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January 19, 2025

2024 Q4 Market Commentary

During the fourth quarter, the U.S. markets reached multiple new highs on the back of more positive economic trends and the conclusion of the U.S. Elections. The economy is growing above trend, led by improving labor productivity, strong employment, consumer resilience, favorable credit conditions and constructive inflation trends. However, there was sufficient worry to keep exuberance in check. Manufacturing and inflation data has been choppy. The Fed dialed back optimism as markets digested the implications of potential Trump policies. The year ended with stocks and bonds selling off, exacerbated by typical year-end selling and loss harvesting, resetting sentiment and digesting gains. That said, the bull market remains intact and will continue until proven otherwise.

2024 was an exceptional year for equity investors. The S&P 500 set 57 all-time highs, the sixth most since 1928, and recorded back-to-back >20% annual gains for only the fifth time. On a relative basis, U.S. equities outperformed the rest of the world for the 13th time in 15 years, with large-cap stocks outpacing small-caps and growth outperforming value. U.S. markets were led by Technology and all sectors were positive except for Materials, which was flat. Bonds underperformed.

The U.S. economy is heading into 2025 from a position of strength. The Atlanta Fed's data driven GDPNow model estimate for real GDP growth is +3% (Chart 1). The labor market is strong and close to full employment. Initial jobless claims remain low and range bound. Most notably, non-farm labor productivity has strengthened above pre-pandemic trends, up 2% in the last year, driving profits and real wage growth (a notable driver of the '90- '00's bull market) (Chart 2). Consumer spending continues to be robust as inflation continues to cool. Credit conditions are favorable as the Fed remains on a path of easing.

With the election uncertainty lifted and expectations of pro-growth Trump policies, both business and consumer confidence continue to improve. In December, the NFIB Small Business Optimism Index saw the biggest sequential increase on record and jumped to highs not seen since October 2018 during Trumps first term (Chart 3). The ISM Manufacturing PMI survey rose 49.3 in December with new orders at 52.5, reflecting the strongest level of demand for new goods in 11 months and supportive of expansion.

Trump policy framework will be an important driver of the economy over the next four years. As a whole, we believe policy direction will be pro-growth as it was in the prior term. Themes like reducing unnecessary regulation and fiscal spending will be beneficial in accelerating activity and reducing costs. With the Federal budget deficit up nearly 40% in the last twelve months, something needs to be done. Other policies like tariffs and immigration are much more complex and do carry risks, but if handled optimally they should not derail progress. We will take a "wait and see" approach as to what final policy decisions bring before becoming overly concerned.

The most important fiscal policy legislative initiative in the first year of the new administration will be renewing the expiring provisions of the 2017 Tax Cuts and Jobs Act. Those tax cuts, and policies like the increased Child Tax Credit, will expire at the end of the year and will result in ~$4 trillion in tax hikes if not extended, with most of the burden falling on working Americans. While not devastating, it will directly impact economic activity and poses a risk to markets if nothing is done.

Tariffs are a complex issue. Negative opinions point to them being a tax on consumers and inflationary. However, markets are self-correcting and elastic. Increasing tariffs cause the dollar to strengthen, offsetting the cost of the tariffs with purchasing power. Second, consumer preferences can shift to buying local goods, therefore increasing economic activity in the US. Exporters may also reduce prices and absorb the “tax” in their margins or be subsidized by their governments to offset them. The 2018 and 2019 Trump tariffs did not result in inflation, nor a material reduce the volume of imports. However, they did increase revenues to the Treasury and impact foreign policy, hence their continuation under Biden. The threat of tariffs alone has also been an effective bargaining tool. Also, the size, scope and timing will matter. Again, it is prudent to wait and see.

For Q4 2024, according to FactSet’s January 17 *Earnings Insight*, the estimated year-over-year earnings growth rate for the S&P 500 is +12.5%. If reported, it will mark the highest (year-over-year) earnings growth rate reported by the index since Q4 2021. Revenue and margins also continue to be strong and supportive. Analysts expect earnings to be strong across all sectors and are projecting +14.8% year-over-year earnings growth for 2025 and +13.6% in 2026 (Chart 4).

Valuations continue to be stretched as price outpaced 2024 earnings growth and cautious estimates ahead of Trump policy uncertainty. The forward 12-month P/E ratio for the S&P 500 is 21.6, down from a recent high following the December pullback, but above the 5-year average 19.7. Positive outcomes will depend on whether the earnings tailwinds continue and bond yields stabilize or fall. The 12-month, bottom-up target for the S&P 500 is now 6757, 13.8% above Friday’s closing level of 5937.

Our playbook continues to focus on significant secular, cyclical, and structural trends. We favor high-quality growth at reasonable prices and businesses with stable free cash flow and healthy balance sheets. We will continue to balance growth and value and are prepared to shift defensively if needed as government policies are formalized.

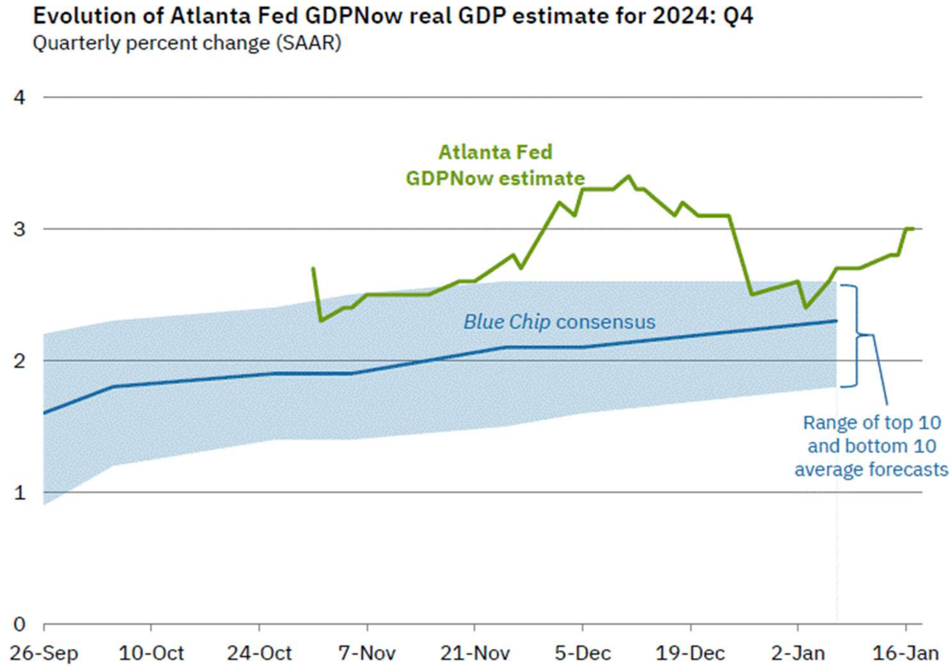
Important themes we are following are AI infrastructure and software beneficiaries, semiconductor cycles, the reshoring of industry, normalizing interest rates, deregulation and shifting trade and energy policy.

We remain in a secular bull market, supported by the weight of evidence. Economic growth, strong balance sheets, an earnings tailwind, coupled with a normalized rate environment and the expectation of pro-growth policies under Trump’s second term support a continued broadening of equity market returns and positive performance. We are optimistic.

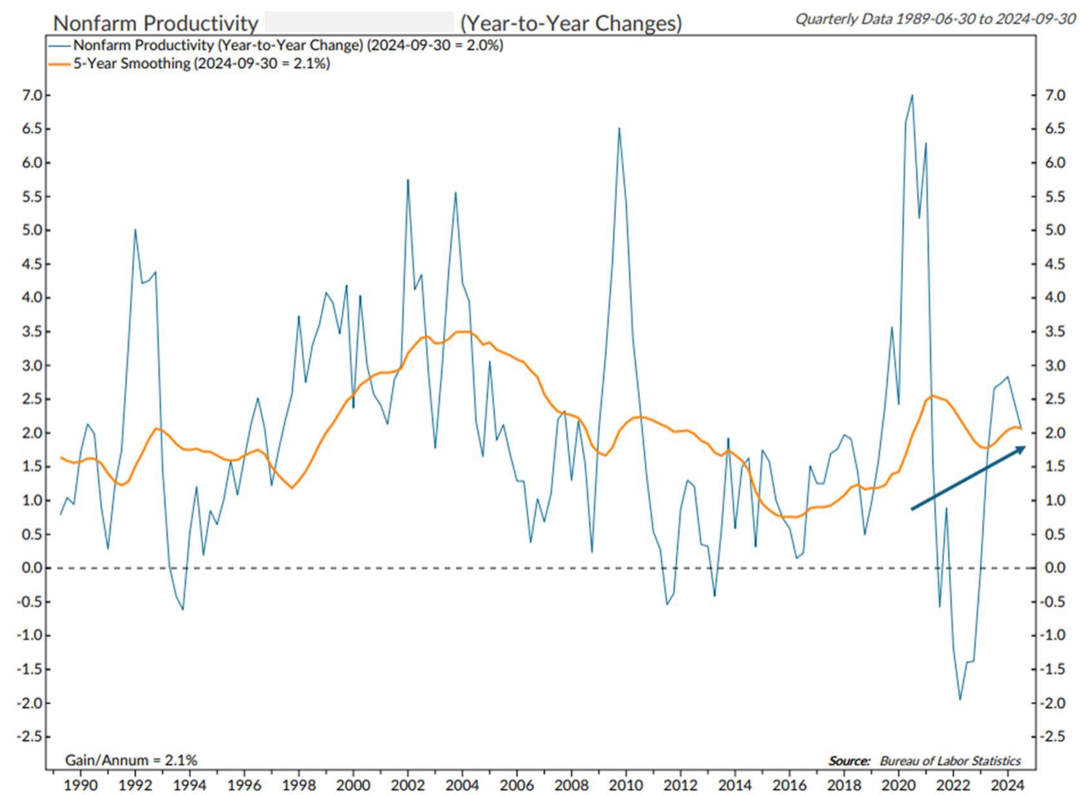
Robert B. Morse

Chief Investment Officer

1.


Evolution of Atlanta Fed GDPNow real GDP estimate for 2024: Q4
Quarterly percent change (SAAR)
Atlanta Fed GDPNow estimate
Blue Chip consensus
Range of top 10 and bottom 10 average forecasts
4
3
2
1
0
26-Sep
10-Oct
24-Oct
7-Nov
21-Nov
5-Dec
19-Dec
2-Jan
16-Jan

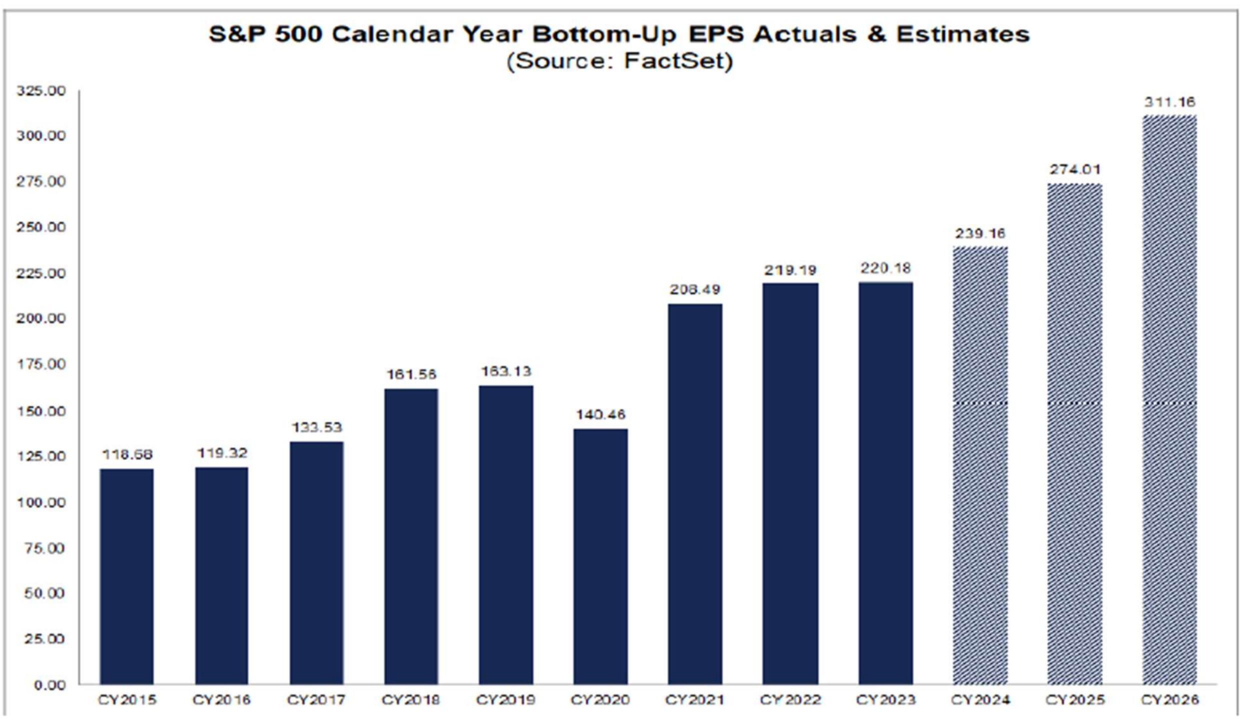
2.


Nonfarm Productivity (Year-to-Year Changes)
Quarterly Data 1989-06-30 to 2024-09-30
Nonfarm Productivity (Year-to-Year Change) (2024-09-30 = 2.0%)
5-Year Smoothing (2024-09-30 = 2.1%)
Gain/Annum = 2.1%
Source: Bureau of Labor Statistics
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018
2020
2022
2024

3.

Small Business Optimism Index at 105.1
Based on 10 survey indicators, seasonally adjusted, Jan. '10 – Dec. '24
Index Value (1986=100)
120
110
100
90
80
70
'11
'14
17
20
23

4.



S&P 500 Calendar Year Bottom-Up EPS Actuals & Estimates
(Source: FactSet)
325.00
300.00
275.00
250.00
225.00
200.00
175.00
150.00
125.00
100.00
75.00
50.00
25.00
0.00
118.58
119.32
133.53
161.56
163.13
140.46
208.49
219.19
220.18
239.16
274.01
311.16
CY2015
CY2016
CY2017
CY2018
CY2019
CY2020
CY2021
CY2022
CY2023
CY2024
CY2025
CY2026