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Wealth Advisory Market Update

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Market Update

Equity Markets:

The S&P 500 advanced 2.8% in January, but volatility increased throughout the month. Several factors contributed to this turbulence, including tariffs from the new administration, competition from China in artificial intelligence (DeepSeek), and the Federal Open Market Committee (FOMC) meeting alongside mixed economic data. We expect this trend to continue. After back-to-back 20% annual gains and record-high valuations, volatility and corrective activity are not only expected but also healthy. Our primary indicator for equity market vulnerability remains credit spreads. So far, they have remained tight so we have stayed close to fully invested despite stretched valuations. If credit spreads begin to widen, we will adopt a more cautious stance on equity allocations.

The market experienced a sharp sell-off in late January after DeepSeek, a Chinese company, announced AI advancements rivaling or surpassing ChatGPT at a lower cost. Consequently, large-cap tech stocks declined significantly, with Nvidia losing nearly $600 billion in market capitalization—the largest single-day market cap loss in history. Given the inflated multiples of these large-cap names, any negative news can trigger substantial sell-offs, affecting both individual stocks and the broader market.

The market remains heavily concentrated in the largest-cap companies. The top 10 constituents of the S&P 500 now account for a record 37% of the index's market capitalization. In our view, the S&P 500 is no longer a diversified index and is overly concentrated in a few large companies in one sector. Several times this year, we have seen instances where 75% of stocks rose while the S&P 500 ended the day lower because the technology sector was down. This is not a healthy market currently. The broader a market advance is the healthier and more sustainable that move will be. We continue to adhere to our disciplined investment approach, seeking opportunities in undervalued sectors and companies trading below their intrinsic value.

Economic Indicators and Monetary Policy:

The FOMC held rates steady in January, which was expected, but its more hawkish tone surprised markets. Initially, markets reacted negatively to the removal of the statement that "inflation has made progress toward the Committee's 2 percent objective," which was replaced with "inflation remains somewhat elevated." However, Chairman Jerome Powell later clarified that this change was not intended to signal a shift in policy but was merely a format adjustment. Powell reiterated that the economy remains strong, and while there were questions about tariffs, he declined to comment on fiscal policy, stating that the Fed will assess any implemented measures.

On the last trading day of January, the new administration announced plans to impose tariffs on Canada, Mexico, and China. Although this was a campaign promise, the market was unexpectedly rattled. However, we viewed the Mexico and Canada tariffs as negotiation tactics similar to those imposed on Colombia earlier in the month. This proved accurate, as both Mexico and Canada agreed to increase border security, leading to the tariffs being put on hold. As with any new policy, we will continue monitoring developments closely.

Economic data continues to diverge from the Fed's outlook. The latest Job Openings and Labor Turnover Survey (JOLTS) indicated significant labor market tightening, with job openings falling by over 550,000 to 7.6 million—well below the 8 million forecast and the second-lowest reading since COVID. Additionally, the personal savings rate declined by 50 basis points in a month to 3.8%, down from 4.3% in October. With consumer spending comprising a significant portion of GDP, any strain on consumer finances could lead to economic downturns. Data also suggests that many consumers are relying on credit to sustain spending, with 48% of credit cardholders carrying month-to-month debt and delinquencies steadily rising. This is not a good sign for our consumer driven economy looking forward.

Strategy:

Our equity strategy remains unchanged. We continue to follow our disciplined investment approach, which has proven successful over the long term. While overall market valuations are high, many companies still offer attractive risk/reward profiles.

Interest rates have risen in recent months, presenting a favorable opportunity to extend maturities in portfolios. Over the long term, we anticipate lower rates, as high debt levels tend to be deflationary. With the U.S. carrying $35 trillion in debt, future growth may be constrained. Credit spreads remain tight, indicating no immediate need to take on additional risk in higher-yielding bonds.

As we navigate this challenging environment, we appreciate the opportunity to collaborate and remain committed to prudent investment management.

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