Market Update: Q4 2024

Looking back at 2024, it was another remarkable year for the U.S. stock market, with large-cap growth stocks, particularly those in the technology, communications, and consumer discretionary sectors, driving strong overall returns. The *Magnificent 7** stocks played a major role, accounting for 55% of the S&P 500's return for the year. The U.S. economy defied traditional indicators, with resilient consumer spending, easing financial conditions, and the rise of AI all fueling steady growth. The fourth quarter brought mixed signals: equity markets displayed some volatility after a post-election rally, while yields on longer-term bonds rose sharply.

Key Takeaways

- Growth and mega-cap stocks dominated in Q4 and 2024 in general
- AI-driven growth fueled market strength
- Economic resilience defied recession fears, with 2.9% GDP growth for the year
- With policy impacts uncertain, volatility is to be expected

INDEX	Q4 2024	YTD	ANNUALIZED 3-YR.
S&P 500	2.4%	25.0%	8.9%
Russell 2000 Small Cap	0.3%	11.5%	1.2%
MSCI EAFE - International	-8.1%	4.3%	2.2%
MSCI Emerging Markets	-7.8%	8.1%	-1.5%
Bloomberg US Agg Bond	-3.1%	1.3%	-2.4%

SOURCE: YCHARTS

Mega-Cap, Growth Stocks Dominate

The S&P 500 generated >20% returns for the second straight year, marking its best two-year run since the late 1990s. As in the late 1990s, growth stocks significantly outperformed value stocks and the capitalization-weighted S&P 500 index topped the equal-weighted S&P 500 index. Similarly, the dominant market theme of the late '90s was the rise of the internet, while in 2024 it was AI, which drove the outperformance of mega-cap stocks. However, unlike the dot-com bubble, the mega-cap growth stocks of 2024 are trading at bearable valuations considering their remarkable earnings growth and cash flow generation.

Enthusiasm for generative AI and other innovations elevated mega-cap growth stock prices and valuation multiples. The S&P 500's top 10 stocks traded at 30x forward earnings in 2024, while the remaining 490 traded at 18x. The top 10 also finished the year at an unprecedented 39% weight within the index, raising some concerns about market breadth. Only 29% of stocks in the S&P 500 outperformed the index itself for the full year, creating a difficult environment for active managers. However, the axiom 'you get what you pay for' has held true. Even with the consensus view that this group's earnings growth will slow, expectations are that it will still significantly outpace most areas of the market.

A Resilient Economy

The U.S. economy grew by approximately 2.9% in 2024 despite elevated interest rates and traditional economic indicators pointing to a recession. Resilient consumer spending and a shift toward a

*Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta Platforms, and Tesla

The U.S. stock market has reached unprecedented levels of concentration, with the S&P 500's 10 largest stocks now accounting for 38.7% of the index. Also notable is the heavy tilt toward technology stocks since 2000, with only Microsoft remaining in the top 10.

TOP 10 U.S. MARKET CAPS 2000 VS. 2024

2000	2024
Microsoft	Apple
General Electric	Nvidia
Cisco Systems	Microsoft
Wal-Mart Stores	Amazon
Exxon Mobil	Alphabet
Intel	Meta Platforms
Lucent Technologies	Tesla
IBM	Broadcom
Citigroup	Berkshire Hathaway
AOL	J.P. Morgan

SOURCE: MORNINGSTAR

dynamic services sector drove this growth, while inflation moderated but remained above the Fed's 2% target. The Fed cut interest rates twice in Q4; but following a strong November jobs report, it signaled fewer rate cuts for 2025. This unexpected shift surprised markets and weighed on late Q4 stock performance. By the end of Q4, market expectations for steady 2025 rate cuts had shifted dramatically. The Fed's actions highlight lingering uncertainty around the impacts of monetary policy on the post-pandemic economy.

Bond Market Mixed

Bond markets had a tumultuous year and a difficult fourth quarter. Treasury yields rose in Q4, driven by economic resilience and the prospect of resurgent inflation, with the 10-year Treasury yield climbing from 3.8% to 4.5%. The yield curve steepened as short-term rates fell and long-term rates increased. Corporate bonds held firm, suggesting that markets are not anticipating an imminent economic downturn.

The rise in long-term Treasury yields creates a conundrum for the Federal Reserve. The goal of lowering short-term rates is to stimulate a slowing economy. However, the resilient economy, tight labor markets, and potentially inflationary policies of the incoming administration have driven long-term bond yields higher. Higher long-term treasury yields translate into higher interest rates on mortgages and consumer loans, raising borrowing costs, suppressing demand, and creating headwinds for growth. Recent strong economic data leaves the Fed at a crossroads with the market expecting fewer rate cuts ahead.

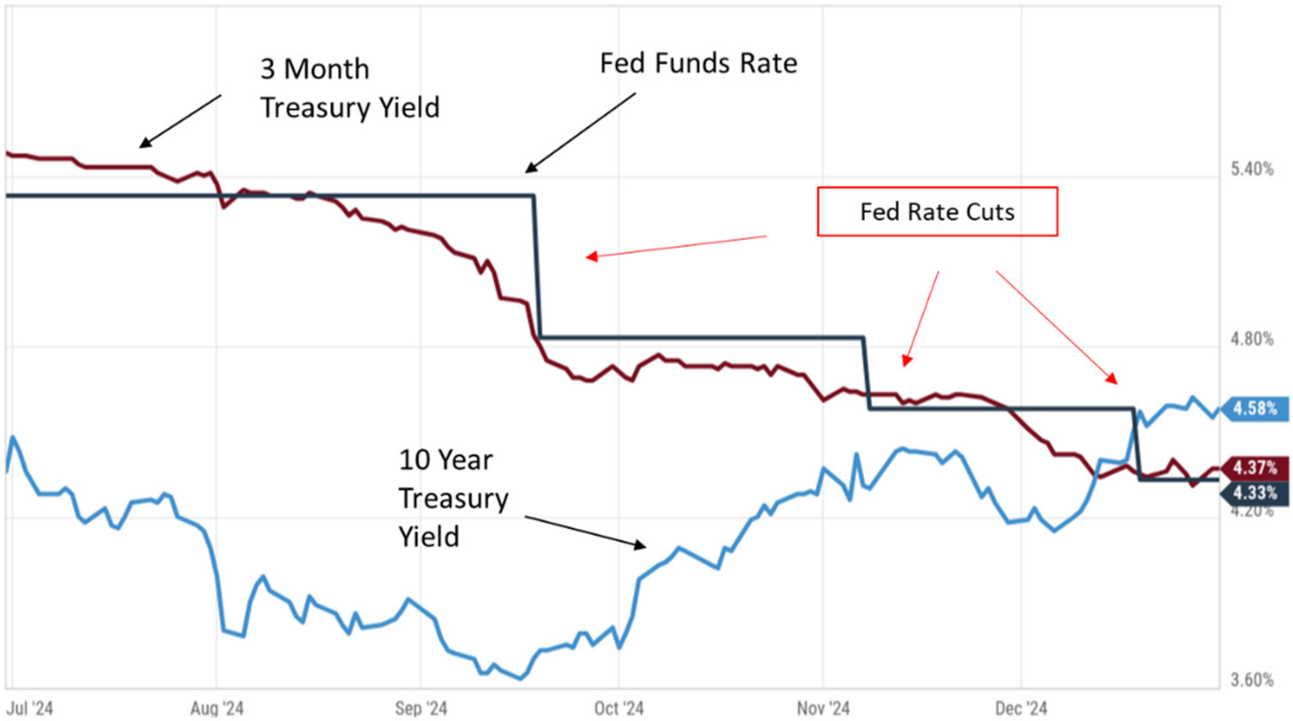
This dynamic complicates the Fed's calculus, making it harder for markets to anticipate its policy direction; and with that, we'll likely see more volatility ahead. The graph on the following page shows the Fed Funds rate stepping lower as the 3-month Treasury yield falls and the 10-year Treasury yield climbs. Rising long-term yields are indicate that the market expects more growth, and perhaps more inflation with it.

All told, we will not be drawn into a Fed guessing game. Instead, we will maintain a short-term quality bias centered on each client's liquidity needs.

Sentiment and Volatility

Post-election, market sentiment surged, increasing the potential for corrections. Prolonged periods of 'extreme optimism' have historically aligned with market peaks; and while frothy short-term sentiment alone does not curtail bull markets, stretched sentiment remains a concern. Speculative assets like gold and Bitcoin have soared past historic milestones, fueled by this optimism. A sentiment downturn could introduce futher volatility which, while potentially unnerving in the short-term,

FED FUNDS RATE VS. 3-MONTH AND 10-YEAR TREASURY YIELDS
SECOND HALF OF 2024



SOURCE: YCHARTS

tends to reward those who maintain a disciplined, characteristics-based approach with opportunities for long-term growth. According to Ned Davis Research, between 1997 – 2025, the S&P 500 dramatically outperformed when the volatility index (VIX) was above 28.5 (see table below). This study underscores the importance of staying invested or deploying capital in periods of heightened volatility.

S&P 500 INDEX PERFORMANCE
1997 TO 2025

VIX INDEX IS	% GAIN/ANNUM	% OF TIME
Above 28.5	51.0	12
21.5 - 28.5	1.5	23
Below 21.5	3.4	65
BUY/HOLD = 7.71% GAIN/ANNUM		

Conclusion

2024 was a year of surprises and strong performance in the U.S. stock market, with dominant growth and mega-cap stocks, especially the Magnificent 7, fueling record highs while also presenting concerns about market breadth and concentration. The economy showed surprising resilience despite monetary tightening, and fixed income markets experienced significant volatility with rising yields. Looking ahead to 2025, we expect more volatility as the direction of the economy, monetary policy, and fiscal policy come in to clearer focus. Policy changes and stubbornly high interest rates, combined with elevated valuations among the largest stocks, are likely to challenge momentum, emphasizing the importance - as always - of taking the long view.