Market & Economic Outlook – 2025: It's All Fun & Games Until Someone Gets Hurt

Major Equity, Commodity & Bond Indices	Value (12/24/24)	2024 YTD (12/31/23 - 12/24/24) Price Return	Total Return*	All-Time High	% from High
S&P 500	6,040.04	26.6%	28.4%	6,090.27	0.8%
Dow Jones Industrial Average	43,297.03	14.9%	17.0%	45,014.04	3.8%
NASDAQ Composite	20,031.13	33.4%	34.4%	20,173.89	0.7%
Russell 2000	2,259.85	11.5%	13.0%	2,442.74	7.5%
MSCI EAFE (USD)	2,246.76	0.5%	3.6%	2,506.69	10.4%
MSCI Emerging Markets (USD)	1,084.99	6.0%	8.9%	1,444.93	24.9%
Bloomberg Commodity Index	98.21	-0.4%	4.7%	237.95	58.7%
Barclays U.S. Aggregate Bond	90.32	-1.5%	1.1%	112.07	19.4%

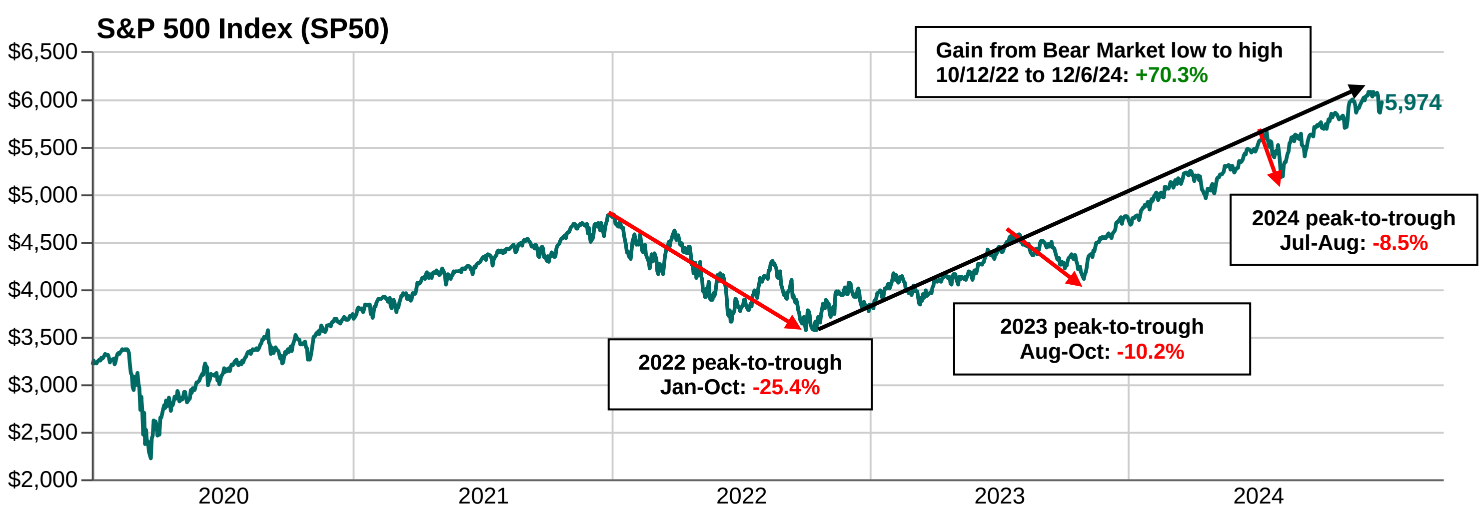
Data Source: FactSet, as of 12/24/24; Total returns include dividends paid

Outlook Summary:

Investor sentiment is high entering 2025 as several of the 2024 positive trends that remain in place were bolstered by November election results, which ignited pro-growth policy expectations. This sets up conditions for equity prices to move higher if the U.S. economy sustains growth above +2% and corporate earnings (the S&P 500 index) grow above +10%. At the same time, optimism is high and valuations remain elevated, creating potential for disappointment and market volatility. We look for solid trends in consumer spending and business investment (the two largest drivers of U.S. economic growth) to sustain this momentum, but both could encounter headwinds that would disrupt investor expectations. Jobs growth is expected to moderate, slowing aggregate spending, and we believe that investment spending to support generative artificial intelligence (GenAI) could peak and begin to slow. Following two consecutive years of +25% total returns (including dividends) for the S&P 500, we look for gains to moderate (i.e., investors should scale back return expectations) but with broader sector participation, benefitting diversified portfolios. While valuations matter (the price-to-earnings, P/E, multiple on the S&P 500 is significantly above long-term averages), it usually takes more than high valuations to derail a bull market. That is often predicated by earnings erosion or a credit contraction brought on by recession. We don't see weak economic conditions forming as 2025 begins, creating a path for equities to deliver gains. But we should expect volatility and recognize that equity market corrections are common. We continue to recommend broad sector diversification and frequent portfolio rebalancing.

While parts of the U.S. economy weakened in 2024, including manufacturing, housing, and construction, quarterly GDP (gross domestic product) surprised to the upside. Consumer spending remained ebullient, but credit balances trended higher and delinquencies increased, especially for low-income borrowers. It would be natural to predict some moderation and a slowdown ahead, but spirits were lifted with the election of President-elect Trump, who promised a pro-growth and investor-friendly platform that includes less regulation, lower taxes, and smaller government. This could broaden economic growth to include more constituents and provide an environment for corporate success. Equities rallied just before the election which continued through November (the S&P 500 index gained +5.7% for the month), perhaps pricing in much of the pro-growth optimism. However, many equity indices declined in December as interest rates rose, perhaps due to investors considering some risks from the Trump agenda, including tariffs, immigration uncertainty, and continued budget deficits. We discuss five components of our 2025 outlook below.

1. Our S&P 500 fair value estimate is 6,300 and we see a potential 2025 range of 5,200 to 6,800.
2. Second-half 2024 sector rotation can continue, leading to improved relative performance from the "average" stock.
3. The second Trump Administration is good for growth but beware of tariffs and immigration battles.
4. The Fed is likely to follow a pause, pause, cut policy as sticky inflation keeps interest rates elevated.
5. For those approaching the 'Wall of Worry,' there is no shortage of risks.



Data Source: FactSet as of 12/23/24. S&P 500 Daily Closing Prices, 12/23/19 to 12/23/24. Price change does not include dividends.

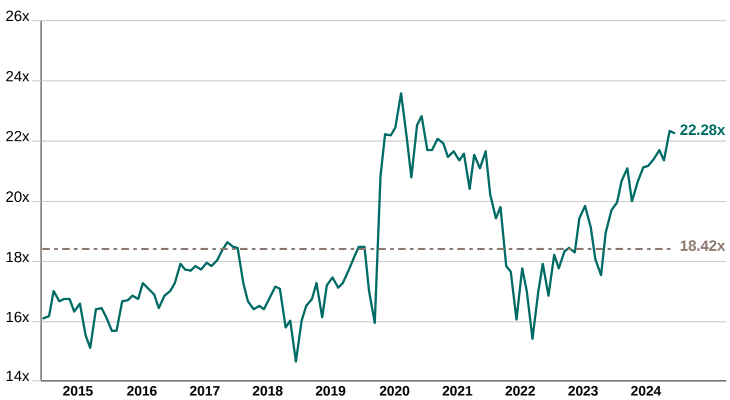
Year in Review Part 1. 2024 was a strong year for most equity investors as 2023's fourth quarter rally extended into the new year. The S&P 500 posted gains in all four quarters (as of 12/24/24, the S&P 500 gained +4.8% in 4Q24 to-date), which last happened in 2021. Equities surged in the first quarter, allowing the S&P 500 index to break out of a two-year trading range, establishing a new all-time high on 1/19/24 for the first time since January 2022. By 12/20/24, the S&P 500 set 57 new all-time highs, and, after starting the year at a price level of 4,770, closed at 6,090 on 12/6/24. As of 12/23/24, the S&P 500's year-to-date (YTD) return was +25.3% on a price basis (at 5,974) and +27.0% on a total return basis (includes dividends). Gains were made with relatively low volatility, and the year's largest peak-to-trough decline (over three weeks from 7/16/24 to 8/5/24) was just -8.5%. This was less than 2023's largest pullback of -10.3% (that decline took three months), marking two consecutive years of lower-than-average volatility (since 1980, the average market pullback in any calendar year exceeded -14%). GDP growth was just +1.6% annualized in 1Q24, rebounded over the balance of the year, and is on pace to increase +2.7% for the full year, well above the +1.2% consensus estimate to start the year. The headline consumer price index (CPI, consumer inflation) was +2.7% in November 2024 compared to +3.4% in December 2023, indicating progress on inflation, but the trend lower slowed in the fourth quarter. This was still enough to allow the Federal Reserve Bank (Fed) to lower the range for its overnight fed funds target, which ended the year at 4.25% to 4.50% after starting the year one percentage point higher. Despite the Fed's reduction in short-term interest rates, U.S. long-term Treasury yields (TY) moved higher as the 10-year TY was 4.60% in late December, up from 3.88% to start the year; however, the increase in the 2-year TY was more modest, to 4.34% from 4.25%. The rise in long-term yields mostly reflects a stronger growth outlook but could also signal concerns about inflation and the federal budget deficit. The 2024 election did not weigh on markets as expected and, in fact, seemed to rally when former President Trump gained in the polls.

Year in Review Part 2. We were overly conservative on the potential for equity gains in 2024 as we started the year with an S&P 500 upside range of 5,200, which we increased to 5,800 in October. Investors reacted positively to sustained U.S. GDP growth, which was helped by surging technology spending to support GenAI, pushing gains in the technology-centric market leaders. We correctly predicted sector rotation that would produce improved performance for the 'average stock,' and this began to take hold in the third quarter, when S&P 500 sector leadership rotated to more sectors. In 3Q24, the average stock in the S&P 500 beat the index, and the small-company Russell 2000 was the top-performing index. After an initial post-election boost in November, the broadening of the rally stalled in December, but we believe this is temporary. For the full year, U.S. large capitalization indices led global equity returns, large cap led small cap, growth stocks outperformed value stocks, and fixed income returns were relatively flat.

Our S&P 500 fair value estimate is 6,300 and we see a potential 2025 range of 5,200 to 6,800. We have moved our fair value estimate higher since our last Market Outlook in October as we look ahead to year-end 2025, and also acknowledge stronger earnings and GDP trends. In addition, our market range is very wide as we 1) see the potential for a more substantial market correction in 2025 after two years of low volatility, and 2) also believe that companies could deliver double-digit percentage earnings growth in 2025, keeping investor sentiment in an upward trend, driving the S&P 500 modestly higher. Our fair value estimate of 6,300 incorporates S&P 500 consensus earnings estimates for 2025 and 2026 that reflect growth of +15% and +13%, respectively (following 2024 expected growth of +10% with fourth quarter, 4Q24, results still pending). Our fair value estimate of 6,300 is +5% above the S&P 500 closing price (12/23/24) of 5,974 and, along with an estimated dividend yield of 1.3%, reflects a total return above +6%. Our upside range of 6,800 is +13% above current index levels, while the downside of 5,200 represents a -13% decline. Over the past 45 years (1980 to 2024), the average calendar year peak-to-trough decline for the S&P 500 was -14.1%, and since 2009 (the past 16 years), the average peak-to-trough decline was -13.8%.

As of 12/16/24, the S&P 500 traded at 22.2x the 2025 FactSet consensus earnings estimate of $273. This represents a premium to the 18.4x P/E (one year forward earnings estimates) average since 2014 (a 10-year period of relatively elevated valuations). Our fair value of 6,300 is 23.1x the 2025 consensus estimate and 20.4x the 2026 consensus EPS estimate of $309. While 2025 and 2026 EPS estimates appear aggressive, recent quarterly earnings results (2Q24 and 3Q24) were better than expected and many companies are optimistic about 2025. While 2026 remains more than a year away, we believe that by the middle of 2025 markets will begin to look at 2026 estimates. Thus, strong results in the first half of 2025 should keep investor expectations high. We do not expect continued P/E expansion like we saw in 2023 and 2024 and believe that continued market gains from current levels is dependent upon earnings growth. In fact, we expect P/Es to trend lower as earnings growth exceeds index gains in 2025 and 2026 (partially because strong earnings growth is already priced in). We don't see a big decline in P/Es driven by economic weakness building at this time, although a decline in P/E levels remains a risk to the market. Our upside range of 6,800 reflects 22.0x the 2026 estimate, and we find it hard to justify valuations above that level. On the downside, 5,200 is 19.0x the 2025 consensus EPS estimate, still a modest premium to the average valuation over the past ten years.

S&P 500 Forward P/E Ratio (estimated next 12 months)

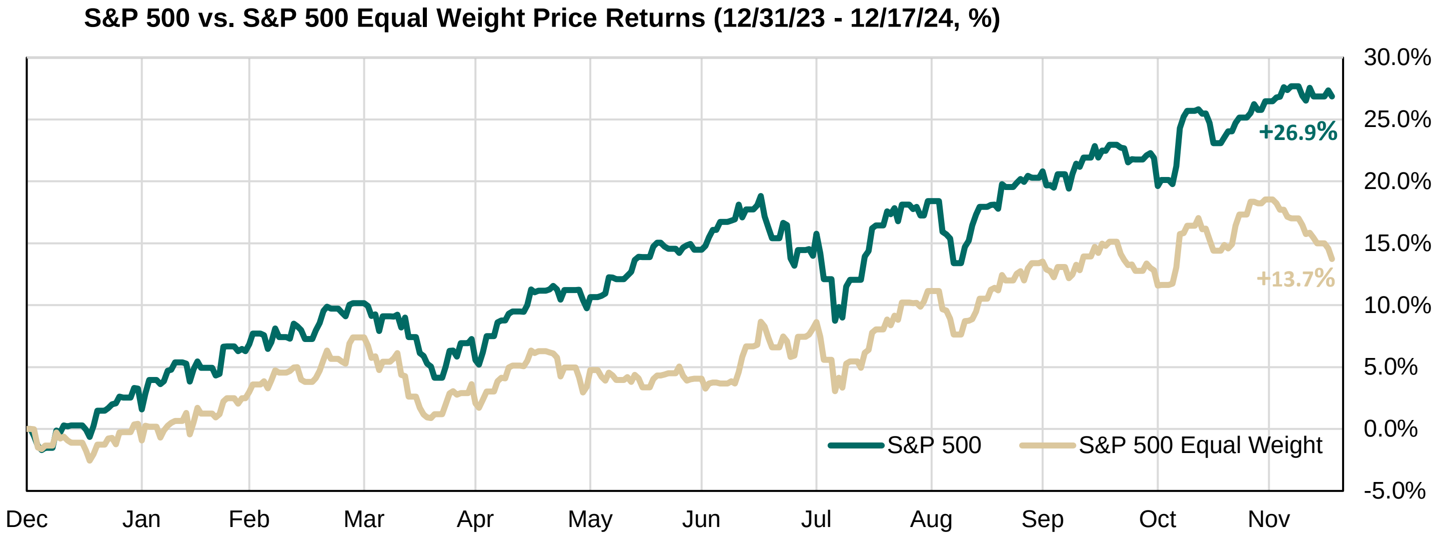


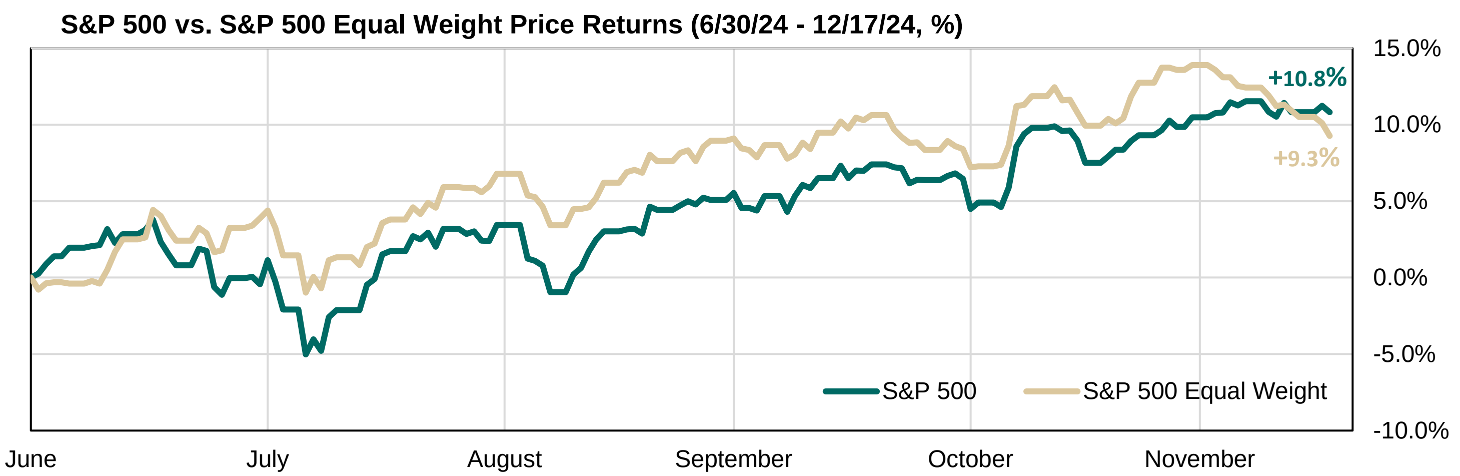
U.S. 10-year Treasury Yields

Data source: FactSet, using exchange data, as of 12/16/24 (see Other Disclosures on page 11 for further discussion of P/Es and Treasury yields)

Second-half 2024 sector rotation can continue, leading to improved relative performance from the "average" stock. Through 12/17/24, the S&P 500 gain of +26.9% (not including dividends) was significantly above the +13.7% increase for the Equal Weight S&P 500, an indication that the largest companies in the S&P 500 delivered stronger returns. We estimate that the ten largest S&P 500 constituents by market capitalization comprised more than 35% of the weight of the index, and from that group, the "Magnificent 7" (Mag 7) stocks produced an average 2024 gain (through 12/18/24) of +62%. Based on each stock's weighting in the S&P 500, the Mag 7 contributed 54% of the index's total return, as of 12/18/24. This means that the other 493+ stocks in the S&P 500 contributed 46% of the year's total return. The 2024 leading relative performance of the larger companies in the index was a repeat of 2023 when the S&P 500 gained +24.2% vs. +11.6% for the Equal Weight S&P 500 (EWSP). The EWSP assigns an equal weighting to all 500+ companies in the index and, in our view, gives the best look at the performance of the "average" large-company stock. In recent years, the S&P 500 is increasingly concentrated in favor of the largest companies, which has driven strong gains in recent periods. However, concentrated gains lead to higher levels of risk, which may not be fully acknowledged by investors. The 2024 (through 12/17/24) EWSP underperformance vs. the S&P 500 of 1,320 basis points is not unprecedented (it was 1,260 basis points in 2023) but the magnitude is rare and we expect the difference to even out over time. Combined in 2023 and 2024, the EWSP underperformance totaled 2,580 basis points (25.8%), a two-year differential last seen in 1998 and 1999 when it underperformed by 2,560 basis points. Following that two-year underperformance, the EWSP went on to outperform the S&P 500 for each of the next seven years (2000 to 2006), although 2000 to 2002 was a period of negative returns for the S&P 500. In fact, from 2000 to 2024 (12/17/23), including dividends, the EWSP delivered a compounded annual return (CAGR) of +9.7% vs. the S&P 500's CAGR of +7.8%. Given our view of slowing, but solid, economic growth in 2025 and a continuation of the sector rotation underway in the second half of 2024, we look for improved performance of the average stock in 2025.

S&P 500 Index vs. Equal Weight S&P 500: First chart is 2024 year-to-date (YTD), second chart is the 2nd half of 2024 from 6/30/24.



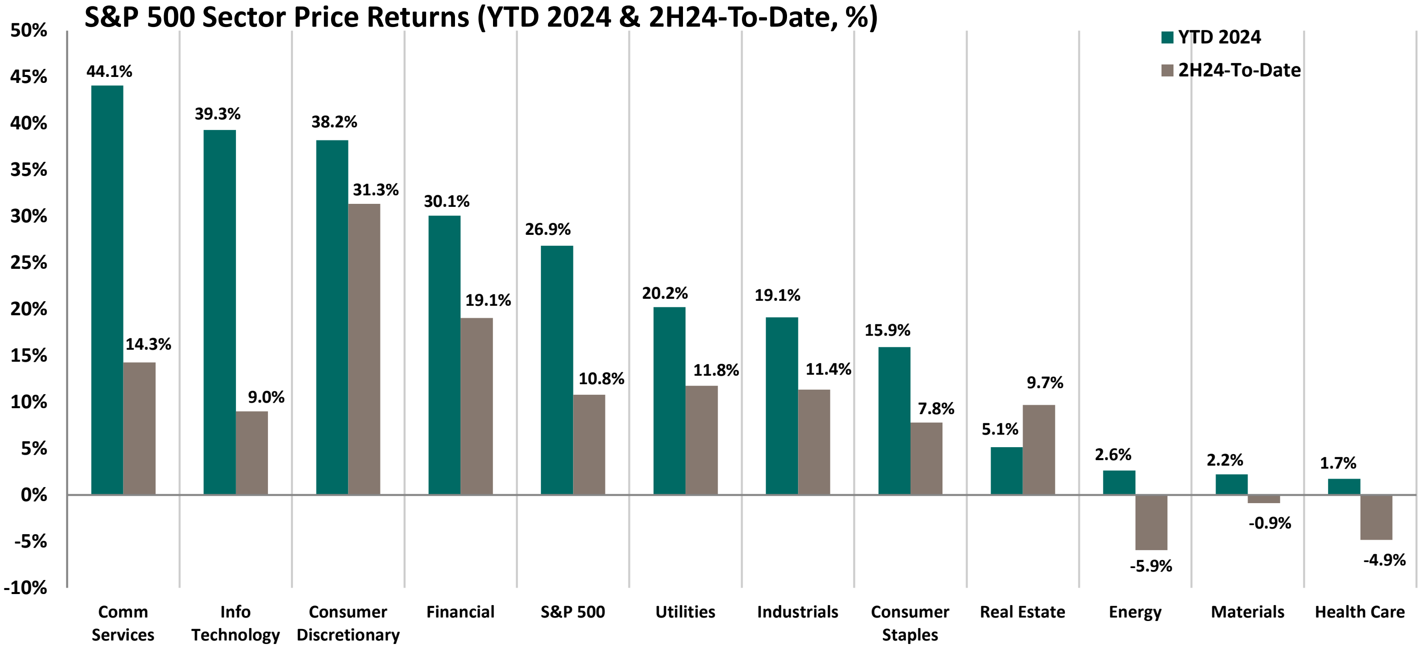


As of 12/17/24, all 11 S&P 500 GICS sectors posted gains in 2024 YTD. However, the bulk of those gains were driven by four sectors: Communication Services, Technology, Consumer Discretionary, and Financials. Other sectors lagged the performance of the broad index, with several posting just single digit percentage returns. Since 6/30/24 (the second half of 2024), five sectors beat the index performance: Consumer Discretionary, Financials, Communication Services, Utilities, and Industrials (not Technology), and three sectors are lower. Through November, second-half gains were broader based but have reversed somewhat in December. We believe that the sector rotation that began in July and included improved relative performance from value stocks and small companies, as measured by the Russell 2000 index, can resume in 2025.

Major Equity Indices: Annual Price Returns 2023 & 2024
Compounded Annual Returns (CAGR) with Dividends 2000 to 2024

Index	Price Return 2024	Price Return 2023	CAGR 2000-2024 price return	CAGR 2000-2024 total return
S&P 500	**26.9%**	**24.2%**	5.9%	7.8%
Equal-Weight S&P 500	13.7%	11.6%	**7.7%**	**9.7%**
Russell 1000 Growth	37.7%	41.4%	6.7%	8.0%
Russell 2000	15.2%	15.1%	6.4%	7.8%
Russell 1000 Value	14.3%	8.8%	4.9%	7.5%

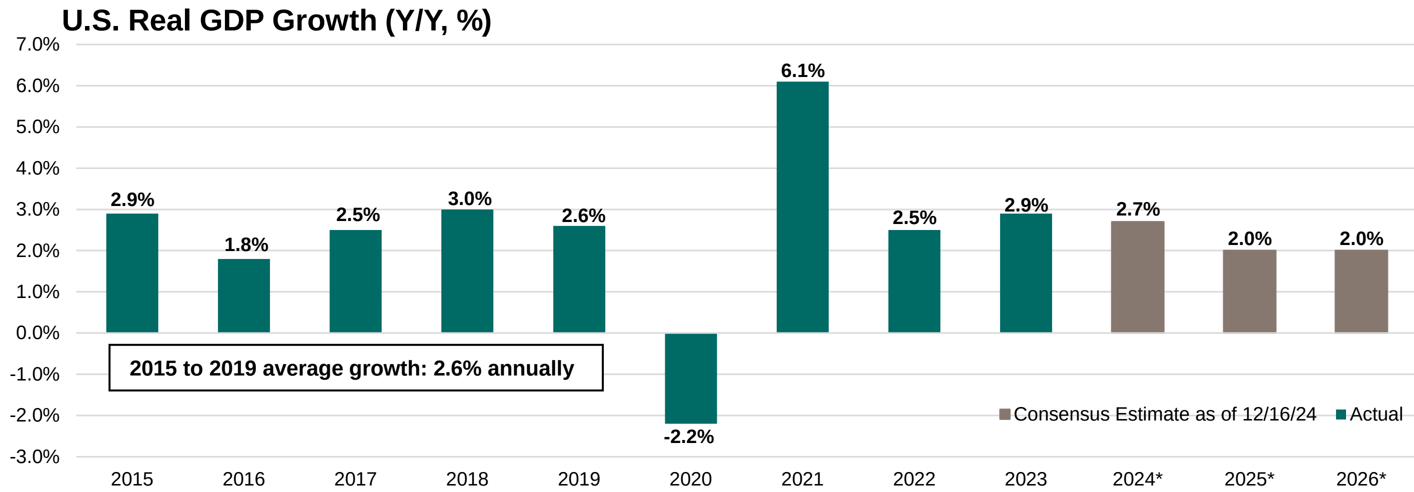
Data Source: FactSet as of 12/17/24. Price return does not include dividends, total return includes dividends. Compounded return calculates the annualized return including price gains and dividends reinvested. 2024 periods are as of 12/17/24.



Data Source: FactSet, as of 12/17/24. S&P 500 Daily Closing Prices, 12/31/23 to 12/17/24 (green) and 6/30/24 to 12/17/24 (gray).

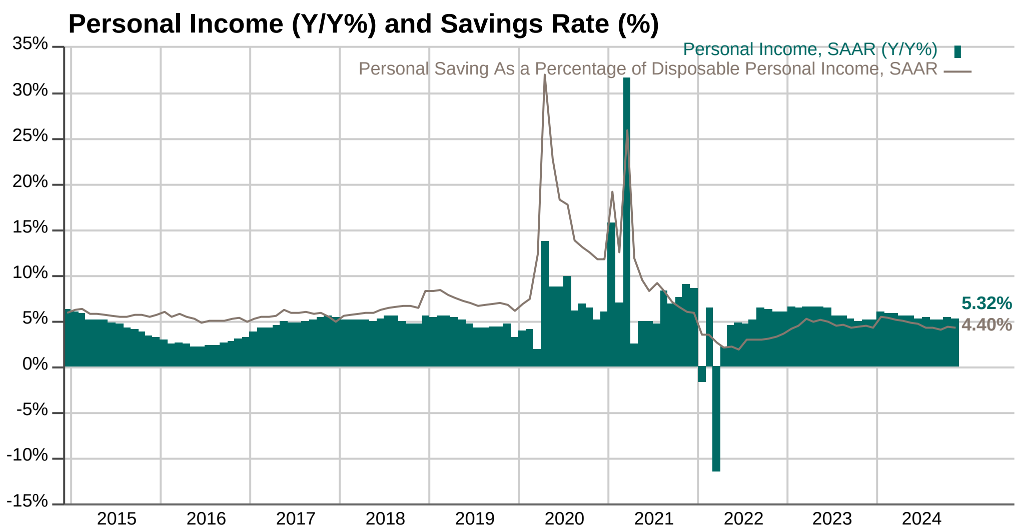
The second Trump Administration is good for growth but beware of tariffs and immigration battles. Equity and bond prices surged following Donald Trump's election victory in November. President Trump becomes just the second U.S. president ever elected to a second term after leaving office. Although hardly an underdog due to leading in many pre-election polls, Trump version 2 nonetheless completed an impressive comeback since leaving office in 2021 with many question marks. Election results also delivered a "red wave" as Republicans flipped control of the U.S. Senate and held on to a narrow majority in the House of Representatives. The S&P 500 equity index rallied +4.3% from Election Day through the end of November and gained +5.7% for the full month of November. This was reminiscent of President Trump's 2016 election win, when the index gained +3.4% in November. In this year's November rally, all 11 S&P 500 industry sectors traded higher, reflecting broad participation and surging investor sentiment. In other indices, the Russell 2000 index, a composite representing small company stocks, increased +10.8% for the month. We attributed the bullish sentiment to potential economic stimulus provided by campaign promises of lower regulation, smaller government, and lower taxes. The U.S. economy, as measured by inflation-adjusted gross domestic product, or real GDP, exceeded expectations in 2024 and is expected to grow +2.7% for the full year (4Q24 official GDP data is due in late January). One year ago, in December 2023, the FactSet consensus estimate for 2024 U.S. GDP growth was +1.2%, but consumer spending, business investment, and government expenditures all surprised to the upside. As of 12/18/24, the consensus estimate for 2025 U.S. GDP growth is +2.0%, reflecting moderating growth from 2024. The 2025 GDP estimate increased from +1.8% at the end of October, reflecting an upward revision since the election.

Over the five years (2015 through 2019) pre-pandemic, U.S. annual GDP growth averaged +2.6%. Growth was disrupted in 2020 as the economy shut down and then the recovery distorted 2021 and 2022 data due to immense fiscal stimulus. GDP growth in 2023 and 2024 (estimated) recovered to levels above the multi-year, pre-COVID average. Looking ahead and incorporating the recent upward revision to GDP growth estimates (2025 and 2026) to +2.0%, this still assumes a moderating trend, driven by concerns about sustained jobs growth, and weakness could weigh on consumer spending. Our general view is that political party transitions (at the federal level) should not alter the core of long-term investor portfolios. Regime changes can implement policy shifts that create opportunities and risks, and as we assess recent election results, we can identify pro-growth policies that would be beneficial for the economy and capital markets. Among policy pivots that alter the business environment are changes in regulation, taxes, and the labor market.

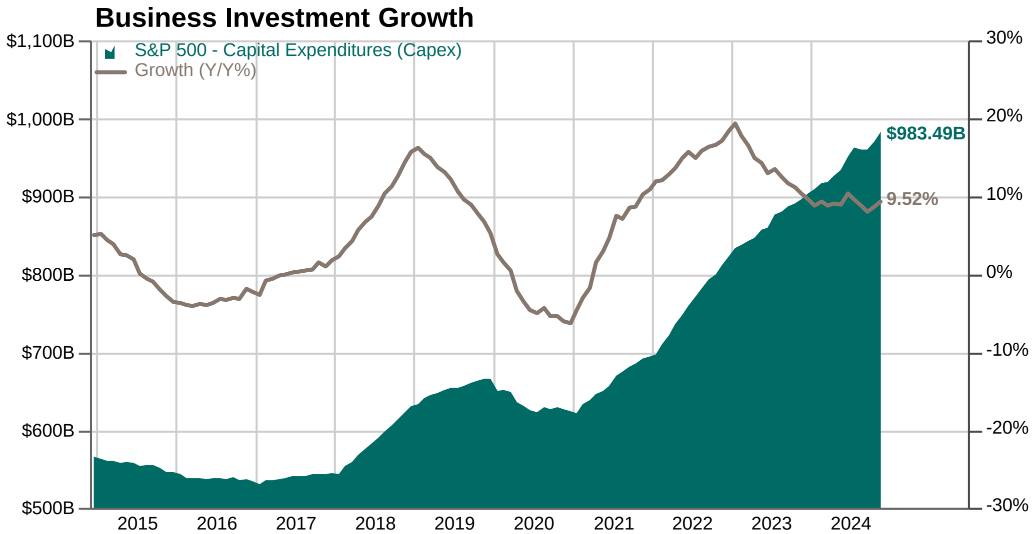


Data Source: FactSet and U.S. Bureau of Economic Analysis (BEA). Annual GDP growth. Past nine years reported (green), three years estimated (gray).

Immediate post-election gains were attributed to investor enthusiasm for Trump policies pitched on the campaign trail, led by easing regulatory roadblocks and lower corporate taxes as both could add fuel to an economy that exceeded expectations in 2Q24 (GDP +3.0%) and 3Q24 (GDP +3.1%). At this point, regulatory changes remain speculative and lack specifics, but we expect a less restrictive environment with an aim to aid construction projects, manufacturing facilities, capital investment, and lending activities. Efforts to encourage activity in each of these areas can boost jobs and stimulate growth, although many projects would move forward regardless, and benefits of these programs could be limited with full benefits extended over multiple years. President Trump is also likely to push Congress to reduce the corporate tax rate to 15% from 21%, but only for profits from products and services made in the U.S. This could be complicated to establish and enforce, but some companies and industries would be well positioned to immediately benefit. Some businesses are clearly "made in the USA" including financials (banks, especially regional banks), utilities, communication and entertainment providers, and some consumer services companies, including most travel-related services. In mid-December, the BEA revised higher its previously reported 3Q24 GDP report to +3.1% from +2.8%, led by consumer activity. Consumer spending in 3Q24 increased +3.7% on an annualized basis, its best sequential annualized growth rate since 1Q23 (six quarters). The FactSet consensus estimate for 4Q24 GDP was +2.1% as of 12/20/24, but the Atlanta Federal Reserve Bank's 4Q24 GDPNow estimate, which tracks current quarter GDP inputs as data is reported, was higher at +3.1%. This suggests that GDP is poised to again exceed estimates in the fourth quarter. With personal income (mostly wages) remaining elevated throughout 2024 and the savings rate holding steady near 4.4%, consumer balance sheets appear stable. If the new Administration's pro-growth policies take hold, then economic growth estimates would be revised higher, and earnings growth could accelerate.

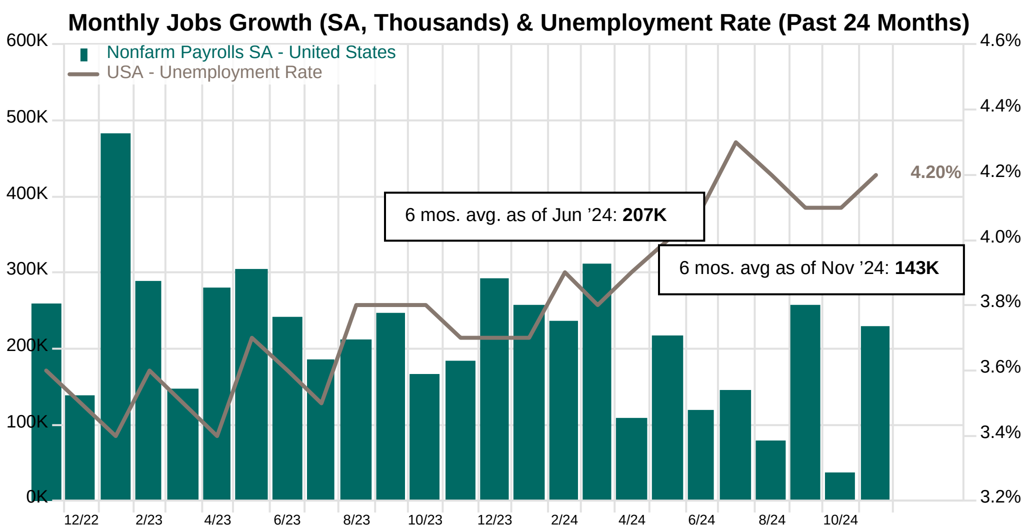


Data Source: FactSet and Bureau of Economic Analysis (BEA) through 11/30/24, reported monthly. SAAR is seasonally adjusted annual rate; Savings Rate is personal saving as a percentage of disposable income. Y/Y is year-over-year.



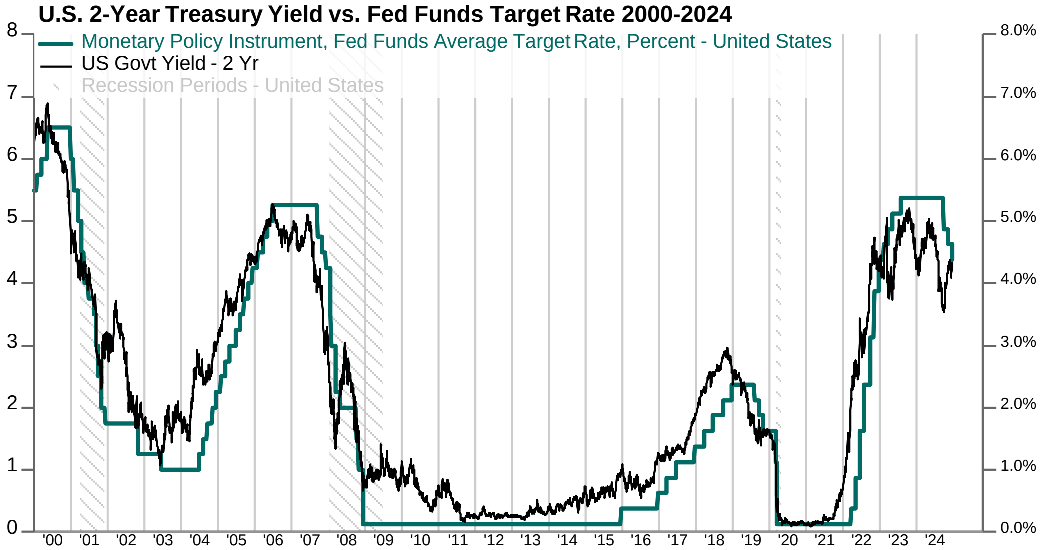
Data Source: FactSet and SEC, as of 11/30/24. Shows the dollar level of capital expenditures (business investment) for all S&P 500 members over the most recent prior twelve months reported in SEC filings. The line graph growth rate compares the twelve-month total ending each month to the twelve-month period for the same period one year ago. Y/Y is year-over-year.

However, in our view, investors should consider risks to the U.S. economic outlook with respect to the outlook for jobs and consumer spending. U.S. jobs growth exceeded expectations in 2024 but became less predictable in the later part of the year. The monthly increase in nonfarm payrolls (jobs) was very strong, above +200 thousand (K) in November and September, but relatively weak, below +80K in October and August. In fact, through November, the average monthly jobs increase over the prior six months was +143K, compared to +207K for the six months ended June 2024. For all of 2023, monthly jobs gains averaged +251K (and +399K in 2022) as recovery from the pandemic, aided by massive immigration at the southern border, surged to meet elevated labor demand and limited wage growth. Labor demand, however, has already weakened, according to the Bureau of Labor Statistics (BLS), which has reported below 8.0 million (M) job openings for seven of the past eight months through October. Job openings peaked at 12.0M in March 2022, and have remained above 8.6M for 35 consecutive months from April 2021 through February 2024. In addition, the November unemployment rate of 4.2%, while still a relatively low number, was above 4.0% for the past seven months after ending 2023 at 3.7%. The incoming Trump Administration is expected to enact global tariffs, halt most immigration, and begin deporting illegal migrants in the U.S. These policies could accelerate the slowdown in jobs growth and could also add to inflation in the form of elevated wage pressure and higher prices (inflation) to offset the impact of tariffs. Perhaps other policies (previously discussed, lower regulation and taxes) can offset these labor forces, but we see emerging risks to the outlook for sustained jobs growth.



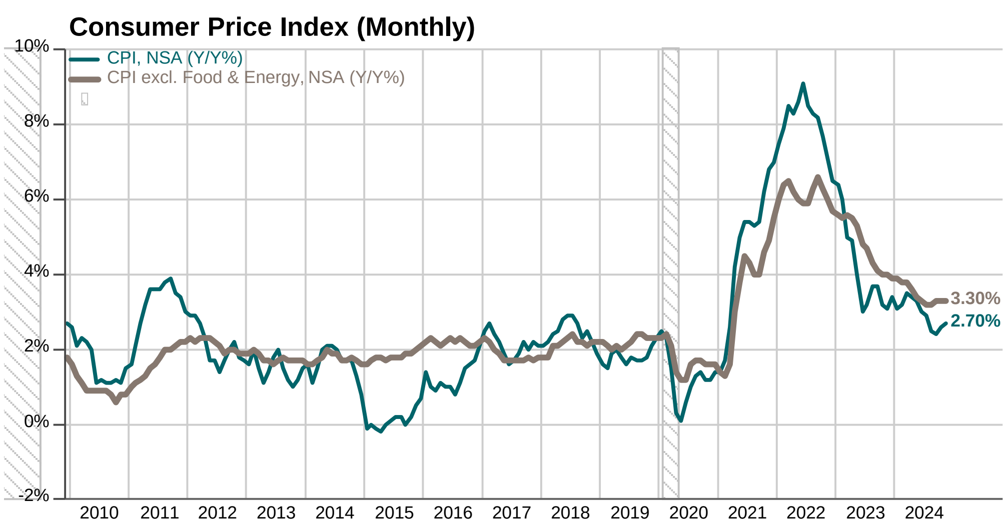
Data Source: FactSet and Bureau of Labor Statistics (BLS) through 11/30/24, reported monthly. SA is seasonally adjusted. Nonfarm payrolls (jobs) are the net change reported in the BLS/Establishment Survey. Unemployment Rate is from the BLS Household Survey.

The Fed is likely to follow a pause, pause, cut policy as sticky inflation keeps interest rates elevated. When the Federal Reserve Bank (Fed) lowered its overnight bank lending fed funds interest rate target by -0.25% to a new range of 4.25% to 4.50% on 12/18/24, it also said that recent inflation trends were higher than it expected a few months ago, and that the potential inflationary impact of President Trump's policies in 2025 are an added risk that could keep inflation higher for longer. This led to equity market weakness immediately after the meeting (partially recovered in the days that followed) as investors assessed the impact of interest rates perhaps remaining elevated in 2025.



Data Source: FactSet and U.S. Treasury. The 2-year U.S. Treasury yield (black line) is market traded. The Fed Funds target (green line) is established by the Federal Reserve Bank and also is market traded but is influence by the Fed buying and selling securities.

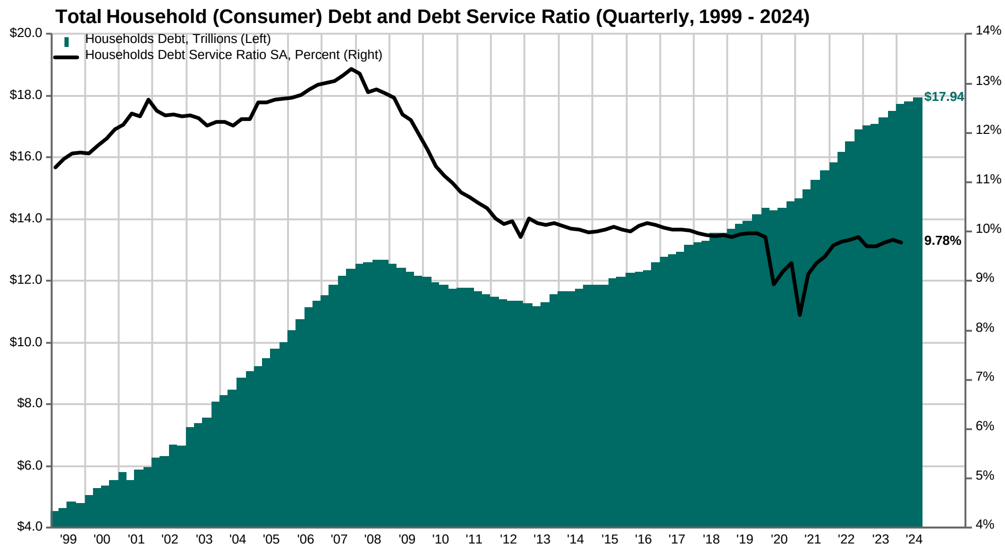
During inflection periods in U.S. interest rates, the 2-year U.S. Treasury yield has often predicted future trend changes in Federal Reserve interest rate policy (the fed funds target rate). In 2019, the Treasury yield began dropping before the Fed began lowering its rate targets, and in the summer of 2021, 2-year yields began moving higher several months ahead of the first Fed interest rate hike in March 2022. Then last year in the fourth quarter of 2023, 2-year yields dropped again, anticipating a 2024 fed funds target cut which ultimately started in September 2024. As of late December 2024, the 2-year Treasury yield and average fed funds rate are about the same level (about 4.30%), possibly an indication for now that bond investors see the potential for the Fed to pause its rate cuts in 2025. In September, the Fed said it was more concerned with slowing jobs growth and less concerned about inflation, but that view may have shifted in December as GDP growth has remained solid, and inflation is sticky and must be watched closely in 2025. The Fed has a +2.0% target for consumer inflation and, in addition to the consumer price index (CPI), it watches an alternative inflation measure, the personal consumption expenditures price index (PCE PI). The PCE PI has run a little lower than CPI in 2024, but both inflation indicators show that inflation progress has stalled since the middle of 2024, with core CPI (excludes food and energy prices) still above +3.0%. We watch core CPI because Fed policy (the fed funds rate) has limited impact on the prices for food or energy. While investors might tolerate inflation that stays near +3% rather than +2%, there is risk if trends resume higher, back to +4% or more. For that reason, the Fed is unlikely to aggressively lower its fed funds target from current levels, at least until inflation data resumes lower for more than a couple months. With eight Fed policy meetings scheduled in 2025, it is possible there could be only two additional -0.25% rate cuts, which means six meetings could end with no change to the rate policy. This would take the year-end 2025 fed funds range to 3.75% to 4.00%. We can watch the 2-year Treasury yield in 2025 to see what the bond market says about this forecast.



Data Source: FactSet and U.S. Bureau of Labor Statistics (BLS). CPI (green line) year-over-year (Y/Y) change in consumer prices monthly compared to same month prior year. Core-CPI (gray line) excludes food and energy prices.

For those approaching the 'Wall of Worry,' there is no shortage of risks. After two years of strong equity market gains, many expect the bull market to continue, but as is usually the case when looking ahead, we see risks that could derail the rally or at least constrain upside from current levels. This includes the potential for consumer spending to ease if jobs growth disappoints or if rising consumer debt levels lead to more delinquencies. Consumer spending is also vulnerable to a return of inflation that could erode purchasing power. In addition, as the U.S. government continues to run high deficits, the national debt has increased and interest expense on that debt continues to grow, creating budget challenges for Congress as they pass spending bills and tax legislation. Finally, the S&P 500 index has completed two years of very strong market gains, extending a bull market. Historically, in the third year of a bull market, investors should expect more modest returns.

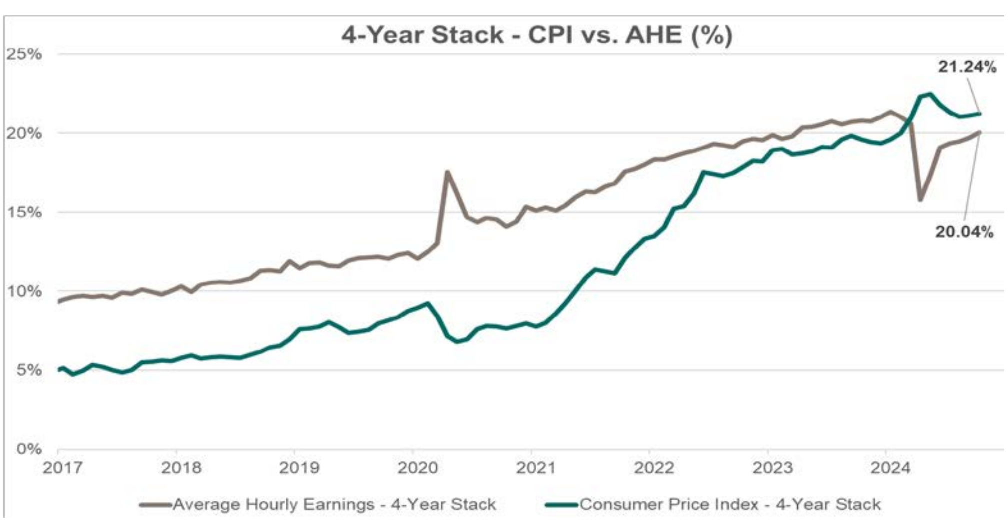
Total household debt (as reported by the Federal Reserve Bank of New York), as of 9/30/24, totaled $17.94 trillion (T), up $650B or +4% from 9/30/23, and increased $2.70T over three years (from 9/30/21). In 2024, income also increased, keeping pace with debt, so that the debt service ratio (the percentage of disposable income required to make debt payments over the same period) of 9.78%, as of 9/30/24, was relatively flat over the past year. While the debt appears manageable for now, borrowing levels are at all-time highs, creating risks in the event of slowing economic growth. This consumer debt includes mortgages ($12.8T), student loans ($1.6T), car loans ($1.6T), credit cards ($0.8T), and personal loans ($0.5T). Further analysis by the New York Fed reveals that lower-income credit borrowers are using more available credit with rising delinquencies. While 52% of credit card holders use less than 20% of available credit, 18% utilize more than 90% of their available credit. Credit card delinquencies for this group are above pre-pandemic levels (users of credit). As the percentage of "maxed out" borrowers and delinquencies increases, it creates risks for continued consumer spending growth, especially if those delinquencies begin to rise for middle-income borrowers.



Data Source: Board of Governors of the Federal Reserve and FactSet, as of 9/30/24. SA is seasonally adjusted. Household debt is mortgages, auto loans, student loans, credit cards, and personal loans. Debt service is the percentage of disposable income required to make debt payments.

Although improving, consumer purchasing power has been eroded. We compare the Y/Y change in average hourly earnings (AHE, a measure of wages reported by the BLS) to the consumer price index, CPI, (consumer inflation also reported by the BLS) to measure "real" (inflation-adjusted) purchasing power. When wages increase faster than inflation, consumer purchasing power is rising, allowing consumers to keep pace or better. In November 2024, AHE increased +4.0% (vs. November 2023) and CPI increased +2.7%, such that wages were well above inflation. In fact, wages have outpaced inflation every month since May 2023. But that does not tell the cumulative story. From early 2021 to mid-2023, inflation exceeded wages every month, and in June 2022, CPI was up +9.1% vs. AHE +5.4%. On a 4-year basis, inflation has exceeded wage growth through November, indicating that consumers have lost purchasing power over the past four years! This is expected to inflect positive in 2025, but if inflation remains sticky, possibly turning higher, consumers could again feel pinched and slow spending.

Consumer Price Index vs. Average Hourly Earnings (4 Years Cumulative, 2017 – 2024)



Data Source: Bureau of Labor Statistics (BLS), as of 10/31/24

The U.S. economy has sustained strong growth since 2019, with nominal GDP increasing +$7.9T, up +36% in five years (the U.S. federal fiscal years end on September 30th). Federal spending has also increased with U.S. total debt swelling to $35.5T and Debt Held by the Public increasing by +$11.5T, or up +68% over the same period. Both revenue (up +42% since 2019) and spending (+48%) have increased dramatically, but government outlays (spending) is more of a problem, in our view. In the five years 2015 to 2019, revenue (individual income, payroll, and corporate taxes) less spending, the deficit, averaged 3.5% of nominal GDP. This spiked during the pandemic, which is usually the case during recessions, but in 2023 and 2024, a period of above-trend GDP growth when deficits should fall, the deficit was 6.2% of GDP. For now, investors have appeared only mildly worried about deficit spending as it supports GDP growth and corporate earnings have rebounded nicely. If bond market concerns rise and drive interest rates higher, it could weigh on investor sentiment. As of 12/23/24, the yield on the 10-year U.S. Treasury was 4.61%, its highest level of 2024, but as of yet, this has not weighed on equity prices. In FY24, government spending of $6.75T was comprised of Medicare and Medicaid of $1.79T, Social Security of $1.46T, net interest of $882B, national defense of $874B, and other spending of $1.74T (includes $671B for income security). Net interest increased +34% (from $659B) in FY24 compared to FY23 and continues to increase with deficit spending and refinancing debt at higher interest rates. Higher interest payments will make it more difficult to reduce spending, which could lead to interest rates that remain higher than expected. Budget issues will remain a market risk in 2025 as Congress must raise the debt ceiling and address the expiration of the 2017 Tax Cuts and Jobs Act, often called the "Trump tax cuts." This process will shine light on the deficit, spending levels, and the rising interest expense.

U.S. GDP, Federal Budget, Annual Deficit, Total Debt

	Average	U.S. fiscal year ends on 9/30						Change
	5 yrs '15-'19	2019	2020	2021	2022	2023	2024	2019 to 2024
Nominal GDP ($ billions)		21,521	21,323	23,594	25,744	27,356	29,375	**7,854**
								36%
								% change since '19
Federal Revenue (Tax)		3,462	3,420	4,046	4,896	4,439	4,919	
Federal Spending		4,547	6,552	6,821	6,272	6,134	6,752	
Budget Deficit		(1,085)	(3,132)	(2,775)	(1,376)	**(1,695)**	**(1,833)**	(10,811)
Revenue as % of GDP	**16.9%**	16.1%	16.0%	17.1%	19.0%	16.2%	**16.7%**	
Spending as % of GDP	**20.4%**	21.1%	30.7%	28.9%	24.4%	22.4%	**23.0%**	
Deficit as % GDP	**-3.5%**	**-5.0%**	**-14.7%**	**-11.8%**	**-5.3%**	**-6.2%**	**-6.2%**	
Total Debt		22,719	26,949	28,429	30,929	33,187	35,465	12,746
Debt Held by Public		16,801	21,017	22,284	24,257	26,369	28,307	**11,506**
								68%
								% change since '19

Data Source: Bureau of Labor Statistics (BLS) as of 10/31/24

In mid-October 2024, the S&P 500 marked the 2nd anniversary of the last major "bear market" index low in October 2022. We define a "bear" market when an index makes a peak-to-trough (we use daily closing prices) decline of -20% or more, and a market "correction" is when that decline exceeds -10% but is less than -20%. In a rising market, a "bull" market is when an index gains +20% from the most recent bear market low. S&P 500 bear markets are relatively uncommon, with 11 of them since 1960, a 64-year period (on average, reflecting a bear market every 5.8 years). We included the period from July 1990 to October 1990, when the S&P 500 declined -19.9%. From the 2022 bear market low on 10/12/22, the S&P 500 gained +63.8% over the next 24 months. This was a strong return, but only slightly above the average 2-year returns from the low since 1960. The historical pattern of past bull markets since 1960 reveals that gains in year 3 are harder to come by. In fact, the average return over those ten, year-3 periods was flat (0.0%). Five years were positive, ranging from +2.0% to +13.9%, and five years were negative, ranging from -2.0% to -11.4%. This suggests that strong rallies from major market lows begin to normalize in year 3, but also that the year-3 returns that were negative reflected relatively normal declines. As year 3 of the current bull market is underway, the near-term trend of solid economic data and positive investor sentiment is positive and provides an environment for the index to move higher. We caution that with high stock valuations and a history of mixed, post-bear market year 3 returns, potential gains are likely to be muted or might even modestly decline.

S&P 500 Price Returns During First Three Years of Bull Markets

S&P 500 Price Returns From Bear Market Lows (since 1960, includes 1990)

Date of Pre-Bear Mkt High	Date of Index Low	S&P 500 Price at Low	% Index Decline peak-to-trough	Peak-to-Trough # of Months	1st Year From Low	2nd Year From Low	1st and 2nd Combined	3rd Year From Low
12/12/61	6/26/62	52	-28.0%	7	31.0%	18.9%	55.7%	2.0%
1/18/66	10/7/66	73	-22.1%	10	32.9%	6.6%	41.7%	-10.2%
11/29/68	5/26/70	69	-36.1%	18	43.7%	11.1%	59.7%	-2.5%
1/11/73	10/3/74	62	-48.2%	19	38.0%	21.0%	67.0%	-7.0%
11/28/80	8/12/82	102	-27.1%	20	58.3%	1.6%	60.8%	13.9%
8/25/87	12/4/87	224	-33.5%	4	22.8%	27.8%	56.9%	-7.1%
7/16/90	10/11/90	295	-19.9%	3	29.1%	6.8%	37.9%	13.1%
3/24/00	10/9/02	777	-49.1%	30	33.7%	8.0%	44.5%	5.8%
10/9/07	3/9/09	677	-56.8%	17	68.6%	15.7%	95.1%	3.9%
2/19/20	3/23/20	2,237	-33.9%	1	74.8%	14.0%	99.2%	-11.4%
1/3/22	10/12/22	3,577	-25.4%	10	21.6%	34.7%	63.8%	?
Averages			-34.6%	14	41.3%	15.1%	62.0%	0.0%
			***bear market**		**Year 1**	**Year 2**	**Year 1 & Year 2**	**Year 3**
					(12-mo period)	**(12-mo period)**	**(24-mo period)**	**(12-mo period)**

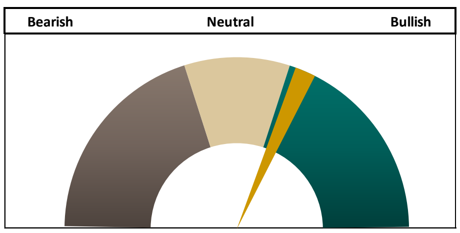
S&P 500 Sector Recommendations -December 2025

GICS Sector	S&P 500 Weight by Market Cap	WM Research 2025 Outlook	Notes (reflect current expectations and are subject to change)	Change
Technology	32.4%	marketweight	keep exposure to this sector as earnings growth remains above average	
Financials	13.3%	overweight	solid earnings growth outlook boosted by lower regulations and tax rates	marketweight
Consumer Discretionary	11.7%	marketweight	after strong Q4, expect consolidation on tariff concerns, but service sector looks good	
Health Care	9.9%	marketweight	earnings growth favorable, recent weakness from political pressure creates opportunity	
Communications Services	9.5%	overweight	one of best earnings growth profiles, and less exposed to tariff risks	marketweight
Industrials	8.2%	overweight	positioned to benefit from pro-growth agenda if GDP remains strong	
Consumer Staples	5.6%	underweight	elevated valuations and exposure to tariffs and health concerns	marketweight
Energy	3.1%	underweight	low energy prices could constrain profits, but electricity demand needs natural gas	marketweight
Utilities	2.3%	marketweight	benefits from energy infrastructure demand, but valuations again elevated	
Real Estate (REITs)	2.1%	underweight	remain selective as higher interest rates a concern, stick with earnings leaders	
Materials	1.9%	marketweight	weak global growth and tariff risk to creat challenges	overweight

Data Source: D.A. Davidson Wealth Management Research as of 12/20/24. Changes compared to July 2024.

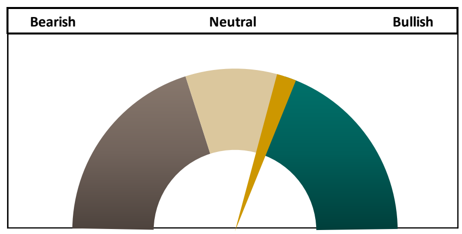
Wealth Management Research Investment Cycle Gauge

Economic Indicator (2025)



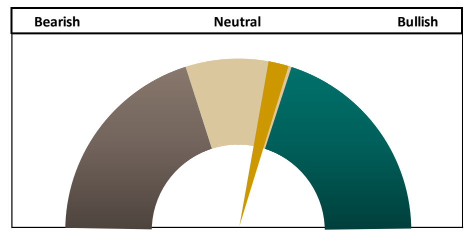
Changes from prior Indicator:
2024 GDP positive surprise set to continue in early 2025

Earnings Indicator (2025)



Changes from prior Indicator:
2025 earnings growth estimate now 14%, up from 2024

Equity Market Indicator (2025)



Changes from prior Indicator:
sentiment positive but scale back return expectations

Source Data: D.A. Davidson & Co. as of 12/20/24.

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Important Disclosure: Information contained herein has been obtained by sources we consider reliable, but is not guaranteed and we are not soliciting any action based upon it. Any opinions expressed are based on our interpretation of the data available to us at the time of the original publication of the report. These opinions are subject to change at any time without notice. Investors must bear in mind that inherent in investments are the risks of fluctuating prices and the uncertainties of dividends, rates of return, and yield. Investors should also remember that past performance is not necessarily an indicator of future performance and D.A. Davidson & Co makes no guarantee, expressed or implied to future performance. Investors should consult their Financial and/or Tax Advisor before implementing any investment plan.

Market Indices: The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Indices provide a general source of information on how various market segments and types of investments have performed in the past. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. You may not invest directly in an index. Past performance is not an indicator of future results. The S&P 500 Index is a market cap weighted index that is designed to measure the US large-cap equity performance. The index is composed of the 500 leading publicly traded US companies based on size, liquidity, industry, and profitability criteria. The Dow Jones Industrial Average is a price weighted index that tracks 30 large, publicly owned companies trading on the New York Stock Exchange (NYSE) and the NASDAQ. The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market. Today the NASDAQ Composite includes over 3,000 companies. The Russell 2000® Index is a market cap weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The MSCI EAFE® Index (Europe, Austral, Asia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The Russell 1000 index is a large company index compiled by the FTSE Russell Group and represents the largest 1000 companies (by market capitalization) in the Russell 3000 index. The Russell 1000 Growth index includes the Russell 1000 companies that exhibit relatively higher price-to-book ratios, and higher expected earnings and sales growth. The Russell 1000 Value index includes the Russell 1000 companies that exhibit relatively lower price-to-book ratios and lower than average expected earnings and sales growth.

Other Disclosures:

The forward S&P 500 price-to-earnings ratio (P/E) is a valuation measure, calculated by dividing the price of the S&P 500 index over the weighted average earnings per share (EPS) estimate of each company in the index. Earnings are based on "forward" consensus estimates expected over the next 12 months (NTM), using quarterly analyst estimates as provided by FactSet.

Fair value refers to a valuation method based on our view of the intrinsic value of an asset or index, determined by macroeconomic factors and earnings expectations rather than current market prices. This is our view of intrinsic value as of the date of this report.

Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. GDP numbers are compiled by the Bureau of Economic Analysis (BEA), a division within the U.S. Department of Commerce. Quarterly GDP is reported as a percentage change from the prior quarter, annualized. The BEA also reports data on a year-over-year percentage change from the same period one year prior. The most recent GDP report can be found at www.bea.gov.

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet Consensus refers to the aggregate of all analyst estimates from firms that submit estimates to FactSet for a given financial metric.

The annual price returns of the S&P 500 index are calculated using index closing value on 12/31 of one year to 12/31 of the next year. 2024 returns are calculated as of the most recent available date in December 2024 (date noted for each table). Intra-year peak-to-trough percentage declines are calculated using the index closing prices from an intra-year high date to a subsequent low date. Closing prices are provided by S&P Global through FactSet. Averages across years are calculated using the arithmetic mean.

S&P 500 earnings growth reflect the year over year change in operating earnings on a per share basis. Earnings data are aggregated for all S&P 500 constituents and are measured according to the relative market capitalization weights for each company. Estimated earnings are the combined FactSet estimates of analysts covering each company included in the index.

The Federal Reserve Bank's Open Market Committee (FOMC) consists of twelve members--the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the remaining eleven Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth.

The Federal Reserve Summary of Economic Projections (SEP) is sourced from federalreserve.gov, as of 12/14/22. Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The Summary of Economic Projections is compiled from Federal Reserve Board members and Federal Reserve Bank presidents.

The term "monetary policy" refers to the actions undertaken by a central bank, such as the Federal Reserve, to influence the availability and cost of money and credit to help promote national economic goals. The Board of Governors of the Federal Reserve System is responsible for the discount rate and reserve requirements, and the Federal Open Market Committee is responsible for open market operations. The Federal Reserve influences the demand for, and supply of, balances that depository institutions hold at Federal Reserve Banks and in this way alters the federal funds rate. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight.

The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury bonds, indicating the relationship between the interest rate and the time ("term") to maturity. The yields of the 2-year and 10-year U.S. Treasury bonds are widely followed barometers of the current U.S. interest rate environment. Treasury bond data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet.

U.S. Personal Consumption Expenditures (PCE) is an indicator of the growth in consumer spending and measures the value of goods and services purchased by persons who reside in the U.S. It is reported monthly by the Bureau of Economic Analysis (BEA). We also track the BEA data on Non-Residential Fixed Investment, as a measure of business investment.

The National Bureau of Economic Research (NBER) is a private non-profit research organization. The NBER is widely used as an organization that analyzes U.S. economic data and the business cycle and determines the start dates and end dates of economic recessions. The NBER defines recession as "a significant decline in economic activity that is spread across the economy and that lasts more than a few months;" and also looks at the depth, diffusion, and duration of the downturn.

The consumer price index (CPI) is a measure of average change over time in the prices paid by urban consumers for a market basket of goods and services. It is reported monthly by the U.S. Bureau of Labor Statistics.

PCE inflation is the percentage rates of change in the price index for personal consumption expenditures (PCE). The index is published monthly by the U.S. Bureau of Economic Analysis.

Volatility is how much and how quickly prices move over a given span of time. In the stock market, increased volatility, in the form of rapidly falling prices is often a sign of rising uncertainty.

The U.S. Census reports annualized monthly data on housing starts, permits and completions. It is a widely followed measure to track construction activity in the residential housing market. New Home sales measures sales of new single family homes and is a measure of the demand for housing. Home price data is monitored from the S&P CoreLogic Case-Shiller Home Price Index.

We define a Bear Market as a peak-to-trough decline (using closing prices) of 20% or more. We generally use the S&P 500 index as a proxy for the broad market for large, leading U.S. companies. Similarly, a Bull Market is declared following a 20% gain from a Bear Market low.

The Bureau of Labor Statistics (BLS) compiles U.S. labor statistics from two monthly surveys. The household survey measures labor force status by demographics; the establishment survey measures nonfarm employment and data by industry. The nonfarm payrolls component of the establishment survey are drawn from private businesses and government entities. The nonfarm payrolls number is among the most widely used data points to assess U.S. employment trends. The unemployment rate is the percentage of the labor force that is jobless and actively willing and available to work. The BLS also publishes the Job Openings and Labor Turnover Survey (JOLTS) which measures job openings, hires, and separations from a monthly survey of U.S. business establishments.

Personal Income and Savings is reported monthly by the Bureau of Economic Analysis for individuals and is defined as personal income less personal outlays and taxes. The personal savings rate is personal savings as a percentage of disposable personal income.

The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity. The 11 sectors are: Communication Services, Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, and Utilities.

The CME FedWatch Tool is published by the CME Group. CME analyzes the probability of FOMC rate moves for upcoming meetings. It uses 30-day fed funds futures prices, as a tool calculate market views (probabilities) on the likelihood of changes in Fed rate policy.

U.S. monthly receipts, outlays, deficit, or surplus are reported by the U.S. Treasury at fiscal.treasury.gov. Supporting data is also available from the Congressional Budget Office (CBO).

We track a measure of wages, average hourly earnings (AHE) of all private employees, which is calculated and reported on a monthly basis by the U.S. Bureau of Labor Statistics. The data measures average hourly earnings of all private employees on a "gross" basis (includes overtime and late shift work, but excludes benefits).

2024 election day was 11/5/24. On the national level, voters selected the next president of the U.S. and state elections determined the party control (Democratic or Republican) of Congress, both the U.S. House of Representatives and the U.S. Senate. Inauguration day is 1/20/25, and the Republican party will control the Presidency and both chambers of Congress. On the campaign trail President-elect Trump had promised the use of widespread (global) tariffs to counter tariffs on U.S., goods in other countries as well as to incentivize more U.S. manufacturing. In addition, Trump intends to limit illegal immigration and asylum seekers and to deport immigration that did not use proper channels. The impact this may have on the U.S. labor market is uncertain.

Generative Artificial Intelligence (GenAI): We think of artificial intelligence as using advanced computers to process large amounts of data to ultimately approach human problem solving and decision making. While still predictive models, generative AI can give detailed responses, much better than a search engine, which does a good job of telling the user where to go to find additional information. As generative AI systems access more data, they become larger and learn to make better decisions. At each iteration, the system gains knowledge, enhancing its predictive (reliable) capabilities and ability to produce original content. Generative AI systems become more robust as they are used as all new data can be trained into the system, creating new challenges and opportunities.

The U.S. Tax Cuts and Jobs Act was signed into law by President Trump on 1/1/18.

The term "Magnificent 7" was first used in early 2023 by Bank of America. It referred to seven publicly traded stocks that at the time were the most highly valued companies in the S&P 500 index ranked by equity market value. The seven stocks were: Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla.

Household Debt, from the U.S. Federal Reserve Bank of New York (FRBNY) is the combined debt of all people in a household, including consumer debt and mortgage loans. Household Debt Service Ratio is the total required debt payment per period divided by total disposable income. Seasonally adjusted (SA) is used to normalize data by adjusting for seasonal changes in business and economic data for a more accurate comparison between different time periods. The most recent report can be found at newyorkfed.org/microeconomics/hhdc

According to the U.S. Treasury the U.S. Total Debt is gross federal debt representing all outstanding borrowing. Debt Held by the Public is what the U.S. Treasury has borrowed from outside investors (individuals, businesses, other institutions, state and local governments, and foreign entities) and excludes borrowings from other agencies within the federal government.

The equity market climbs a "wall of worry" has been used for decades to signify a market that trades higher despite the presence of negative news. It refers to investor behavior as equity investors always face some level of risk even when markets rally.