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Market Overview

All three major averages experienced fourth-quarter gains. However, it was The Nasdaq[1] that outperformed followed by the S&P 500[2], and the Dow Jones Industrial Average[3]. Indices rallied post-election but as yields continued higher, uncertainty kicked in, and a more hawkish tone from the Fed in their December meeting led to a retreat from all-time highs going into the end of the year. The Nasdaq led the fourth quarter stock gains, finishing up 6.35%, with the S&P 500 Index, and The Dow Jones Industrial Average trailing at 2.41% and 0.90%, respectively.

During the fourth quarter of 2024, consumer discretionary was the best performing sector, gaining 12.18%, followed by communication services at 7.37%, and financials by 7.10%. The best performing sectors year to date were communication services, up 34.70%, followed by financials, which was up 30.55%, consumer discretionary which was up 26.51%, and utilities which gained 23.28%. The worst performing sectors for the year were real estate, finishing up 5.07%, followed by healthcare (up 2.47%), and lastly materials, which narrowly finished in positive territory, up 0.14% on the year. Coincidentally, the bottom three sectors experienced a fourth-quarter sell-off.

The Federal Reserve ("the Fed") continued their interest rate cutting cycle throughout the quarter. In November and December, the Fed cut rates by 25 basis points (.25%) at each meeting, bringing the effective federal funds rate to 4.25% to 4.50%. At the December meeting the dot plot gave expectations for only two rate cuts during the 2025 calendar year. Federal Reserve ("the Fed") chair Jerome Powell said, "We can therefore be more cautious as we consider further adjustments to our policy rate." This statement shook the market as the Fed is seeing sticky inflation and economic growth above trend. These two factors do not favor multiple rate cuts going forward. There is also discussion about the Fed's target inflation rate now being higher than previously estimated. Ideally the Fed wants 2% inflation, but now those expectations are shifting higher, possibly towards 3%. Could we be living in a higher inflation world in the future? Since the first rate cut in September, yields have moved higher and continued their uptrend during the quarter. Uncertainty about the US government debt limit and interest payments, higher than trend economic growth, and sticky inflation brought the bond vigilantes back into the marketplace. During the fourth quarter of 2024, the 10-year Treasury yield reached a high of 4.63% on 12/26/2024 and a low of 3.69% on 10/01/2024.

Turning to international markets, international and emerging markets experienced fourth quarter declines. The rising U.S. dollar, continued economic downturn in the Chinese economy, and under performance in Europe contributed to negative returns during the quarter and subpar performance throughout the year.

Mark L. Blom, CFP® — Brent Miller, CFA® — Kirk Masci

U.S. Equity Returns Table
Source: Tamarac

Index	Q4 2024 Returns	2024 Returns
Dow Jones	0.93%	14.99%
S&P 500	2.41%	25.02%
NASDAQ	6.35%	29.57%
Russell 2000	0.34%	11.54%
MSCI World	-7.50%	6.09%

U.S. Treasury Yield Table
Source: Treasury

	12/2024	12/2023	12/2022
3 month	4.37%	5.40%	4.42%
2 year	4.24%	4.23%	4.41%
5 year	4.37%	3.84%	3.99%
10 year	4.55%	3.88%	3.88%
30 year	4.77%	4.03%	3.97%

Other Indices Table
Source: Morningstar

	Q4 2024 Returns	2024 Returns
Gold (GLD)	-0.38%	26.66%
Brent Oil (BNO)	5.79%	9.67%
U.S. Dollar Index (UUP)	9.09%	13.48%
Int'l Equity Markets (EFA)	-8.36%	3.51%
Emerging Equity Markets (EEM)	-7.27%	6.50%

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Can the Market Realize a Third Consecutive Year of Positive Returns?

The S&P 500 Index finished 2024 up 25.0%, following a 26.6% increase in 2023. Historically, consecutive years of outsized returns of this magnitude have been rare, leading some market observers to question the sustainability of this trend. While we are skeptical that the market can pull off another year of returns exceeding 20%, we believe that the prospect of slowing but still robust economic growth, moderating inflation, stable employment, and the continued advancement of generative artificial intelligence ("AI") technologies will propel large cap domestic equity returns into positive territory for the third consecutive year.

As of 12/20/25, the FactSet 2025 consensus earnings per share (EPS) estimate for the S&P 500 Index implies growth of 14.8%, representing a marked acceleration from expected 2024 earnings growth of 9.4%. In addition, the 2025 expected growth rate is well above the 10-year average annual earnings growth rate of 8.0% (2014-2023). While the S&P 500 Index's current forward price-to-earnings ratio ("forward P/E") of 21.2 is 16.1% higher than the ten-year median value, we do not believe the market is materially overvalued in aggregate due to the strong expected earnings growth underlying the 2025 estimate. The question then becomes, why is the Street so optimistic about earnings growth in 2025?

In our view, the most important factor underlying this optimism is a relatively strong economic backdrop. Thus far, the economy continues to post robust real GDP growth[4], likely indicating that a recession is not imminent and that the Fed did not wait too long before initiating its rate cutting cycle.[5] In addition, while inflation, particularly on the services side of the economy, has perhaps proven to be more persistent than expected, there is no indication that aggregate price level increases are reaccelerating.[6] Finally, the labor market appears stable, with job creation numbers and the unemployment rate well within historical norms.[7] Thus, we believe the "soft landing" scenario for the economy remains the most probable outcome, lending credence to optimistic analyst forecasts regarding 2025 earnings growth.

The Fed's updated Summary of Economic Projections released on 12/18/24 indicated a median expectation among Federal Open Market Committee ("FOMC") members of two 25 basis point rate cuts in 2025, down from an expectation of four 25 basis point cuts in September 2024.[8] With services and shelter inflation proving to be stickier than expected and the economy growing at healthy clip, we believe this more restrained approach to monetary easing is prudent. If the Fed engages in two additional 25 basis point rate cuts by year end, without reigniting inflation and before the economy slips into a recession, i.e. a continuation of the soft-landing scenario, we continue to believe there is more room for the market to run.

While the projected earnings 2025 growth for the "Magnificent Seven" stocks of 21% exceeds the 13% expected earnings growth of the remaining 493 companies in the S&P 500 Index by a considerable margin, the 13% growth projection represents a material acceleration from analyst expectations of just over 4% in 2024.[9] Consequently, while we expect the Magnificent 7 stocks to maintain their market leadership position in 2025, we believe the market will broaden considerably, leading to a much smaller performance gap in 2025 relative to 2024.

From a sector perspective, we expect robust earnings growth to once again result in strong returns in the information technology and communication services sectors in 2025. Much of this forecast is attributable to the exposure of these sectors to generative AI-related technologies. We remain firm believers in the promise of generative AI and believe companies that can successfully leverage this technology to the benefit of their customer bases in tangible ways will continue to enjoy outsized market returns.

Can the Market Realize a Third Consecutive Year of Positive Returns? (cont.)

In addition, we believe the health care and materials sectors, both of which were significant performance laggards in 2024, to be among the top performing sectors in 2025 due to expected earnings growth of 20.6% and 17.4%, respectively, and relatively attractive valuations. Finally, in our view, there is a heighted probability of interest rate sensitive sectors such as utilities and real estate lagging aggregate market performance with the expectation of just two 25 basis point rate cuts in 2025 rather than the four 25 basis point rate cuts projected a few months ago.

In sum, while we are not forecasting a third consecutive year of market returns exceeding 20%, we do believe that a modest rate cutting environment in the absence of recessionary economic signals and/or resurgent inflation should propel the market higher by year end. This does not imply a smooth ride, however, and we are predicting a continuation of the trend that persisted through much of the latter part of 2024, wherein we observed periodic oscillation between “risk on” and “risk off” trading environments. In this type of trading environment, large cap growth stocks and small cap stocks may lead the market on one day and defensive, value-oriented equities and safe haven commodities such as gold serving as the market leaders the next.

While the ride ahead may be a bit bumpier form a performance perspective, we continue to believe our diversified growth at a reasonable price (“GARP”) stock portfolios provide some protection against the potential downside of periodic bouts of rotation from growth to value sectors. In addition, while the market in aggregate appears to be priced at a premium, there are pockets of the market that still appear attractive from a valuation and growth perspective, and within these undervalued market segments, we believe it is possible to find stocks that trade at a material discount relative to their near and long-term earnings power.

Brent J. Miller, CFA – Senior Portfolio Manager

Sources:

1. The Nasdaq-100 Index is U.S. stock market index comprised of the largest 100 non-financial companies listed on the Nasdaq stock exchange. The index is dominated by technology companies and is commonly used as proxy for U.S. large cap technology performance.
2. The market cap weighted S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
3. The Dow Jones Industrial Average, Dow Jones, or simply the Dow, is a stock market index of 30 prominent companies listed on stock exchanges in the United States.
4. Q3 2024 GDP growth was recently revised to 3.1%, up slightly from 3.0% growth in Q2 2024. While the initial estimate for Q4 2024 GDP will not be released until 1/30/25, the Federal Reserve Bank of Atlanta’s GDPNow forecasting model is currently calling for Q4 2024 GDP growth of 2.6%, which remains consistent with a robust and growing economy.
5. The Fed opted to cut the federal funds rate by 50 basis points on 9/18/24, marking the first rate cut since the Fed begin its tightening cycle in March 2022. The Fed followed this initial rate cut with a 25-basis point rate cut on 11/7/24 and a second 25-basis point rate cut on 12/18/24.
6. The November Personal Consumption Expenditures (PCE) Price Index reading increased by 0.1% in November and 2.4% from the year-ago period, moving closer to the Fed’s 2.0% target. Prices for good decreased 0.4% from November 2023 while services prices increased 3.8%.
7. After Hurricane Milton and the Boeing strike adversely impacted job growth in October, November nonfarm payrolls rebounded materially, increasing by 227,000, slightly above the consensus expected 220,000. While the unemployment rate ticked up to 4.2% from 4.1% in October, the result was in-line with expectations and remains near the low-end of historical norms.
8. Source: FOMC. https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20241218.pdf
9. Source: FactSet. https://insight.factset.com/sp-500-cy-2025-earnings-preview-analysts-expect-earnings-growth-of-15#:~:text=The%20estimated%20(year%2Dover%2D,earnings%20growth%20rate%20of%208.0%25%20)

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