ACIMA PRIVATE WEALTH

ECONOMIC & INVESTMENT PERSPECTIVES

January 2, 2025

DECEMBER: STOCKS & BONDS FALL
2024 YEAR-END MARKET PERFORMANCE REVIEW

Figure 1: 12/31/2024 Returns (source: Bloomberg)

Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	QTR	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-1.7%	-3.1%	1.3%	-5.0%	2.2%
Investment Grade Corp Bonds	LQD	-2.7%	-4.1%	0.9%	-6.3%	2.6%
U.S. 20+ YR Treasuries	TLT	-6.4%	-9.7%	-8.1%	-14.1%	0.4%
Muni Bonds	MUB	-1.3%	-0.9%	1.3%	-2.1%	1.1%
US High Yield	HYG	-0.8%	-0.1%	8.0%	-2.1%	4.0%
Non-US Corp Bonds	IBND	-3.0%	-6.5%	-2.8%	-9.7%	1.2%
Emerging Markets Bond LC	EMLC	-2.2%	-7.0%	-3.0%	-9.5%	0.1%
Global Equity						
ACWI Global Equity	ACWI	-2.7%	-0.8%	17.5%	-4.9%	18.4%
ACWI Global Equity ex US	ACWX	-2.8%	-7.5%	5.2%	-10.0%	7.1%
International Developed	EFA	-2.9%	-8.4%	3.5%	-10.6%	4.2%
Emerging Markets	EEM	-1.7%	-7.3%	6.5%	-11.8%	11.6%
Global Equity by Region						
United States	VTI	-3.0%	2.7%	23.8%	-4.3%	24.7%
Europe	IEUR	-2.9%	-10.3%	1.4%	-12.7%	3.0%
Asia ex-Japan	AAXJ	-1.3%	-6.7%	10.4%	-12.2%	17.7%
China	MCHI	0.9%	-6.2%	17.7%	-21.6%	31.7%
Japan	BBJP	-2.1%	-4.8%	7.5%	-9.5%	9.6%
Latin America	ILF	-6.1%	-16.0%	-23.1%	-28.0%	0.4%
US Equity						
US S&P 500	IVV	-2.4%	2.4%	24.9%	-3.8%	25.6%
NASDAQ 100 QQQ	QQQ	0.5%	4.9%	25.6%	-5.2%	29.3%
US Large Growth	IWF	0.9%	7.1%	33.1%	-4.3%	36.7%
US Large Value	IWD	-6.9%	-2.0%	14.2%	-7.6%	15.0%
US Eqwt S&P 500	RSP	-6.3%	-1.8%	12.8%	-6.9%	14.5%
US Mid Cap	IJH	-7.2%	0.4%	13.9%	-8.8%	16.9%
US Small Cap	VTWO	-8.4%	0.3%	11.5%	-9.9%	17.9%

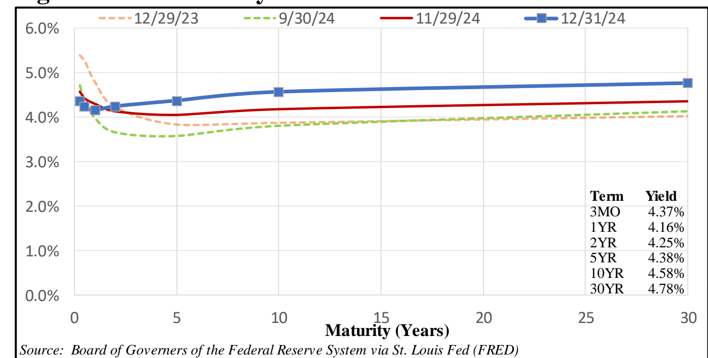
Stocks and bonds retreated in December as expectations for further Fed rate cuts diminished, and investors took profits after another very strong year for the US stock market. Performance highlights for the month and fourth quarter (Q4) are below; a discussion of calendar year 2024 returns is included on page 2.

- Bonds: The US Aggregate index (AGG) fell 1.7% this month (-3.1% Q4) as yields rose on muted expectations for further Fed rate cuts. Long-term Treasuries (TLT) are very sensitive to interest rates, losing 6.4% (-9.7% Q4). Corporate bonds (LQD) fell 2.7% (-4.1% Q4); high yield (HYG) lost 0.8% (-0.1% Q4). A strong dollar led to weaker returns for non-US bonds.
- Global equity (ACWI): -2.7% in December (-0.8% Q4).
- US Equity: The broad market (VTI) fell 3.0% (+2.7% Q4), and the S&P 500 (IVV) lost 2.4% (+2.4% Q4). Small stocks (VTWO) gave back most of their November gains, losing 8.4% this month (+0.3% Q4). Ten out of eleven sectors lost value in December with losses of over 8% in Materials (XLB), Energy (XLE), REITs (XLRE), Utilities (XLU) and Industrials (XLI). For the quarter, most stocks and sectors were down, but winners included the “Magnificent 7” and Financial stocks (XLF).
- Non-US Equity: Non-US stocks were down on muted growth expectations and a strengthening US dollar. Developed markets (EFA) fell 2.9% this month (-8.4% Q4), and emerging market stocks (EEM) lost 1.7% (-7.3% Q4). Almost all major markets we track posted losses for the month and quarter, including double-digit Q4 losses in Brazil (EWZ), Korea (EWY), Australia (EWA) and Mexico (EWW).

Interest Rates and the Economy

The yield curve (Figure 2) plots the interest rates for various US Treasury maturities. Short-term yields declined in December as the Federal Reserve (Fed) cut rates by another 0.25% to a target rate to 4.25-4.50%. Longer-term rates rose measurably as the Fed projected only two more cuts in 2025 amid resilient economic and labor market growth, while inflation remains sticky (November CPI +2.7% vs. a year ago) above their 2.0% target. Investors continue to focus on incoming economic data to calibrate expectations for future cuts. US 10-year Treasuries now yield 4.58%.

Figure 2: US Treasury Yield Curve

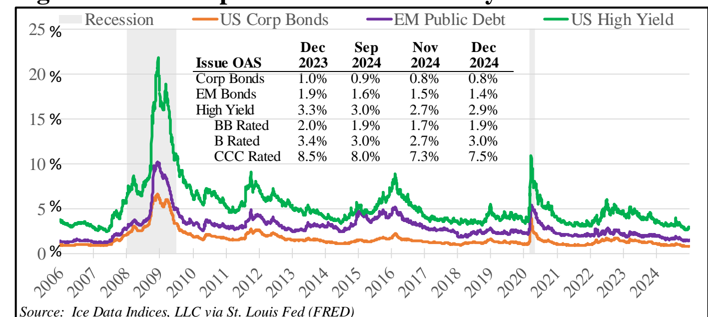


Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)

For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between their yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism, while high or widening spreads signal fear. Spreads have been relatively stable in recent months at historically low levels.

- Investment grade corporate bond spreads were stable at +0.8% but have tightened from +1.0% over the past year.
- High yield (non-investment grade) spreads widened to +2.9% last month but have narrowed from +3.3% a year ago. Spreads of the riskiest bonds (rated CCC & below) widened slightly to +7.5% but remain well below +8.5% spreads one year ago.
- Emerging market spreads narrowed to +1.4% and have tightened over the past year; investors see low risk in EM debt.

Figure 3: Credit Spreads vs. U.S. Treasury Yields



Source: Ice Data Indices, LLC via St. Louis Fed (FRED)

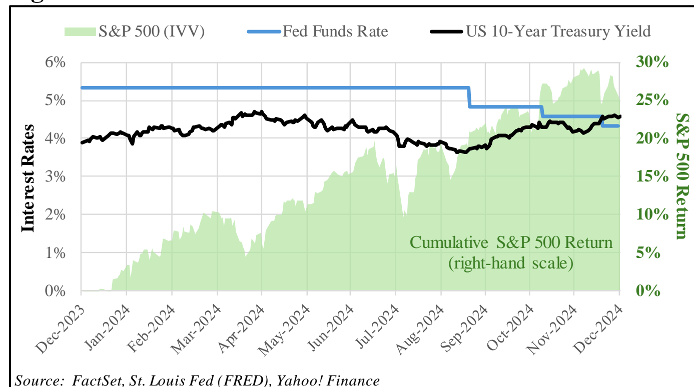
2024 Market Performance Review

US economic and stock market growth were surprisingly strong again in 2024. Some highlights for the year include:

- Real GDP growth is expected to be roughly 2.8% for the year, surpassing expectations and in-line with the pre-pandemic growth rates. (Note: Real Gross Domestic Product is the value of all final goods and services produced, net of inflation.)
- CPI inflation declined from 3.3% to 2.7% year-over-year as of November; core inflation (core Personal Consumption Expenditures, the Fed's favored inflation metric, which excludes volatile food and energy prices) is now 2.8%, down significantly since 2022 but still above the Fed's 2.0% target.
- The Fed began cutting interest rates in September, reducing their target rate from 5.25-5.50% to 4.25-4.50% by year-end.
- US stocks surged over 20% for the second year in a row.

Although the S&P 500 rose 25% for the year, it was a bumpy ride, with a 5% decline in April, a nearly 10% correction July-August, and the volatility continued through the end of the year. Figure 4 plots the path of interest rates and the S&P 500 in 2024.

Figure 4: Interest Rates vs. S&P 500 Returns in 2024

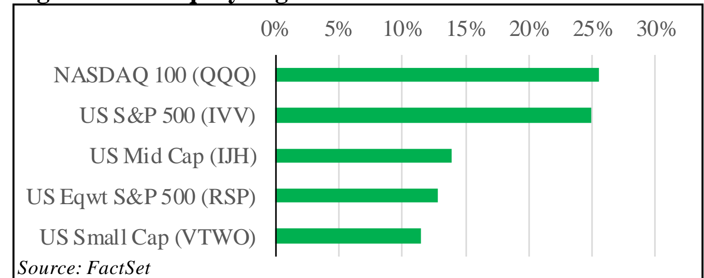


Source: FactSet, St. Louis Fed (FRED), Yahoo! Finance

Until the Fed actually began cutting rates in September, most of the market movements were driven by changing expectations regarding when they would start to cut and by how much. We can see this in the relationship between the Fed Funds rate (blue line in Figure 4 above) and the 10-year bond yield (black line). Early in the year, inflation remained elevated while employment growth stayed strong, leading investors to expect that interest rates would stay higher for longer. By April, the 10-year Treasury bond yield had risen above 4.5%, and the stock market sold off. Subsequent inflation and employment reports were softer (lower inflation and job growth), leading to expectations for imminent and significant rate cuts; stocks soared and the 10-year yield fell back below 4%. Interestingly, as the Fed began to cut in September, the 10-year yield began to rise again and is now back above 4.5%. This reflects investors' belief that the Fed will not cut rates much further, as the Fed stated in their latest summary of economic projections in December, and stocks retreated.

Despite a weak December, the S&P 500 rose 25% including dividends in 2024. As has been the story for the past several years, the strong returns were driven by a handful of technology stocks, i.e., the "Magnificent 7" (Apple, Microsoft, Google, Nvidia, Tesla, Amazon, and Meta-Facebook), which reported consistently strong earnings growth amid the artificial intelligence (AI) boom. Other stocks and market segments logged more modest earnings and stock price growth, as illustrated in Figure 5.

Figure 5: US Equity Segment ETF Returns in 2024

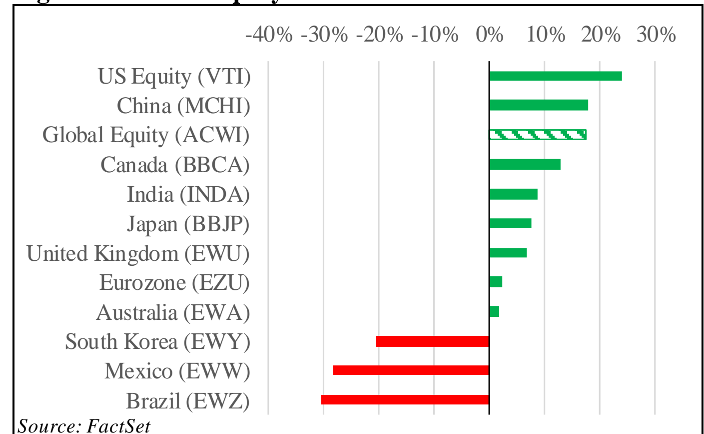


Source: FactSet

The Nasdaq 100 (QQQ) and S&P 500 (IVV) each gained about 25% in 2024; we note that the Magnificent 7 stocks carry huge weights in both indices (43% and 32%, respectively). The rest of the US market did not perform nearly as well. The average stock in the S&P 500 was up about 13% last year (represented by the equal-weighted S&P 500 ETF, RSP); small and mid-cap stocks also posted more modest returns relative to the S&P 500.

As US-based investors, we tend to focus on US markets, and while the US is the world's largest economy, nearly 75% of global economic activity occurs outside of our borders. Figure 6 below shows the equity performance of the world's largest economies (roughly 77% of global GDP in total). The US was the best market, but most markets posted respectable returns, including China, which has rebounded in the wake of significant fiscal and monetary stimulus. The weakest markets (Brazil, Mexico and South Korea) experienced significant economic and political upheaval.

Figure 6: Global Equity ETF Total Returns in 2024



Source: FactSet

Bottom Line

The US stock market logged gains of more than 20% for the second year in a row, fueled by solid earnings growth and Fed interest rate cuts. Going forward, we are focused on several themes:

- **Central Bank Policy:** Declining inflation in the US and other developed economies has led global central banks (including the Fed) to cut interest rates; we expect modest further cuts.
- **Growth & Earnings Outlook:** Profit growth drives stock returns; current prices and valuations already reflect high earnings growth forecasts, especially for the Magnificent 7. Further gains will require continuing economic strength and broader market leadership in the US and global equity markets.
- **Risks:** Inflation, debt and deficit uncertainty will impact markets, especially in the US; conflict in the Middle East, Ukraine and China/Taiwan increases uncertainty.

As volatility is likely to continue, diversification remains critical.

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