Market Chronicles

Market Update: A Complex Start to 2025

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As the first full trading week of the year comes to an end, a confluence of factors is shaping the market's tone. December's robust payrolls report jolted markets with a rare dose of conviction, especially from traditional asset managers, marking their most significant engagement so far this year. Yet, this newfound activity underscores the fragility and uncertainty that has defined 2025 so far.

A higher-rate environment, persistent inflation risks, deficit spending, stretched valuations and elevated cash levels funneled into US markets leave many questions unanswered. With corporate earnings expectations at lofty levels, the battleground for clarity may well be this earnings season.

Liquidity in focus: A tale of two markets

Despite a strong institutional flow throughout 2024—the best seen in nearly a decade—the close of the year hinted at a shift. Following the hawkish tone of the December Federal Open Market Committee (FOMC) meeting, trading patterns softened, complicated by holiday seasonality and the looming uncertainties of a presidential transition.

Yet, market volumes tell a different story. Over the fragmented final weeks of 2024, daily trading averaged an eye-popping 14.6 billion shares, with spikes above 20 billion on certain days. Off-exchange volumes surged, driven by retail order flow dominating wholesaler activity,

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creating a liquidity dynamic far removed from the institutional balance that defined most of last year.

This divergence has become particularly evident in the prevalence of sub-$5 stocks among the most-traded names, reflecting a surge in lower-quality retail-driven activity. Volumes in the $1 – $5 category saw a notable uptick in Q4, climbing to over 20% of total market volumes.

Retail resurgence: The Trump 2.0 effect

The November election victory of Donald Trump, combined with 2024's strong US equity performance, has set the stage for an expansion of retail trading activity. Historically, retail participation aligns closely with equity market performance, fluctuating between 10% and 20% of total volumes depending on market conditions.

Proposed deregulatory policies promise to further fuel this trend, potentially boosting retail trading platforms and expanding their product offerings. Wholesalers stand to benefit from reduced regulatory pressure, while emerging avenues like crypto trading and prediction markets add growth opportunities. However, this shift could challenge market health metrics such as depth, spreads, and execution costs, especially if retail flows proliferate while traditional asset managers move to the sidelines.

Earnings season: High stakes amid volatility

The spotlight now turns to earnings season, where consensus forecasts call for 7.5% growth in Q4—a robust figure, second only to the highest pre-season expectations in three years. Early results from major banks, including JPMorgan Chase, Bank of America, and Morgan Stanley, have all exceeded expectations, lending early support to this forecast. With implied volatility in S&P 500 names averaging a 4.7% move on earnings days, this season is poised to deliver significant price swings.

Last Friday's 1.74 standard deviation drop in the S&P 500 brought strong institutional conviction—which has been rare so far in 2025. Breadth indicators on Monday offered a glimmer of optimism as equal-weighted S&P 500 outperformed cap-weighted by 60 basis points, a welcome shift after December's narrow market leadership. If earnings results continue to impress across sectors, this breadth could improve further. Conversely, weak results in other areas could tighten leadership back to a narrower set of outperformers.

Still, elevated expectations remain a double-edged sword. Two consecutive years of 20%+ market returns have stretched valuations, and any misstep in earnings could exacerbate volatility. While bank earnings have delivered strength, underperformance in other sectors or individual names could trigger broader market reactions, keeping the stakes high this season. Traders and portfolio managers look to the volatility bands to set entry and exit points. And while all earnings seasons carry a high level of importance, this one seems to be particularly under the microscope.

Navigating the road ahead

Traders should remain vigilant, particularly in high-volatility scenarios. Implied price ranges derived from options markets can provide valuable guidance for entry and exit points. Broader sell-offs could also strain liquidity, leading to wider spreads, lower dark pool volumes, and increased execution risks.

As we navigate the early days of 2025, markets face a delicate balancing act. Strong economic tailwinds from pro-growth policies may sustain the rally, but the shifting liquidity dynamics and elevated earnings expectations demand careful attention.

Good luck in earnings season.

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