Market Talking Points

January 1, 2025

Near-term Outlook (3 months) *

The S&P 500 gained more than +20% for a second consecutive year in 2024. Mega-cap stocks drove the equity market rally, and while most smaller companies posted solid returns, they significantly underperformed. Stocks ended 2024 trading lower as the post-election optimism faded, but expectations for both the economy and earnings are high heading into 2025. This creates the potential for a growth scare if the economy underperforms expectations, like in summer 2024. We're also monitoring the long-term implications of high valuations and see pressure building underneath the surface. The question is when and how it releases. It will be important to balance the potential for continued near-term momentum with the risk of below-average long-term returns.

Long-term Outlook (12 months) *

The Fed has ended its tightening cycle and is cutting interest rates as it prioritizes unemployment over inflation. The market shares the Fed's focus, but recent labor market and inflation data have caused both to lower their rate cut expectations for 2025. The main question is whether the economy is deteriorating or normalizing. Some parts of the economy, such as housing, manufacturing, and loan growth, show the impact of higher rates, while others indicate it is still growing, just at a slower pace. Our view is that the economy is normalizing after the pandemic, but the primary risks remain: economic and earnings expectations are high, households are heavily allocated to stocks, and the biggest companies trade at high valuations. The starting point is less attractive. We're not calling for a recession or bear market, but we're lowering our expectations for 2025. It will be difficult to post a third consecutive year of +20% gains.

Current Market Themes

Federal Reserve Policy	Fed begins rate-cutting cycle as inflation eases & labor market cools; Primary question is how much Fed cuts
Corporate Earnings	Analyst forecast S&P 500 EPS growth, driven by profit margin expansion
Inflation Pressures	Inflation pressures are easing as labor market softens, energy prices stabilizes, & economic activity normalizes

Economic Factors

U.S. GDP Growth	Consumer & gov't boosted Q3 growth, while residential & business investment slowed; Remains above trend
Inflation	Expect inflation to ease, but there is a risk that inflation remains stuck above the Fed's 2% target
Employment	Early signs of softer labor demand, but labor market remains tighter than pre-pandemic due to early retirees
U.S. Consumer	Softening labor market, but supported by rising home /stock prices, locked-in low interest rates, & wage growth
Interest Rates *	Market & Fed now forecast -0.50% of cuts in 2025; Likely remain volatile due to policy & uncertain economic path
Long Duration Bonds *	Yields could move higher in 1Q25, but Q4 yield spike + elevated growth expectations = bonds look more attractive

Asset Class Outlooks

Large Cap Growth	Historically outperforms during Fed rate cutting cycles; Mindful that Mega Cap Growth crowded & expensive
Large Cap Value *	Trades at a discount to Growth, but expensive vs its own history
Small Caps	History suggest Small can continue to outperform after lagging Large; Near-term risk due to economic growth
Developed Markets	Rate hikes having a bigger impact in non-U.S. countries; Favor Quality & Dividend factors
Emerging Markets	Slower global growth = EM risk, but EM central banks have more room to cut; More earnings potential than DM
U.S. Corporate Bonds *	Remain overweight as credit risk increases; Favor mid duration due to credit spread risk
U.S. High Yield Bonds	Tight spreads leave little room for further tightening; Tight lending standards = refinancing risk

* Denotes updated views in this version of the Market Talking Points

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