TJT CAPITAL GROUP
REGISTERED INVESTMENT ADVISOR

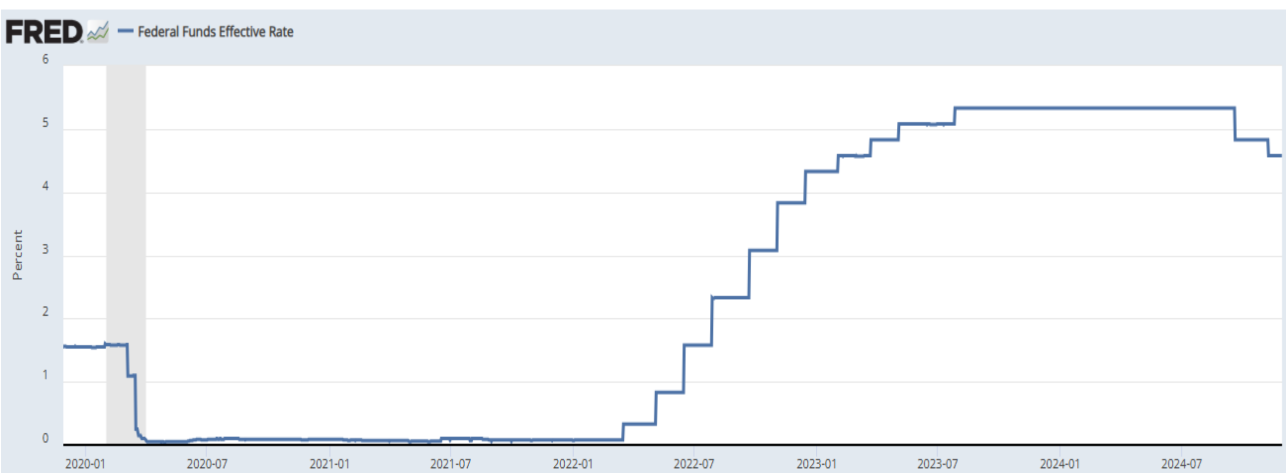
On Our Radar – December 2024

Following the highly anticipated presidential election, the S&P 500 index rallied 5.7 percent in November and closed above 6,032 for the first time. This advance was driven by the resolution of election uncertainty and the absence of a contested outcome, which prompted the unwinding of negative bets and a wave of fresh capital investments. Meanwhile, the 10-year U.S. Treasury Note saw its yield decline by 10 basis points (0.10%) during the month, ending at 4.18 percent, as the Federal Reserve implemented its second interest rate cut of the year. Oil prices remained relatively stable, holding just below $69 per barrel.

TJT Capital Group's InVEST Risk Model ® has helped our clients participate in bull markets and protect capital from the devastation of bear markets by focusing on 5 indicators that really matter when it comes to determining the health and direction of markets. The following is the most recent update.

Interest Rates (Monetary Policy)

The Federal Reserve lowered its policy interest rate by 25 basis points (0.25%), adjusting the federal funds target range to 4.50–4.75 percent. Alongside this move, the Fed will continue reducing its balance sheet, which currently stands at approximately $6.9 trillion. Fed Chairman Jerome Powell emphasized that the central bank aims to gradually transition toward a neutral policy stance but indicated they are in no hurry to lower rates.



As we've previously noted, the Fed's approach to measuring inflation has often shifted based on which metric aligns more closely with its 2 percent target. For years, the Fed's preferred gauge was Core PCE (personal consumption expenditures excluding food and energy). During an October 2023 speech at the Economic Club of New York, Mr. Powell reiterated this preference, stating, "Core PCE inflation, which omits the volatile food and energy components, provides a better indicator of where inflation is heading."

However, with Core PCE inflation rising to 2.8 percent year-over-year, Powell and other Fed officials have recently turned their attention to the headline PCE figure, which shows a more modest 2.3 percent annual increase. While Core PCE has declined from its 2022 peak of 5.58 percent, progress has stalled in recent months.

The Federal Open Market Committee (FOMC) is set to reconvene on December 17–18, 2024, to evaluate whether another rate cut is warranted in light of these developments.

Valuation

Recent revisions place the S&P 500's earnings estimates for 2024 at approximately $234, with projections for 2025 rising to around $273. The index's forward Price/Earnings (P/E) ratio currently exceeds 22, which, while below the March 2020 peak of 24.4, remains elevated by historical standards. Furthermore, high-yield credit spreads compared to investment-grade bonds are now at their tightest levels in 17 years.

Economic Cycle

The U.S. economy grew at an annualized rate of 2.8 percent in the third quarter, buoyed by resilient consumer spending. While some sectors showed strengthening investment, the housing market continued to struggle due to rising mortgage rates following the Federal Reserve’s 50-basis-point (0.50%) rate cut in September.

Economic indicators remained positive. The Institute for Supply Management (ISM) Services Index rose to 56, indicating solid expansion, while October retail sales increased 0.4 percent month-over-month. Consumer confidence climbed to 111.7 in November, marking its highest level since February.

However, the labor market presented a more complex picture. Although the official unemployment rate stood at 4.1 percent, the Bureau of Labor Statistics recently revised job numbers downward by 1.24 million for the year ending June 2024, adding a note of caution to an otherwise strong economic narrative.

Sentiment

Investors Intelligence reports bullish sentiment at approximately 60 percent, with bearish sentiment at around 17 percent. This optimistic outlook is fueled by several factors, including the resolution of the election without contestation, expectations for a more growth-oriented and deregulated economy, the potential for future tax cuts, and initiatives aimed at reducing wasteful government spending.

Technical Factors

At the end of November, approximately 69 percent of stocks were trading above their 50-day moving average, rebounding from a recent dip in the mid-50s but still below the late September peak of around 82 percent.

Despite the major market averages reaching new highs, notable weaknesses have emerged in specific areas, including healthcare and segments of the technology sector, such as semiconductor equipment. These declines reflect concerns over future drug pricing and the potential for additional tariffs on China.

Outlook

The Eurozone economy grew by 0.4 percent in the third quarter, as Germany - its largest economy – eked out a modest 0.2 percent expansion. In October, the European Central Bank (ECB) cut interest rates by 25 basis points (0.25%) to support economic growth even as it forecasted a potential rise in inflation in the coming months.

The Bank of England (BOE) also lowered interest rates by 25 basis points (0.25%), citing a 0.1 percent economic growth rate in the third quarter. At the same time, the BOE raised its inflation outlook, signaling concerns about price pressures.

Japan's economy rebounded with 0.3 percent growth in the third quarter, following two consecutive quarters of year-over-year declines. Meanwhile, China introduced a massive $1.4 trillion stimulus package aimed at bolstering economic growth amid an intensifying property slump and weaker-than-expected industrial production.

Following the election, optimism surrounding the incoming Trump administration's agenda of reducing regulation, fostering a pro-growth environment, and improving government efficiency has fueled market advances. However, concerns over potential increased tariffs have pressured certain sectors, particularly autos, while uncertainty over drug pricing has weighed heavily on the pharmaceutical industry.

President-elect Trump has proposed additional tariffs of 10 percent on all Chinese imports and 25 percent on goods from Canada and Mexico. These potential measures have prompted some companies to stockpile goods in anticipation, fearing the end of the free trade agreement signed in 2020. If enacted, these tariffs could spark retaliation from Beijing and disrupt trade dynamics.

The proposed Department of Government Efficiency (DOGE) could significantly address rising U.S. debt, which has surpassed $36 trillion — a 56 percent increase since 2020 — resulting in annual interest expenses exceeding $1 trillion. The U.S. budget deficit reached $1.8 trillion for fiscal year 2024, with projections by the Congressional Budget Office (CBO) suggesting it could rise to $2.8 trillion by 2034. Notably, the Department of Defense - with an $880 billion annual budget - failed its seventh consecutive audit, and Medicare and Medicaid reportedly lose over $100 billion annually to fraud. If successful, the focus on efficiency and audit compliance could pave the way for future tax rate reductions.

Meanwhile, geopolitical risks continue to escalate. Ukraine's use of U.S.-made missiles to strike inside Russian territory has prompted President Vladimir Putin to sign a decree authorizing the use of nuclear weapons if an attack was aided by a nuclear power. In response, Russia has intensified its attacks on Ukraine's energy infrastructure. The ceasefire between Israel and Hamas has faltered, with accusations of violations on both sides, and a civil war has reignited in Syria, including reports of Russian airstrikes on Aleppo rebels.

Domestically, the trajectory of the second Trump administration's policies and their impact on the economy have yet to been seen. In addition, geopolitical tensions seem to be escalating around the world, which could increase the likelihood of a pause or correction. (12.4.24)