Market Commentary

January 2025

Equity and Bond Market Update

(as of December 31, 2024)

Index	YTD	1-Year
Dow Jones Industrial Average TR	+15.0%	+15.0%
S&P 500 Total Return Index	+25.0%	+25.0%
Russell 2000 Total Return Index	+11.5%	+11.5%
MSCI EAFE Index (net)	+3.8%	+3.8%
MSCI Emerging Markets Index (net)	+7.5%	+7.50%
Bloomberg US Aggregate Bond TR	+1.3%	+1.3%

Recent Economic Indicators

	Statistic	Data as of
Unemployment Rate	4.2%	Nov 2024
Gross Domestic Product (GDP)	3.1%	Q3 2024
Consumer Price Index (CPI) – Y/Y	+2.7%	Nov 2024
Consumer Confidence (1985=100)	104.7	Dec 2024
30-year fixed mortgage rate	7.01%	Wk of Dec 29
Housing Starts (single family)	1,011,000	Nov 2023
10-Year Treasury Yield	4.58%	12/31/2024

2024 saw the second consecutive year where the S&P 500 Index returned more than +20%. Since the end of 2022, the index has advanced over +53.2% after a year (2022) that saw the first calendar year where we experienced double-digit losses in both stock and bond markets. Since then, while the stock market experienced a two-year period for the books, the bond market advanced +6.9% for the 24-month period, during which the federal funds rate was hiked by 100 basis points in 2023, and then cut by 100 basis points in 2024. Foreign stock market counterparts, both developed foreign and emerging markets, also posted gains in 2024, albeit overshadowed by U.S. market returns, especially those of mega-cap stocks of the domestic-U.S. Magnificent Seven, which collectively advanced over +62% for the year.

The best performing sectors in 2024 were Communications Services (+40.2%), Information Technology (+36.6%) and Financial Services (+30.5%). The worst performing sectors were Materials (-0.1%), Health Care (+2.6%) and Real Estate (+5.2%). The S&P 500 Index was up 58% of the days during 2024, and down 42% of the time. The biggest drawdown fell short of a market "correction", with a decline of (-8.5%) during late July and early August, only to completely recover that decline within the subsequent two months. The best performing day was November 6th (+2.53%) right after the presidential election, and the worst day was August 5th (-2.99%), which followed a -12% single-day drop in the Japanese stock market.

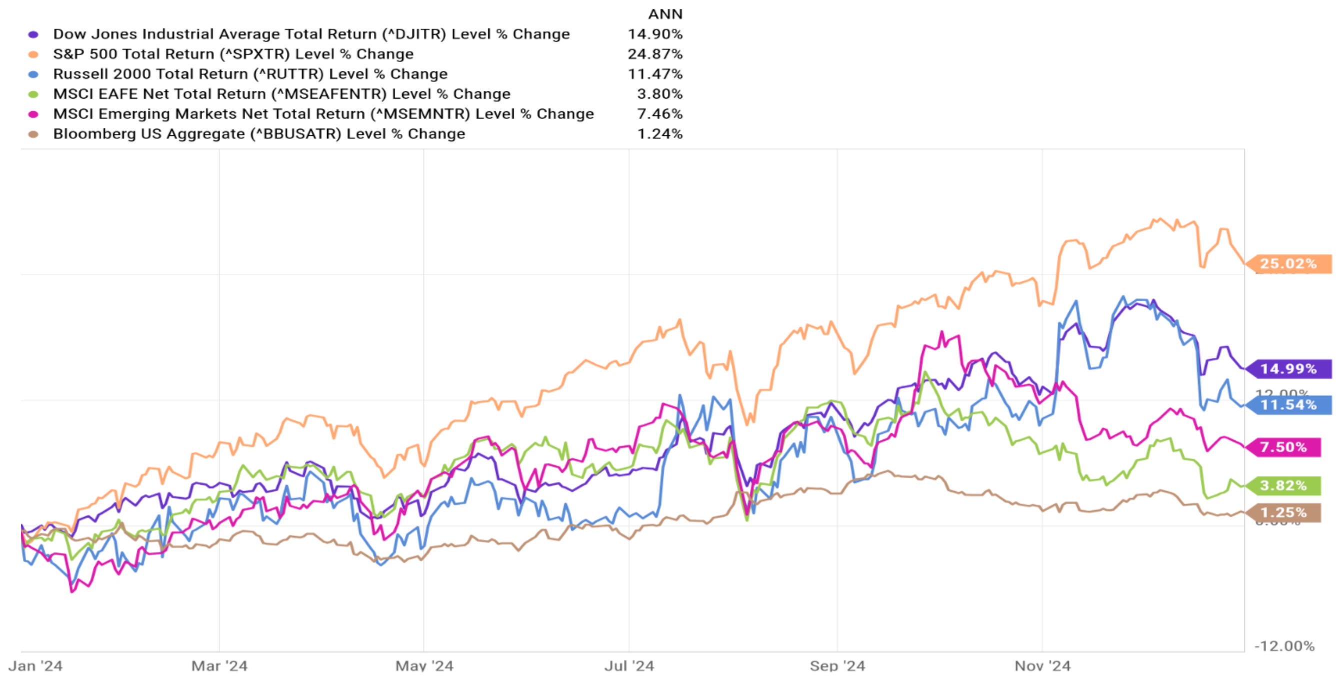
Stellar S&P 500 Index returns in 2024 can be explained by both P/E (Price/Earnings) multiple expansion as well as earnings growth. In either of these scenarios by themselves, stock prices will go up. At the beginning of the year, P/E ratios were hovering around 22.3, and by the end of the year around 24.9. If earnings don't grow at all, then the only way this ratio would rise is if the P (Prices) goes up, and hence an upward stock market. However, while this was happening, corporate earnings were also rising to the tune of just over +9% over the previous year. These two coupled together generated S&P 500 Index returns of +25% for 2024.

Looking forward, analysts are currently forecasting earnings growth of over +16% for 2025. If this growth materializes, even if we see P/E multiple contraction, we could experience positive returns for the third year in a row. With previously mentioned mega-cap stocks setting such a high hurdle over the past couple of years of earnings growth, it will be difficult for these companies to continue this high growth trend in the coming years. If that comes to be, then it will be up to the remaining 493 companies to make up the difference, and therefore, a shift towards market returns being attributable to "smaller" large-cap stocks will be in store.

So far, S&P 500 Index forecasts from big banks for the end of 2025 range from mostly positive all the way up to +19% returns, to some much more bearish outlooks of -12%. The justifications for both of these scenarios make sense, and is why we will most likely see more volatility in the coming year than we had in 2024, as these different schools of thought position themselves for their projected scenarios. As a side note, all of these big banks were wrong in their forecasts for last year, with the worst being -37 percentage points too low, and the best still being -16 percentage points off.

Currently, fed funds futures are projecting that we will most likely NOT see another rate cut by the Federal Reserve until possibly two or three Fed meetings into the year. That would put us in the mid-March to early-May time period. In addition, these fed fund futures are

Major Market Indices Price Return (YTD through December 31, 2024)



Source: YCharts

only forecasting one or two rate cuts for the entire year. At the year-end Fed meeting in December 2024, the Fed Dot Plot, a chart that records each Fed policy maker's projection of the short-term interest rate, was updated to show that the majority of officials projected their policy rate would be between 50-75 basis points lower than current levels. This is closely consistent with the before mentioned fed funds futures projecting two cuts for 2025. In addition, there are more and more economists that have recently forecasted we may not see any rate cuts at all in 2025. That may be the case if we don't see improvement in inflation numbers along with a resilient labor market.

The treasury yield curve has "un-inverted" back to a normal state. This means that shorter-term (3-month and 2-year) rates are now lower than the 10-year treasury rate. Although the risks of an imminent recession have subsided, we are in that time period based on various factors where we have historically seen a recession materialize (the last four recession cycles over the last 35 years have exhibited the same factors). These factors include: (1) the yield curve un-inverts after a period of inversion, (2) the Fed begins or has begun cutting rates, and (3) the stock market becomes more volatile and loses support. Over the last four cycles, a recession has materialized almost immediately after yield curve un-inversion up to around six months afterwards. As a marker, the 3-month rate and 10-year rate crossed yield levels in mid-December last year, about two to three weeks ago. Needless to say, we will be keeping a close eye on this.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.

Please contact Lifestyle Asset Management, Inc. at (281) 612-2035 or by email at **pjackson@lsaminc.com** should you have any questions or comments.

Sources: S&P Dow Jones Indices website (us.spindices.com)
MSCI Barra website (http://www.mscibarra.com)
The Conference Board (www.conference-board.org)
Bureau of Economic Analysis (www.bea.gov)
JP Morgan Guide to the Markets
CME FedWatch Tool (www.cmegroup.com)
FTSE Russell (www.ftserussell.com)
Bankrate.com (www.bankrate.com)
Bureau of Labor Statistics (www.bls.gov)
United States Census Bureau website (www.census.gov)
Federal Reserve Bank of Atlanta (https://www.atlantafed.org/cqer/research/gdpnow)

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities. The index is meant to reflect the risk/return characteristics of the large capitalization U.S. universe.

The S&P 500® Equal Weight Index is the equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

The Russell 2000 is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of the 3,000 largest stocks in the United States. The Russell 2000 serves as a benchmark for small-cap stocks in the U.S. and is meant to reflect the risk/return characteristics of the small capitalization U.S. universe.

The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada. It is maintained by MSCI Barra, a provider of investment decision support tools; the EAFE acronym stands for Europe, Australasia and Far East.

The MSCI Emerging Markets Index is an index created by Morgan Stanley Capital International (MSCI) designed to measure equity market performance in global emerging markets.

The Barclays US Aggregate Bond Index is a broad-based benchmark index that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS and CMBS.

The Dow Jones Equity All REIT Index is designed to measure all publicly traded real estate investment trusts in the Dow Jones U.S. stock universe classified as equity REITs according to the S&P Dow Jones Indices REIT Industry Classification Hierarchy. These companies are REITs that primarily own and operate income-producing real estate.

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