

Sabrient Systems Sector Detector

December 9, 2025



Stocks eye a third straight banner year, so why is socialism gaining traction?

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Overview

Bullish conviction was severely tested in November for the first time since the April “Liberation Day” selloff. All the naysayers quickly piled on with warnings of an AI bubble and financial returns on immense capex not being realized for many years, if ever. To make matters worse, they warned of sluggish global liquidity growth in the face of rising debt and an impending “debt maturity wall,” i.e., enormous government and corporate refinancing that could overwhelm capital markets, surge borrowing rates, tighten lending standards, crowd out smaller businesses, and thereby constrain economic growth. But alas, the fear didn’t last long, as the old “bad news is good news” narrative was resurrected to predict increasingly dovish Fed monetary policy would save the day. Indeed, it appears that the S&P 500 still has a shot at finishing 2025 with its third straight year of 20%+ returns (which would be only the second time in history, after the five straight years of the 1995-99 dotcom/Y2K run). And yet the K-shaped economy (i.e., investor/creditor class vs. working/debtor class) is leaving too many citizens behind, particularly young and working-class people.

Remember the famous quote from the fearsome heavyweight champion boxer Mike Tyson, “*Everyone has a plan until they get hit in the face*”? Well, Steve Forbes had a similar quote for the stock market, “*Everyone is a disciplined, long-term investor...until the market goes down.*” Indeed, the AI-driven bull run seemed uninterrupted for over six months, with the S&P 500’s 50-day moving average providing reliable support all along the way...at least until 11/17 when for the first time in 138 days (since 4/30) the index closed below its 50-day moving average and triggered a panicky selloff. And then even after another incredible earnings report on 11/19 from market leader NVIDIA (NVDA) that sent the market surging higher on 11/20, by mid-day it came crashing back down on news suggesting maybe the jobs market really wasn’t so bad, which led to worries that the Fed might not cut this month after all, and the market finished the day with a big, ugly, red bearish-engulfing candle. As they say, the more overbought, the worse the correction.

But thankfully, that big, bad, bearish-engulfing candle turned out to be a double-bottom (with the 10/10 low). The S&P 500 found support at its 100-day moving average and then embarked on a rally that has almost entirely retraced its fall from October’s all-time high. It has largely been a speculative “junk rally,” led by the “meme” stocks—like the Roundhill Meme Stock ETF (MEME) and the iShares Micro-cap ETF (IWC), followed by the lower-quality small-cap iShares Russell 2000 (IWM), in which about 40% are unprofitable, then the higher-quality small-cap SPDR S&P 600 (SPSM), in which all are required to be profitable for index entry, and with the mid and large caps trailing behind. Defensives have lagged since April, as illustrated in the chart below showing the ratio of the S&P 500 Low Volatility (SPLV) divided by the S&P 500 High Beta (SPHB), which after a brief jump during the November pullback has returned to its extreme low.

Interestingly, the stock market briefly added a new member of the \$1 trillion market cap club during the broad market correction, with drugmaker Lilly & Co. (LLY) enjoying a huge November surge (along with much of the Healthcare sector overall, in a mean reversion catch-up), largely driven by sales in its weight-loss drug Zepbound. So, as LLY pulled back, the trillion-dollar club today is back to 10 members—the original MAG-7 (NVDA, AAPL, GOOGL, MSFT, AMZN, META, TSLA) plus Broadcom (AVGO), Taiwan Semi (TSM), and Berkshire Hathaway (BRK.B).

Short-term technicals on the broad market indexes overbought once again but still well supported within a bullish uptrend. Nevertheless, for the S&P 500 to hit the 20% return mark for the year will require a bullish catalyst. Most likely it will be the highly anticipated Fed rate cut this week, and importantly, some soothingly dovish words from chairman Jay Powell on additional easing measures plus guidance on the “dot plot” of future rate cuts. However, he can’t be overly



dovish as to bring out the “bond vigilantes” in protest, spiking longer-term yields, which would not be favorable for stocks. Market maven Jim Bianco said in an [interview](#) on The Money Path that he thinks the tell will be in the number of FOMC member dissents on the expected rate cut, with several dissenters mollifying the bond vigilantes and no dissent angering them. So, Powell walks a tightrope on this, and messaging matters.

Regardless, the liquidity cycle is turning back up, with the Fed already halting its balance sheet reduction (quantitative tightening or QT) as of 12/1, and with more rate cuts in the offing, plus perhaps relaxed capital requirements for banks (like the enhanced supplementary leverage ratio or eSLR) and some form of “QE-lite” to gradually re-expand its balance sheet without antagonizing the bond market. All of this should result in rising M2 money supply. In addition, China has introduced fiscal stimulus and monetary tactics like repurchase operations (“repo”) and a lowered bank reserve requirement ratio (RRR). Furthermore, supply chain pressures are muted, fiscal expansion is underway with lower tax rates and less red tape from the One Big Beautiful Bill Act (OBBBA), and money market funds (aka cash on the sidelines) exceed \$8 trillion (the highest ever).

In fact, the Atlanta Fed’s GDPNow is projecting real GDP growth of 3.5% growth in Q3, and forecasters think Q1 2026 might see US growth above 4% given the imminent fiscal impulse (including massive tax refunds in Q1) that should boost the struggling consumer. So, aggregate demand would be expected to rise, likely above the rate of aggregate supply since demand can shift much faster than supply can adjust to match. This would lift asset prices initially, which could be inflationary. As such, some market commentators believe the fed funds neutral rate should match the current rate of *nominal* GDP growth of 5-6%.

I’m not one of those people. I think any short-term inflationary pressures will be fleeting and offset by the secular disinflationary pressures I often describe: Global Supply Chain Pressure Index (GSCPI) continues to hover at or below the zero line (i.e., its historical average), the benefits of globalization (including comparative advantage) persist despite some strategic onshoring and supply chain diversification, there is a deflationary impulse from China as it dumps cheap goods on the world market in the face of weak domestic demand, and productivity continues to increase through automation and disruptive innovation (including Gen AI).

So, my long-held view remains that a terminal/neutral rate near 3.0% seems right, and the latest fed funds futures suggest 66% odds we get there next year—and that likelihood should increase with the appointment of a new Fed chairman in May (most likely economist Kevin Hassett). Bond yields have normalized with the 10-year Treasury under 4.2%. The flatter yield curve is a market signal to the Fed that it should cut on the short end. The economy needs lower interest rates, including a 30-year mortgage closer to 5%, in tandem with business-friendly fiscal policy and a weaker dollar to: a) sustain rising global liquidity, b) relieve indebted consumers and businesses, c) support US and global economies, and d) avert a global credit crisis. And once that neutral rate is achieved, the Fed can go back into the shadows where it was always intended to be and let fiscal, trade, and tax policies from Congress and the President dominate the news cycle. No more sitting on pins-and-needles at every FOMC meeting or Fed governor speaking engagement.

The return of the “bad news is good news” outlook has fed funds futures solidified at 89% odds of a December cut on 12/10. It also has pushed stocks to within spitting distance of new all-time highs. But notably, bitcoin and other cryptocurrencies corrected much more sharply than stocks, mostly due to deleveraging, and have not yet bounced back like stocks have. Nevertheless, blockchain, tokenization, and stablecoin implementation continue to progress, so I’m not concerned about my crypto allocation—in fact, bitcoin might have just put in a bottom at its 100-week moving average.

Yes, uncertainty persists around trade deals, wars, rising debt, civil strife, stock valuations, a hesitant Fed, and potential government shutdown redux in late January. But investors are positioning for tax and interest rate cuts, deregulation, tame inflation, strong margins & earnings, improving revenue growth, re-privatization, re-industrialization, fast-tracking of power generation infrastructure, robust capex and share buybacks, rising liquidity, a potential “peace dividend,” and a continued flow of foreign capital into the US. Importantly, DataTrek pointed out that Q3 corporate revenue increased by a multi-year record of +8.4%, which is critical for future earnings power—as earnings growth via sales growth is better than cost cutting (higher quality earnings beats). Also, they point out that the percentage of after-tax operating earnings that paid for dividends and stock buybacks has fallen from 96% in 2018 to 81% today, which suggests the difference is being reinvested in business growth—and supports today’s elevated valuations.

In my full commentary below, I talk in greater depth about the K-shaped economy, electricity prices, earnings, debt, inflation, jobs, and Fed policy, as well as the difficulty in “turning the economic ship”—from overreliance on vast, stifling government spending to a robust, unleashed private sector—in the face of political obstructionism, a hostile media, and the impatience of voters in feeling the benefits of the newly passed fiscal stimulus package and the Fed’s monetary stimulus on affordability and mortgage rates, pushing many of them (especially young people and the lower-income/non-asset-holding working class) to shortsightedly embrace the “free stuff” promises of socialist candidates.

I close my commentary by revealing Sabrient’s latest fundamental-based SectorCast quantitative rankings of the ten U.S. business sectors, current positioning of our sector rotation model, and several top-ranked ETF ideas. Top-ranked sectors in Sabrient’s SectorCast model include Technology, Healthcare, and Financials. In addition, Basic Materials, Industrials, and Energy also seem poised to eventually benefit from fiscal and monetary stimulus, domestic capex tailwinds, a burgeoning commodity Supercycle, rising demand for natural gas for power generation, and more-disciplined capital spending programs.

History shows that rising GDP growth, stable inflation, and falling interest rates tend to favor small caps. And because small cap indexes are more heavily allocated to Industrials, Basic Materials, and Financials, enhanced infrastructure spending and a revved-up economy could disproportionately benefit them. Indeed, rather than a continuation of the FOMO/YOLO momentum rally on the backs of

a narrow group of AI leaders (and some speculative coattail riders), I expect the euphoria will be more tempered next year such that we get a healthy broadening and wider participation across caps and sectors and with a greater focus on quality and profitability. There are plenty of neglected high-quality names worthy of investment dollars. So, rather than the passive cap-weighted indexes, investors may be better served by active stock selection that seeks to identify under-the-radar, undervalued, high-quality gems primed for explosive growth. This is what Sabrient seeks to do in our various portfolios, all of which provide exposure to Value, Quality, Growth, and Size factors and to both secular and cyclical growth trends.

Concerningly, only 22% of active fund managers are outperforming their passive benchmark this year, largely due to the narrow market leadership from the AI-leading Big Tech titans. However, Sabrient has been performing well. We are best known for our 13-stock **"Baker's Dozen"** growth portfolio franchise, which is issued quarterly as a 15-month unit investment trust (UIT) by First Trust Portfolios, and each is designed to offer the *potential for outsized gains*. For example, the **Q1 2024 Baker's Dozen** terminated on 4/21/25 with a gross return of **+45.7%** vs. +8.2% for S&P 500, and the **Q3 2024** portfolio terminated on 10/20/25 up **+41.7%** vs. +24.1% for S&P 500.

In addition, last year's 33-stock **Forward Looking Value 12** terminated on 11/10/25 up **+19.9%** vs. +12.7% for the S&P 500 Value Index. Also, small caps tend to benefit most from lower rates and deregulation, and high dividend payers become more appealing as bond alternatives as interest rates fall, so Sabrient's quarterly **Small Cap Growth** and **Sabrient Dividend** (growth & income strategy) also might be timely as beneficiaries of a broadening market.

The Baker's Dozen growth portfolio and three offshoot strategies for value, dividend, and small cap all leverage Sabrient's process-driven, growth-at-a-reasonable-price methodology, which was developed by founder David Brown. All four strategies are described in his latest book, [*Moon Rocks to Power Stocks: Proven Stock Picking Method Revealed by NASA Scientist Turned Portfolio Manager*](#) (catch the low-price promotion this week only!). To learn more about both the book and the companion subscription product we offer (which does most of the stock evaluation work for you), please visit: <https://DavidBrownInvestingBook.com>

Click **HERE** to find this post online, as well as my latest presentation slide deck on Sabrient's portfolios and my 3-part series on "The Future of Energy, the Lifeblood of an Economy." *As always, I'd love to hear from you! Please feel free to email me your thoughts on this article or if you'd like me to speak on any of these topics at your event!*

Market Commentary

Ever since OpenAI's ChatGPT officially launched on 11/30/2022 (nearly three years ago), Nasdaq 100 (QQQ) is up +117% (as of 12/5), cap-weight S&P 500 (SPY) +75%, equal-weight S&P 500 (RSP) +36%, S&P 400 MidCap (MDY) +34%, Russell 2000 SmallCap (IWM) +39%. And then of course we have juggernaut NVIDIA (NVDA) up nearly +1,000%—and briefly eclipsing an incredible \$5.0 trillion in market cap, which is as large as Germany's GDP (the world's third-largest economy!)—due to its dominance in designing high-performance GPU semiconductors for AI infrastructure.

As 2025 comes to a close, this eventful year (the first of President Trump's new term) saw a rollercoaster of sentiment and market volatility, with Trump's "Liberation Day" rollout of onerous tariffs on every country in the world leading to 50+ spike in the VIX and broad rotation into international assets and currencies, but it turned out to be a tremendous buying opportunity as a low-quality "junk rally" ensued, driven by passage of the OBBBA, various peace accords, and massive AI-related capex (mostly for datacenters and associated infrastructure). And then most recently, we endured the longest federal government shutdown in history due to a political standoff over the 12 annual appropriations bills (discretionary spending for the fiscal year that runs 10/1-9/30), which is still not resolved but merely postponed by a temporary continuing resolution (CR) until the end of January. And yet stocks still have enjoyed another strong year, with the S&P 500 having a good shot at achieving another 20%+ return. This is primarily due to policymakers prioritizing economic growth through fiscal stimulus (lower taxes and deregulation) and supportive monetary policy.

DataTrek Research created this table showing the number of times each year since 1980 that the S&P 500 has peaked in a given month. Interestingly, history shows that the S&P 500 peaks in December 53% of the time. Moreover, history suggests that even if the 10/29 peak stands as the high for the 2025, the average annual return for an October peak is still a robust 19%.

The scourge of a K-shaped economy:

Although not a new topic, discussion has ramped up about the bifurcated K-shaped economy—i.e., market vs. real economy, Wall Street vs. Main Street, haves vs. have-nots, bourgeoisie vs. proletariat, investor/creditor class vs. working/debtor class—in which some citizens (high-wage and/or asset-rich) are doing just fine while the majority (lower-wage and/or asset-poor) are struggling and falling deeper into the hole. The Boston Federal Reserve observed that the wealthiest 10% of Americans (i.e., those who own the vast majority of assets like stocks and real estate and benefit immensely from asset inflation) not only own nearly 90% of US stocks but also account for roughly 50% of consumer spending—which are the highest percentages ever and illustrates our economy's unhealthy reliance on the spending habits of the wealthiest 10%.

How Often the S&P 500 has Peaked for the Year Each Month since 1980			
	Number of Years	Percent of Total	Average Total Annual Return
January	5	11%	-18.6%
February	1	2%	1.3%
March	1	2%	-9.0%
April	1	2%	2.1%
May	1	2%	1.4%
June	0	0%	N/A
July	1	2%	-3.1%
August	1	2%	5.8%
September	2	4%	5.8%
October	4	9%	19.0%
November	4	9%	20.2%
December	24	53%	21.9%

This divide started with the end of the dollar's gold standard in 1971 followed by hyper-financialization/deindustrialization of the US economy, emphasis on services over goods production, globalization of supply chains and the rise of China's mercantilist system (through WTO membership), decoupling of productivity vs. wage growth, the Internet boom, automation/digitization, Fed intervention/QE/ZIRP in response to the Global Financial Crisis, and the pandemic lockdowns (helicopter money, remote vs. in-person jobs). So, to summarize, our modern economy goes like this:

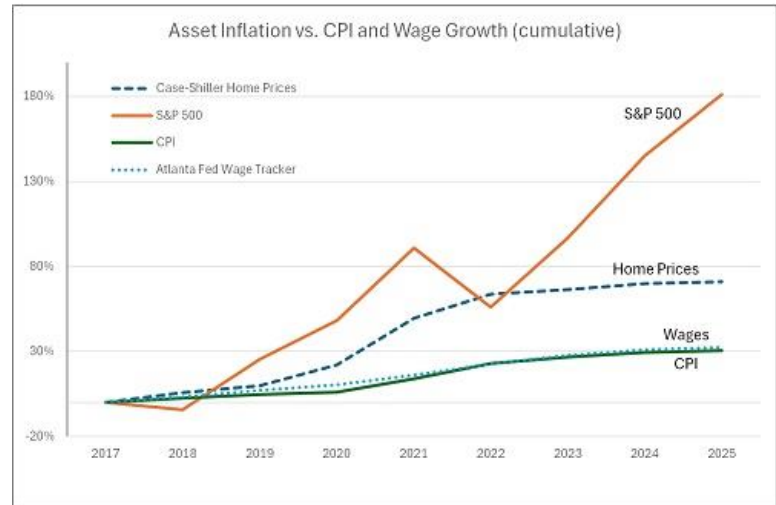
1. The US imports goods from abroad, for which foreign exporters receive dollars.
2. Those foreign exporters reinvest those dollars in US assets (foreign capital inflows, i.e., balance of payments).
3. This capital influx strengthens the US dollar and boosts asset prices—but also makes our exports more expensive, leading to more factory closures.
4. US asset owners have increased purchasing power, buying even more imports, and the trade deficit grows.
5. The K-shaped economy, income inequality, and the "wealth gap" worsen.

In a nutshell, America today primarily imports goods and exports financial assets, which tends to enrich asset owners (Wall Street) but undermines the working class (Main Street). Asset inflation has far surpassed consumer inflation and wage growth over the past several years, as illustrated in the chart below (annual cumulative data points). While home price appreciation has leveled off after the COVID-era jump, stocks have continued to surge.

This yawning divide is what got President Trump elected, and his administration has been working furiously to shore up working class jobs and reduce import dependency and the trade deficit by:

1. Incentivizing the reshoring of manufacturing jobs, deregulating domestic businesses, boosting domestic production, and protecting critical industries through both incentives ("carrot") and tariffs ("stick").
2. Scaling back the size and scope of low-ROI government spending and hiring and the deficit/GDP ratio, while reprivatizing the economy, cutting personal income taxes, and incentivizing the private sector.
3. Controlling immigration.

Of course, the capitalist, free market approach takes more time to germinate but is much more economically sustainable. It's like turning a supertanker. There is a lot of inertia in any large organization, but changing the federal government is much harder than a commercial enterprise due to the massive internal resistance ("the swamp") to anything new or contrary to the prevailing political mindset. Indeed, organizational failure might be preferred by some in order to regain political power. And then there is the impatience of a struggling electorate, most of whom do not objectively study and weigh the economic theories but simply react emotionally to political messaging and their immediate needs. Progress must show up fast—and it must be felt on Main Street not just Wall Street (so please stop talking about the stock market and rising 401k accounts, Mr. President!).



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As a result, some politicians and their constituents naively believe that the best or most compassionate approach is socialism and an ever-growing welfare state, including Universal Basic Income (UBI) and Medicare for All (including illegal/undocumented residents) as human rights, onerous regulation including limits on everything from divisive speech to free markets (and many of the Bill of Rights in our constitution), and open/sanctuary immigration. Britain is already far along this path.

Indeed, public impatience is on display in pricey urban areas like New York City and Seattle, both of which just elected socialist mayors. I think we can guess how that's likely to work out. After Zohran Mamdani's visit to the White House, it occurred to me that both he and President Trump were elected largely based on their populist views and desire to uplift the middle and working classes—although they have very different approaches to achieve it. In contrast to Trump's methodical plan outlined above for restoring a fairer capitalist system by "turning the supertanker," Mamdani's socialist approach is to immediately "rob Peter to pay Paul," tax the job creators to pay for Big Government and redistribute the spoils to provide free stuff, ranging from housing and childcare to healthcare and bus fare. As he said in his victory speech, *"We will prove that there is no problem too large for government to solve...."* This approach might provide faster relief for his residents, but it is wholly unsustainable (as every previous attempt at socialism has shown).

Of course, the capitalist view is that providing such largesse for free to all comers just incentivizes sloth while attracting the poor, unskilled, and uneducated of the world to come here to leech off the sweat of hard-working Americans. So, the biggest obstacle for President Trump's America-First, can-do agenda is overcoming the entrenched political obstructionism bent on sabotage (again, primarily to regain political power).

Notably, it is the progressive policies of New York that have directly worsened its affordability crisis. Rent control (which reduces housing supply) and a high minimum wage (which both reduces employment and is passed through to product pricing) are examples. Energy prices are another: According to a scathing [report](#) from the Progressive Policy Institute (whom you might expect to be sympathetic to New York's decarbonization goals and focus on renewable energy), *"New York's energy system is entering an environment where policy-driven pressures are converging to make the 2019 climate goals increasingly untenable. A combination of*

shrinking reliable energy supply, inflated demand growth, and mounting cost pressures is creating a collision course that threatens both grid stability and consumer affordability.... This collision is not accidental; it is the direct result of a policy framework that simultaneously dismantles reliable supply while mandating a surge in demand, with ratepayers bearing the inevitable and escalating cost."

New York electricity prices are 44% higher than the national average, with residential rates rising 36% since 2019 (3x faster than the rest of the country), and the power utilities are pursuing an additional 20% rate hike to address aging infrastructure, storm repairs, and rising operating costs. The report's author, PPI Managing Director Neel Brown, remarked in an interview, *"New York set bold climate targets, but ignored the economic and technical realities required to achieve them. The result is an energy system that is less reliable, more expensive, and now politically unsustainable."* I discussed this topic at length in my August [3-part series](#) on the Future of Energy.

Moreover, you can't have pockets of socialism within a large, free, capitalist country since the people with money can easily move to the next jurisdiction to escape the onerous taxation. As Margaret Thatcher once said, *"The problem with socialism is that you eventually run out of other peoples' money."* And as renowned economist Mark Skousen explains, *"Democratic socialism is all about sharing the poverty. Democratic capitalism is about sharing the wealth."* Indeed, as Swedish historian Johan Norberg noted regarding Sweden's renaissance from a democratic socialist malaise to a robust capitalist economy, it taxes the rich plenty, but it also taxes the poor at a fairly high rate. *"You can't turn your back on 'the well' (i.e., the wealthy),"* Norberg says.

But that doesn't mean Main Street isn't feeling the pinch, and they want real answers sooner than later (so please stop calling the "affordability" narrative a hoax, Mr. President!). The latest retail sales and consumer confidence metrics were not good. Rather than the 50-year mortgage suggestion that just further deepens indebtedness, another idea floated about for housing is to restrict the ability of big institutional investors and private equity firms from buying up homes—often to remodel and rent out, adding to our country's trend toward creating a society of renters, with the median age of first-time home buyers hitting 40 years old (compared to 33 just five years ago). I experienced this myself in 2022 in Scottsdale during the frantic spike in home prices, when it seemed that only those with full-cash offers well above asking price were winning the bidding war—and those winners were often institutional investors. It was quite frustrating.

Our founding fathers designed our federal system to restrain concentrated power, not to operate with the efficiency of a business. Their priority was to prevent tyranny through checks and balances, dispersed authority, and slow, deliberative policymaking. They believed some degree of conflict was healthy and that "ambition would counteract ambition"—but they also believed that elected officials would ultimately be guided by civic virtue and a shared commitment to preserving the republic. What they did not foresee was today's combination of entrenched polarization, nationalized media incentives, political rewards for obstruction rather than compromise, and full frontal assault on the US Constitution as Eurocentric, xenophobic, outdated, and in need of reinterpretation and redesign.

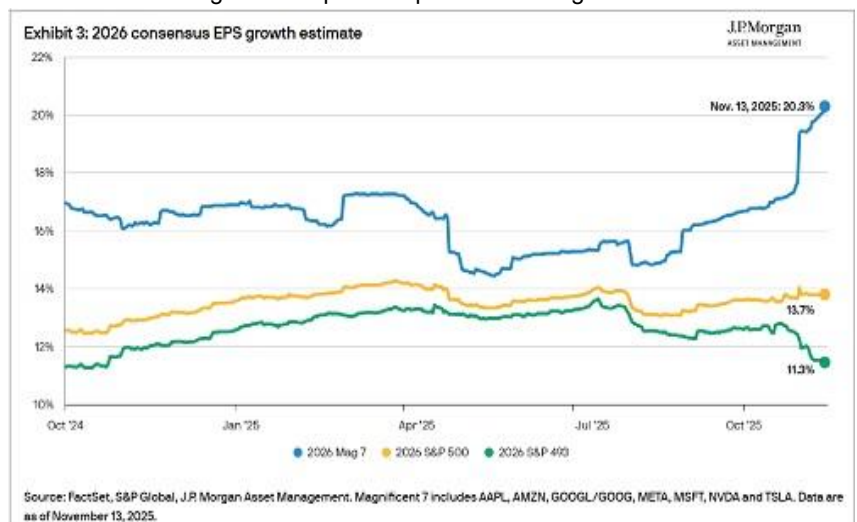
In a private company, the leaders can encourage and incentivize employees to work hard together for a few years toward a common goal. But garnering such unified common purpose in our federal government—plus cooperation from state and local governments—is an impossible task as there is little personal incentive to do so. Helping the other political party succeed, even for the good of the country, is political suicide. Perhaps one of our best and brightest will come up with better incentive structures for cooperation and collaboration in a federal constitutional republic, more akin to a private company. (Elon, are you listening?)

Here are a few ideas for overcoming this modern dysfunction. The system must somehow realign incentives so that cooperation is more beneficial than sabotage. For example, procedural reforms in Congress like fast-track votes for broadly supported bills or consequences for failing to pass budgets can shift behavior toward collaborative governance. Similarly, cross-agency mission teams, milestone-based funding, and performance metrics for senior civil servants can create private-sector-style accountability. And because federalism (and states' rights) adds another layer of complexity, states can be incentivized to work constructively with the federal government through funding tied to cooperation. Ultimately, the intention should not be to alter our Constitution's core structure but instead to alter the incentive structure so that political self-interest better aligns with bipartisan problem-solving.

Corporate earnings and government debt:

This chart came from JP Morgan's "Year-Ahead Investment Outlook" comparing 2026 earnings estimates for the MAG-7, the "S&P 493," and the S&P 500 overall. Nick Colas of DataTrek Research noted, *"The 8 US Big Tech names (38% of the S&P 500) are largely valued on future earnings growth (70% of current market value, 66% ex-Tesla), whereas the valuation of the 'S&P 492' is almost equally anchored (72%) by its current earnings power. The potential impact of disruptive innovation in the form of Gen AI and other technologies explains this extremely large gap."*

Overall, Q3 earnings growth came in at 13.1% for S&P 500 and 15.9% for Nasdaq 100—both of which have been driven by the Tech sector's 27.3% EPS



growth rate (and an incredible 49% in the semiconductor industry, led of course by NVIDIA)—and analysts continue to raise estimates for the next 12 months. Profit margin for the S&P 500 hit 13.1%, the highest since 2009 coming out of the Global Financial Crisis (GFC), enhanced by the Tech sector's free cash flow margin of nearly 20% (which is more than double its late-1990s level). Record high profit margins and rising earnings estimates (now +13% for 2026) seem to warrant the record high valuations and tight credit spreads that we continue to see today.

Given the modern, noncyclical secular make-up of the major indexes today with expanding profit margins (across sectors) and high capital efficiency (e.g., ROIC/ROCE), it is unlikely that we will see multiple contraction as long as strong economic growth and rising corporate revenues persist. Moreover, today's real interest rate on the 10-year Treasury note (subtracting market expectations for inflation) is well below 2.0%, which is no higher than it was prior to the GFC and the ensuing period of ZIRP, and US BBB corporate bond spreads are running near the low end of their 2-year range.

This all suggests little market fear about dollar stability or imminent doom from the feared "debt maturity wall" in which huge amounts of government and business debt are coming due for refinancing (surging demand) at rates that are generally higher than the terminating notes—i.e., surging demand in the face of tightening credit conditions, which drives up rates and crowds out less-creditworthy companies, pushing more of them into the shadow banking system (like the growing private credit market)...or into austerity and perhaps higher savings rates among consumers.

That's not to say that government debt doesn't matter or that the enormous debt maturity wall isn't real. The Mercatus Center [studied](#) over 70 academic papers on the relationship between debt and growth and concluded that, *"Clear and persistent empirical study: higher public debt levels (as a percentage of GDP) are associated with slower economic growth.... Debt can stimulate growth when the debt is low but hinder growth when the debt becomes excessive."* In general, the "tipping point" for advanced economies is a ratio of 75-80% for publicly held debt/GDP, above which it imposes a tangible cost by "crowding out" private investment (the CBO estimates that every dollar of deficit spending reduces private investment by 33 cents), putting upward pressure on interest rates, and reducing private capital formation, productivity, and wage growth, with heightened risk of inflation and credit crises. Our public debt/GDP ratio today has surpassed 100% (and total federal debt including intragovernmental holdings is nearly 125% of GDP).

"High and rising public debt is consistently associated with slower economic growth," says Mercatus, and it may create stagflation (slowing growth coupled with rising inflation). Moreover, they point out that 3% average annual growth doubles GDP in 23 years whereas 2% growth doubles GDP in 35 years. That's a big difference. In addition, Wellington's Brij Khurana recently [wrote](#) in *Barron's* that robust corporate profit growth has been *"inflated by massive government deficits, ambitious business investment, and debt-funded shareholder returns. If fiscal stimulus subsides and household savings rates rise...the bubble that has sustained U.S. corporate profits since 2008 might burst."*

Still, today's US economy is growing nicely while corporate earnings growth is accelerating—including in the small cap space, not just in Big Tech. DataTrek Research observed that S&P 500 sector correlations to the index are well below the long run average (0.68 versus 0.80), reflecting strong investor confidence, which according to DataTrek makes the current bull market *"superior to either the 2019 rally or the 2020–2021 post-Pandemic Crisis rebound."* In addition, mutual fund and ETF flows into US equities increased in November for the first time since April. This all bodes well for stocks.

The AI buildout is boosting productivity, while deregulation and support for oil & gas development have contained oil prices, and all of this has helped constrain inflationary pressures, while "financial repression" has helped lower government debt servicing costs. Financial repression is a set of government policies that artificially lower the cost of borrowing and help government to reduce its debt, including interest rate ceilings, capital controls, and directed lending (to support industrial policy). Of course, the worry about all the economic stimulus is that it could lead to a blow-off top in stocks and other risk assets.

Jobs, inflation, and Fed policy:

In contrast to the strong corporate margins and earnings, metrics for jobs growth, retail sales, consumer confidence, industrial production, and ISM Manufacturing have weakened. BLS Employment Situation Report for September finally came out showing +119,000 new jobs, an unemployment rate of 4.4%, and 4.2% higher wages than one year earlier. But this is not yet current following the government shutdown. No October report will be published, and the November report will be released on 12/16. So, looking at the private ADP Employment Report for November, which uses actual payroll records from over 400,000 businesses (as opposed to the BLS surveys of 150,000 businesses), ADP reported last week that private companies *shed* -32,000 jobs in November compared to +47,000 jobs added in October. And looking ahead, US employers have announced over 1.0 million planned layoffs, whether via attrition, hiring freezes, or outright firings—led of course by the federal government's 307,000 planned job cuts.

In addition, the Conference Board's index of consumer confidence dropped from 95.5 in October to 88.7 in November, its largest month-over-month drop since April and the second lowest reading in the past five years. And while the University of Michigan Consumer Sentiment Survey ticked up in December to 53.3, it is well below year-ago December's 74.0 reading. The ISM Manufacturing Index declined to a 4-month low of 48.2 in November and has been below 50 for nine straight months.

Of course, the FOMC is trying to balance the stagnant jobs market with sticky inflation, but they have been somewhat in the dark from the government shutdown's delays on data collection and reporting. So, here we are in December, and we only have September data. PPI for September came in at 2.7% YoY, CPI and Core CPI both rose 3.0%, and PCE and the Fed's preferred Core PCE were both just

reported last Friday at 2.8%. Notably, although New Tenant Rents have been falling for some time, it's finally showing up in the long-lagged Shelter cost components of CPI and PCE. The BLS just announced that its October CPI/PPI reports won't be published due to a lack of data collection. However, the real-time, blockchain based [Truflation](#) metric, which is updated daily based on 30 million data points and tends to presage CPI by several months, reads 2.50% YoY (as of 12/8).

The AI buildout is boosting productivity, and deregulation and incentives for oil & gas development has contained oil prices, all of which has helped constrain inflationary pressures. And hopes for progress in the Russia-Ukraine conflict drove oil prices lower, reinforcing the broader disinflation narrative. And yet, electricity prices continue to rise. This is not simply due to rising demand from AI, much of which will be fulfilled by collocated/dedicated power sources. Rather it will be due to the disproportionate reliance on wind, solar, and battery storage capex, which is unreliable and non-dispatchable compared to fossil fuels and nuclear. Such projects not only allow the utility companies to take advantage of the lucrative Biden-era subsidies for wind and solar that are set to phase out in the next five years.

According to "Energy Bad Boys" on *Substack*, *"As long as utility regulators approve these capital expenditures, utilities can earn a full rate of return on the assets, which is why so many of them adopted voluntary carbon-free goals—the 'green' movement was essentially a blank check for utilities to rate base as much as they wanted.... This will continue the flood of unreliable wind and solar energy sources coming onto the electric grid, exacerbating the ongoing distortion of energy markets by eating into revenue streams of reliable generators, and without adding much benefit to meeting expected peak demand growth.... New gas generation coming online is encouraging, but some of this new capacity is being used to replace existing coal plants rather than meeting new demand. In our book, this is a mistake. The best way to alleviate price hikes for consumers and provide more power to industries is to keep existing resources online and add new capacity to meet the demand. Otherwise, we're one step forward, one step back, and in the same pickle we started in...."*

Also worth noting is the disinflationary impulse from China and India. *Bloomberg* published an [article](#) in early November titled, *"The True Cost of China's Falling Prices: Bloomberg analysis shows deflation on the ground feels more pronounced than official data show, with prices of everyday goods plunging and the share of loss-making companies at a 25-year high."* It describes a deflationary spiral, with demographic issues reducing consumer demand leading to dumping of goods on the global market and a plethora of "zombie" companies that can't pay their debts—which ultimately may lead to a currency devaluation. Notably, economist Ed Yardeni pointed out that China's GDP deflator has been down for 10 consecutive quarters, the worst stretch since 1993, which Yardeni says, *"increases the odds that China will share its deflation troubles with a global economy that's staggering out of 2025 and worried about what 2026 will bring."* In addition, India's inflation rate fell to 0.25% in October, the lowest rate since data collection commenced back in 2012, and the Reserve Bank of India (RBI) now expects inflation to be just 2% in the next fiscal year (compared to his longer run average of 6%).

So, for now, I think the Fed is still behind the curve on interest rates. Notably, New York Fed President John Williams (on rotation as a voting member) recently said that there is room to lower rates to avoid "undue risks" to the labor market. Also, San Francisco Fed President Mary Daly (currently a non-voting member) now supports more rate cuts due to concerns that a labor market downturn is both more likely and more difficult to manage than a resurgence in inflation. And former Fed governor Kevin Warsh, who is under consideration to replace Powell, wrote in a WSJ guest [column](#) in November, *"The Fed should...abandon the dogma that inflation is caused when the economy grows too much and workers get paid too much. Inflation is caused when government spends too much and prints too much. Money on Wall Street is too easy, and credit on Main Street is too tight. The Fed's bloated balance sheet, designed to support the biggest firms in a bygone crisis era, can be reduced significantly. That largesse can be redeployed in the form of lower interest rates to support households and small and medium-size businesses."*

Exactly! Allow me to reiterate from my prior posts that I believe the path to economic sustainability (given our accelerating federal debt and deficit spending spiral) may require a 3-pronged attack: 1) "inflate away" the debt with somewhat elevated inflation around 2.5%, 2) "cut away" the debt by reducing government waste and spending, and 3) "grow away" the debt by truly stimulating real organic, private-sector-led productivity and economic growth with lower tax rates and deregulation. Capital tends to flow to where it is most welcome and earns its highest returns.

Let me close this section with a couple of brief comments regarding inflation fears. First, regarding strategic onshoring and deglobalization in the US, on its face it threatens to create inflationary pressures, as onshoring of critical industries in the US would tend to boost costs (capex and higher operating costs, offset by transport savings). But the US is not the only country pursuing what seem to be poor economic decisions in the pursuit of national security purposes. China is pursuing massive, capital-intensive, environmentally unfriendly (high carbon footprint) coal-to-liquids (e.g., synthetic natural gas—even though the global market offers cheap, abundant supplies), as well as nuclear, renewables, and hydroelectric projects in an effort to become energy independent—for national security and freedom from the reach of potential US sanctions. But regardless, according to the National Association of Manufacturers here in the US, every \$1 spent creates a total impact of \$2.65 to the US economy, and every new worker leads to 4.8 workers added to the economy—that's the kind of ROI the private sector brings (compared to low-ROI government spending (on entitlements and boondoggles).

Second, the real yield (subtracting inflation expectations averaging around 2.3% annually) on the 10-year Treasury note is only around 1.8% today (as reflected by the 10-year TIPS), which suggests that investors do not consider today's sticky inflation numbers to be entrenched in the economy. Also, US BBB corporate bond spreads are running near the low end of their 2-year range. The cost of US High Yield corporate debt is back to its pre-pandemic average, thanks to both tight spreads and lower Treasury yields. The Global Supply Chain Pressure Index ([GSCPI](#)) continues to hover at or below the zero line (i.e., its historical average), helping to keep inflation in check.

Final Comments:

These were my Final Comments exactly one year ago—on 12/10/24, in my blog [post](#), “A 3-pronged approach to boost the economy and roll back debt under Trump 2.0”—which continue to ring true to me today:

Let's not ignore the defensive signals that are showing up in various corners, including narrowing market breadth among US stocks despite continuing to hit new all-time highs (on the backs of the mega-caps), and from the bond market as US Treasuries are getting bought again (with the 10-year yield closing last week at 4.15%), and Chinese yields have fallen precipitously to near historic lows (with the 10-year yield below 2%), which reflects deep concern about its struggling economy, deflation, and the potential for new US tariffs, and its consumers are focused more on savings than consumption—which of course would have serious global impact given the size of China's economy. The ratio of PCE to GDP in the US is 68% but only 39% in China, and Chinese consumers today are further reducing discretionary spending and major purchases in a defensive posture.

Furthermore, the consumer is getting more and more stretched. Both household credit card debt and credit card interest rates are at record highs. So, it should be no surprise that 11% of credit-card balances are more than 90 days delinquent, which is the highest delinquency rate since 2012 (coming out of the Global Financial Crisis). On the other hand, according to the St. Louis Fed, household debt service payments as a percentage of disposable personal income remains below pre-pandemic levels at 11.3% (which is the highest post-pandemic reading but stable over the past 3 quarters).

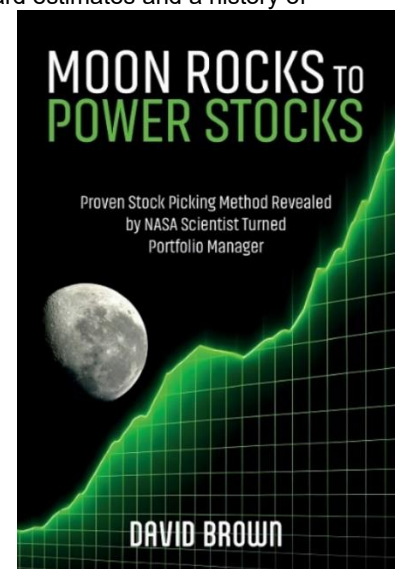
Regardless, I think any significant pullback or technical consolidation to allow the moving averages to catch up would be a buying opportunity into year-end and through 2025, and perhaps well into 2026—assuming the new administration's policies go according to plan. Adding exposure to cyclical sectors and small caps may be prudent. Yes, the broad indexes are already highly valued, with the mega-cap-dominated S&P 500 (SPY) and Nasdaq 100 (QQQ) at 22.7x and 27.2x, respectively, but the equal-weighted indexes are more attractively valued, with the equal-weight S&P 500 (RSP) and Nasdaq 100 (QQQE) at 18.0x and 24.0x, and the S&P 600 SmallCap (SPSM) at 16.5x. [Today, SPY=23.2x, QQQ=27.9x, RSP=17.5x, QQQE=22.9x, SPSM=15.4x, which shows that the market has only narrowed further over the past year, with higher valuations of the cap-weight indexes and lower (better) valuations on the equal-weight and small cap indexes.]

Overall, my suggestion to investors in this optimistic Trump 2.0 climate is to not chase the highflyers and instead focus on high-quality businesses at reasonable prices, hold inflation and dollar hedges like gold and bitcoin (both of which are at or near all-time highs), and be prepared to exploit any market correction (such as by buying out-of-the-money put options in advance of a potential pullback while VIX is low) and then buy those high-quality stocks as they begin to rebound for further gains through 2025 and beyond, fueled by massive capex in blockchain and AI applications, infrastructure, and energy leading to better productivity, increased productive capacity, and economic expansion.

Again, I think these comments still ring true today. Regarding inflation and dollar hedges, historically under “normal” economic conditions, gold and bonds are both defensive plays and show positive price correlation with each other and inverse correlation with stocks. In other words, gold goes up as bond prices go up (and yields and stock prices fall), and conversely, gold often struggles as bonds fall (and yields and stocks rise, particularly since gold doesn't pay a dividend). However, when the “fear trade” kicks in, gold serves as a hard-asset hedge against financial disruption. Other hedges might include bitcoin, ether, and energy stocks (which did quite well during the 2022 bear market).

And regarding “high-quality businesses,” I mean fundamentally strong, displaying a history of consistent, reliable, resilient, durable, and accelerating sales and earnings growth, positive revisions to Wall Street analysts' consensus forward estimates and a history of meeting/beating estimates, rising profit margins and free cash flow, high capital efficiency (e.g., ROI), solid earnings quality and conservative accounting practices, a strong balance sheet, low debt burden, competitive advantage, and a reasonable valuation compared to its peers and its own history. These are the factors Sabrient employs in our quantitative models and in selecting our **Baker's Dozen, Forward Looking Value, Dividend, and Small Cap Growth** portfolios (which are packaged and distributed as UITs by First Trust Portfolios). We also use many of these factors in our SectorCast ETF ranking model. And notably, our Earnings Quality Rank (EQR) is a key factor in each of these models, and it is also licensed to the actively managed, low-beta **First Trust Long-Short ETF (FTLS)** as a quality prescreen.

Our process-driven, growth-at-a-reasonable-price methodology is described by Sabrient founder David Brown in his new book, *[Moon Rocks to Power Stocks: Proven Stock Picking Method Revealed by NASA Scientist Turned Portfolio Manager](#)*. It is available in both paperback and eBook formats on Amazon for investors of all experience levels. It teaches how to methodically and strategically build wealth in the stock market—**making it a great holiday gift idea (catch the low-price promotion this week only!)**. David describes his path from NASA engineer in the Apollo Program to creating quant models for ranking stocks and building portfolios in four distinct investing styles—Growth, Value, Dividend, and Small Cap. To learn more about **David's book and the companion subscription product** we offer that does most of the stock evaluation work for you, visit: <https://DavidBrownInvestingBook.com>.



Latest Sector Rankings

Relative sector rankings are based on Sabrient's proprietary SectorCast model, which builds a composite profile of each of roughly 1,500 equity ETFs based on bottom-up aggregate scoring of the constituent stocks. The *Outlook Score* is a Growth at a Reasonable Price (GARP) model that employs a forward-looking, fundamentals-based multifactor algorithm considering forward valuation, historical and projected earnings growth, the dynamics of Wall Street analysts' consensus earnings estimates and recent revisions (up or down), quality and sustainability of reported earnings, and various return ratios. It helps us predict relative performance over the next 3-6 months.

In addition, SectorCast computes a *Bull Score* and *Bear Score* for each ETF based on recent price behavior of the constituent stocks on particularly strong and weak market days. A high Bull score indicates that stocks held by the ETF recently have tended toward relative outperformance when the market is strong, while a high Bear score indicates that stocks within the ETF have tended to hold up relatively well (i.e., safe havens) when the market is weak. Outlook score is forward-looking while Bull and Bear are backward-looking.

As a group, these three scores can be helpful for positioning a portfolio for a given set of anticipated market conditions. Of course, each ETF holds a unique portfolio of stocks and position weights, so the sectors represented will score differently depending upon which set of ETFs is used. We use the iShares that represent the ten major U.S. business sectors: Financials (IYF), Technology (IYW), Industrials (IYJ), Healthcare (IYH), Consumer Staples (IYK), Consumer Discretionary (IYC), Energy (IYE), Basic Materials (IYM), Telecommunications (IYZ), and Utilities (IDU). Whereas the Select Sector SPDRs only contain stocks from the S&P 500 large cap index, I prefer the iShares for their larger universe and broader diversity.

The table below shows the latest fundamentals-based Outlook rankings and our full sector rotation model:

Sector	ETF	Outlook Score	Bull Score	Bear Score	Net Score: Neutral Bias	Net Score: Bullish Bias	Net Score: Defensive Bias
TECHNOLOGY	IYW	95	56	47	95	90	57
HEALTHCARE	IYH	62	45	70	62	57	90
TELECOMMUNICATIONS	IYZ	59	42	57	59	50	62
FINANCIALS	IYF	41	49	58	41	58	57
INDUSTRIALS	IYJ	41	48	56	41	56	53
BASIC MATERIALS	IYM	41	56	56	41	72	53
ENERGY	IYE	29	41	65	29	39	66
CONSUMER DISCRETIONARY	IYC	28	48	53	28	52	41
UTILITIES	IDU	17	38	69	17	29	69
CONSUMER STAPLES	IYK	15	33	76	15	18	82

Sabrient's Outlook Score employs a forward-looking fundamentals-based scoring algorithm to create a composite profile of the constituent stocks. Bull Score and Bear Score are based on price behavior of the underlying stocks on particularly strong and weak days over the prior 40 market days. High Bull indicates a tendency for relative strength in a strong market, and high Bear indicates a tendency for relative strength in a weak market (i.e., safe havens). High for all scores is 100, and higher is better.

The latest rankings display a neutral bias, in my view, given that cyclicals, secular growth sectors, and defensive sectors are interspersed across the rankings, and only three sectors score above 50 on Outlook score.

Technology (dominated by the mega-cap Big Tech titans and AI-driven highflyers) remains at the top with a robust Outlook score of 95, despite having by far the highest forward P/E—a lofty 28.8x (although somewhat lower than the 31x it hit a few months ago). However, because of its ever-rising EPS growth estimate of 22.3%, the forward PEG (ratio of P/E to EPS growth) of 1.29 remains reasonable. Keep in

mind, investors are quite willing to “pay up” for strong growth. Tech also displays strongly positive sell-side analyst earnings revisions, the highest profit margins and return ratios, and the best insider sentiment (open market buying). Because many Tech stocks are riding secular growth trends (i.e., little cyclicality), no other sector comes close to the consistent sales growth, margins, operating leverage, and return on capital. And Tech not only benefits from its own product development and productivity gains, but those products help other companies with their product development, product delivery, and productivity—so Tech benefits by helping all sectors grow and prosper.

Rounding out the top 6 are Healthcare, Telecom, Financials, Industrials, and Basic Materials—with the latter 3 scoring almost the same on all 3 scores. Financials and Telecom display the lowest forward P/E of 14.0x and very nearly the same low forward PEG of around 1.15-1.20. Basic Materials has the lowest forward PEG of 0.88 given its relatively low forward P/E of 17.3x and a strong projected EPS growth rate of 19.7%.

At the bottom of the rankings are defensive sectors Consumer Staples and Utilities. Consumer Staples has the highest forward PEG of 2.51 due to its low projected EPS growth rate of just 6.8%. Because of the capital spending going into building out the power grid and infrastructure, Utilities has been a solid performer this year, even though the sector is typically considered to be a defensive “bond proxy” dividend play. However, the Utilities sector as a whole suffers from relatively high valuations for only modest projected EPS growth over the next 12 months (9.1%) and a high forward PEG of 2.01, but this should change with the datacenter buildout and future ramp-up in power demand. Although US electricity consumption has been increasing only gradually over the past few years, ICF International forecasts a 25% increase by 2030 and 78% by 2050, driven largely by AI-related initiatives.

Keep in mind, the Outlook Rank does not include timing, momentum, or relative strength factors, but rather reflects the consensus fundamental expectations at a given point in time for individual stocks, aggregated by sector.

Notably, our ETF rankings continue to display much stronger Outlook scores for the cap-weight indexes, like SPY (50) and QQQ (69), over the equal-weight indexes, like RSP (33) and QQQE (54), which reflects the higher quality of the mega cap companies that dominate the cap-weight indexes. You can learn more about gaining access to Sabrient's ETF Scorecard, which ranks roughly 1500 ETFs, by visiting: <http://davidbrowninvestingbook.com>

Sector Rotation Model and ETF Trading Ideas

Our rules-based Sector Rotation model, which appropriately weights Outlook, Bull, and Bear scores in accordance with the overall market's prevailing trend (bullish, neutral, or defensive), returned to a **bullish** bias on 11/25 after briefly dropping to neutral when the S&P 500 fell below its 50-day moving average during November. (Note: In this model, we consider the bias to be bullish from a rules-based trend-following standpoint when SPY is above both its 50-day and 200-day simple moving averages, but neutral if it is between those SMAs while searching for direction, and defensive if below both SMAs.)

As highlighted in the table above, the Sector Rotation model suggests holding **Technology (IYW), Basic Materials (IYM), and Financials (IYF)**. However, if you prefer a neutral stance, it suggests holding Technology, Healthcare (IYH), and Telecom (IYZ). Or, if you prefer to take a defensive stance, it suggests holding Healthcare, Consumer Staples (IYK), and Utilities (IDU).

Here is an assortment of other interesting ETFs that are scoring well in our latest rankings: WisdomTree Efficient Gold Plus Gold Miners Strategy (GDMN), iShares MSCI Global Gold Miners (RING), SPDR S&P Pharmaceuticals (XPH), Abacus FCF Innovation Leaders (ABOT), Castellan Targeted Equity (CTEF), iShares Global Tech (IXN), Sprott Active Gold & Silver Miners (GBUG), AOT Growth and Innovation (AOTG), Pacer US Large Cap Cash Cows Growth (COWG), Global X PureCap MSCI InfoTech (GXPT), American Century US Quality Growth (QGRO), Pacer US Small Cap Cash Cows Growth Leaders (CAFG), US Global GO Gold and Precious Metal Miners (GOAU), iShares US Pharmaceuticals (IHE), Guinness Atkinson Smart Transportation & Technology (MOTO), Neuberger Berman Disrupters (NBDS), Technology Trusector (TRUT), Amplify Video Game Leaders (GAMR), Janus Henderson Global Artificial Intelligence (JHAI), First Trust Small Cap Buy-Write Income (FTKI), First Trust Active Factor Small Cap (AFSM), AXS Esoterica NextG Economy (WUGI), NYLI US Large Cap R&D Leaders (LRND), Invesco Biotech & Genome (PBE), and Horizon Digital Frontier (YNOT)—my favorite ticker symbol. All score in the top decile (90-100) of Sabrient's Outlook scores.

As always, I welcome your thoughts on this article! Please email me anytime. Any and all feedback is appreciated. Also, please let me know of your interest in any of Sabrient's **new indexes for ETF investing**, such as *High-Quality Growth* (similar to our Baker's Dozen model), *High-Quality Growth & Income*, *SMID-Cap Quality Plus Momentum*, *High-Quality Energy*, *Quality Legacy & Green Energy*, *Defensive Equity*, *Space Exploration & Off-Earth Sustainability*, and the *Sabrient Select High Conviction Portfolio (active)*.

IMPORTANT NOTE: I post this information periodically as a free look inside some of our institutional research and as a source of some trading ideas for your own further investigation. It is not intended to be traded directly as a rules-based strategy in a real money portfolio. I am simply showing what a sector rotation model might suggest if a given portfolio was due for a rebalance, and I do not update the information on a regular schedule or on technical triggers. There are many ways for a client to trade such a strategy, including monthly or quarterly rebalancing, perhaps with interim adjustments to the bullish/neutral/defensive bias when warranted, but not necessarily on the days that I happen to post this article. The enhanced strategy seeks higher returns by employing individual stocks (or stock options) that are also highly ranked, but this introduces greater risks and volatility. I do not track performance of the ideas mentioned here as a managed portfolio.

Disclosure: At the time of this writing, of the securities mentioned, the author held positions in SPY, IWM, FTLS, NVDA, GOAU, gold, bitcoin.

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