QUARTERLY

MARKET INSIGHTS

BEST TWO-YEAR STRETCH FOR S&P 500 SINCE 1998-1999 AND LOOKING TO 2025

4Q 2024

"The test of a first-rate intelligence is the ability to hold two opposing ideas in mind at the same time and still retain the ability to function." **-F. Scott Fitzgerald**

SUMMARY

- The US economy grew above trend for much of 2024 and will likely finish the year with real GDP growth between +2.5% to 2.8%[1].
- The S&P 500 returned +25.0% for the year.[2] Market breadth, while not robust, improved from 2023, particularly in the second half of 2024 which saw small caps outperform their large cap peers.
- The US labor market and US consumer remained stable despite interest rates rising early in 2024.
- Corporate America thrived with earnings and margins largely delivering on the lofty expectations that analysts set at the outset of the year.
- Corporate credit markets performed well, underpinned by solid corporate fundamentals and low default rates, while rising treasury yields limited aggregate bond market returns.

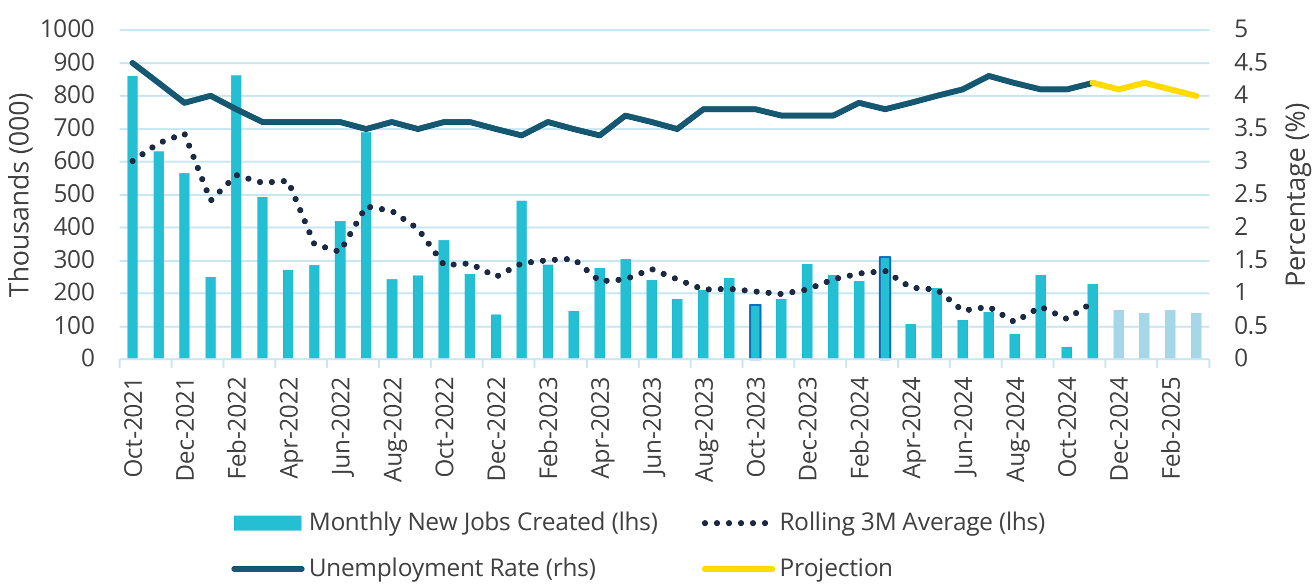
ECONOMY

American exceptionalism in 2025.

2024 turned out to be a good year. Both the US economy and US risk assets performed better than expected. As we started 2024, market watchers were fretting about the Fed's mantra of a higher for longer interest rate policy. There were fears that US economic growth would underwhelm amidst a worsening fiscal backdrop and that the myriad of geopolitical risks—wars in the Middle East and Ukraine, and elections in over a dozen major countries (including the US)—would provide a negative global shock. Expectations for the S&P 500 were tepid amidst fears that profits and margins would disappoint or that once again only a few tech stocks would be making gains. However, none of those fears came to pass, amplifying the importance of being able to balance the opposing ideas of macro risks with a fundamental backdrop that may contradict those macro concerns.

As the economy enters 2025, the notion of American exceptionalism remains front and center. Next year, real GDP growth should be similar to this year in the 2.5% to 3.0% range.[3] While much of the rest of the world's large economies under-delivered in 2024, the US economy outperformed. The US created 180,000 new jobs on average every month in 2024 (as of November's employment report), while unemployment claims for the full year were lower than last year and the fourth lowest on record since 1969.[4] Given that the vast majority of Americans were employed, retail sales remained solid and US corporations saw levels of productivity growth above their pre-Covid trend.

US Labor Market Stable in H1-2025



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[1] FRED - Federal Reserve Bank of St. Louis, 12/31/2024.

[2] Bloomberg LP, 12/31/2024.

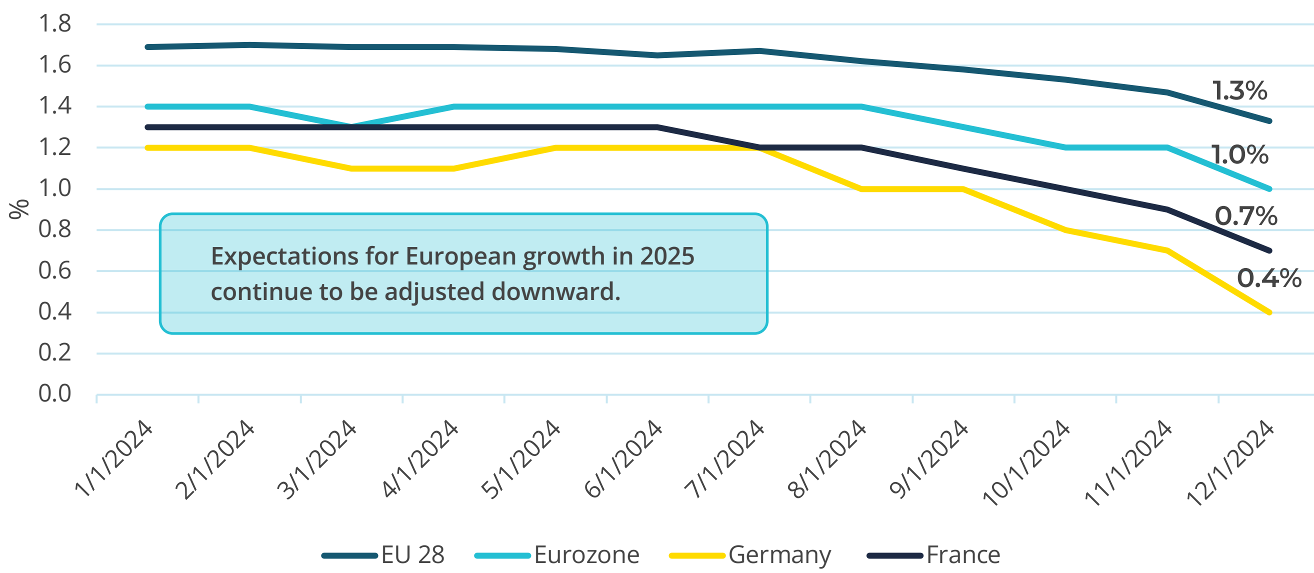
[3] Clearstead research.

[4] FRED - Federal Reserve Bank of St. Louis, 12/31/2024.

Source: Clearstead; Federal Reserve Bank of St. Louis – 12/20/2024; Projection assumes an approximate job growth at 3-month moving average ≈145k level.

In contrast, Germany and France are struggling with sub-1 percent growth in recent quarters and both are amid political gridlock. France could not pass a new budget for 2025, which caused the Prime Minister to step down last month. Germany is headed to new elections in February and polling suggests that current German Chancellor Olaf Scholz is likely to be ousted. Throughout Europe, growth expectations for next year are being revised lower from already modest levels. Meanwhile, China continues to waffle on its economic policies and is struggling to put a floor under its real estate market and boost consumer and business sentiment. Whereas, the US election delivered a clear winner and Trump's team is putting together a new pro-growth economic agenda.

Median Forecast - Real GDP Growth 2025



Source: Clearstead, Bloomberg LP, consensus GDP estimates, as of 12/31/2024.

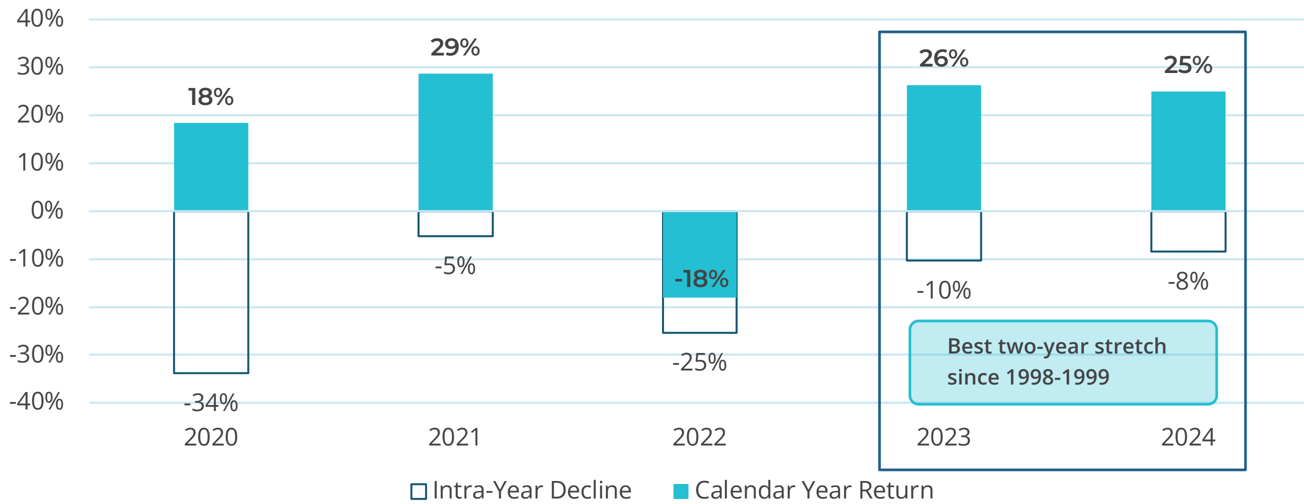
While portions of the new Trump administration's policy goals could be mixed in their economic impact (tariffs and immigration), their goals to lower energy prices, improve government efficiency, reduce regulations, and potentially cut taxes should provide a tailwind to numerous US industries. Along with the potential for at least one additional Fed rate cut in 2025, a new capital-expenditure (capex) cycle may lift off and help boost growth next year.

EQUITY MARKETS

Muted prospective long-term returns, but near-term fundamentals remain positive.

There are dueling narratives for 2025 in terms of equity markets. The bearish case is that US equity valuations, particularly for the S&P 500, are very high, which portends lower long-term returns going forward. Investor sentiment with regard to equities is quite bullish after back-to-back strong years (S&P 500 +26.3% in 2023 and +25.0% in 2024), which represent the best 2-year returns since the 1998-1999 period.[5] As a result, investors' allocations to equities—versus bonds or cash—have neared the historic highs set in late 1990s and almost matched the period during the height of mid-2000s US housing boom.[6] Pessimists point to these measures and conclude a bubble has formed (or is forming) and that next year's equity returns will disappoint.

Post Covid Cycle: Calendar Year Declines and Calendar Year Returns for the S&P 500



Source: Clearstead, Bloomberg LP, as of 12/31/2024.

Optimists see things differently as they point to a strong US economy. The US will arguably be the envy of the world next year given the strength of most US corporate balance sheets, earnings expectations of around +15.0%, and the fact that equities outside the US look uninspiring from a fundamental point of view— given weaker earnings, profit margins, balance sheets, and more geopolitical risk.[7] The US has been enjoying a productivity renaissance which has helped US companies maintain or improve their margins despite higher input and labor costs. Additionally, analysts expect that all the investments made in AI in recent years will begin to provide real-world applications that will help corporate America further advance productivity and profits. Given this backdrop, it is easy to see why many US investors—as well as an increasing number of foreign investors—have maintained their bullishness on US equities.

As a side note, the S&P 500 has experienced 20+% returns in 40% of all calendar years since 1928 and we now add 2024 to that list.[8] While recent returns have been larger than average, this does not necessarily portend market declines. In fact, since 1928, when the S&P 500 has gained over 20% in a calendar year, the following calendar year has seen positive gains nearly 70% of the time.[7] It is important to note that, (a) equity markets generally go up over time, (b) investors

[5] Bloomberg LP, 12/31/2024.

[6] FRED - Federal Reserve Bank of St. Louis, 12/31/2024.

[7] Factset Earnings Insight, 12/20/2024.

[8] Clearstead, Morningstar, 12/31/2024.

rarely, if ever, experience “average returns,” and (c) large market advances don’t necessarily lead to large market declines (i.e., greater than -20%), as those are typically reserved for recessions, which we do not see on the horizon. This is important as we think about expectations for 2025.

GEOPOLITICAL RISKS

A light at the end of a tunnel?

Last year at this time, we highlighted in our client communications the numerous geopolitical risks at play in the world. Those included ongoing and intensifying conflicts in the Middle East and Eastern Europe, over 2 billion people going to the polls to vote in new governments, and simmering tensions between the US and China. At the dawn of 2024, the risks to all these geopolitical challenges looked clearly skewed to the downside, but as we head into 2025, it is worth noting the risks look more balanced. Further escalation and even more risk is still possible in many areas of the world, but there is a plausible—but by no means assured—path to several of these geopolitical challenges to recede rather than become more acute. For instance, fighting in the Middle East between Israel, Hamas, and Hezbollah looks more likely to diminish in the coming months rather than re-intensify. Israel and Hezbollah began a 60-day tentative ceasefire in late November that could be extended in the coming weeks. Meanwhile, the incoming Trump administration seems to be floating plans to secure a ceasefire between Israel and Hamas in Gaza as well as to begin some sort of conflict settlement talks between Russian and Ukraine. The success of any of these measures is highly uncertain, but compared to the beginning of 2024, at least there is hope for better days to come.

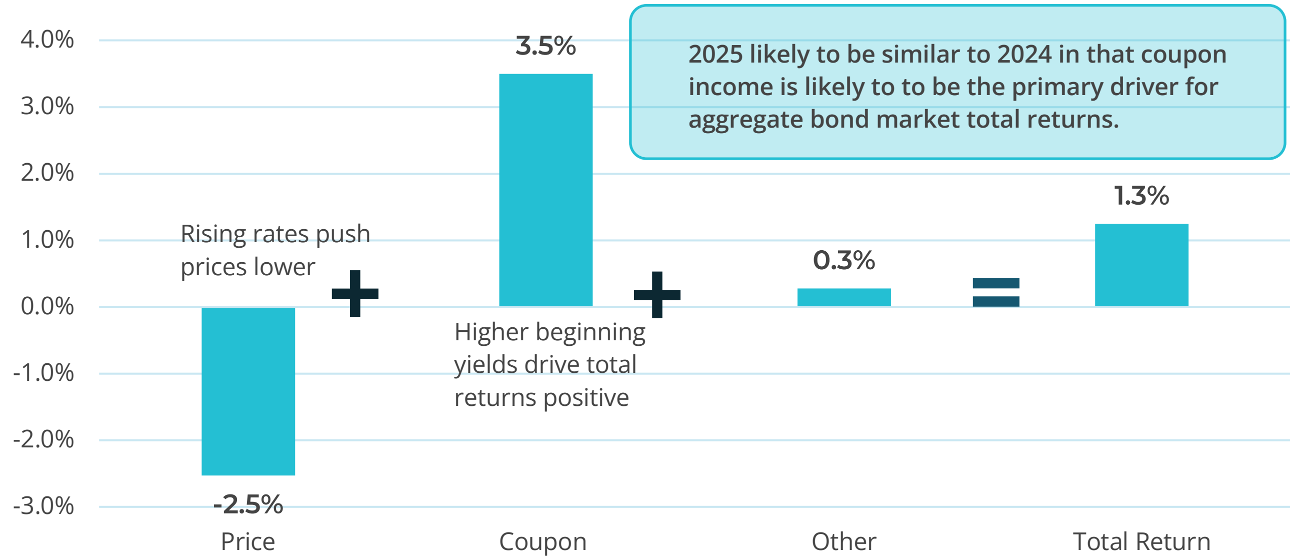
FIXED INCOME MARKETS

Volatility likely to remain in US Treasury markets, coupon income remains key.

Volatility was a consistent theme in US Treasury markets throughout 2024. The 10-Year US Treasury yield started the year at 3.9% before increasing to 4.6% to close out the year—the highest 10-Year yield to end a calendar year since 2006.[9] Broad bond market returns were weighed on by rising treasury yields, with the Bloomberg Aggregate Bond index and the Bloomberg Municipal bond index eking out gains of +1.3% and 1.1% for the year, respectively.[9] Corporate credit indexes, meanwhile, were positive as credit spreads remained relatively stable. Investment grade bonds (Bloomberg US Corporate Bond index) gained +2.1% in 2024 while the less interest rate sensitive high yield bond market (Bloomberg High Yield index) jumped +8.2% for the year.[9]

[9] Bloomberg LP, 12/31/2024

2024 Bloomberg Aggregate Bond Market Index Total Returns



Source: Clearstead, Bloomberg LP, decomposition of benchmark return as of 12/31/2024.

Credit spreads remain extremely narrow versus history, with investment grade and high yield option adjusted spreads (OAS) both well below their respective long-run averages, with investment grade credit spreads in the top 15% of all observations and high yield in the top decile of all observations[10]—both reflecting the strength of the economy and of corporate America. Given the economic backdrop and favorable consumer and corporate fundamentals heading into 2025, we do not see big risks with respect to upticks in default rates though a widening of credit spreads would not come as a surprise given their relatively 'rich' starting points.

2025 OUTLOOK

Economy remains strong, though lower returns ahead.

As we look out at 2025 it's fair to say we see the glass as half full rather than half empty. The stretched valuations of the S&P 500 are legitimate and a real worry, but it's equally worth noting that outside the largest 10-names in the S&P 500, valuations are only slightly above their past 15-year average. US mid-caps, dividend-oriented names, and small caps all represent opportunities to gain exposure to US equities at reasonable valuations. We believe that 2025 is set up for a broader set of market leaders than we experienced in either 2023 or 2024.

After two incredibly strong years, we expect that 2025 is more likely to provide modest returns in the mid-to-high single digits than provide a third-straight year of double-digit returns. We would, however, expect after two years of below-trend volatility, that the path of equity returns in 2025 will be choppier. Additionally, as of this writing, negative returns for broad indexes next year seems less likely and would mean either a major negative geopolitical shock has materialized or that market sentiment radically soured—in the face of a strong economy and solid earnings—

[10] Bloomberg LP, 12/31/2024.

leading to a sizable compression of earnings multiples. We would also add the risk to our baseline expectations that stickier inflation could cause long-term interest rates to rise beyond 5.0% in which case equity markets may experience pronounced volatility driven by a contraction in valuation multiples.

The existing strength of the US economy, the prospect of further deregulation and tax cuts, its structural advantage over much of the world in the functioning of its capital markets, and its increasing advantage in productivity and innovation suggests to us that the momentum may continue. While the big winners of 2024 may not be the winners of 2025, it is highly likely the best returns are still likely to be found in the US rather than abroad.

In bond markets, our 2025 fixed income outlook remains largely consistent with that of 2024 in that we continue to expect to expect volatility in US Treasury markets and the general trend for the benchmark 10-Year US Treasury yield is likely to be spent closer to 4.75% rather than closer to 3.75% for 2025. A deeply negative budget deficit, increasing debt levels, and the potential for inflation to remain stickier than expected are some of the motivating factors for why we see yields hanging around higher for longer in the near term.

As in 2024, expected returns in fixed income for 2025 are likely to come from coupon income rather than capital appreciation with low single digit returns the likely outcome for traditional bond market indexes.

SUMMARY

There are risks to our outlook—there always will be—and unexpected shocks (by definition unanticipated events) could occur, but, on balance, there seem to be more things that could go right next year than wrong. As fiduciaries, our task is to provide clients with the best guidance we are able to that is consistent with their individual goals and risk tolerance. While staying invested after two very strong years may seem uncomfortable, it is still the best course of action given the present conditions. We fully expect that as compared to 2024, 2025 is likely to be characterized as having more volatility with lower returns for both fixed income and equity markets.

	MTD	QTD	YTD	1 YEAR
DOMESTIC EQUITY				
Russell				
All Cap	-3.06%	2.63%	23.80%	23.80%
Large	-2.79%	2.74%	24.50%	24.50%
Large Growth	0.88%	7.07%	33.35%	33.35%
Large Value	-6.85%	-2.00%	14.35%	14.35%
Mid	-7.04%	0.62%	15.34%	15.34%
Mid Growth	-6.22%	8.14%	22.10%	22.10%
Mid Value	-7.32%	-1.75%	13.06%	13.06%
Small	-8.26%	0.33%	11.53%	11.53%
Small Growth	-8.19%	1.70%	15.14%	15.14%
Small Value	-8.34%	-1.07%	8.04%	8.04%
Micro	-5.80%	5.88%	13.66%	13.66%
S&P				
500	-2.39%	2.39%	25.00%	25.00%
400	-7.12%	0.33%	13.89%	13.89%
600	-7.96%	-0.59%	8.65%	8.65%
Other				
DJIA	-5.13%	0.93%	14.99%	14.99%
NASDAQ	0.56%	6.36%	29.60%	29.60%
INTERNATIONAL EQUITY				
MSCI				
EAFE	-2.27%	-8.11%	3.82%	3.82%
ACWI ex USA	-1.94%	-7.60%	5.53%	5.53%
ACWI ex USA Growth	-2.14%	-7.88%	5.07%	5.07%
ACWI ex USA Value	-1.36%	-6.91%	6.19%	6.19%
ACWI ex USA Small Cap	-2.13%	-7.66%	3.36%	3.36%
EAFE Small Cap	-2.30%	-8.36%	1.82%	1.82%
World ex US Small Cap	-2.62%	-7.86%	2.76%	2.76%
Emerging	-0.14%	-8.01%	7.50%	7.50%
ALTERNATIVES				
NAREIT Developed	-6.93%	-9.45%	2.00%	2.00%
FTSE Global Infrastructure 50/50	-5.77%	-5.55%	10.46%	10.46%
GS Commodity	3.28%	3.81%	9.25%	9.25%
Alerian MLP Index	-7.19%	4.85%	24.05%	24.05%
SPDR Gold Shares	-1.41%	-0.38%	26.66%	26.66%
FIXED INCOME				
Bloomberg US Agg	-1.64%	-3.06%	1.25%	1.25%
Bloomberg Global Agg	-2.15%	-5.10%	-1.69%	-1.69%
Bloomberg US Corporate High Yield	-0.43%	0.17%	8.19%	8.19%
Bloomberg Long G/C	-4.79%	-7.42%	-4.15%	-4.15%
Credit Suisse Leveraged Loan	0.59%	2.29%	9.05%	9.05%
J. P. Morgan Emerging Markets Bond	-1.50%	-2.12%	5.73%	5.73%
Bloomberg Municipal Bond	-1.46%	-1.22%	1.05%	1.05%
Bloomberg 1-3 Year Gov/Credit	0.21%	-0.02%	4.36%	4.36%

Source: Clearstead, Morningstar, MSCI, Bloomberg LP, as of 12/31/2024
Past performance is not an indicator of future results.

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