Economic Outlook & Market Review

| 1Q25

KEY TAKEAWAYS:

1. **The US economy and stock market proved resilient in 2024, as continued labor market strength, moderating inflation, and enthusiasm around the promise of more pro-growth policies outweighed concerns of an economic slowdown and political uncertainty.**
2. **Interest rates rose in the fourth quarter as the Fed offered cautious commentary on the future path of interest rate cuts. While yields are elevated relative to the previous decade, they are in line with historical averages and we expect bond yields to remain range-bound and conducive for stock prices.**
3. **We expect market breadth to continue to improve, particularly as an expected surge in capital spending by the "Magnificent 7" stocks should benefit a broad swath of suppliers including more traditional technology companies, energy providers, and infrastructure.**
4. **The US has led the world's recovery since the pandemic, and the promise of continued economic growth should benefit domestic stocks. Short- and longer-term bonds continue to offer attractive income prospects and diversification benefits.**

New Year's celebrations were marred by what appear to be two terrorist attacks. The attacks in New Orleans and Las Vegas are despicable and cowardly acts. Our thoughts and prayers are with the victims, their families, our nation, and the witnesses. As in past incidents, the country will rally to support those affected. If these acts are contained, as they appear to be, their impact on our economy and markets is expected to be relatively small.

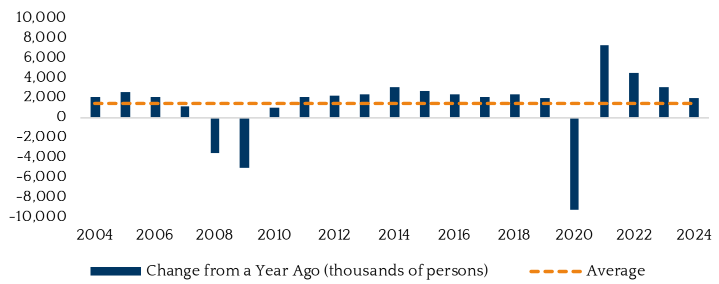
"All's Well That Ends Well" is a Shakespeare comedy. The phrase may also describe the U.S. economy and stock market in 2024. Concerns regarding an economic recession, social unrest, and political uncertainty fell away in the fourth quarter of 2024. For the year, the economy grew around 3% and the S&P 500 rose about 25%. The stock market was driven, for a second consecutive year, by enthusiasm for artificial intelligence advancements, best captured by Nvidia's nearly threefold increase in value over 2024. The exuberance at year end spread to more speculative areas such as Bitcoin, other cryptocurrencies, and unprofitable companies that are long on promise but short on positive cash flows.

To be sure, some of the year end stock rally must be attributed to the conclusive results of the presidential election and promises of more pro-growth policies, including lower taxes, "America First" trade policies, and incentives for reshoring American manufacturing operations. Most importantly, the promise of an easier regulatory environment is expected to bring tangible benefits to consumers, businesses, and other organizations.

President Trump inherits a strong economy that should continue to hum. Any benefits or harms from his policies are unlikely to materially impact the economy in 2025. At close to $30 trillion, the U.S. economy is massive, and changes take time, affording all economic players opportunities to adjust to policy changes. Short-term, knee-jerk reactions to any presidential administration change are often misguided. At its core, the economy is about people and their ability to earn a living to support themselves and their families. The labor market and inflation levels are of paramount importance to a healthy economy. Both measures are constructive for continued growth in 2025.

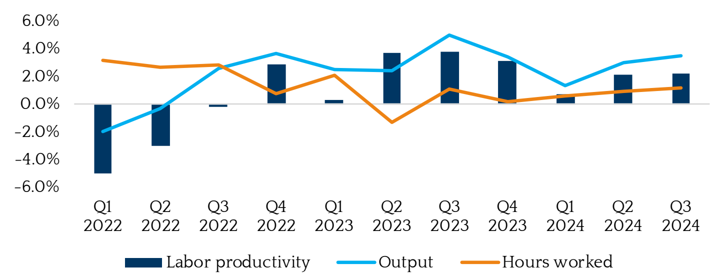
The economy added approximately 2 million jobs in 2024, in line with long-term averages, and unemployment, even at 4%, is low by historic standards. A renewed spurt in labor productivity is also a tailwind, aided by AI and a push for returning to offices by organizations. If maintained, this surge could be like the one experienced in the early days of the internet and could usher in another period of secular growth accompanied by low inflation.

Annual Job Growth 2004 – 2024



Source: US Bureau of Labor Statistics

Labor Productivity % Change from Previous Quarter at Annual Rate 2022 – 2024



Source: US Bureau of Labor Statistics

Inflation's downward trajectory has paused at an elevated 2.5% rate, depending on the measure. This pause is the primary reason that the Federal Reserve recently offered cautious commentary on future interest rate cuts. Leading inflation indicators suggest, however, that the downward trend is more likely to continue than to reverse.

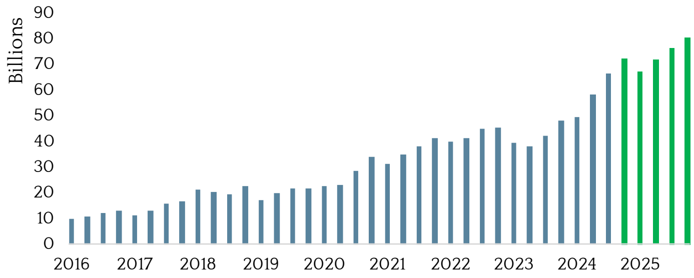
Over the past few years, subjective economic measures such as consumer sentiment and optimism have been weak, in contrast with data-based economic measures. The financial strength of consumers and businesses rebounded during the pandemic, even if not captured by subjective data. In this virtual tug of war, data-based measures have won out, and the subjective measures are now painting a more positive near-term outlook.

The stock market is anticipating continued economic growth, as reflected in the strong stock returns of the last two years. We expect greater market volatility this year as investors shift their focus to current fundamentals such as earnings, cash flows, and interest rates. For market valuations to remain sustainable, corporate earnings must continue to grow. Driven by improved productivity and profit margin expansion, earnings growth should be supportive of stocks.

Another challenge for stocks is the level of interest rates, which rose during the fourth quarter of 2024. While in line with historical averages, the U.S. Treasury 10-year yield remains above 4.5%, higher than during the 2010s. Higher interest rates introduce income competition for dividend-paying stocks and reduce the future value of non-dividend-paying stocks. While we expect longer-dated bond yields to remain in the 4-5% range and be conducive for stock prices, a sustained rise in interest rates would impact stock valuations.

As 2024 ended, there were indications that market breadth was improving. Small company stocks showed more resilience in 2024, and some large technology stocks like Microsoft and Apple achieved market-like mid-20% returns. We expect market breadth to continue its improvement with derivative AI plays benefiting. Capital spending by the "Magnificent 7" stocks (Amazon, Meta, Alphabet, Nvidia, Microsoft, Apple, and Tesla) is expected to reach $80 billion per quarter early this year, essentially doubling since late 2023. That spending should benefit suppliers to the Magnificent 7, including more traditional technology companies, energy providers, electric distribution and transmission companies, and smaller device and tool providers.

Quarterly Mag 7 Capex Spending 2016-2025 (forecasted)



Source: Bloomberg
Magnificent 7: Amazon, Meta, Google, Nvidia, Microsoft, Apple, Tesla

The U.S. economy has led the world's recovery since the pandemic. Stock investors have been rewarded for the ingenuity, entrepreneurship, and risk-taking that American democracy and capitalism foster. As the 2020s progress, the rest of the world will benefit from the technology advancements primarily developed in the U.S. Over time, that may improve the relative attractiveness of foreign investments. For now, however, the promise of continued economic growth should benefit domestic stocks. In addition, both short- and longer-term bonds offer attractive income prospects and diversification benefits for investors.

Best wishes for a safe and healthy New Year.

Investment Oversight Committee
Daniel A. Lagan, CFA | Chief Investment Officer