Economic Overview

Steve Scranton, CFA, SVP, Economist

Economic growth in the 4th quarter continued to show the positive growth that has existed this year. After experiencing year-over-year growth of 2.9% in the 1st quarter, 3.0% in the 2nd quarter, 2.7% in the 3rd quarter, current forecasts from economists surveyed by Bloomberg are for 2.4% growth in the 4th quarter. We will not get the first estimate of 4th quarter growth until later in January but the monthly data for October and November has been solid.

To use an automotive analogy, overall the economy was "firing on all cylinders" in 2024 and the 4th quarter continued that trend. The consumer remains the biggest contributor to economic growth, but 2024 saw business spending making solid contributions too.

Consumer Spending

Since 12/31/23, the US has added 1,984,000 jobs as of 11/30/24. Although that was "only" 1.3% jobs growth, those jobs created income at a faster pace. Personal income grew 4.9% over the same period. That income was used as follows:

How Income Was Used	Percent of Personal Income
Personal spending	80.5%
Taxes	12.3%
Interest Payments on Debt	2.2%
Government Transfer Payments	1.1%
Savings	3.9%

As of the 3rd quarter GDP data (9/30/24) personal spending accounted for 68.9% of total Real GDP. Based on the Retail Sales data as of 11/30/24 this percentage will be similar for the 4th quarter.

Business Spending

After two quarters of negative contribution is 2022 and another negative quarter in 2023, business spending has been a solid contributor to Real GDP growth in 2024. Although spending on structures (i.e., residential and commercial real estate) has continued to struggle, overall construction spending is up 11.5% since 12/31/23. Much of the construction spending is related to manufacturing facilities for computer chips, data centers and electric vehicle batteries. Businesses are also spending on intellectual property products. This is most likely related to businesses investing in technology to increase productivity, as the cost of labor and the availability of qualified help remain a challenge for many businesses.

Government Spending

Defense spending has experienced the largest percentage increase since 12/31/23, as defense spending has risen 4.5%. Non-defense spending grew 1.7%. State & Local spending grew 2.1% as state and local governments are still spending federal stimulus funds that were received after the pandemic crisis.

As discussed above, the US economy has experienced solid growth through the 3rd quarter of 2024 and the incoming data for the 4th quarter remains solid. The results of the economic data showed that, despite the "noise" and distractions of the national election, the economy continued to power forward and appears to have ended the 4th quarter on solid footing.

Strategy Review

Derrick Wilson, CIMA®, VP, Portfolio Manager

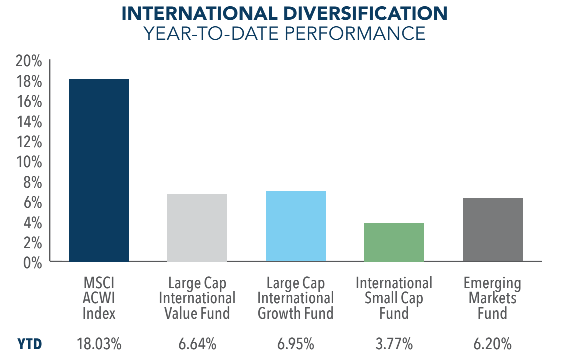
Although it was a strong year overall, the 4th quarter was rocky for global financial markets. Pre-election uncertainty had markets a bit on edge with polls indicating a close race. For broad US equities and fixed income, positive returns in November were sandwiched between negative returns in October and December. International investments were a little worse off as the US dollar strengthened markedly with the prospect of higher tariffs from the anticipation of, and ultimate re-election of, President Trump.

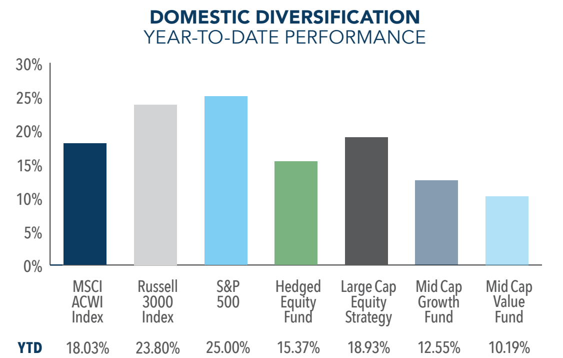
Global equities ended the quarter with a slight loss and were really weighed down by the greater losses on the international side. Comparing US and foreign equities, domestic equities gained 2.41% based on the S&P 500, whereas foreign equities declined 7.50%, measured by the MSCI AWCI ex USA index. Large caps dominated returns once again in the US, with mid and small caps only marginally higher for the quarter. Within international markets, emerging outperformed developed (-7.84% vs. -8.06%, respectively), as China (-6.70%) declined a little less, buoyed by optimism around the possibilities that government stimulus measures would help to turn economic activity around. Europe lagged with some political instability in Germany and France.

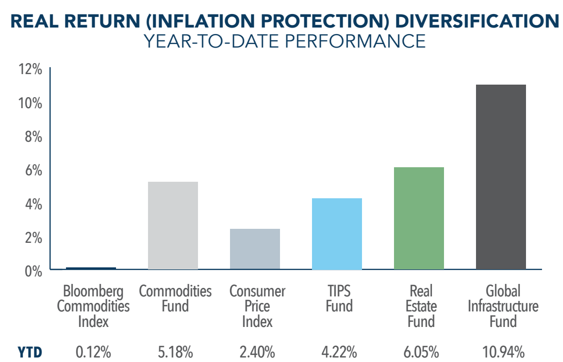
During the quarter, the Federal Reserve lowered the Fed funds rate in November and December by 25 basis points each. While yields on the front end of the curve followed the Fed lower, the long end rose sharply over concerns that Trump policies will be inflationary. Reacting to these moves, US aggregate bonds suffered losses of just over 3% in the quarter as intermediate and longer maturities and mortgage-backed bonds were hurt by the steepening yield curve. Short maturities benefitted from the drop in the near term as they gained a little over 1%. High yield had a strong November, which helped it to post a barely positive return for the quarter. Emerging market debt declined nearly 2%.

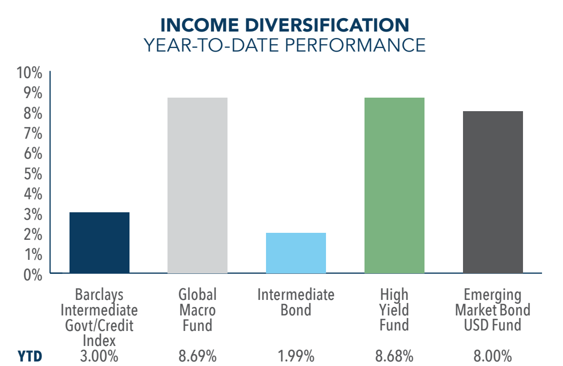
Alternative strategies had mixed results. Managed futures trend-following and global macro strategies both finished a little higher over the quarter. The steepening yield curve hurt real estate and global infrastructure. Broad commodities were down less than 0.50% but saw some extremes within. Industrial metals fell by over 7% with nickel, tin, and copper all down double digits due to decreased demand from slowing industrial activity in major economies. Energy rose 5.50% with oil prices up between 6 and 8% with a tighter global market amid continued OPEC+ production cuts and ongoing geopolitical tensions in the Middle East.

As we enter a new year, recent memory may give reason to be optimistic about the markets going forward, but always remember that the good times do not last forever. Though markets do trend higher over time there is always the next unknown around the bend.









Fourth Quarter 2024 – Wealth Management Insights

Domestic Equities

Gayle Sprute, VP, Senior Portfolio Manager

The 4th quarter gave stock investors much to think about. The Federal Reserve (Fed) began its rate reduction cycle in mid-September and the elections took place in early November. These events occurred amidst a solid macro-economic backdrop and rising earnings for corporate America. Although the major domestic indices delivered gains for the overall quarter, the path was somewhat turbulent.

Going into October, enthusiasm was high about the Fed's rate cutting path after its initial larger-than-expected 50 basis point rate reduction in mid-September. However, October brought news of better-than-expected labor market data, solid economic data, and some hotter-than-expected readings on inflation. This data pressured expectations about how many rate cuts might be coming. During October the market priced out over 60 basis points of rate cuts expected just before the Fed's cut in September. The major domestic indices gave back ground, falling between 0.5% and 1.4%.

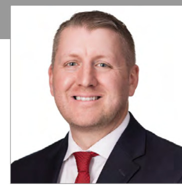
But November brought a significant reversal. The same indices gained between 5.8% and 11%. The outcome of the presidential and congressional elections was a major driver of this rally. With former President Trump chosen as the 47th president and the Republican party gaining control of both the House and Senate, speculation was rampant about how the political landscape could shape up over the next four years (and the prospect that a Republican sweep could make it easier to enact policy changes). Anticipation of possible changes (i.e., pro-growth policies, deregulation, and tax cuts, offset by tariffs) had traders busy placing bets. There were significant rotations into cyclicals and small caps.

The pendulum swung back in the opposite direction in December and the indices gave back between 2.4% and 8.3%. The only exception was that the Nasdaq Composite gained 0.6%. As speculation remained rampant about changes by the incoming presidential administration, traders again rotated, pushing money back into growth and the mega cap technology companies. However, during the month the Fed also telegraphed that rate cuts could come at a slower-than-expected pace in 2025, owing to the possibility that some of the new presidential administration's policy changes could pressure inflation amidst a solid economic backdrop. This put a dent in investor enthusiasm – and the market's performance.

In summary, speculation and changing expectations fueled a bit of a roller coaster ride during the 4th quarter. Gains procured by the indices during the quarter were as follows: Nasdaq Composite +6.4%, S&P 500 +2.4%, Dow Jones Industrial Average (Dow) +0.9%, Russell Mid Cap +0.6%, and Russell 2000 +0.3%. Sector leadership came from consumer discretionary, up 14.3% and communication services, up 8.9%. Meanwhile, the laggards were basic materials, down 12.4%, and healthcare, down 10.3%. From a style perspective, growth rose by 6.0%, far outpacing value, which declined by 2.7%.

Looking at the overall year, 2024 was pretty spectacular. Unsurprisingly, the index leader was the Nasdaq Composite, up 29.6%, followed by the S&P 500, up 25.0% (and its second consecutive year of +20% gains). The Russell Mid Cap index took third, up 15.3%, and the Dow was fourth, up 15.0%. The Russell 2000 came in last place, up 11.5%. Growth stocks rose by an impressive 35.8%, eclipsing value's 12.3% gain. Sector winners were communication services, up 40.2%, followed by information technology, up 36.6%. Sector laggards were basic materials, down 0.1% (the only sector in negative territory for the year), and healthcare, up 2.6%.

As we launch into 2025, enthusiasm about the future is elevated on top of two years of heady gains. The following could be headwinds or tailwinds in the coming year, depending on how they unfold: 1) the incoming Trump administration's policy changes; 2) the path for the Fed's interest rate cuts relative to expectations; 3) data on the economy, labor market and inflation; and 4) earnings from corporate America. The S&P 500 companies are currently expected to deliver 15% year/year earnings growth in 2025. The good news during 2024 is "priced in" to the market's elevated valuation level so there is little room for disappointment.



Fixed Income

Callen Young, VP, Portfolio Manager

The 4th quarter witnessed a rise in yields across the Treasury curve, spanning intermediate to longer-term maturities. Interestingly, this upward trend began before the end of the 3rd quarter. The Federal Reserve's initiation of short-term interest rate cuts on September 18th marked the starting point of the increase in yields. The Fed followed the September 50-basis-point cut with 25-basis-point reductions at both of its 4th-quarter meetings. In the waning weeks of 2024, citing stalled inflation, the Fed signaled a slower pace of easing in 2025.

This shift comes after the Fed hiked interest rates faster and to higher levels than other major central banks, maintaining those elevated rates for an extended period. Despite the higher degree of policy restraint, the US economy expanded at a near 3% rate over the past year, outpacing other economies that struggled under tighter fiscal policies. Market expectations for Fed easing took a rollercoaster ride throughout 2024. Sticky inflation early in the year dampened hopes for rate cuts, while labor market weakness in the summer reignited calls for more aggressive action. Since the Fed began easing in September and following President Trump's election victory, market participants have revised their expectations, now pricing in fewer 2025 cuts than previously anticipated.

Political developments also played a significant role in driving yield movements during the latter part of the 3rd quarter and throughout the 4th quarter. Yields initially declined after President Biden stepped off the ticket and Vice President Harris stepped in, narrowing election polls. However, yields began to rise in late September as capital markets increasingly suspected that the polls might be inaccurate, and that former President Trump could be reelected. The election outcome, coupled with a Republican sweep of both the Senate and the House, fueled market expectations of higher growth, increased spending, and elevated inflation.

Treasury yields peaked for 2024 in April when the 10-year note rose to 4.70%, driven by strong employment data and mixed inflation figures. During the 4th-quarter selloff, the 10-year yield approached that level again, reaching 4.62% in late December – a more than 90-basis-point increase from the Federal Reserve's initial 0.50% rate cut in September.

Municipal bond yields also experienced a rise during the 4th quarter, though the increase was more subdued. Many issuers front-loaded their supply into September and October, reducing new issuance pressures during the 4th-quarter selloff. Nonetheless, 5-year AA-rated general obligation municipal bond yields rose from 2.46% at the beginning of the quarter to 2.98% by December 31st. This 51-basis-point increase, while significant, was less pronounced than the 82-basis-point rise in 5-year Treasury yields, which climbed from 3.56% to 4.38% over the same period.

Credit spreads continued to narrow and ended the year near historically tight levels. The Bloomberg Aggregate Corporate Index closed at +80 basis points, just 6 basis points above its tightest level in more than 25 years. As a proxy for perceived risk, credit spreads suggest minimal compensation for credit risk and reflect no immediate concerns about potential economic disruptions.

Looking ahead to 2025, the uncertainty surrounding potential policy initiatives from the incoming administration, combined with the razor-thin Republican majority in the House, makes this one of the most challenging years to forecast in recent memory. Fixed income markets have experienced significant volatility in recent quarters, a trend we expect to persist. While most yields remain below their recent peaks, the recent rise presents an attractive opportunity for fixed-income investors.

Fourth Quarter 2024 – Wealth Management Insights

International

Matthew Clarke, CIMA®, VP, Senior Client Portfolio Manager

It was a tough quarter, but a good year. 2024 was defined by geopolitical uncertainty and transformative shifts including an unprecedented number of elections, ongoing conflicts, and economic pressures.

In the final quarter the international markets stumbled. Not unsurprising, as Europe had a tough time on growing concerns about recession, political instability in France and Germany and the new UK government's fiscal policies presented in their Autumn Budget. The EU Stoxx 600 closed out the quarter lower by -2.5%. Following the US presidential election and subsequent promise of protectionist policy (tariffs), stocks in export-driven economies such as China, Vietnam, Korea, and Mexico all declined more than -7%. As such, the MSCI All Country World Index (ACWI) ex US closed out the quarter lower by -7.5%.

Though the markets underwhelmed at the end, it was still a good year for the international markets. **Emerging markets outpaced developed** with the MSCI Emerging Markets index returning 8% versus the MSCI EAFE (developed international) at 4.4%. Within emerging markets, both China and India delivered impressive returns. In China, stimulative policy was announced that exceeded expectations and boosted optimism, helping the Shanghai Shenzhen CSI 300 to deliver 18% on the year. India's Sensex returned 9.6%, marking the ninth straight year of gains and simultaneously making it one of the most expensive markets in the world.

Within the developed international markets, **Taiwan stood out, proving to be the best performing market in Asia (even outpacing the S&P 500).** Semiconductor companies thrived on demand for artificial intelligence (AI) related needs propelling Taiwan's Taiex index 3.8% in the quarter and an impressive 32% for the year. In Asia, Japan followed with the Nikkei returning 5.3% on the quarter and 21% for the year on a weaker yen and the belief that deflation is now behind them. Hong Kong rounded out the top three with the Hang Sang returning 18% for the full year.

Unlike stocks, global bonds had a tough quarter and a tough year. The Bloomberg Global Aggregate (measure of global investment grade debt) closed out the quarter lower -5.1% and -1.7% for the year. Bonds continued to be influenced by fluctuating inflationary pressures, central bank policy, and geopolitical concerns. Of mention, European sovereign debt outperformed US Treasuries on expectations that interest rates there would continue to fall.

As we peer into 2025, **we believe a prudent blend of optimism and rationality is in order.** There is still quite a bit of geopolitical uncertainty in the global arena (two land wars) and of course a number of "what if's" at home as it relates to potential changes to policy. We continue to advocate the importance of staying disciplined, diversified and to maintain a long-term perspective.

Additional and expanded information to this newsletter discussion may be obtained by contacting your relationship manager. We will be happy to expand our discussion with you to meet your individual requirements as a client of Wealth Management & Advisory Services.

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