Quarterly Economic Commentary

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Market Returns

	12/31/2023	12/31/2024	% Gain/Loss
Dow	37,690	42,544	15.0%*
S&P 500	4,770	5,882	25.0%*
NASDAQ	15,011	19,311	29.6%*

**Total Return Including Dividends*

With 2024 "in the books," it is time to reflect on the past year and look forward to 2025. In this extended version of my Economic Commentary, we will review what happened in 2024, the effects of what happened, and the outlook for the year ahead. I am including articles from several sources, so please forgive me for the length of this first look at the new year.

While 2024 stock market returns were eerily similar to the returns from 2023, there was one index that didn't do quite as well. In 2024, Dow was up 15.0% vs. 2023, up 15.9%; S&P was up 25.0% vs. 2023, up 26.0%; NASDAQ was up 29.6% vs. 2023, up 44.50%. The top three sectors pulled a "do-over," but the bottom three sectors were completely different. Communication Services was up 40.2% vs. 2023, up 55.8%; Technology was up 36.6% vs. 2023, up 55.8%; Consumer Discretionary was up 30.6% vs. 2023, up 42.4%. The bottom three for 2024 were Materials, flat at 0.0%; Healthcare, up at 2.6%; and Real Estate, up at 5.2%.

On the fixed income side of the equation, 2024 was a mixed bag, with US government bonds down 1.7% for the year and the yield on the 10-year Treasury sitting at 4.58%. US corporate bonds were up 1.3%, with an average yield of 4.91%. Municipals were up 1.1%, yielding 3.74% (nationally).

Following rate cuts in September and November, the FOMC did not disappoint in December with the third cut, a 0.25% cut, totaling a 1.0% decrease in 2024. What disappointed me was the language in their statement (included below) and the following press conference where Chairman Powell strongly suggested a much slower pace of rate cuts in 2025.

Invesco – Tactical Asset Allocation January 2025
By Alessio de Longis, Head of Investments, Invesco Solutions

"The December FOMC meeting provided a noticeable break in the prevailing expectation for a long and gradual easing cycle. After delivering 100 basis points (bps) in rate cuts over the last three meetings, the FOMC effectively delivered a U-turn on its economic forecasts and expected policy path compared to Powell's Jackson Hole speech in August and the September FOMC meeting. Headline and core inflation statistics are no longer decelerating at the at the rapid pace experienced in 2023 and the first half of 2024. This, coupled with higher inflation uncertainty due to increased ambiguity regarding tariffs, global trade, and immigration policies, has caused the Federal Reserve's inflation projections to "kind of fall apart," as described by Chair Powell. The FOMC made clear that any adjustments to policy rates will hinge on further progress in cooling price increases, expecting to deliver only two additional rate cuts in 2025 compared to earlier projections for four rate cuts."

While the Presidential race was decided fairly quickly, with a slight red ripple, the markets promptly celebrated the win for a Pro-Business Administration. However, that was short-lived as the concerns over tax cuts, increased targeted spending, trade tariffs, and immigration brought inflation back into the spotlight. I have often said that the markets do not like uncertainty, and for now, volatility is in the air until at least some of the uncertainty has been resolved. While the markets were soft in December and are off to a soft start in January, I expect this to settle down over the next several weeks as the Trump Administration takes office and begins work.

UBS Daily House View – January 7, 2025

The US negotiating stance will differ from the end outcome. President-Elect Trump wants the threat of universal tariffs as credible leverage for bilateral trade negotiations, and taking this off the table now would obviously limit his bargaining power. We view this report as an indication of the difference between a bargaining position and policy goals. It's worth remembering Trump's late November threat to impose tariffs over non-trade issues, in which he confirmed a willingness to use tariffs as a transactional tool.

The Trump economic team understands its mandate, in our view. While media criticism may see Trump dig in on his pledge for harsher tariffs, we doubt the administration will pursue the kinds of extreme policies that would send inflation higher, create major supply disruptions, or risk broader economic fallout. There is also a political calculation here, with the Republican House majority already extremely thin. A "shock therapy" approach could significantly harm Republican chances in the 2026 midterms.

Trump 2.0 will likely usher in renewed headline volatility. The market whiplash from Monday's tariffs agenda story and denial may offer a taste of the trading year ahead, with a return to policymaking by a tweet suggesting a new period of heightened cross-asset volatility. So, while tariff talks are worth monitoring, a constructive stance is still warranted on both global equities and on US stocks in particular. We expect the bull market to continue, with the S&P 500 reaching 6,600 by the end of the year, primarily driven by healthy profit growth of 9%. Our base case remains for selective new tariffs under Trump 2.0, likely causing one -time price increases in the US without triggering a more damaging inflationary spiral. We see a smaller chance for a "tariff shock" bear case, in which Trump imposes large, blanket tariffs on most US imports, triggering significant retaliation from trading partners and pushing inflation higher. We suggest investors who are under-allocated to US equities consider using any near-term turbulence to add exposure.

Now, for an in-depth look at 2025. I expect 2025 to be overall positive, with a low, double-digit return for the year. I believe volatility will be most evident during the early part of the first quarter, late spring, and the summer months. Equities will build a foundation during this time, showing modest gains through the third quarter and finishing the year reasonably strong. Interest rates have risen since the end of the year and will probably stay elevated through the first quarter, trying to determine the path forward for the FOMC. I think the next interest rate cut will come late in the second quarter or early third quarter. Right now, I see two, maybe three cuts this year, pending stubborn inflation. Here is a little more insight from UBS.

UBS Daily House View – January 8, 2025

US equities and Treasuries fell on Tuesday following the release of stronger-than-expected economic data. The S&P 500 slid 1.1%, the Nasdaq dropped 1.9%, and the yield on the 10-year US Treasury jumped seven basis points to 4.68%, the highest level since April last year. However, while risk sentiment is likely to remain fragile, we continue to see a favorable macro backdrop for equities and bonds and believe that market fundamentals should benefit these asset classes.

Further Fed cuts remain in store this year. The labor report for December is due this Friday, and inflation data next week will provide more details on the state of the US economy. While the Fed is unlikely to cut interest rates at its first policy meetings of 2025, we expect data in the coming months to show slowing inflation and a softening labor market, allowing the US central bank to start cutting again by the June policy meeting. In line with the Fed's latest economic projections, we expect a second rate reduction to follow later this year, most likely in the third quarter.

Healthy corporate profit growth should continue to support equities. While US equity valuations are higher than the historical average, we think they reflect the current positive economic conditions. Valuations historically have also had little correlation with returns over the next 12 months. Instead, with lower borrowing costs, resilient US economic activity, further AI monetization, and the potential for greater capital market activity under a second Trump administration, we expect healthy profit growth of 9% for S&P 500 companies in 2025. This should help equities gain further ground.

The secular AI story should drive further growth but at a slower pace. NVIDIA Chief Jensen Huang revealed a suite of new tools, chips, and model frameworks aimed at speeding up the adoption of AI across robotics, autos, the industrial sector, and the enterprise workforce. Broadly, we remain bullish on the AI investment theme, favoring AI semiconductors and leading cloud platforms. We expect big tech's combined capital spending to grow another 25% this year to USD 280bn, after an estimated 51% increase in 2024, while monetization continues to increase. So, while volatility is likely to persist in the year ahead, potentially driven by tariffs, fiscal battles in Congress, inflation trends, Fed actions, and the outlook for economic growth, we think the fundamentals should continue to support equities and bonds. Our year-end S&P 500 price target of 6,600 would represent a near 12% gain versus Tuesday's index close. We also believe quality bonds and diversified fixed-income strategies remain valuable in a portfolio context as cash returns fall.

For 2025, we are continuing to over-weight Technology (mega-cap names), Industrials (manufacturing recovery), Energy (pipelines and natural gas producers), and Utilities (grid infrastructure build-out utilizing natural gas and increased AI demand). On the fixed income side, we are concentrating on quality, slightly extending our maturities out five to seven years, trying to capture and lock in higher yields.

We believe that periods of volatility will provide opportunities to position our portfolio better. A great example is that the 10-year US Treasury yield spiked to over 4.60% earlier this week. We had a large position in a US Treasury maturing on 01/31/2025, so I would have to replace that bond in a few weeks. In looking at the maturing bond, I could sell it, make a nice gain on the purchase price, collect the income up until the date of sale, and reinvest the proceeds into a new 10-year US Treasury and lock in a 4.63% yield. Two things about this that you should know. First, while 4.63% may not sound great right now, I expect it will look spectacular this time next year! Second, interest earned on a US Treasury is not state-taxable. What does that mean? You pay taxes to the IRS and your home state on the interest earned in a CD. On a US Treasury, you pay taxes to the IRS, no state taxes. In NC, you get roughly a 7% tax break (if this is NOT in an IRA). The net effect on the 4.63% now equates to a 4.98% interest rate (4.63 / .93 = 4.98%). Our goal is to make you the most money, tax efficiently, while taking the least amount of risk.

With the new Administration and their Foreign Policy, I believe that geopolitical concerns that we have faced over the past few years, while still the same concerns, may have a greater chance of resolution in 2025. I even think negotiations are already in the works for a peaceful stand-down.

Oil prices are currently sitting in the mid-$70 range. That seems to be a reasonably stable price range for now, and I don't expect that to change much during 2025. While Trump plans to increase US energy production and export, oil/gas prices do not seem counter-productive to economic growth. As such, I think we will not see a significant movement in oil/gas prices during 2025.

Now let's review my 10 expectations for 2024 and score them 1-10:

1) Interest rates will trend lower, but the Fed will be reluctant to lower rates until at least the second half of the year; *10 - This was correct, starting in September.*

2) Bonds will perform better in 2024 than in 2023; *10 - While results were mixed, 2024 was better.*

3) Oil prices will remain in the $75 - $95 range; *9 - While the price did dip into the $60's, the vast majority of the time, this was correct, and this was the case at year-end.*

4) 2024 will continue to be very precarious geopolitically with no resolution in Israel or Ukraine; *10 - Correct*

5) China will make a proposed annexation of Taiwan; *0 - Wrong*

6) Iran and N. Korea will continue to push the envelope militarily; *10 - Correct, especially Iran*

7) The US stock market will end the year with a high, single-digit or low, double-digit return; *8 - Up, better than expected.*

8) The US will not go into a recession; *10 - Correct*

9) Gridlock will continue in domestic politics, but no government shutdown; *10 – It was close in December, but correct*

10) I will not make any predictions for the 2024 Presidential election! *No Score*

Finally, it is time to announce my 10 expectations for 2025!

1. The US stock market will end the year with a high, single-digit or low, double-digit return;

2. Oil prices will remain in the $70 - $85 range;

3. By 12/31/2025, the yield on the 10-year US Treasury will be between 4.0% and 4.25%;

4. The US economy will continue to grow between 2.0% and 2.5%;

5. Inflation concerns increase but do not meaningfully re-accelerate;

6. Russia / Ukraine conflict is resolved

7. Iran crawls back into the dark corner

8. North Korea goes quiet

9. Relations with China get more tenuous as US moves to limit/repurchase US land currently owned by China

10. Israel defeats Hamas with more US assistance

We appreciate each client's uniqueness and will always strive to do what is best for each individual client. Please do not hesitate to ask us questions or express your concerns. This is your money, and we are your stewards. Have an excellent 2025!

We are committed to maintaining a clear focus on building and preserving client's wealth and enhancing their quality of life, both now and in the future. Working in a fiduciary capacity, the KS Trust team provides a single point of contact for a full array of investment services.

Our team's collective knowledge and experience forges our ability to serve our clients more extensively and develop a clear path. It allows us to address the increasingly complex challenges of today's landscape and provide comprehensive financial advice with a clear vision for the future.

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