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Joseph LoBue, CIPM
Head Trader

Q4 Market Review

Riding 2024's Tailwinds Into 2025

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Equity markets made gains in Q4. Donald Trump's historic victory in the U.S. Presidential Election, along with the Federal Reserve's 25 basis point interest rate cut in November and December, helped contribute to the market's positive momentum. However, prior to year end, the Fed announced that it would scale back the number of rate cuts it had planned for 2025, which in turn triggered a pullback. Fortunately, the announcement wasn't enough to derail the year's gains and markets closed out 2024 strong. The S&P 500 finished the fourth quarter, +2.4% total return, and rounded out the year near its all-time highs of +25% total return. The "Magnificent Seven," once again, accounted for a disproportionate amount of the index's total return for the year with roughly +56.7% attributed to the mega cap stocks. Communication Services (+33.2%), Financial Services (+28.5%), and Consumer Discretionary (+25.5%) were the highest performing sectors for the year, while Basic Materials (-1.6%), Healthcare (+.9%), and Real Estate (+1.5%) were the poorest performers. We head into 2025 with many reasons to be optimistic. The U.S. economy is growing at a rate of roughly 3%, the Consumer Price Index – the U.S. government's preferred measure of inflation – has dropped to just under 3%, and Corporate Profits are at record levels. However, we are also anticipating higher volatility in the year ahead as President Trump gets sworn into office, proposed tariffs on foreign countries take effect, and geopolitical tensions remain unresolved. We will be closely monitoring several key factors as we weigh making investment decisions including the overall health of the economy, inflation and interest rates, the state of the U.S. consumer, the valuation of the U.S. stock market, and corporate earnings projections.

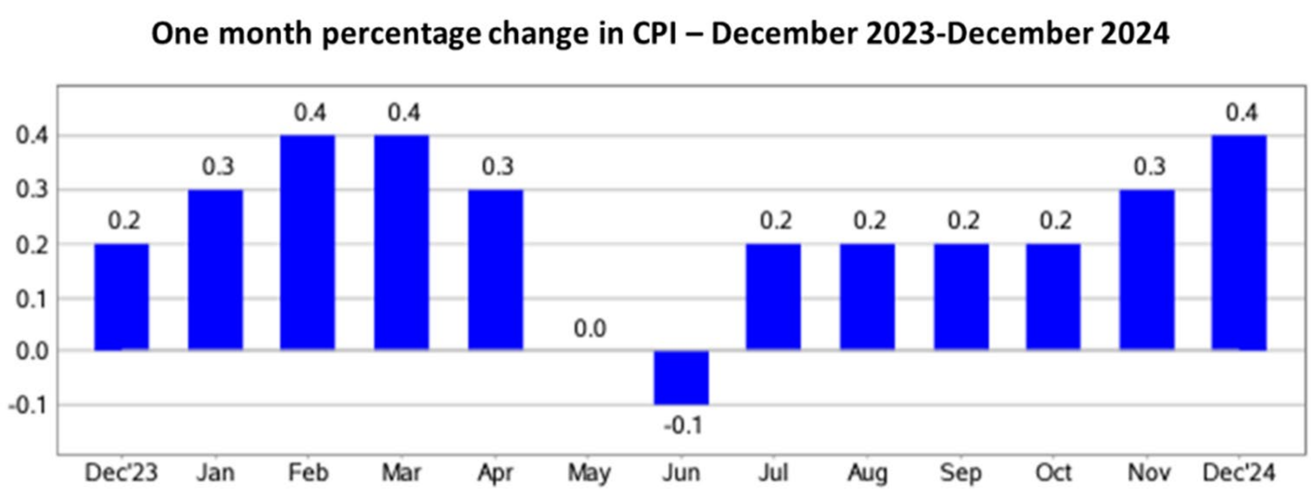
The Economy

Steady consumer spending, historically low unemployment, continued corporate earnings growth, and strong productivity have all contributed to keeping the economy on track. We're hopeful that the positive momentum will keep pace in 2025, but it will not be without some headwinds. According to the U.S. Department of Labor, labor market demands are cooling, and wage growth has remained sticky in the 4% range. The meaningful but unexpected 1% increase in the 10-Year U.S. Treasury Note from a 3.62% Yield-to-Maturity on September 16, 2024, to its current 4.62%, may indicate that interest rates could stay higher for longer. Uncertainty also remains around regulatory, immigration and trade policy which poses the risk of creating some inflationary impact. Ed Yardeni, CEO of Yardeni Research, believes that the change in political leadership may help to neutralize the economic uncertainty. Yardeni recently wrote "We believe Trump 2.0 represents a major regime change that's bullish for the economy and stocks. We now expect a sooner end to major geopolitical crises and possibly some improvement in the fiscal situation." Despite Yardeni's optimism, overall economic growth is expected to slow in the coming year. EY's December 2024 report projects real GDP growth to decelerate modestly from 2.7% in 2024 to 2.1% in 2025.

Inflation and Interest Rates

Per Figure 1, the U.S. Bureau of Labor Statistics reported that the Consumer Price Index (CPI) for December increased 0.4% across all categories on a seasonally adjusted basis, after rising 0.3% in November. The index for energy rose 2.6% in December, which accounted for more than 40% of the monthly all items increase. The gasoline index increased 4.4% for December and the in-home food and away-from-home food index both rose .3%. This represents a still sticky and persistent inflationary environment. The Fed has signaled that they are likely to only cut rates just two times in 2025 due to continued economic strength - including a full-employment economy - and the new administration's proposals for tariffs and tax cuts.

Figure 1



Source: U.S. Department of Labor

The Fed normally increases rates as a measure to reduce inflation by making borrowing more costly. This, in turn, cools demand. It then lowers rates to give a struggling economy or job market a boost. Considering that inflation is hovering around 3%, and its official target is 2%, the Fed still has its work cut out for them in 2025 and we expect them to act accordingly.

The Consumer

The University of Michigan's January, 2025 consumer sentiment survey reported that consumer confidence remained relatively stable, falling less than one index point from December, 2024. Assessments of personal finances improved by 5% but the economic outlook declined -7% in the short run and -5% in the long run. The survey's director, Joanne Hsu, says, "this is only the third time in the last four years that long-run expectations have exhibited such a large one-month change. For both the short and long run, inflation expectations rose across multiple demographic groups, with particularly strong increases among lower-income consumers and independents." Although consumers reported feeling better about the overall cost of living, their primary concern remains the uncertainty surrounding inflation in the long run. Per *Figure 2*, the January numbers reflect this concern as Year-over-Year changes for Consumer Sentiment (-7.3%), Economic Conditions (-4.9%), and Consumer Expectations (-8.9%) all declined by -4.9% or more. The uncertainty around the new administration's regulatory, immigration and trade policy appears to be the primary factor triggering long-term inflation concerns among consumers. As the new administration settles in and their objectives are made clear, it's possible we may see these concerns dissipate.

Figure 2

Preliminary Results for January 2025

	Jan 2025	Dec 2024	Jan 2024	M-M Change	Y-Y Change
Index of Consumer Sentiment	**73.2**	74.0	79.0	-1.1%	-7.3%
Current Economic Conditions	**77.9**	75.1	81.9	+3.7%	-4.9%
Index of Consumer Expectations	**70.2**	73.3	77.1	-4.2%	-8.9%

Source: University of Michigan, 2025 Consumer Sentiment Survey

The U.S. Stock Market

If you recall in Q3, the Equal Weight S&P 500 outperformed the S&P 500 (capitalization-weighted) after lagging much of 2024. This outperformance, however, did not continue for the rest of 2024, particularly in December. For the month, the Magnificent 7 increased 10% while the S&P 500 declined 1%. Moreover, only 64 other stocks, besides the Magnificent 7, in the S&P 500 were positive for the month. Per *Figure 3*, economic sector participation for 2024 was led by Communications Services (+33.2%), Financial Services (+28.5), and Consumer Discretionary (+25.5), which all outperformed the S&P 500 (+23.5%). Basic Materials (-1.6%) was the worst performing sector, followed by Healthcare (+.9%), and Real Estate (+1.5%).

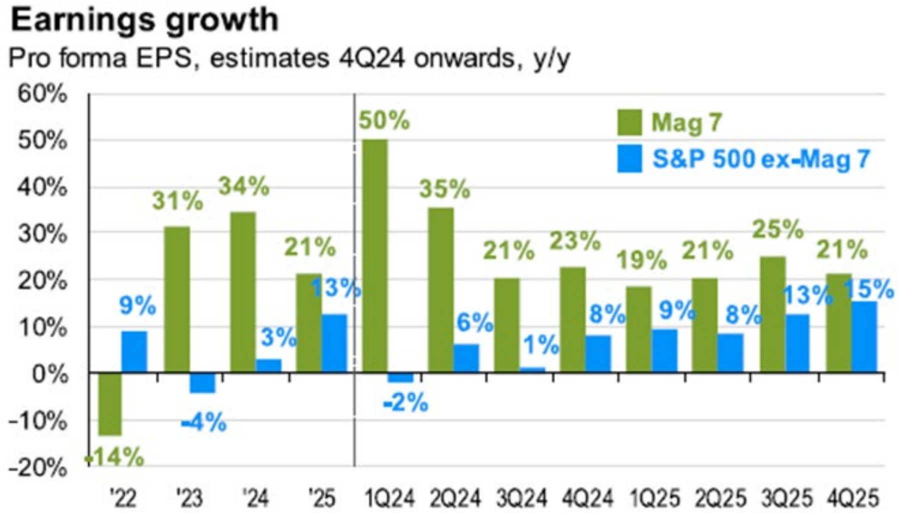
Figure 3

Sector	2024
Technology	+20.8%
Communication Services	+33.2%
Consumer Discretionary	+25.5%
Industrials	+15.6%
Basic Materials	-1.6%
Financial Services	+28.5%
Real Estate	+1.5%
Healthcare	+0.9%
Consumer Staples	+9.1%
Energy	+2.2%
Utilities	+19.5%
S&P 500	+23.3%

Source: S&P Global

We have been reporting for the past year about the market's lack of breadth. Overall, the market did broaden in 2024, but it was only marginally greater than it was in 2023. According to Fidelity's 2025 outlook, 41% of stocks outperformed the S&P 500 Index in 2024 versus 26% in 2023. This narrowness has been a concern for us and continues to be a concern. Per *Figure 4*, the Magnificent 7's earnings per share is currently expected to increase by an average of 21.5% in each quarter of 2025. The other 493 S&P 500 stocks' earnings per share are expected to increase by an average of 11.25% during the same period. However, this projected 11.25% increase represents a significant improvement from the 3.25% earnings per share increase reported for 2024 and the 4% decline reported for 2023. As a result, we continue to see many attractive investment opportunities in the 493 stocks beyond the Magnificent 7 in the S&P 500 due to their lower price/earnings valuations and the significantly higher earnings per share growth projected for 2025 compared to the two prior years (2023 and 2024).

Figure 4

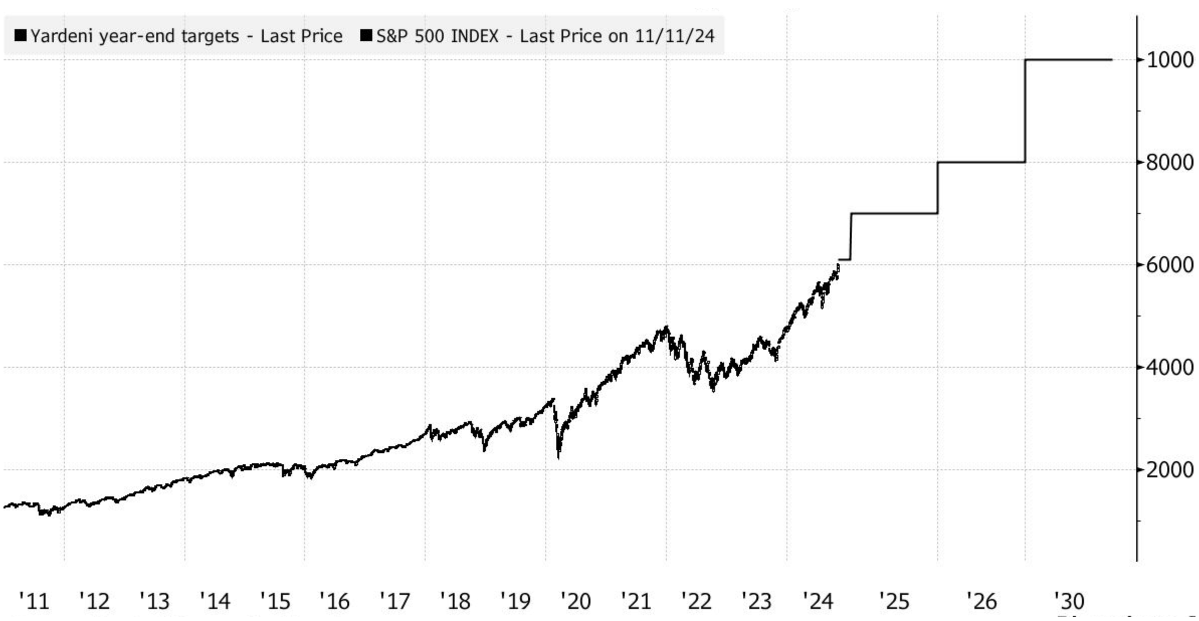


Source: JP Morgan Asset Management

Earnings Outlook

Wall Street strategist, Ed Yardeni, President of Yardeni Research, is bullish on the S&P 500 for 2025. Per his forecast in *Figure 5*, Yardeni is projecting that the S&P 500 has the potential to hit 7000 by the end of 2025 and 10000 by the end of 2030.

Figure 5



Source: Ed Yardeni Research

Yardeni supports his rationale with the following points:

- The Trump administration's pro-business policies such as tax cuts and deregulation, could help support economic expansion.
- Quick resolutions to global conflicts, such as the Russia-Ukraine war and tension in the Middle East, has the potential to unlock additional market gains.

In *Figure 6*, Yardeni estimates 18.8% year-over-year growth in the S&P 500 for 2025 versus 12.3% for the analysts' consensus in the same timeframe.

Figure 6

S&P 500 EARNINGS FORECASTS: YRI VS ANALYSTS' CONSENSUS (1/24/2025)

2021	a	208.1	49.0	208.1	49.0
Q1	a	49.1	48.3	49.1	48.3
Q2	a	52.6	87.9	52.6	87.9
Q3	a	53.7	38.8	53.7	38.8
Q4	a	54.0	26.7	54.0	26.7
2022	a	218.1	4.8	218.1	4.8
Q1	a	54.8	11.5	54.8	11.5
Q2	a	57.6	9.6	57.6	9.6
Q3	a	56.0	4.3	56.0	4.3
Q4	a	53.2	-1.5	53.2	-1.5
2023	a	221.4	1.5	221.4	1.5
Q1	a	53.1	-3.1	53.1	-3.1
Q2	a	54.3	-5.8	54.3	-5.8
Q3	a	58.4	4.3	58.4	4.3
Q4	a	57.2	7.5	57.2	7.5
2024	e	246.5	10.6	243.7	10.1
Q1	a	56.6	6.6	56.6	6.6
Q2	a	60.4	11.3	60.4	11.3
Q3	a	63.2	8.2	63.2	8.2
Q4	e	65.0	13.7	62.3	9.1
2025	e	285.0	18.8	273.8	12.3
Q1	e	na	na	62.5	10.5
Q2	e	na	na	67.0	10.8
Q3	e	na	na	71.1	12.5
Q4	e	na	na	72.6	16.6
2026	e	320.0	12.3	310.8	13.5

* a = actual / e = estimate

Source: Ed Yardeni Research

The Year Ahead

We remain optimistic for the year ahead as the U.S. equity market rides 2024's tailwinds into 2025. The U.S. economy continues to grow, inflation is getting closer to the Fed target rate and 2024 finished with record equity market returns and corporate profits. We do, however, anticipate higher volatility and that the market is likely to run into some headwinds as well. Geopolitical tensions remain, inflation and interest rates may stay higher for longer and there is a definite degree of unpredictability surrounding President Trump's policies and how they will impact foreign trade and tariffs. Given the tailwinds from 2024, the solid foundation of economic growth and the analysts' consensus for 12.3% S&P 500 E.PS. growth this year, we recommend that our clients remain fully invested in equities. Trump 2.0 will likely generate higher volatility. However, we have confidence in the high quality, well-managed companies that we own in our clients' portfolios and believe they will enable us to ride out the market's ups and downs.

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*GIPS Composite Data and Verification Information Available Upon Request