withum WEALTH MANAGEMENT

Winter, 2025

Investment Commentary

2024 Recap

What a remarkable year it was for U.S. equity markets in 2024. Major indices posted notable gains, with the S&P 500 achieving its second consecutive year of 20%+ performance for the first time since 1998. The market set a staggering 57 record highs during the year, though it ended slightly below its December peak.

As with last year, much of the strength came from the "Magnificent Seven" mega-cap names. These top performers significantly outpaced the broader market again, as evidenced by the equal-weighted S&P's more modest return.

The broader market saw varied performance across sectors, with semiconductors, cybersecurity, networking, airlines, and financials standing out as key areas of strength. Optimism about artificial intelligence and digital transformation continued to bolster adjacent industries, including utilities. Conversely, energy, industrial metals, and several consumer-facing sectors like restaurants, cosmetics, and drug stores lagged. The tech-heavy Nasdaq posted the strongest gains among major indices, while smaller-cap stocks as measured by the Russell 2000 rose less. Meanwhile, gold stood out in commodities, logging its best year since 2010 and hitting an all-time high above $2,800 per ounce in October. Bitcoin also made headlines, breaking above $100,000 before pulling back in December.

Total Returns	4th Quarter	Full Year 2024
US Stocks		
Standard & Poor's 500	3.4%	25.0%
S&P 500 Equal Weight	-1.3%	13.0%
Nasdaq Composite	8.0%	29.6%
Russell 2000	1.8%	11.5%
International Stocks		
MSCI World Ex-US	-6.9%	5.3%
MSCI Emerging Markets	-7.9%	8.1%
Fixed Income		
Bloomberg US Agg Bond Index	-3.4%	1.3%
90-Day Treasury Bill	1.2%	5.3%

Return figures from FactSet

While the Federal Reserve's monetary policy dominated news again in 2024, the narrative shifted notably over the course of the year. Starting 2024 with a 5.25-5.50% target rate, the Fed began easing monetary policy in September with a 50-basis-point rate cut,

followed by smaller reductions in November and December. These moves were prompted by clear signs of a reduction in inflation and growing concerns about cracks in the labor market. Despite these rate cuts, longer-term Treasury yields rose post-election, and the yield curve—which had been inverted since 2022—turned positive to close the year. The dollar strengthened, gaining 7% for the year, as resilient U.S. growth and a cautious Fed attracted global capital flows.

On the economic data front, 2024 continued to validate the "soft-landing" narrative, with economic growth, job creation, consumer spending, and disinflation all making (sometimes uneven) progress throughout the year. Economic growth accelerated through the middle of the year, with GDP rising at annualized rates of 3.0% in Q2 and 3.1% in Q3. Inflation measures trended lower, with headline CPI at 2.7% year-over-year in November compared to 3.3% in late 2023. Labor market dynamics, however, painted a more mixed picture. Nonfarm payrolls grew by nearly 2M through November, but unemployment ticked up slightly to 4.2% as continuing jobless claims reached three-year highs. Retail sales remained resilient, buoyed by what appears to have been a solid holiday shopping season, though some post-Christmas reports suggested a more price-sensitive consumer. While concern about "sticky" shelter prices has been easing, some focus has remained on the health of the labor market and its potential impact on consumer spending.

The markets responded positively to the US presidential election. In November, both the S&P 500 and the Russell 2000 recorded their strongest monthly gains of 2024, driven by optimism surrounding potential individual and corporate tax reductions, as well as anticipated deregulation. These policy expectations were seen as favorable for sectors such as mergers and acquisitions, energy production, and cryptocurrency. However, the narrowly averted government shutdown in December raised concerns about the administration's ability to effectively leverage its congressional majorities. Additionally, apprehensions emerged regarding the possibility that new tariffs could impede progress on inflation, and that an aggressive immigration policy could disrupt labor supply. Investors are also closely monitoring the potential impact of an expanding deficit on the Treasury market.

In sum, 2024 was a year of robust market performance driven by continued economic resilience, monetary policy shifts, and renewed investor optimism. The market broadened in the final months of the year, suggesting a healthier foundation for 2025. As we turn the page, we remain focused on navigating the opportunities and risks that lie ahead.

2025 Market Outlook: Analysts "Bulled Up"

If you follow the stock market, it's hard not to pay attention to "forecasts". We put forecasts in quotations here because the word can be applied to anything from the most empirically supported predictions to wild guesses flippantly posted to X (née Twitter). Either way, it's entertaining to watch the "experts" compete for the title of Most Prescient. As we enter 2025, Wall Street analyst projections for the year are almost universally bullish, with consensus estimates for the S&P 500 clustering around the 6500-6600 range, indicating an anticipated gain of approximately 8.3% from the 6,000 mark. Historical analysis reveals that analyst predictions often miss the mark, either overestimating or underestimating actual market performance by a wide margin. Last year was a prime example: at the end of 2023, the average Wall Street forecast predicted the S&P 500 would reach 4,861 by the end of 2024. Instead, the index surged to approximately 6,000, far exceeding these projections. In reality, average return years are quite uncommon, with the long-term average instead derived by combining really good 20%+ years like the last two with occasional bear markets.

The unanimous bullish sentiment for 2025 is particularly noteworthy. When all major investment firms share a similar optimistic outlook, it may be a red flag for potential overconfidence in the market. Such consensus may inadvertently overlook underlying risks or emerging challenges that could impact market dynamics. Several factors contribute to the difficulty in making precise market forecasts. Economic indicators, geopolitical events, and unexpected global developments can all influence market trajectories in unforeseen ways. The complexities of these variables mean that even the most well-informed predictions are subject to substantial uncertainty. Not quite "wild guesses", but close.

Strategists Often Miss The Mark When Forecasting

Predicted and actual returns for the S&P 500

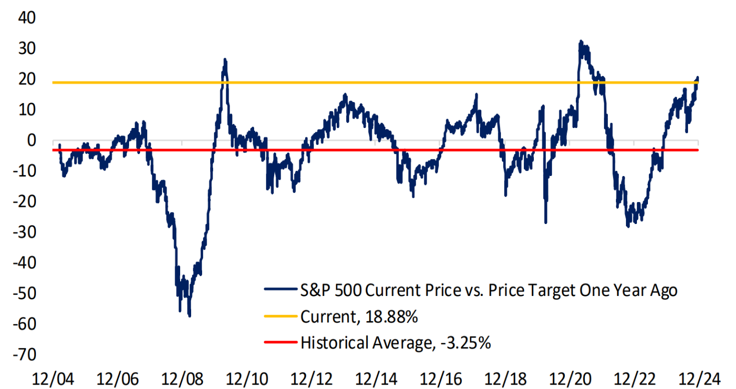
Source: Bloomberg

Note: Forecasts and actual returns are for price change only.

On the other hand, maybe analysts undershooting with last year's targets was a good thing. The chart to the right from Bespoke shows that in the past twenty years, there have only been two other periods with a wider gap between S&P price targets for the year ahead and the actual result, and both occurred early in bull runs (after Covid and after the Financial Crisis).

S&P 500 Distance (%) From Analyst Price Target

12m Ago - Past 20 Years



Source: Bespoke 2025 Pros and Cons

Given these considerations, it's prudent for investors to maintain a diversified portfolio and exercise caution when interpreting consensus forecasts. While the projected growth for 2025 may be encouraging, acknowledging the limitations of such predictions is crucial.

There's Still a "Wall of Worry"

Most investors are familiar with the phrase "bull markets climb a wall of worry". This aphorism reflects the time-tested observation that markets often rise despite persistent concerns or negative news that might suggest otherwise. In this metaphor, every obstacle "Mr. Market" overcomes becomes a foothold for his climb higher as positive factors and sentiment outweigh negative items that prove less bad than feared.

With that in mind, what are the key obstacles the market will have to navigate this year if it is to continue higher? One of the most significant risks lies in the potential for unexpected interest rate movements. While many expect rates to decline as global growth moderates, this consensus may be underestimating the interplay of factors such as persistent fiscal deficits, robust cyclical growth, and lagging productivity. These dynamics could lead to a sharp and unexpected rise in long-term interest rates, challenging the Federal Reserve's ability to lower short-term rates as planned. Should inflation accelerate or growth re-accelerate, the Fed might be forced into a more hawkish stance, tightening monetary policy further. Such moves could have ripple effects across sectors like private credit, real estate, and large-cap growth stocks, which are particularly sensitive to interest rate changes.

The reliance on the "Magnificent Seven" stocks also presents a unique challenge. These high-growth technology and consumer-facing companies have consistently exceeded earnings expectations, driving significant market gains. However, their elevated valuations leave little margin for error. A sustained slowdown in earnings growth could undermine not just these specific stocks but also the broader market, given their outsized weight in major indices and the "halo effect" they have on other companies. Should investor confidence in these market leaders wane, we could see a rotation away from momentum-driven investments, accompanied by heightened volatility and downward pressure on equity prices.

Adding to these challenges are policy-related risks, particularly those stemming from President Trump's proposed tariffs and immigration policies. On the trade front, plans for substantial tariff increases—such as a potential 60% tariff on Chinese imports or across-the-board tariffs on other countries—could stifle global trade, raise input costs for businesses, and accelerate inflation. These measures risk disrupting supply chains and eroding profit margins, particularly for multinational corporations and sectors heavily reliant on international trade. Historically, tariff escalations have had stagflationary effects, creating an environment of higher inflation coupled with slower economic growth, which poses a significant challenge for both policymakers and investors.

Immigration policy adds another layer of complexity. President Trump's platform includes reducing immi-

Estimated Cumulative Change (from 2025-2028) in U.S. GDP

Sector production and consumer prices from the following policy proposals

Item	Deportation of unauthorized immigrant workers		Additional 10 percentage point increase in U.S. tariffs on all trading partners		Additional 60 percentage point increase in U.S. tariffs on China	
	1.3 million	8.3 million	Without retaliation	With retaliation	Without retaliation	With retaliation
GDP ($ billions)	-812	-5101	-283	-721	-129	-327
Energy ($ billions)	-29	-182	-80	-156	-77	-72
Mining ($ billions)	-7	-43	-14	-26	-16	-23
Agriculture ($ billions)	-19	-119	-55	-102	-61	-124
Durable manufacturing ($ billions)	-597	-3750	-649	-1402	-526	-862
Nondurable manufacturing ($ billions)	-106	-668	-233	-462	-145	-255
Services ($ billions)	-604	-3802	-181	-492	-11	-146
Consumer Price Index (%)	1.5	9.1	0.8	1.8	0.7	1.1

Source: Charles Schwab, Peterson Institute for International Economics (PIIE), as of 9/2024.

gration and accelerating deportations, both of which could shrink the labor force and slow economic growth. While wage growth might see a short-term boost due to reduced labor supply, the broader economic impact could be negative, as fewer workers translate to diminished consumer demand and lower productivity. Such policies may also introduce logistical and financial strains on industries dependent on immigrant labor, such as agriculture, construction, and services, further dampening economic activity. For the Federal Reserve, these dynamics complicate the path of monetary policy, as they must balance the competing forces of potential wage-driven inflation and slower GDP growth.

Finally, geopolitical risks and currency market instability add to the uncertainties for 2025. The combination of trade barriers, elevated global debt levels, and geopolitical tensions could lead to sharp adjustments in currency values, particularly in emerging markets. A strengthening U.S. dollar, driven by higher rates or "flight-to-safety flows", could strain economies reliant on dollar-denominated debt, while countries seeking to improve their competitive positioning may resort to devaluing their currencies. These dynamics risk creating a feedback loop of volatility in both currency and equity markets, echoing past crises where sudden currency adjustments had widespread destabilizing effects.

Handicapping AI

As we move into 2025, artificial intelligence continues to be a pivotal driver of corporate investment, with significant capital expenditures dedicated to AI infrastructure and development. Notably, Microsoft has announced plans to invest approximately $80B in AI-enabled data centers during its fiscal year 2025, with over half of this investment allocated within the United States. This substantial commitment reflects a broader trend among major technology firms, collectively projected to increase AI-related capex to around $200B in 2025, doubling their 2021 spending levels.

The anticipated surge in AI investment is expected to enhance productivity and stimulate economic growth. Goldman Sachs' baseline forecast is that AI adoption will boost U.S. productivity growth by 1.5 percentage points per year over a 10-year period, potentially increasing the S&P 500's compound annual growth rate in earnings per share from 4.9% to 5.4%.

The actual impact of these investments on the market will depend on several factors. The effectiveness with which companies deploy AI technologies will determine productivity gains and, consequently, financial performance. Concerns have been raised about the re-

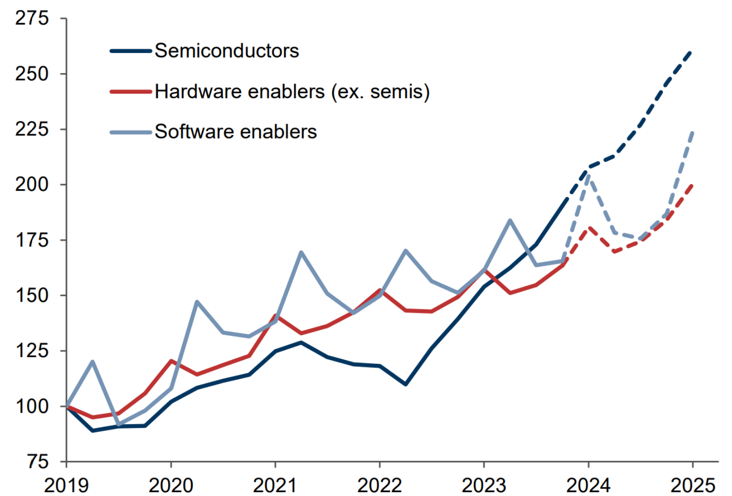
turn on investment (ROI) of substantial AI capex, with some analysts suggesting that returns may not immediately justify the expenditures. Investor perceptions of AI's potential can drive market valuations, but any shortfall in expected advancements and financial returns or a signaled decrease in future spending could lead to market volatility.

In addition to AI advancements, Google's recent breakthrough in quantum computing with its new chip, Willow, signifies a parallel trajectory in technological innovation. Willow can perform computations in under five minutes that would take the fastest classical supercomputers an estimated 10 septillion years. This leap in computational power has profound implications for AI development, as quantum computing can process complex algorithms more efficiently, potentially accelerating AI research and applications.

A debate persists regarding whether the current enthusiasm for AI is fully reflected in stock market valuations. Some analysts caution that the rapid appreciation of AI-related stocks may be reminiscent of past market bubbles, where exuberant expectations outpaced actual technological progress and financial returns. Many have compared the current AI investment surge to the dot-com era, suggesting that while AI's potential is significant, market valuations may have outstripped realistic short-term advancements. Conversely, others argue that the transformative potential of AI justifies elevated valuations, anticipating substantial long-term gains as AI technologies become increasingly integrated into various sectors.

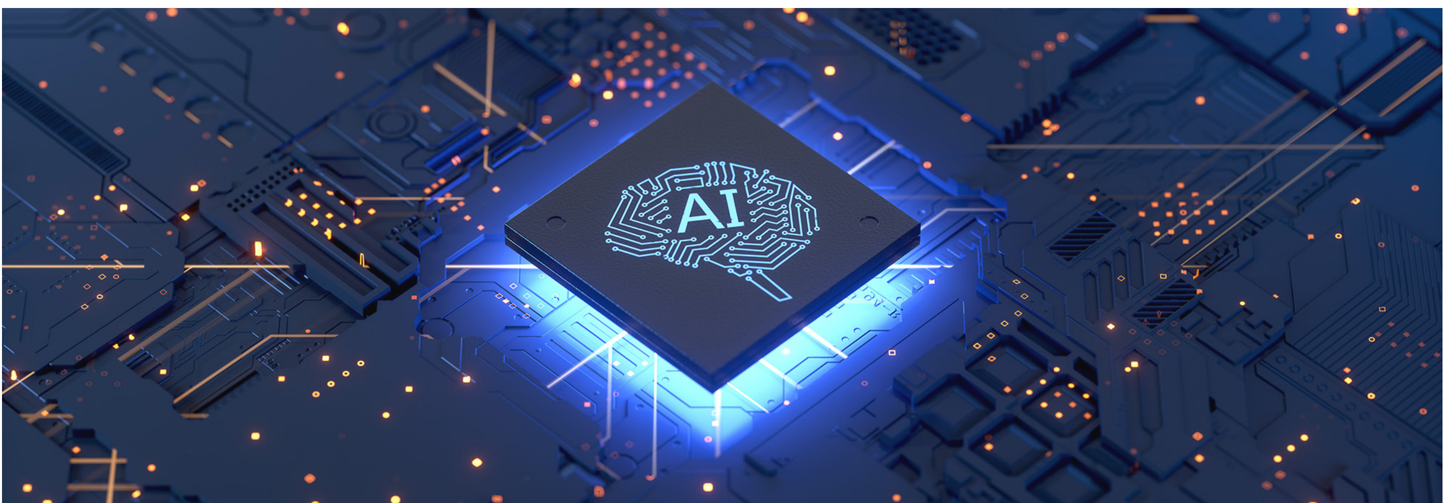
AI Investment Has Surged

Actual and forecasted revenues by AI-exposed sector, index



4Q19 = 100; Dashed lines in this chart indicate consensus revenue forecasts.
Source: Goldman Sachs GIR

In summary, while projected increases in AI capex for 2025 and beyond signal strong confidence in AI's transformative potential, the actual market trajectory will hinge on the successful implementation of these technologies and the realization of anticipated productivity gains. Investors must continue monitor corporate AI strategies and their tangible outcomes to assess the broader market implications.



Closing Thoughts

As we close the books on 2024, it's clear this year has delivered a mix of remarkable market performance, evolving economic dynamics, and a fair share of uncertainty. With U.S. equities achieving another year of strong gains and economic resilience defying many predictions, 2024 reminds us of the importance of staying invested through both challenges and opportunities. At the same time, it underscores the need to approach the coming year with thoughtful preparation and measured expectations.

The upcoming year presents its own set of uncertainties, amplified by shifts in monetary policy, geopolitical tensions, and significant policy changes under the new administration. While optimism surrounding AI, deregulation, and tax policy is encouraging, potential risks such as tariffs, immigration constraints, and heightened global debt levels necessitate a vigilant approach. Historically, markets have shown resilience even in challenging environments, climbing the proverbial "wall of worry," but that climb is rarely linear. As always, we caution against reacting to short-term noise or attempting to time the market based on headlines or predictions.

As we look to 2025, we encourage investors to remain disciplined and focused on long-term objectives, recognizing that even the most confident forecasts are subject to the unpredictable forces. Our approach remains rooted in building well-diversified, high-quality portfolios designed to withstand volatility and capitalize on opportunities. On the equity side, we emphasize companies with strong earnings, robust cash flows, and sustainable business models. In fixed income, we maintain a balanced view on duration and favor credit quality to mitigate risks in a shifting rate environment. As always, we stand ready to help you navigate whatever lies ahead with a steady hand and a clear focus on your financial goals. ▪

Thank you for the trust you place in us. We look forward to continuing to work together in 2025 and beyond.

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