

Economic and Market Summary – January 2025

Market Performance Recap

- **Equities:** November delivered a robust 6% gain for the S&P 500, driven by strong economic fundamentals and positive sentiment around U.S. leadership stability. Consumer discretionary led gains (+13%), powered by Tesla's +40% surge and solid performance from Amazon. Financials followed closely, up +10%, fueled by regulatory optimism. However, December markets turned volatile, with the S&P 500 losing 2% over the week ending December 23. Small caps, represented by the Russell 2000, faced outsized declines of 4% amid risk-off sentiment and rising yields.
- **Sector Insights:** Growth-oriented sectors continued their dominance in 2024. Technology and communication services, boosted by strong earnings and innovations, were the top-performing sectors for the year. Mega-cap stocks like Nvidia and Apple drove gains, contributing significantly to the broader index performance. Conversely, defensive sectors like utilities and healthcare lagged, pressured by higher bond yields and limited investor appetite for low-growth areas.
- **International Equities:** Global markets presented a mixed picture. Developed markets underperformed due to geopolitical tensions in Germany, France, and South Korea, coupled with a strengthening U.S. dollar. Emerging markets, however, benefited from China's stimulus measures, providing a rare bright spot in international equities.

Fixed Income

- **Bond Market:** Fixed income markets continued to feel the weight of rising yields. The Bloomberg Aggregate Bond Index lost 1.4% in December, reducing its YTD gain to a modest 1.3%. High-yield bonds performed well, up 8.9% YTD, as investors sought higher income despite tighter spreads. Preferred securities also remained attractive, particularly in light of stable credit markets.
- **Treasury Yields:** The 10-year Treasury yield rose by 25 basis points last week, reaching approximately 4.5%. This increase was driven by persistent inflation concerns and a repricing of rate cut expectations. The Federal Reserve has adopted a cautious tone, balancing inflationary pressures with signs of a cooling labor market.

Economic Indicators

- **Labor Market:** The job market remains resilient but is showing early signs of softening. The unemployment rate ticked up to 4.2% in December and may reach 4.3–4.4% in the coming months, according to unemployment claims data. While wage growth remains solid, businesses are approaching hiring more conservatively as economic uncertainties linger.
- **Inflation:** The latest consumer and producer price index (CPI and PPI) reports revealed mixed signals. CPI aligned with expectations, but the PPI exceeded forecasts, raising concerns about potential inflationary pressures in early 2025. This has kept markets on edge about the pace of future Fed rate cuts.

- **Consumer Spending:** Retail activity showed strength during the holiday season, underpinned by millennial spending power. With this demographic entering peak earning years, consumer spending remains a robust driver of economic growth.

Commodities

- **Energy:** Crude oil remained subdued, hovering near \$70 per barrel. Weak demand and geopolitical uncertainty have weighed on prices. Meanwhile, natural gas saw a notable breakout above its 2023 highs, driven by colder weather and supply adjustments.
- **Precious Metals:** Gold surprised markets by outperforming the S&P 500 in 2024. Central bank buying, geopolitical risks, and dollar dynamics provided a supportive backdrop for the metal despite rising real yields.

Outlook for 2025

- **Economic Growth:** The U.S. economy is expected to slow modestly but avoid a recession. Capital expenditure (CapEx) by businesses, particularly in research and development, is poised to support growth. The millennial demographic will continue to play a significant role in driving economic activity.
- **Interest Rates:** The Federal Reserve is expected to cut rates cautiously in 2025, with the 10-year Treasury yield likely to stay within 3.75–4.25%. The “golden age” for income investing will continue, emphasizing high-quality bonds and municipal securities as top picks for yield-focused investors.
- **Equity Markets:** Large-cap stocks, particularly the “Magnificent Seven” mega-cap tech companies, may see moderated performance in 2025 as earnings growth broadens to other sectors. International equities are expected to face continued challenges from a strong U.S. dollar and geopolitical instability.

Notable Risks

- **Geopolitical Tensions:** Continued uncertainty in Eastern Europe and the Middle East, alongside potential tariff policy shifts under the U.S. administration, could create market headwinds.
- **Inflation and Monetary Policy:** Persistent inflation or slower-than-anticipated rate cuts could pressure both equity and bond markets. Additionally, concerns over the U.S. fiscal deficit and Treasury supply may influence long-term yields.

Key Takeaways

Investors should focus on a balanced portfolio strategy, emphasizing high-quality fixed income for income generation and select growth-oriented equities. Staying nimble and responsive to macroeconomic shifts, including inflation trends and geopolitical developments, will be crucial as we navigate the evolving market landscape of 2025.