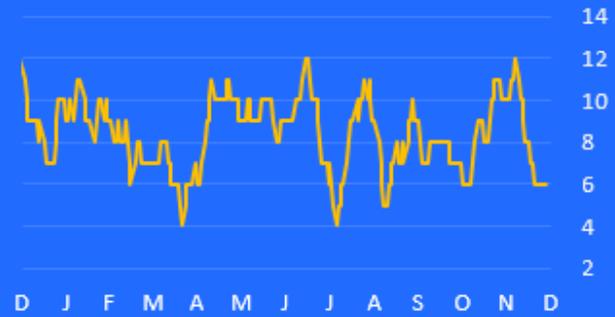
# Market Dashboard

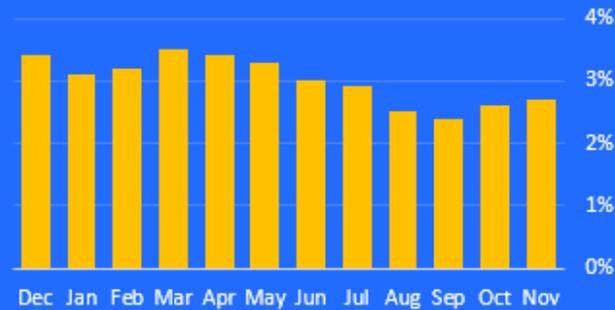©ZenInvestor.org

## S&P 500 Drawdowns 2024



## Up Days out of Last 15 Days
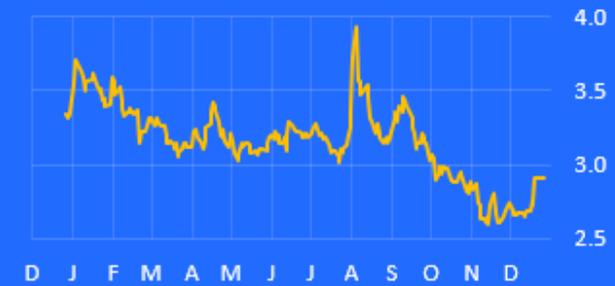


## Treasury Yield Curve Last 12 Months



## YOY Inflation 2023 - 2024



## SP500 Moving Averages Last 12 mo.

— 50 Day  — 200 Day  — 1 Day



## Junk - Treasury Spread

The dashboard has six individual charts, each offering a different perspective on the capital markets. It's designed to give the reader a quick recap of the recent trends for each view of the market.

**Drawdowns**. Optimistic buyers have dominated the market action since October 2022. They have put together a 2 year rally that has moved us **66%** off the bottom. The current drawdown from the Decembber 6 high water mark is **0.8%.**

**Net Up days out of the last 15** is a measure of momentum. This indicator has a tendency to bounce between 6 and 10, with a long-term average of 8 up days out of the most recent 15 trading days. Today it has a reading of **6.** This indicates that short term momentum is negative but the market is approaching an oversold condition.

**Treasury Yield Curve.** This chart shows the difference between the rate on the 10-yr Treasury bond and the Fed Funds rate. When this indicator turns negative, as it is now (the rate on the 10-yr is lower than the Fed Funds rate) it usually signals a recession. The current reading of **0.5%** means that we have finally escaped the negative curve shape after a long lasting inversion.

**YOY Inflation rate.** The **2.7%** CPI print for November was not good enough to pacify the Fed. Chair Powell telegraphed this when he said that the Fed doesn't have to be in a hurry to cut rates. The Fed has adopted a more cautious stand since the November CPI came out in December.

**Moving Averages** are in a positive configuration, where the 50 day moving average is above the 200 day. It takes several weeks if not months of market action to move the needle on this indicator. The spread between these two lines has been widening for a few months. The current spread of **7.2%** is well above the long term average of **2.4%.** This indicates that the market has gotten ahead of itself and is now in the process of pulling back.

**Junk-Treasury Spread** measures how confident bond investors are about the future. This month we see a wideng of the spread, from **2.61%** last month to **2.91%** today. (The long-term median spread is **4.76%.**) Today's reading is an indication that yield-seeking investors are becoming slightly more concerned about about taking the risks associated with holding junk bonds.

# My Top Stock & ETF picks

In this part of the report, I share the stocks and ETFs that I am either watching closely or already own. What sets these picks apart from my trading strategies and model portfolios is that I do not use an algorithm or an asset allocation scheme. These are just individual picks that I have watched for months, and sometimes years, and I have a pretty good idea of what the upside/downside probability is for each of them.

The best way to use these picks is to consider them as ideas that you can investigate further, using your own methodology and criteria. My watch list has between 50 and 100 names at any given time, and what you see here are the ones I have the most confidence in.

## My top 10 stock picks for 2024

I publish this list at the end of each year and hold all 10 names for the next 12 months. Mergers, takeovers, or delisting would be the only reasons for me to change this list mid-year. The Zen Ten has performed very well YTD 2024.

| 2024 Zen Ten stock picks | | 12/29/23 | 12/27/24 | Gain |
|---|---|---|---|---|
| ACGL | ARCH CAPITAL GROUP LTD | 74.61 | 92.67 | 24.2% |
| AMZN | AMAZON | 151.54 | 229.05 | 51.1% |
| CTVA | CORTEVA INC | 47.83 | 57.48 | 20.2% |
| HRMY | HARMONY BIOSCIENCES HOLDINGS INC. | 31.10 | 34.06 | 9.5% |
| KNSL | KINSALE CAPITTAL GROUP | 334.10 | 470.95 | 41.0% |
| MELI | MERCADOLIBRE INC. | 1,562.61 | 1,743.29 | 11.6% |
| META | META PLATFORMS INC. | 351.32 | 607.75 | 73.0% |
| MHO | M/I HOMES | 135.40 | 136.11 | 0.5% |
| MSFT | MICROSOFT | 373.86 | 439.33 | 17.5% |
| NVDA | NVIDIA CORPORATION | 49.24 | 140.22 | 184.7% |
| Zen Top 10 | | | | 43.3% |
| Vanguard Ttl Stock Mkt | | 237.33 | 297.12 | 25.2% |

If you are a long-term investor who does not have time to play around in the market, the Zen Ten might be the right model portfolio for you. But if you are more active in the market, there are some decent bargains out there that cannot be ignored. The following two models – one for stocks and one for ETFs – are not subject to the one-year minimum holding period.

## Top picks for January 2025

This list differs from the previous one in the fact that I have the flexibility to make changes to the lineup at the end of each month. Some months there may not be any changes, and other months the complete list could change, although that would be very rare. The suggested holding period for these picks is 12 months or longer. It's not a short-term trading list. If you want trading ideas, follow this link.

# This month's top stock picks

| Name | Ticker | 12/24/24 | VQG* |
|------|--------|----------|------|
| 🏛 CINEMARK HOLDINGS, INC. (XNYS:CNK) | CNK | $ 30.71 | 82.5 |
| 🏛 TXNM Energy, Inc. (XNYS:TXNM) | TXNM | $ 48.81 | 89.1 |
| 🏛 BRINKER INTERNATIONAL, INC. (XNYS:EAT) | EAT | $ 137.19 | 86.6 |
| 🏛 Qifu Technology, Inc. (XNAS:QFIN) | QFIN | $ 38.00 | 81.7 |
| 🏛 PINNACLE WEST CAPITAL CORPORATION (XNYS:PNW) | PNW | $ 85.61 | 87.4 |
| 🏛 S&P 500 INDEX | INX | 6040.04 | |

*VQG is the combined scores for Value, Quality, and Growth. 100 is the max score.

# This Month's Top ETF picks

| Name | Ticker | 12/24/24 | Rating* |
|------|--------|----------|---------|
| 🏛 iShares Bitcoin Trust (XNAS:IBIT) | IBIT | $ 56.23 | 92.7 |
| 🏛 IShares:Gold Trust (ARCX:IAU) | IAU | $ 49.39 | 93.1 |
| 🏛 VanEck:VG and eSports (XNAS:ESPO) | ESPO | $ 84.45 | 87.8 |
| 🏛 T Rowe:Blue Chip Gro ETF (ARCX:TCHP) | TCHP | $ 43.65 | 88.6 |
| 🏛 RBB:Motley Fool 100 Idx (BATS:TMFC) | TMFC | $ 62.08 | 84.6 |
| 🏛 S&P 500 INDEX | SPX | 6040.04 | |

*Rating is based on momentum and money flow. 100 is the max score.

# Asset allocation

**Our Current Asset Allocations as of 12/24/24**

I made two changes to the model portfolios this month. I moved a small amount of money from Private Equity (which looks fully priced to me) to hedging vehicles like the inverse S&P 500 ETF (**SH**). This short position will increase if the models call for it.

The model portfolios are tactical in the sense that they reflect changes in my bullish/bearish posture towards various asset classes and the market in general. They are designed to minimize short term trading and are meant for long tterm investors.

The cash allocation of 5% is about average for a bull market like we're in now. If the Fed overplays its hand and keeps rates too high for longer than necessary, we could see a market correction of 10% or more. If that were to happen, I want to have cash on hand to take advantage of it.

| Asset Class - Taxable | Percent Allocation |
|---|---|
| **Summary** | |
| **Stocks** | 55.0 |
| **Bonds** | 30.0 |
| **Commodities** | 7.0 |
| **Cash** | 5.0 |
| **Non-traditional assets** | 3.0 |
| | 100.0 |
| **Details** | |
| US Large Cap Stocks | 9.0 |
| US Mid Cap Stocks | 12.0 |
| US Small Cap Stocks | 12.0 |
| **US Stocks Total** | 33.0 |
| Intl Developed Mkt Stocks | 10.0 |
| Intl Emerging Mkt Stocks | 12.0 |
| **Non-US Stocks Total** | 22.0 |
| US Core 1-5 yr Treasury Bonds | 8.0 |
| US Muni Bonds | 3.0 |
| US IG Corporate Bonds | 7.0 |
| US High Yield Bonds | 3.0 |
| **US Bonds Total** | 21.0 |
| Intl Developed Mkt Bonds | 5.0 |
| Intl Emerging Mkt Bonds | 4.0 |
| **Non-US Bonds Total** | 9.0 |
| **Cash Total** | 5.0 |
| Energy | 2.0 |
| Precious Metals | 5.0 |
| **Commodities Total** | 7.0 |
| Hedging Vehicles | 1.0 |
| Private Equity | 2.0 |
| **Non-traditional assets Total** | 3.0 |
| | 100.0 |

| Asset Class - Deferred | Percent Allocation |
|---|---|
| **Summary** | |
| **Stocks** | 54.0 |
| **Bonds** | 28.0 |
| **Commodities** | 8.0 |
| **Cash** | 5.0 |
| **Non-traditional assets** | 5.0 |
| | 100.0 |
| **Details** | |
| US Large Cap Stocks | 8.0 |
| US Mid Cap Stocks | 11.0 |
| US Small Cap Stocks | 12.0 |
| **US Stocks Total** | 31.0 |
| Intl Developed Mkt Stocks | 10.0 |
| Intl Emerging Mkt Stocks | 13.0 |
| **Non-US Stocks Total** | 23.0 |
| US Core 1-5 yr Treasury Bonds | 8.0 |
| US Muni Bonds | 0.0 |
| US Corporate Bonds | 8.0 |
| US High Yield Bonds | 4.0 |
| **US Bonds Total** | 20.0 |
| Intl Developed Mkt Bonds | 4.0 |
| Intl Emerging Mkt Bonds | 4.0 |
| **Non-US Bonds Total** | 8.0 |
| **Cash Total** | 5.0 |
| Energy | 2.0 |
| Precious Metals | 6.0 |
| **Commodities Total** | 8.0 |
| Hedging Vehicles | 2.0 |
| Private Equity | 3.0 |
| **Non-traditional assets Total** | 5.0 |
| | 100.0 |

As of 12/24/2024

# Asset Class Weighting

| | Under | Neutral | Over |
|---|---|---|---|
| **Cash** | | ⇔ | |

| | Under | Neutral | Over |
|---|---|---|---|
| **Equities** | | ⇔ | |
| US large cap growth | | ⇔ | |
| US large cap value | | ⇔ | |
| US mid cap | | | ⇑ |
| US small cap | | | ⇑ |
| Intl developed markets | | ⇔ | |
| Emerging markets | | | ⇑ |

| | Under | Neutral | Over |
|---|---|---|---|
| **Bonds** | | | ⇑ |
| US Treasuries | | | ⇑ |
| US TIPS | | ⇔ | |
| US Munis | | ⇔ | |
| US IG corporate | | | ⇑ |
| US high yield | | ⇔ | |
| EM US currency | | ⇔ | |
| EM local currency | | ⇔ | |

| | Under | Neutral | Over |
|---|---|---|---|
| **Alternatives** | | ⇔ | |
| Precious metals | | | ⇑ |
| Energy | | | ⇑ |
| Private Equity | | ⇔ | |
| Hedging vehicles | ⇓ | | |

As of 12/24/2024

# Final Thoughts

After strong years for equities in 2023 and 2024, I see further upside in 2025. I expect the S&P 500 to reach 6,600 by the end of 2025, around 10% higher than today's levels. If tariff negotiations devolve into tariff wars, I expect a spike in volatility. The market could correct by 10-12% but long term investors should stand pat and look for bargains.

I view the outlook for US equities as constructive from a macroeconomic and structural standpoint. The combination of resilient US growth and lower Fed rates has historically been a powerful combination for US stocks. In the past, when the Fed cut rates and the US did not enter recession, US equities rose 18% on average in the 12 months after the first Fed rate cut. That was in September 2024.

The September earnings season showed that AI spending intentions remain strong, supporting my positive outlook on US technology stocks. Earnings growth is also broadening into non-tech businesses in the US, a trend which could be further supported by US deregulation and tax cuts.

Valuations are quite high in a historical context. On a 12-month forward price-to-earnings ratio basis, the S&P 500 currently trades at 22.2x versus a 20-year average of 16x. But I believe this valuation is justified by the healthy US economic backdrop and the high degree of exposure to structural growth.

The US economic backdrop is supportive, the market is less at risk from tariffs than other international markets, and structural trends around AI and power and resources bolster the outlook. AI-related companies that span semiconductors, cloud service providers, devices, and data centers account for over one-third of the S&P 500 by market cap. I expect around 10% S&P 500 earnings per share growth in 2024 and 16% in 2025.

Until next time,

Erik

# Appendix

## The Data Driving the Equity Market Traffic Lights

**Fundamentals are green.** Revenues, earnings, and profit margins are improving. Credit conditions are tight bbut loosening of late.

**Technicals are yellow,** indicating near term caution while still supporting a healthy longer term outlook. Bear in mind that these technical readings are prone to quick reversals during counter-trend rallies and corrections.

**Valuation remains stuck on red** as it continues to be the biggest threat to the market. High valuations alone can't trigger a bear market. They need help from the other factors.

**Risk** is yellow. While the threat of recession is low, it remains a possibility, especially if the Fed makes a serious policy error.

| Fundamental | Jul | Aug | Sep | Oct | Nov | Dec est |
|---|---|---|---|---|---|---|
| Revenue & Earnings | 2 | 3 | 3 | 3 | 2 | 2 |
| Profit Margins | 2 | 2 | 2 | 3 | 2 | 2 |
| Credit Conditions | 4 | 4 | 4 | 4 | 4 | 4 |

| Technical | Jul | Aug | Sep | Oct | Nov | Dec est |
|---|---|---|---|---|---|---|
| Momentum | 3 | 4 | 4 | 3 | 3 | 3 |
| Breadth | 3 | 3 | 3 | 4 | 4 | 4 |
| Leadership | 4 | 3 | 3 | 3 | 3 | 4 |

| Valuation | Jul | Aug | Sep | Oct | Nov | Dec est |
|---|---|---|---|---|---|---|
| Price Ratios | 7 | 7 | 7 | 7 | 8 | 8 |
| Risk Premium | 7 | 7 | 7 | 7 | 8 | 8 |
| Return Ratios | 6 | 6 | 6 | 6 | 7 | 7 |

| Risk | Jul | Aug | Sep | Oct | Nov | Dec est |
|---|---|---|---|---|---|---|
| Recession Threat | 3 | 3 | 4 | 3 | 3 | 4 |
| Bear Mkt Threat | 2 | 2 | 2 | 2 | 2 | 2 |
| Volatility | 4 | 5 | 4 | 4 | 4 | 4 |

# The Data Driving the Recession Warning Traffic Lights

Where do the traffic lights get their signals? From a set of coincident indicators shown in this table. The numbers range from 1-10, with 1 being the best possible condition for each indicator. The benefit of showing this board is that it tracks the trend of each indicator over the last 6 months.

Readings higher than 7 will be highlighted in red. When the board begins to turn from green to yellow, it's time to adopt a more defensive posture. But for now, stay fully invested, with perhaps 5% cash.

**Recession Watch**

| Indicator | Jul | Aug | Sep | Oct | Nov | Dec est |
|---|---|---|---|---|---|---|
| R-Score | 5 | 4 | 3 | 3 | 3 | 3 |
| Employment | 4 | 5 | 4 | 4 | 3 | 3 |
| Ind Production | 3 | 4 | 3 | 3 | 3 | 3 |
| Credit & Debt | 6 | 6 | 6 | 6 | 6 | 6 |
| Market Trend | 3 | 5 | 4 | 3 | 3 | 3 |
| Market Stress | 4 | 4 | 4 | 4 | 4 | 4 |
| Earnings Trend | 2 | 2 | 3 | 2 | 3 | 3 |

**R-Score**. This indicator combines the treasury yield curve, inflation, and unemployment. It's listed first because it has the strongest predictive value of all the indicators on this board.

**Employment.** Year-over-Year % Change in private non-farm employment.

**Ind Production**. Year-over-Year % Change in industrial production.

**Credit & Debt**. Difference between Junk bond and Treasury bond yields.

**Market Trend**. Year-over-Year % Change in the S&P 500 index.

**Market Stress**. Combination of stock market price change and the Year-over-Year % change in the unemployment rate.

**Earnings Trend**. Year-over-Year % change; Beats; Revisions; Analyst rating upgrades.

## How to use the data tables

The numbers in the data tables may look a little simplistic but rest assured that quite a lot of thought and effort went into translating the raw data coming out of government and industry sources and putting them in a format that is simple and intuitive to grasp. Each of the numbers is an expression of the percentile rank (deciles) for the category.

I could have, for instance, just reported the raw numbers as published, but that would assume that readers could gauge the significance of the raw numbers. If you happen to have an advanced degree in macroeconomics, it might work for you. But for the rest of us, I think simple is better.

The way I recommend using the data is to scan each line and look at the changes in trend. If you notice that an indicator has recently changed direction, you might want to find out why. And whether it's significant in the larger picture.

I went a step further and created a traffic light metaphor to summarize what all of the individual indicators were saying. The probability speedometers do something similar, by taking lots of raw data points and converting them into a single number that represents the likelihood that an event – a bear market or a recession – might arrive within the next 4-6 months.

All of this work is in the service of one thing – managing the asset allocation and risk profile of your portfolio. As the risks increase, so should your cash and hedging positions. When risks are low, you can be as aggressive as your investment plan allows.

As always, comments and questions are encouraged.