Market Commentary
Fourth Quarter 2024

RPA RETIREMENT PLAN ADVISORS

THE FUTURE IS BETTER THAN YOU THINK

MARKET SNAPSHOT

The S&P 500 Index marched higher throughout the year, finishing up 25% while notching 57 new all-time highs—the sixth most since 1928—and finishing with consecutive annual gains of over 20% for the first time since the late 1990s.

Overseas, returns were not nearly as strong, as developed international stocks (MSCI EAFE) posted a modest 3.8% gain and emerging-markets stocks (MSCI EM Index) finished the year up 7.5%.

Bonds were mixed as the 10-year U.S. Treasury experienced significant volatility, ending the year at 4.58% and producing a 1.3% return for the Bloomberg U.S. Aggregate Bond Index.

Looking ahead, the market remains focused on the future paths of inflation, the labor market, and the Fed's approach to interest rates.

We remain cautiously optimistic as we enter 2025, though we expect economic growth and, in turn, equity markets to grow at a slower pace than what we've seen over the last two years.

Market Recap

The U.S. economy and the stock market proved much stronger than many had anticipated in 2024. The S&P 500 Index marched higher throughout the year, finishing up 25%, while notching 57 new all-time highs—the sixth most since 1928—and finishing with consecutive annual gains of over 20% for the first time since the late 1990s.

The robust gains in U.S. stocks were driven by a healthy U.S. economy, moderating inflation, and widely expected rate cuts from the Federal Reserve. Of course, enthusiasm around artificial intelligence (AI) played a meaningful role, as companies associated with the theme, namely Nvidia and Broadcom, were main contributors to this year's stellar returns. Within the U.S. stock market, large-cap growth stocks (Russell 1000 Growth) once again led the charge; they ended the year positive 33%, outperforming large-cap value stocks (Russell 1000 Value) and small-cap stocks (Russell 2000), which ended the year up 14.4% and 11.5% respectively.

Overseas, returns were not nearly as strong. Developed international stocks (MSCI EAFE) posted a modest 3.8% gain. Calendar-year returns for most foreign markets were dragged down by fourth-quarter losses following the Trump presidential victory, which sparked fears of a widespread economic slowdown due to tariff risks and a stronger U.S. dollar. Emerging-markets stocks (MSCI EM Index) had a volatile year, finishing the year up 7.5%. Much of that volatility can be attributed to China. The Chinese stock market (MSCI China Index) had a strong year (up 19.4%), but it was tumultuous, marked by significant swings in investor sentiment.

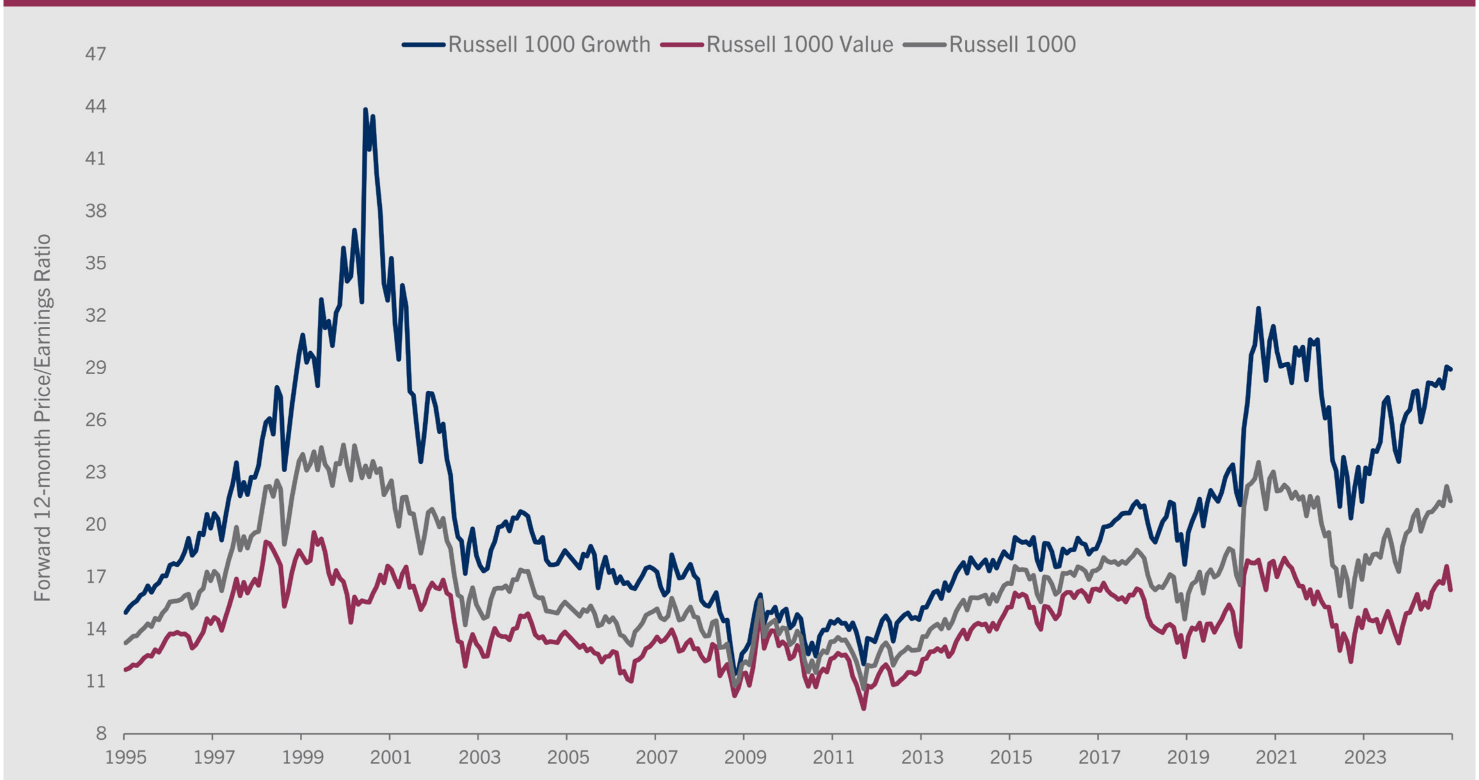
Within the bond markets, calendar-year returns were mixed across fixed-income segments. The benchmark 10-year Treasury yield experienced significant volatility throughout the year amid concerns around inflation, interest rates, and the impact of potential tariffs under the Trump administration. Against this backdrop, the interest-rate-sensitive Bloomberg U.S. Aggregate Bond Index was slightly positive at 1.3%. Conversely, short-term and credit-sensitive sectors of the bond market performed well during the year. The Bloomberg Short-term Treasury Index rose 5.3%, and high-yield bonds (ICE BofA Merrill Lynch High Yield Index) were up 8.2% for the year.

Investment Outlook

Looking to 2025, our base case is that the U.S economy will continue to grow, albeit slower, with a low probability of recession. This should be a supportive backdrop for both bonds and stocks, although we expect the pace of gains to slow. We continue to think it likely that the market will broaden out beyond large-cap growth stocks to include small- and mid-caps and non-tech sectors of the market.

While our economic outlook is generally positive, there are plenty of risks. For starters, following two consecutive years of strong returns for U.S. stocks, valuations are expensive and reflect a significant amount of investor optimism (see chart below). Current valuation levels—particularly for large-cap growth stocks—suggest that there is less room for upside and more downside risk if expectations are not met.

Elevated Valuations



Source: Bloomberg LP. Data as of 12/31/2024.

Another consideration is a high level of concentration in the S&P's top-weighted stocks, which could magnify volatility if any of these companies disappoint. The weight of top-10 stocks in the S&P 500 index has reached an all-time high at nearly 39%. While this narrow market leadership could persist for some time, the generals cannot lead the market higher into perpetuity. The infantry must join the battle for a healthy bull market to continue. Otherwise, failure of a few companies to meet extremely optimistic expectations will drag down market cap weighted indexes (like the S&P 500).

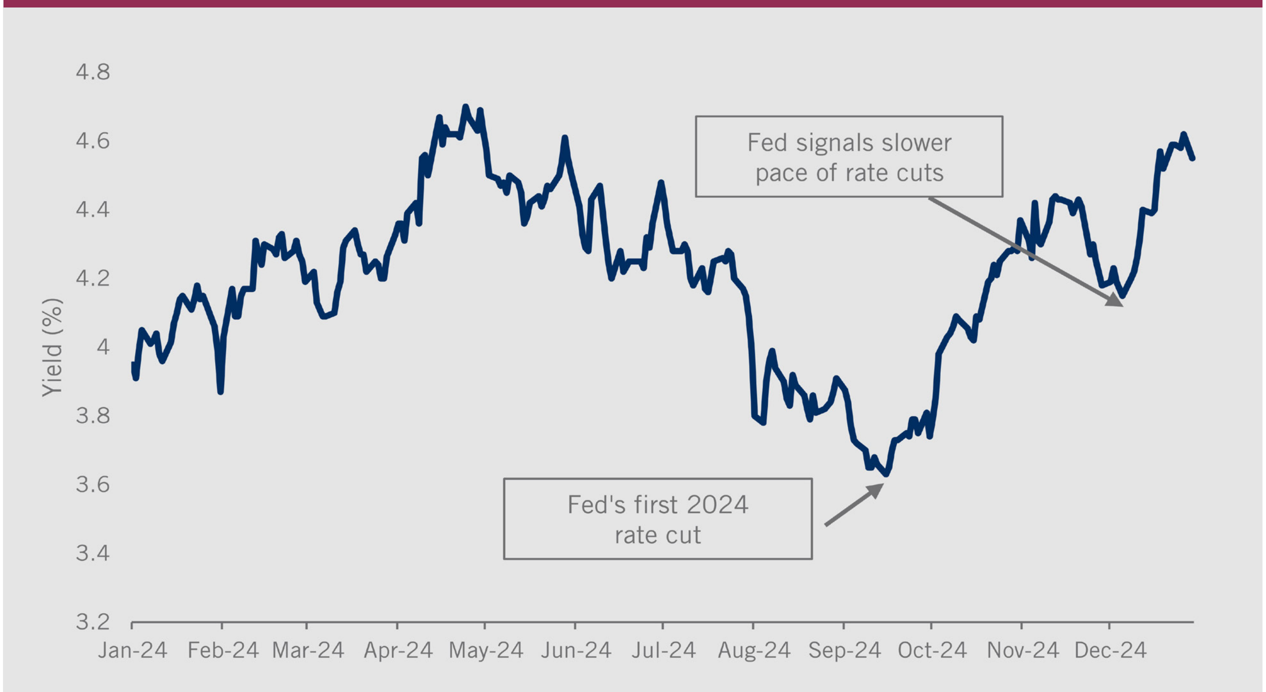
Outside of expensive starting valuations and market concentration, there are the usual suspects that could cause market volatility, including inflation, monetary policy, and uncertainty surrounding incoming President-elect Donald Trump's fiscal and global trade policy. Investors should be prepared to weather occasional storms in 2025.

Within the bond markets, investors remain hyperfocused on every economic data release, ranging from inflation and employment reports to GDP growth and consumer strength. Each data point has been heavily scrutinized for its potential impact on central bank policy, driving heightened volatility as investors attempt to project the likelihood of interest rate changes and the implications on returns. Investor guesswork has led to a very volatile year for the 10-year U.S. Treasury bond, reflecting the market's sensitivity to economic conditions in an uncertain environment.

The year started with persistent inflation pressures, prompting the Fed to keep interest rates elevated. As the year progressed, inflation began to trend lower, and the Fed cut rates in September. The September rate cut was the first cut in over four years, and it was a more aggressive 50 basis point (bps) reduction compared to the typical 25 bps cut. This was followed by a 25 bps reduction in November, and another widely expected 25 bps cut in mid-December at the final Fed meeting of the year.

While the December cut was expected, the Fed showed a renewed concern over slowing disinflation momentum. The Fed's median inflation estimates, as measured by core Personal Consumption Expenditures (PCE), for 2025 and 2026 increased from 2.2% to 2.5% and 2.0% to 2.2%, respectively. The market did not like the news, and the following day stocks fell sharply and long-term bond yields increased. In fact, since the Fed started cutting rates in mid-September, 10-year treasury rates have increased by roughly 100 bps (see below).

10-Year Treasury Yields in 2024



Source: Federal Reserve. Data as of 12/31/2024.

Looking to 2025, the U.S. bond market is stuck between the Fed's plans to cut interest rates (to some degree) and the risk of higher inflation and increasing federal deficits. As was the case in 2024, we think 2025 will be another bumpy ride for fixed income.

As mentioned above, there can be a wide range of economic forecasts even within the Fed, despite its extensive resources, highly skilled staff, and the wealth of theoretical and empirical models at its disposal. Therefore, it should come as no surprise that we do not hang our hat on the Fed and view them as any other forecaster: imperfect.

Our investment approach attempts to navigate uncertainty rather than trying to predict precise outcomes. Instead of relying on pinpoint forecasts, we focus on understanding a range of possible scenarios and analyzing their potential implications for our portfolios. By evaluating risks and opportunities across different economic and market conditions, our goal is to stack the odds in our favor, even in complex and volatile environments.

Closing Thoughts

We remain cautiously optimistic as we enter 2025. While there are promising signs of growth and resilience in the economy, we are also acutely aware of the potential risks that could negatively impact market stability. For example, the U.S. economy will likely downshift into a slower gear. We do not believe this slower growth, in and of itself, will cause a recession, but it does leave the economy more vulnerable to shocks, including significant policy changes from the new administration. Furthermore, the past two years of strong returns leaves valuations elevated. Our focus will continue to be on identifying opportunities to improve long-term returns while being vigilant of the risks we are taking. By staying disciplined and opportunistic, we aim to navigate the complexities of the market and position our investments for long-term success.

As always, thank you for your continued confidence and trust.

Best regards,

Retirement Plan Advisors

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Market Indicators
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S&P Sectors

	QTR	YTD	1Y	5Y
S&P Technology Select Sector TR USD	3.14	21.74	21.74	21.66
S&P Financial Select Sector TR USD	7.09	30.56	30.56	11.70
S&P Consumer Disc Select Sector TR USD	12.14	26.62	26.62	13.39
S&P Health Care Select Sector TR USD	-10.30	2.58	2.58	7.99
S&P Industrial Select Sector TR USD	-2.27	17.47	17.47	12.02
S&P Cons Staples Select Sector TR USD	-4.63	12.34	12.34	7.44
S&P Energy Select Sector TR USD	-1.63	5.65	5.65	12.23
S&P Utilities Select Sector TR USD	-5.51	23.43	23.43	6.62
S&P Real Estate Select Sector TR USD	-7.94	5.23	5.23	4.57
S&P Materials Select Sector TR USD	-12.29	0.21	0.21	8.70
S&P Telecom Select Industry TR USD	6.77	35.06	35.06	10.12

Market Returns

	QTR	YTD	1Y	5Y	10Y
S&P 500	2.41	25.02	25.02	14.52	13.10
Russell Mid Cap	0.62	15.34	15.34	9.92	9.63
Russell 2000	0.33	11.54	11.54	7.40	7.81
MSCI EAFE	-8.11	3.82	3.82	4.73	5.20
MSCI Emerging Markets	-8.01	7.50	7.50	1.70	3.64
BBgBarc U.S. Agg Bond	-3.06	1.25	1.25	-0.33	1.35
High Yield	0.17	8.19	8.19	4.21	5.17

Value / Growth Returns

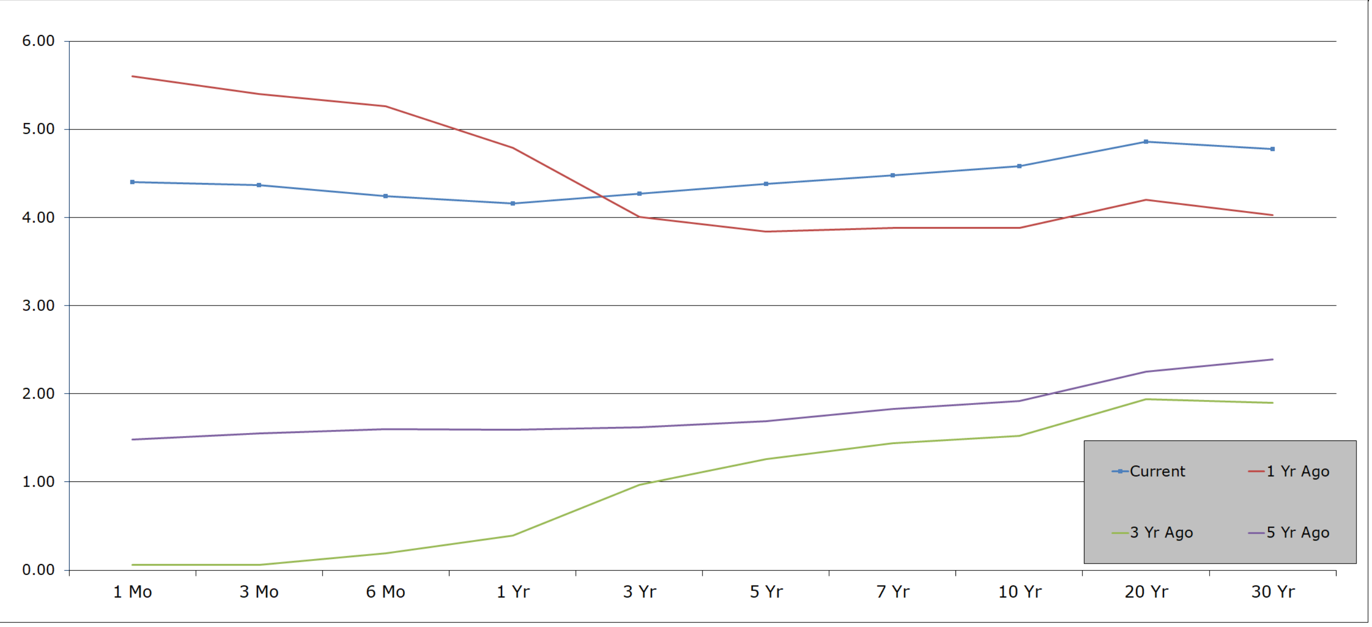
	YTD			Previous Calendar Year		
	Large	Mid	Small	Large	Mid	Small
Value	12.29	11.71	5.15	12.29	11.71	5.15
Growth	36.07	15.94	9.63	36.07	15.94	9.63

Benchmarks by size/style – Large Value: S&P500 Value; Large Growth: S&P500 Growth; Mid Value: S&P400 Value; Mid Growth: S&P400 Growth; Small Value: S&P600 Value; Small Growth: S&P600 Growth

Index Characteristics

	LTM P/E	NTM P/E	Div Yld	Earn Yld
S&P 500	27.14	21.83	1.21	4.58%
Russell Mid Cap	21.22	17.51	1.27	5.71%
Russell 2000	17.47	15.56	1.15	6.43%
MSCI EAFE	16.25	13.61	3.24	7.35%
MSCI Emerging Markets	13.99	12.28	2.42	8.15%

Long-Term Outlook on Treasury Yield Curve



Source: Morningstar

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