MARKET COMMENTARY

Vibes

Q4, 2024

- U.S. large-cap stocks hit over 50 new all-time highs in 2024, ending the year up 25%. U.S. small-cap stocks gained 11%, and U.S. intermediate-term bonds ended 2024 up 1%.
- Post-election, small business optimism recorded the largest month-over-month increase since July 1980. A similar shift in sentiment was noted in various CFO surveys.
- Despite sticky inflation and higher interest rates, the U.S. consumer remained resilient while U.S. government spending continued unchecked.
- The incoming administration appears focused on the challenging task of bolstering economic growth while at the same time reducing the deficit.
- The most critical element of this endeavor will be curtailing the deficit while keeping longer-term yields contained so as not to disrupt economic expansion.

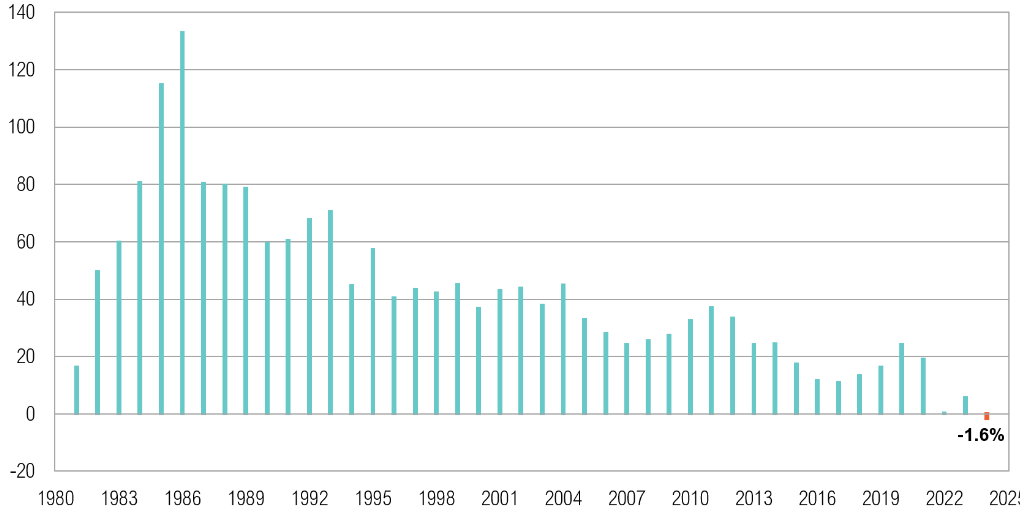
Overview

Markets ended 2024 with mixed results. U.S. large-cap stocks ended the fourth quarter up 2.4% and ended the year up 25.0%. The S&P 500 hit over 50 new all-time highs in 2024. Over the past two years, the S&P 500 has risen a cumulative 53%—the strongest performance since the nearly 66% increase experienced between 1997 and 1998. U.S. small-cap stocks gained 11.5% over the year after a fourth quarter gain of 0.3%. In contrast, 2024 was another challenging year for U.S. intermediate term bonds. After declining 3.1% in the fourth quarter, the Bloomberg U.S. Aggregate Bond Index ended 2024 up only 1.3%. This marks a cumulative decline of 1.6% over the past five years, making it the worst five-year return since at least 1980.

2024 marks the worst five-year return for U.S. intermediate-term bonds since 1980

U.S. Intermediate-Term Bonds Ended 2024 with Worst 5-Year Return Since 1980

U.S. Intermediate-Term Bonds, Cumulative 5-Year Return, %



Source: Bloomberg. U.S. intermediate-term bonds proxied by the Bloomberg U.S. Aggregate Bond Index.

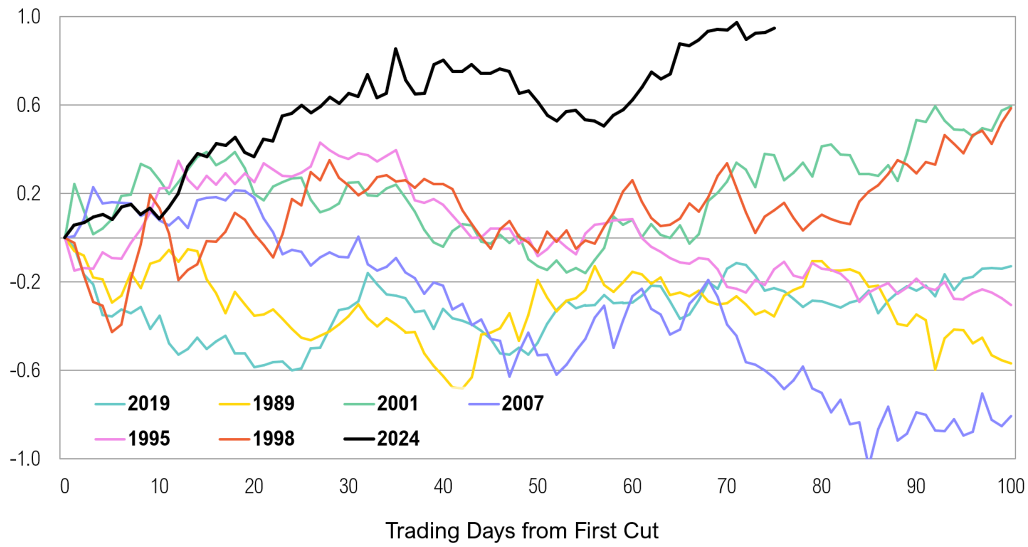
Between September and December, the Fed cut interest rates by 1.0%

After easing to 2.4% year over year in September, headline inflation, as measured by the Consumer Price Index (CPI), ended the year at 2.7%, and housing inflation remained the key contributor.[1] Core inflation, which excludes food and energy, ended 2024 up 3.3% and has been above 3% for 43 months.[2] On September 18, with inflation still well above the official 2% target, the Federal Reserve (Fed) began to cut short-term interest rates. During the fourth quarter and across three different meetings, the Fed cut interest rates by 1.0%, bringing the year-end rate to 4.25% - 4.5%.

At the December 18 Federal Open Market Committee meeting, the Fed's economic projections indicated that committee members expected the equivalent of two 0.25% rate cuts in 2025, even though their year-end 2025 inflation expectations increased from 2.1% to 2.5%.[3] The 10-year Treasury yield has climbed higher since the first rate cut in September (an unprecedented move relative to historical rate-cutting cycles). This pushed 30-year mortgage rates higher, to end December at 7.3%, 0.6% higher than they were prior to the first Fed interest rate cut. By early January, markets were anticipating the equivalent of only one 0.25% interest rate reduction for 2025.[4]

The 10-Year Treasury Yield Has Risen Since The First Rate Cut

Absolute Change in 10-Year Treasury Yield During Major Rate Cutting Cycles, %



Source: Bloomberg

Online sales increased by a record $241 billion during the 2024 holiday spending season

Two key factors have characterized the U.S. economy: the resilience of the U.S. consumer and the alarming rate of government deficit spending. Consumer spending continues to be robust. Online sales increased by a record $241 billion (or 9% year over year) over the holiday spending period.[5] This is despite credit card interest rates nearing record highs at an average of 24% and the personal saving rate standing at 4.4%—well below the historical average of 8.4%. According to Mastercard Economics Chief Economist Michelle Meyer:

> "*The holiday shopping season revealed a consumer who is willing and able to spend but driven by a search for value as can be seen by concentrated e-commerce spending during the biggest promotional periods… Solid spending during this holiday season underscores the strength we observed from the consumer all year, supported by the healthy labor market and household wealth gains.*"[6]

In the 2024 fiscal year, the U.S. government fiscal deficit reached $1.8 trillion, making it the largest deficit in a non-crisis or non-recessionary year on record.[7] Already, the fiscal deficit for 2025 (which began in October) has surpassed $620 billion and is projected to reach $1.9 trillion by the fiscal year end.[8,9] With interest rates still elevated, the interest expense on U.S. public debt rose by 20% over the past 12 months, climbing to $886 billion. This is nearly on par with national defense spending ($928 billion) and spending on health care programs ($926 billion).

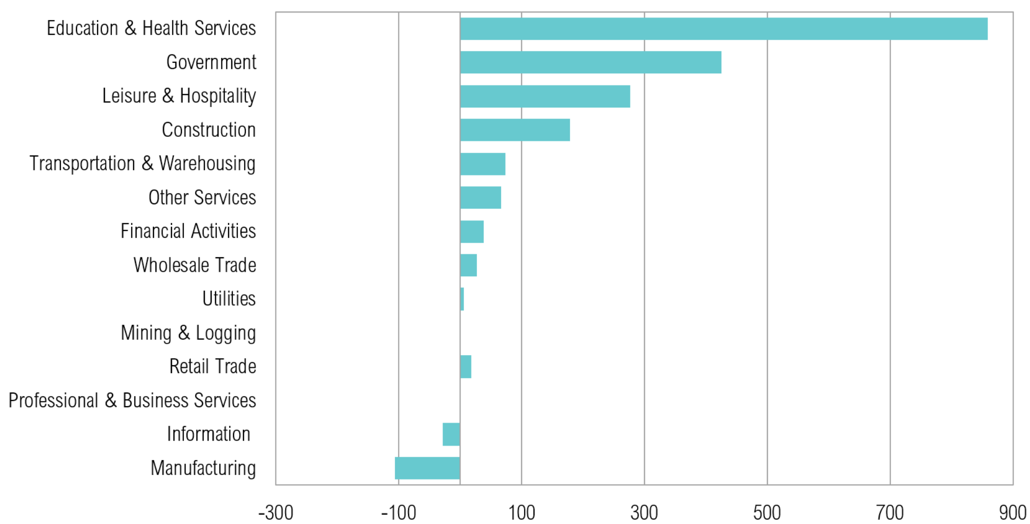
The services sector of the economy continues to expand

The U.S. economy expanded by an annualized 3.1% quarter over quarter in the third quarter, and projections for the fourth quarter are estimated to be 2.3%. The services sector remains the primary growth driver. The ISM Services PMI continued to expand throughout the fourth quarter and ended December with a reading of 54.1.[10] In contrast, the manufacturing sector has contracted for eight consecutive months, and the ISM Manufacturing PMI ended 2024 with an improved reading of 49.3—the highest reading since April. (A reading below 50 signals contraction in the sector).[11] The manufacturing sector experienced the largest reduction in employment in 2024, losing over 106,000 jobs during the year, followed by the information sector, which lost over 28,000 jobs. Conversely, the education and health services sectors added nearly 860,000 jobs in 2024, and the government sector gained nearly 425,000 jobs.[12] Overall, the labor market remained robust throughout 2024, and the unemployment rate finished the year near record lows at 4.1%.[13]

The manufacturing and information sectors saw the largest decline in jobs in 2024

Most New Jobs in 2024 Were Created in Education & Health and Government

2024 Change by Employment Sector, Thousands of Persons



Source: Bureau of Labor Statistics

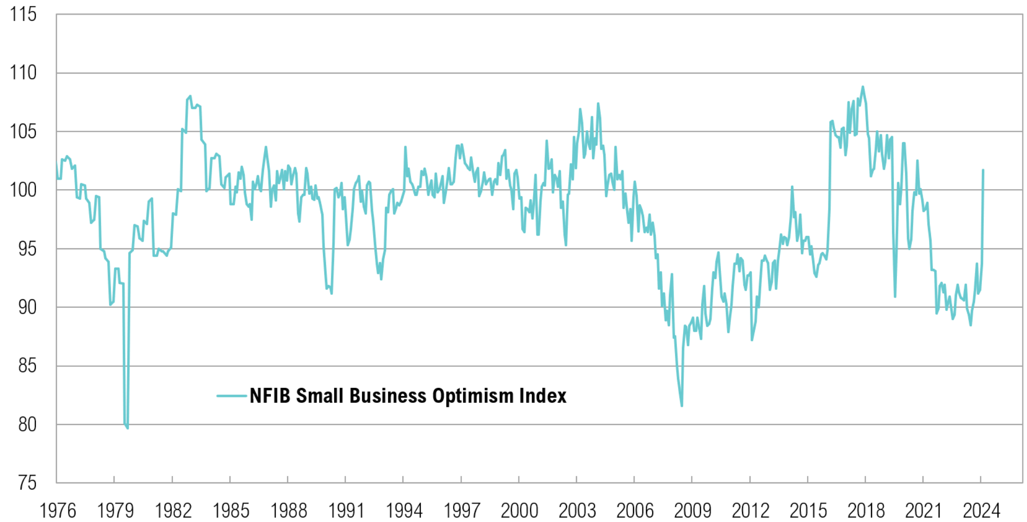
Vibes

Consumer sentiment increased, driven by Republican voters

One of the defining events of 2024 was the 60th U.S. presidential election, held on November 5. After the election, which saw the Republican party emerge as the decisive winner, consumer sentiment ticked up from 72 in November to 74 in December. This was largely driven by the 16-point spike in Republican sentiment, which offset the nearly 12-point drop in Democrat sentiment. Similarly, small business optimism jumped by eight points in November—the largest month-over-month increase since July 1980.[14] A similar (7.4 points) spike in small business optimism was recorded in 2016. After that, the Russell 2000 Index gained 25% over the next 12 months and an annualized 13% over the next four years. The S&P 500 gained 24% over the next 12 months and an annualized 20%

over the next four years.

Small Business Optimism Saw the Largest Monthly Rise in November Since 1980
National Federation of Independent Business (NFIB) Small Business Optimism Index



Source: Bloomberg

Small business optimism jumped by eight points in November—the largest month-over-month increase since July 1980

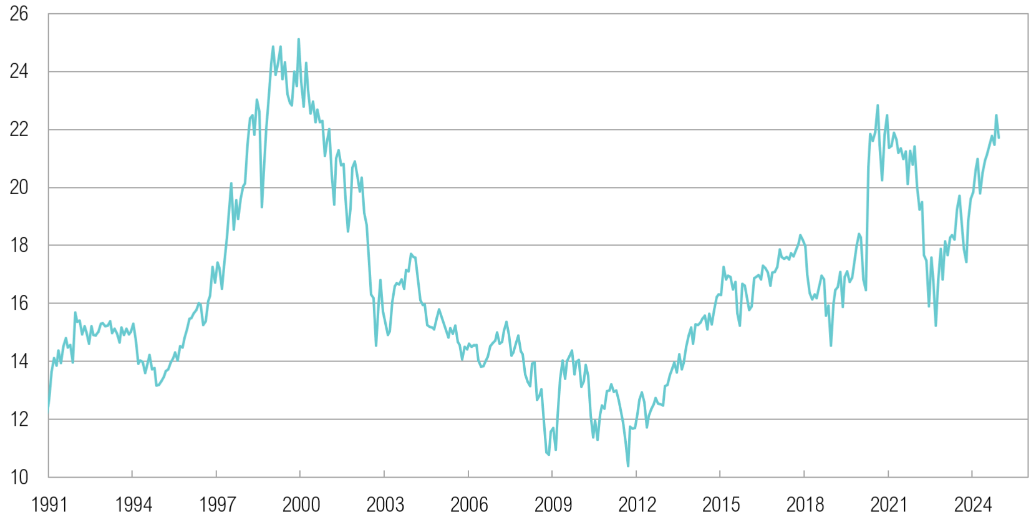
According to the November 2024 National Federation of Independent Business (NFIB) small business survey, 36% of respondents expect the economy to improve, 18% of respondents plan to increase hiring, and 28% plan to make capital outlays.[14] CFO surveys of larger companies conducted between October and November 2024 show a similar increase in optimism about the U.S. economy, and concerns about the health of the economy, company sales, and revenue declined sharply relative to the survey conducted between August and September 2024.[15] Another area of markets that continued to signal economic optimism were U.S. high yield credit spreads, which ended December near historical lows, at 2.7%, and continue to suggest that the economy may achieve a "soft landing." Further, the November Job Openings and Labor Turnover Survey (JOLTS) report, released in early January, showed signs of stability. Job openings ticked higher for the second consecutive month (the first two-month rising streak since December 2022), and the total number of job openings surpassed the 8-million mark for the first time since May 2024.[16] Vibes are shifting with larger businesses too as they seek to align themselves with the new administration. Meta recently announced changes to the company's moderation policies and practices, citing a shifting political and social landscape and a commitment to embracing free speech.[17,18] The company has also announced that it will be moving its content moderation and trust and safety teams from California to Texas.[17,18]

U.S. high yield credit spreads remained near historical lows

Even before post-election economic sentiment surveys showed increased optimism, equity valuations remained elevated throughout the year and even climbed back to extreme levels, akin to the tech bubble. Despite valuations at extremes, U.S. large-cap returns were once again above average. With only 19% of S&P 500 constituents outperforming the broader index over the past year, returns remain substantially driven by a handful of mega-cap technology stocks, including Nvidia (up 171% in 2024), Meta (up 65%), Tesla (up 63%), and Amazon (up 44%). The Magnificent Seven now account for over a third of the S&P 500, up from a fifth of the index in 2022. Earnings growth for the S&P 500 is expected to be 15% for 2025.[19] In contrast, earnings growth for the Russell 2000 index is expected to accelerate by 40% in 2025.[20]

Despite elevated valuations, U.S. large cap stocks posted above-average returns in 2024

U.S. Large Cap Equity Valuations Were Near Extreme Levels Throughout 2024
S&P 500 12-Month Forward Price-to-Earnings (P/E) Ratio



Source: Bloomberg

Bessent's "3-3-3" target aims at reducing the deficit, raising economic growth, and increasing U.S. energy production

With the new administration taking office on January 20, President-Elect Donald Trump has already announced several key nominations for Cabinet posts and White House roles. Among these is Scott Bessent (a former Democrat donor), who has been nominated as Treasury Secretary.[21,22] Bessent has outlined a "3-3-3" target, which includes achieving 3% economic growth, reducing the federal deficit to 3% of GDP by 2028, and increasing daily energy production by the equivalent of 3 million barrels of oil—approximately a 20% increase from current levels.[23,24,25] When asked about his decision to accept the nomination, Bessent remarked:

> "*This election cycle is the last chance for the U.S. to grow our way out of this mountain of debt…*"[26]

Bessent's remark shows a stark contrast between the incoming and outgoing administrations' perspectives on the U.S. fiscal deficit burden and a shift in attitude about approaching the issue. At a Wall Street Journal CEO Summit, held on December 10, current Treasury Secretary Janet Yellen remarked:

> "*Well, I am concerned about fiscal sustainability, and I am sorry that we haven't made more progress. I believe that the deficit needs to be brought down, especially now that we're in an environment of higher interest rates.*"[27]

DOGE will seek to improve accountability within federal agencies

Conquering the rocky mountain size of the fiscal deficit is daunting; however, there is reason for optimism. In addition to Bessent, Trump has also announced the creation of the Department of Government Efficiency (DOGE). Led by Elon Musk and Vivek Ramaswamy, the department will seek to improve government accountability and efficiency within federal agencies.[28] While DOGE will not be an official government department but rather an advisory board, it could enlighten and subsequently lighten the U.S. fiscal deficit burden. For instance, the U.S. spent $20 million on a Sesame Street show in Iraq and uses less than 20% of its building space in D.C.[29,30] Further, an estimated $100 billion in improper payments were made in the Medicare and Medicaid programs, and in December, the Department of Justice filed a complaint against CVS for filling unlawful prescriptions of opioids and seeking reimbursement for them.[31,32]

The new administration is expected to usher in a more supportive regulatory environment for digital assets. Bitcoin surged 43% in the fourth quarter and ended 2024 up 130%. In a noteworthy move, Trump has appointed David Sacks as the nation's first Crypto and Artificial Intelligence (AI) Czar. In this advisory role, Sacks will facilitate communication between government officials and tech industry leaders while working to establish a regulatory framework that supports the growth of digital currencies.[33]

Source: SpringTide, Noah Kroese

Markets

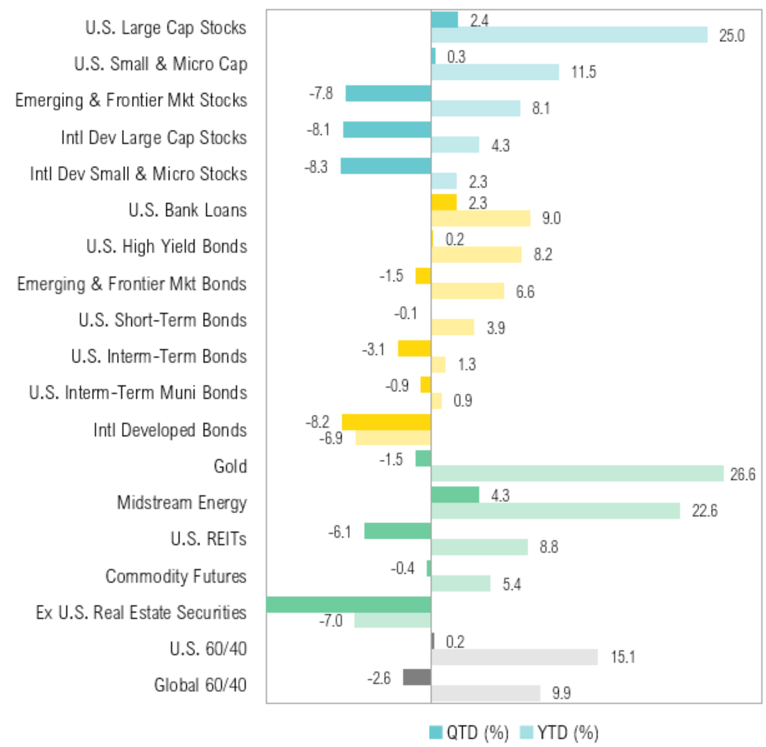
The U.S. dollar ended the month at its highest level since November 2022

U.S. equity markets fared significantly better than their international counterparts over the fourth quarter. U.S. large-cap stocks gained 2.4% while international developed large-cap stocks ended the quarter down 8.1%. Similarly, while U.S. small-cap stocks ended the quarter flat after gaining only 0.3%, international developed small-cap stocks dropped 8.3% over the quarter. Emerging and frontier market stocks ended the fourth quarter down 7.8%, driven by declines in South Africa (-12.1%), India (-11.3%), and Turkey (-10.1%). Plus, the U.S. dollar ended the month at its highest level since November 2022. Fixed income markets exhibited similar dynamics: while U.S. intermediate-term bonds ended the fourth quarter down 3.1%, international developed market bonds ended the quarter down 8.2%.

U.S. national average gas prices reached a three-year low in December

Despite ending the fourth quarter down 1.5%, gold ended 2024 up 26.6%, setting over 30 new record highs. After reaching a one-year low of $65.8 per barrel on September 10, West Texas Intermediate (WTI) crude oil ended the year at $71.7 per barrel. Despite rising oil prices, U.S. national average gasoline prices reached a three-year low of $3.02 on December 12.[34]

Q4 2024 Key Market Total Returns



Source: Bloomberg

International equities lagged their U.S. counterparts over the fourth quarter

In September, the People's Bank of China unveiled a series of economic stimulus measures, including interest rate cuts, increased government spending, and relaxed property market restrictions aimed at revitalizing sluggish growth in the face of a weak real estate sector and declining consumer confidence.[35] However, progress has been underwhelming, and further announcements have been delayed as authorities appear to be waiting for greater clarity on tariffs and the policies of the incoming Trump administration. On December 20, a week after the Chinese government announced its first loosening of monetary policy in 14 years, short-term Chinese sovereign bond yields fell to 0.92%—their lowest level since the Global Financial Crisis.[36] The MSCI China Index ended the fourth quarter down 7.7%.

The MSCI China Index ended the fourth quarter down 7.7%

In global fixed income markets, 10-year Japanese government bond (JGB) yields ended early January at the highest level since 2011, reaching 1.18%.[37] Similarly, in early January, UK 10-year Gilt yields reached the highest level since August 2008, rising to 4.76%. 30-year UK Gilt yields reached the highest level since August 1998 in early January, rising to 5.3%.

Looking Forward

The incoming administration appears focused on bolstering economic growth while at the same time reducing the deficit. The most critical element of this endeavor will be curtailing the deficit and, in the process, keeping longer-term yields contained to not disrupt the economic expansion.

While the Federal Reserve can dictate short-term interest rates through policy decisions, they have less control over longer-term rates. Since the first rate cut in September, longer -term yields have reacted with a unique vibe, moving higher than other rate cutting cycles.

The incoming administration will need to keep bond yields contained in order to achieve their policy goals

That's not to say a rise in bond yields is bad, per se, but unless it is driven by higher long-term growth prospects that translate to higher corporate earnings, rather than fiscal irresponsibility or other perceived policy errors, it could negatively impact risky asset valuations. It will now be up to fiscal policymakers to thread this needle. If they can, it will allow the continuation of government policies that support economic growth, which are critical for supporting equity and credit markets.

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DEFINITIONS

Asset class performance was measured using the following benchmarks: U.S. Large Cap Stocks: S&P 500 TR Index; U.S. Small & Micro Cap: Russell 2000 TR Index; Intl Dev Large Cap Stocks: MSCI EAFE GR Index; Emerging & Frontier Market Stocks: MSCI Emerging Markets GR Index; U.S. Intermediate-Term Muni Bonds: Bloomberg Barclays 1-10 (1-12 Yr) Muni Bond TR Index; U.S. Intermediate-Term Bonds: Bloomberg Barclays U.S. Aggregate Bond TR Index; U.S. High Yield Bonds: Bloomberg Barclays U.S. Corporate High Yield TR Index; U.S. Bank Loans: S&P/LSTA U.S. Leveraged Loan Index; Intl Developed Bonds: Bloomberg Barclays Global Aggregate ex-U.S. Index; Emerging & Frontier Market Bonds: JPMorgan EMBI Global Diversified TR Index; U.S. REITs: MSCI U.S. REIT GR Index, Ex U.S. Real Estate Securities: S&P Global Ex-U.S. Property TR Index; Commodity Futures: Bloomberg Commodity TR Index; Midstream Energy: Alerian MLP TR Index; Gold: LBMA Gold Price, U.S. 60/40: 60% S&P 500 TR Index; 40% Bloomberg Barclays U.S. Aggregate Bond TR Index; Global 60/40: 60% MSCI ACWI GR Index; 40% Bloomberg Barclays Global Aggregate Bond TR Index.

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