Fourth Quarter 2024 Letter

Figure 1 – S&P 500

Figure 2 – U.S. 10-Year Treasury Yield

In November, I celebrated the 25th anniversary of my start in the investment business. When I began, I was excited about the opportunity to research investments and make portfolio management decisions. My timing couldn't have been worse. Six months later the bear market of 2000 – 2002 began. But it wasn't until I began meeting with clients who were concerned about their financial future that I started to understand the importance of our work: taking care of you and your financial future. We appreciate the trust you place in us, and we'll always work hard to help you meet your financial goals, putting your needs first every step of the way.

Market Recap

Stock returns were mixed in the fourth quarter of 2024. The large cap S&P 500 (**Figure 1 – S&P 500**) rose +2.4%, finishing the year +25.0%. Small and mid cap stocks treaded water: the S&P Midcap +0.3% and the Russell 2000 Small Cap +0.3%. Outside the U.S., the picture was very different as international stocks fell hard. Traders fled both developed (-8.1%) and emerging markets (-8.0%) on fears of tariffs, U.S. dollar strength, and rising U.S. interest rates. The climb in interest rates (**Figure 2 – U.S. 10-Year Treasury Yield**) also weighed on bond prices as the Bloomberg U.S. Aggregate Bond index fell -3.1%. U.S. value stocks also suffered from profit-taking after a strong third quarter, giving up 2.7%, but investors stuck with growth stocks, which rose 6.2%.

Stocks began October with steady gains. Solid earnings growth pushed aside political concerns for much of the month, although some investors took to the sidelines just before the U.S. election. Once results were known, U.S. markets rallied, led by financial stocks and other expected beneficiaries of the incoming administration's policies. However, in December stocks began to pull back as the election boost waned and investors focused on the potentially inflationary impact of upcoming policies, including tariffs and the threat of deportations. When the Federal Reserve cut interest rates a quarter percent, they also indicated fewer cuts in 2025 due to stubbornly high inflation, adding to investor concerns.

S&P 500 earnings rose 8.4% in the third quarter on 5.5% revenue growth, slightly lower than the 2nd quarter's growth of 9.9% but much better than the 3.9% expected at the beginning of earnings season. 73.9% of companies topped analyst forecasts, lower than the prior quarter's result of 79.8%, an early sign that growth may be slowing. The technology sector (+22.5%) again produced the strongest earnings growth. Consumer discretionary and retail earnings were also solid, demonstrating the continued strength of the U.S. consumer. Fourth quarter earnings are forecast to grow 7.4%, with technology slowing and other sectors, including finance, accelerating. Investors will be watching for signs of broadening strength in the economy, which may be needed to move markets higher.

Economic Perspective

The U.S. economy grew 3.1% in the third quarter, roughly the same annual rate as the prior quarter. Purchasing manager surveys, a closely followed indicator of the direction of the economy, strengthened at the end of the quarter. Business activity in the services sector leaped in November and the manufacturing survey was the strongest since March of 2023. It's possible that businesses were waiting for clarity from the national elections. The housing sector provided mixed signals. Permits were up marginally over the prior year but new housing starts fell 1.8%. Higher mortgage rates continue to weigh on home builders, sellers and buyers.

Employers added jobs every month in the fourth quarter. December's report of 256,000 jobs added was much stronger than expected, another sign of economic activity improving late in the quarter. Unemployment remained low at 4.1%, and average hourly wages grew 3.9%, staying ahead of current inflation readings. Yesterday's robust report added to fears that the Federal Reserve won't be cutting interest rates in the foreseeable future. In addition, the tight employment situation, along with the potential for tighter immigration policies, increased fears of persistent wage inflation. Stocks fell hard as good news about employment became bad news about interest rates and inflation.

Speaking of inflation, it has remained stubbornly above the Federal Reserve's 2% long-term target. After reaching a 3 year low in September of 2.4%, the consumer price index (CPI) rose 2.6% in October and 2.7% in November. Food, shelter and especially automobile expenses were all drivers of the increase, while energy costs rose more modestly. While these changes may seem modest, the movement up reduces the probability of additional interest rate cuts, and has been a factor in the recent rise in long-term yields (**Figure 2 - U.S. 10-Year Treasury Yield**). Inflation concerns may weigh on investors in the near term, but if other economic news remains positive, stocks may benefit.

Looking Ahead

U.S. equity markets made it through the election last quarter without much difficulty. While it is impossible to fully predict the impact of the incoming administration's policies, some industries, including financials, seem likely to benefit. The large investment banks should get a boost from lighter regulation and a more favorable anti-trust approach to mergers and acquisitions. As noted above, analysts have already been raising growth estimates for this sector. On the other hand, stocks outside the U.S. (**Figures 3 & 4**) dropped hard on fears that economic nationalism, including more aggressive tariffs on imports, will hurt Asian and European companies that rely on exports. We continue to underweight international stocks in our portfolios.

Figure 3 – MSCI EAFE ETF

Figure 4 – MSCI Emerging Markets ETF

The fires in the Los Angeles area the past week have shocked and saddened us. We hope and pray that you and your loved ones are safe, and that the ongoing blazes will be fully extinguished in the coming days.

And as always, we look forward to speaking with you soon.

Best regards,

Kenneth M. Bernard, CFA

Index returns taken from Morningstar.com