Fourth Quarter 2024 Market Commentary

An Oxford Harriman & Company Market Commentary

Oxford Harriman Offices

Astoria, New York

Boston, Massachusetts

Buffalo, New York

Chagrin Falls, Ohio

Cleveland, Ohio

Detroit, Michigan

Fairfield, New Jersey

Kingston, New York

Lorain, Ohio

Madison, Wisconsin

Mentor, Ohio

Newport News, Virginia

Park Avenue, New York

Rhineback, New York

Sarasota, Florida

Saratoga County, New York

Short Hills, New Jersey

St. Joseph, Michigan

Syracuse, New York

Westlake, Ohio

Woodcliff Lake, New Jersey

oxfordharriman.com

There was no shortage of market-moving events during a very active fourth quarter. The stock market opened the quarter with a slow start in October, but the outcome of the presidential election triggered a broad rally in November. The rally faded as the year ended, although the S&P 500 was only a few percentage points below its all-time high. The bond market was equally active in the fourth quarter, with the Federal Reserve cutting rates by another 0.50%, bringing the sum of rate cuts in 2024 to 1.0%.

However, a major development was the changing 2025 outlook. Both the Fed and the market expect fewer rate cuts in 2025 compared to the end of the third quarter, which resulted in a sharp increase in Treasury yields. We had previously written about rate cut expectations being too aggressive.

This commentary recaps the fourth quarter, looks back on the 2024 stock market rally, provides an update on the economy and the Fed's rate-cutting cycle, and looks ahead to 2025.

Looking Back on the 2024 Stock Market Rally

The past two years have been positive for equities, with the S&P 500 delivering strong returns in back-to-back years. The stock market's rally in 2024 saw the S&P 500 set more than 55 new all-time highs. The index posted gains of over 20% in 2023 and 2024, marking the first time since the 4-year stretch from 1995 to 1998. Additionally, like the late 1990s, large-cap technology stocks played a major role in the S&P 500's gains.

In 2024, there was a significant gap between the returns of large-cap and small-cap stocks. The Magnificent 7, a group that includes Microsoft, Apple, Alphabet, Meta Platforms, Amazon, Nvidia, and Tesla, now account for more than 33% of the S&P 500. These seven stocks collectively returned over 60% in 2024. When the group of stocks expands from the Magnificent 7 to the 50 largest S&P 500 stocks, the 2024 return falls to 32%. Broadening the group further to include all S&P 500 companies reduces the index return to approximately 23%, and weighting companies equally, rather than by market capitalization, lowers the return to 11%.

The key takeaway is that the largest companies contributed a significant portion of the S&P 500's return in 2024. Smaller companies delivered solid returns of approximately 10%, but

they underperformed on a relative basis. Also, mid-cap and micro-cap stocks returned 12%.

For the second consecutive year, fewer than 30% of S&P 500 companies beat the index in 2024. This is significantly below the average of 49% since 2000 and highlights the dominance of the largest companies in 2024.

The concentrated stock market rally, which was driven by the outperformance of the largest companies, led to an unusual outcome. For the second consecutive year, fewer than 30% of S&P 500 companies beat the index in 2024. This is significantly below the average of 49% since 2000 and highlights the dominance of the largest companies in 2024.

Economic Data Highlights the U.S. Economy's Resiliency

The U.S. economy has consistently defied expectations of a slowdown since the Fed started raising interest rates in March 2022. Economists and market participants initially expected growth to slow as the Fed raised interest rates. However, it has now been nearly three years since the Fed's first rate hike, and the economy continues to grow at an above-trend rate. While higher rates have slowed housing demand and weighed on business investment, the U.S. economy has managed to defy expectations with solid GDP growth. The U.S. economy grew at a 3.1% annualized pace in the third quarter, marking the third quarter in the past four with growth above 3%.

While higher rates have slowed housing demand and weighed on business investment, the U.S. economy has managed to defy expectations with solid GDP growth.

A key driver of economic growth since early 2022 has been consumer spending. Despite high interest rates, consumer spending has remained a steady driver of growth in recent quarters. Multiple factors have increased household net worth and bolstered consumers' financial strength, including record-high stock prices, rising home values, and solid wage growth. Additionally, many borrowers locked in low interest rates during the pandemic, which has made the U.S. economy less sensitive to rising interest rates this cycle.

There has also been a surge in manufacturing-related construction in recent years. For a long time, manufacturing construction was relatively modest, as most activity was outsourced to China, Mexico, and elsewhere. However, that changed in late 2021, around the time Congress approved trillions in new spending on infrastructure, green energy, and subsidies to incentivize U.S. manufacturing.

We believe these spending bills have supported the U.S. economy and created a boom in the manufacturing of semiconductors, electric vehicles, batteries, and solar panels.

We believe these spending bills have supported the U.S. economy and created a boom in the manufacturing of semiconductors, electric vehicles, batteries, and solar panels. The result is a surge in manufacturing-related construction, the largest on record, as companies build new warehouses, industrial facilities, and semiconductor plants.

The artificial intelligence industry's emergence has provided another catalyst, as companies like Microsoft, Amazon, and Meta spend billions on data centers, information processing equipment like semiconductors, and energy production to meet growing power demand.

Economic growth is forecast to slow but remain solid this year, driven by the Trump administration's pro-growth policies. The new administration's policy agenda focuses on

extending the 2017 tax cuts, reducing regulations across industries, and boosting domestic manufacturing through targeted incentives. These measures have the potential to stimulate capital expenditures, expand manufacturing capacity, and attract foreign investment to the U.S.

An Update on the Fed's Interest Rate-Cutting Cycle

Despite the two rate cuts and the previous .50% rate cut in September, Fed Chair Jerome Powell and other Fed presidents indicated they are not in a hurry to cut rates further.

The Fed continued its rate-cutting cycle in Q4, lowering interest rates by 0.25% at both the November and December meetings. These rate cuts were well-telegraphed by the Fed and widely expected, but the big development in the fourth quarter was the changing outlook for 2025. Despite the two rate cuts and the previous .50% rate cut in September, Fed Chair Jerome Powell and other Fed presidents indicated they are not in a hurry to cut rates further. The change in tone follows the U.S. economy's recent strength, which has caused the Fed to re-examine the need for additional rate cuts.

Recent economic strength has also led the market to re-evaluate its rate-cut forecast. This can be seen in the bond market, where longer-maturity Treasury yields have increased sharply since the first rate cut in September. Since that initial cut, the federal funds rate has decreased by 1.00%. While the Fed controls shorter-maturity interest rates, the bond market dictates longer-maturity interest rates. Over the same period, the 10-year Treasury yield has had the opposite reaction: rising by nearly 1.00%. These changes have normalized the yield curve, which had been inverted since July 2022.

Two key data points contributed to the Fed's decision to start cutting rates in September: falling inflation and rising unemployment.

Two key data points contributed to the Fed's decision to start cutting rates in September: falling inflation and rising unemployment. Inflation declined from 3.3% in July 2023 to 2.6% in August 2024, while unemployment rose from 3.5% to a high of 4.3%. The two trends caused the Fed to shift its focus from lowering inflation to supporting the labor market.

However, since the Fed started cutting, the trends have reversed. Inflation progress has stalled since September, and unemployment has declined to 4.2%.

Heading into 2025, the Fed and the market have similar rate cut expectations: approximately 0.50% in cuts for the entire year. The question is whether they are placing too much emphasis on recent trends and underestimating the need for rate cuts.

As both the Fed and the market realized in 2024, forecasting Fed policy is difficult, especially this cycle. From statements made after the last Fed meeting, it seems several members of the Fed had the incoming President's potential policy moves informing their views regarding the potential for higher inflation. This is an interesting point since we do not yet know exactly what policies and at what magnitude such policies might be implemented.

Stay tuned for our thoughts on this topic as we gain a clearer understanding of the actual way forward from a policy perspective.

Equity Market Recap – Stocks End the Year Higher

The stock market ended the fourth quarter higher, but the path included periods of volatility. In October, the S&P 500 ended its five-month winning streak, with most of the equity market finishing slightly lower. The sluggishness occurred as Treasury yields rose after the Fed's first rate cut in September, suggesting the sharp rise in yields may have played a role in October's market action. However, stocks rebounded in subsequent months.

In November, the quick and decisive election outcome became a tailwind for stocks. Investor enthusiasm fueled the post-election rally, with stocks trading higher in anticipation of tax cuts, deregulation, and U.S.-focused trade policies aimed at benefiting U.S. companies.

In November, the quick and decisive election outcome became a tailwind for stocks. Investor enthusiasm fueled the post-election rally, with stocks trading higher in anticipation of tax cuts, deregulation, and U.S.-focused trade policies aimed at benefiting U.S. companies.

Small caps led the way during the broad market rally, with the Russell 2000 rising 11% in November to set a record high. Bank stocks were another popular post-election trade as investors priced in expectations for financial deregulation and strong economic growth. Industrial stocks saw broad-based strength in anticipation of the Trump administration's pro-growth and protectionist policies, which could spark an industrial renaissance in the U.S. By the end of November, the S&P 500's year-to-date return surpassed 26%, putting the index on track for consecutive gains of more than 20%.

In December, the market's excitement cooled, with the S&P 500 trading sideways and ending the month lower. Beneath the surface, a familiar trend from earlier in the year impacted returns, with smaller companies underperforming larger ones by a wide margin. The Russell 2000 Index was hit hardest, falling 8.4% and giving back most of its post-election gains. Value stocks also traded lower in December, with the Russell 1000 Value Index declining by 6.8%. In contrast, the Magnificent 7 stocks discussed earlier gained more than 5%.

Shifting the focus to global markets, we saw international stocks underperform U.S. stocks in the fourth quarter.

Shifting the focus to global markets, we saw international stocks underperform U.S. stocks in the fourth quarter. The MSCI Emerging Market Index declined by 7.2%, while the MSCI EAFE Index of developed market stocks dropped by 8.3%. Both major international equity indices underperformed the S&P 500 by nearly 10% due to currency headwinds (i.e., a stronger U.S. dollar) and the outperformance of U.S. mega-caps.

Looking ahead to 2025 for international markets, the potential for tariffs under the Trump administration is creating significant uncertainty across several global regions.

Bond Recap – Bonds Trade Lower as Interest Rates Rise

The sharp rise in Treasury yields weighed on bond returns in the fourth quarter. The biggest differentiator within the bond market was duration, or the sensitivity of a bond's price to

interest rate movements.

Excluding interest received and only looking at price returns, an index of investment-grade corporate bonds posted its biggest quarterly loss since Q3 2022.

Investment-grade bonds declined 4% as rising yields had a bigger impact on their longer maturities. Excluding interest received and only looking at price returns, an index of investment-grade corporate bonds posted its biggest quarterly loss since Q3 2022.

Full-year bond returns highlight the key themes that shaped the bond market throughout 2024. Higher-quality bonds like U.S. Treasuries, corporate investment-grade, and mortgage-backed securities underperformed as the market debated and ultimately lowered its rate-cut expectations.

In contrast, lower-quality bonds outperformed as economic growth and corporate fundamentals remained solid. Corporate credit spreads, which measure the difference in yield between two bonds with a similar maturity but different credit quality, steadily tightened throughout the year. This provided a boost to lower-quality bonds in 2024 but has left credit spreads near their lowest levels in decades. For context, the U.S. high-yield corporate credit spread is near its lowest level since 2007, which means investors are receiving less yield in return for assuming greater credit risk.

2025 Outlook

The S&P 500's steady climb in 2024 reflects the market's growing confidence. Investors are optimistic about the artificial intelligence industry's growth potential. The U.S. economy outperformed expectations, growing at an above-trend rate in three of the past four quarters despite high interest rates.

The S&P 500's steady climb in 2024 reflects the market's growing confidence. Investors are optimistic about the artificial intelligence industry's growth potential. The U.S. economy outperformed expectations, growing at an above-trend rate in three of the past four quarters despite high interest rates. The stock market rally intensified after the election in November as investors focused on the incoming administration's policy agenda. Expectations for tax cuts, deregulation, and energy production are fueling hopes for stronger economic growth. The bond market echoes the equity market's confidence, and corporate high-yield credit spreads are near their lowest levels in over 15 years. However, the equity market rally has made broad market indices like the S&P 500 more concentrated and more expensive.

The question on many minds is whether the momentum can continue in 2025. The S&P 500 currently trades at nearly 22x the next 12-month earnings estimate, a level not seen outside of periods like the late-1990s tech boom and the recent post-COVID recovery, when interest rates were near zero. This compares to an average P/E multiple over the past 10 years of 18.5x.

Investors have shown a willingness to pay higher multiples, but with valuations now at extremes, earnings growth will likely play an important role in determining the stock market's path in 2025. Outside of the Magnificent 7, the other 493 companies in the S&P 500 exited an earnings recession in 2024. With the overall S&P 500 earnings expected to grow

between 13% and 17% in 2025, it's possible for the bull market to continue even if earnings multiples contract. Also, markets may react more sharply to negative news or surprises due to current valuations, which could increase volatility in both the equity and bond markets.

Inflationary pressures may persist, spurred by geopolitical tensions, continued investments in AI infrastructure, and the global push toward a low-carbon economy. Additionally, slowing immigration could magnify the challenges of an aging workforce, keeping wage growth high.

The Federal Reserve is expected to hold off on any aggressive rate cuts, with interest rates likely staying above 4%. ombine this with ongoing budget deficits, persistent inflation, and increased market volatility, and we foresee long-term Treasury yields continuing to rise as investors demand higher returns to offset elevated risks.

The Federal Reserve is expected to hold off on any aggressive rate cuts, with interest rates likely staying above 4%. Combine this with ongoing budget deficits, persistent inflation, and increased market volatility, and we foresee long-term Treasury yields continuing to rise as investors demand higher returns to offset elevated risks.

One of the reasons rates continue to be firm is because the U.S. economy is strong. We do not believe the same can be said for economies in Europe and Asia, which is why we continue to favor the U.S. over international equities. Also supporting this view is the strength of the U.S. dollar. While we expect volatility in the currency markets, the firmer Fed approach to interest rates and domestic earnings growth may continue to support the U.S. dollar, which in turn makes it more difficult for international equities to outperform on a relative basis.

It will be interesting to see if the favorable tax and reduced regulatory environments anticipated with the second Trump administration offset any lingering inflation. Indeed, a reduction in regulatory scrutiny may increase merger & acquisition activity, therefore providing support for equity valuations.

We will do our best to keep you updated as the events of 2025 unfold.

Dennis P. Barba, Jr.
CEO & Managing Partner

Michael P. Finkelstein, CFA
Partner

Robert Frenkel, CFP ®
Chief Investment Officer

Wells Fargo Advisors Financial Network did not assist in the preparation of this report, and its accuracy and completeness are not guaranteed. The opinions expressed in this report are those of the author(s) and are not necessarily those of Wells Fargo Advisors Financial Network or its affiliates. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Additional information is available upon request.

S&P 500 Index: The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

Russell 2000® Index: The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

Russell 1000® Value Index: The Russell 1000® Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

MSCI Emerging Markets Index: MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of 23 emerging markets.

MSCI EAFE® Index: The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of 21 developed markets, excluding the U.S. and Canada. PM -07072026-7505454.1.1