Coffee & Commentary

January 20, 2025

Good Morning!

Welcome to Coffee & Commentary, presented by Alpha Zero's Managing Partner and CIO, Eric Mechler CFP®, ChFC®, AIF®, BFA™, RICP®.

Let's get started.

1. What is currently impacting financial markets?

- After a sluggish start to the week, stocks surged on Wednesday and Friday, propelling the major U.S. indexes to weekly gains of approximately 2% to 4%. This marked only the second positive week out of the last six for the S&P 500, which ended Friday less than 2% shy of its record high reached on December 6. Final results on the week were; S&P 500 +2.9%, Nasdaq +2.4%, and the Dow +3.7%.
- Yields on U.S. government bonds retreated, reversing from their highest levels in over 14 months and pausing a surge that began last September. The 10-year Treasury note closed at approximately 4.61% on Friday, down from 4.77% the week before.
- Stocks rose and bond yields dropped on Wednesday following the release of the latest Consumer Price Index report, which indicated a pause in the recent trend of stronger-than-expected inflation readings. In December, core CPI, which excludes food and energy prices, increased at an annual rate of 3.2%—slightly lower than the prior month and below economists' forecast of 3.3%.

2. How are we to prepare and act?

- The early days of 2025 have been marked by a dynamic blend of market volatility and cautious optimism, shaped by the interplay between inflation trends, bond yields, and corporate earnings. As mentioned above, bond yields briefly touched a 14-month high, reflecting market concerns about inflation and the Federal Reserve's measured approach to interest rate cuts. However, recent inflation data offered some relief, marking the first decline since July and easing fears of a reacceleration in prices. This moderation in inflation, alongside robust economic growth and strong labor market conditions, underscores the complexity of the Fed's decision-making process. While the Fed has reduced rates from their 2023 peak, it has signaled no urgency for further cuts, citing the need to balance inflationary pressures with a resilient economy. Historically, bond yields tend to peak around the end of rate-hike cycles, and the Fed's current stance suggests that yields may stabilize or decline from here.
- As for the stock market, the focus is shifting from valuation-driven gains to earnings growth as the primary driver of returns, especially in light of higher interest rates that have pressured valuations. Early reports from major financial institutions indicate a robust start to the fourth-quarter earnings season, with S&P 500 profits expected to grow by over 10% in 2025—representing the strongest earnings growth in three years. This momentum is crucial for sustaining the ongoing bull market, even as other factors like monetary policy and elevated valuations potentially limit upside potential. Policy uncertainty, including the potential impacts of new fiscal and trade initiatives, may contribute to bouts of market volatility, but these periods can provide opportunities for disciplined, long-term investors. Diversification across sectors, styles, and asset classes will remain critical, as will the ability to rebalance portfolios to take advantage of market dips. With inflation showing signs of easing, strong corporate earnings growth, and a labor market that remains robust, the fundamental drivers of the bull market appear intact.

3. Taking a look at the week ahead.

- Monday — Presidential inauguration and MLK Day
- Friday — University of Michigan Consumer Sentiment survey

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As always, here at Alpha Zero we believe knowledge is power and look forward to helping you Think Beyond What's Next.

Please feel free to share this newsletter with friends and family, and we thank you in advance for any introductions you send our way.

Have a great week and please reach out to us with any questions.

Sincerely,

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