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Quarterly Review and Outlook

With inflation moderating, the Fed easing and the Presidential election behind us, the stock market advanced to a record high in the fourth quarter. The S&P 500 index registered a gain of 2% for the fourth quarter and 23% for the year. This is the second year in a row of the stock market increasing by over 20%, which is welcome, but certainly not a given looking into the future. Following a period of correction in the late summer-early Fall, large capitalization growth stocks, particularly the Mag 7 stocks, (Alphabet (Google), Amazon, Apple, Meta Platforms (Facebook), Microsoft, Nvidia and Tesla) returned to lead market performance. While the market moved higher into the fourth quarter, it experienced a pullback in the latter part of December that most likely resulted from investor disappointment with the Federal Reserve's messaging during its December 17th meeting, at which time they guided to slightly higher inflation and fewer interest rate cuts in 2025.

Supporting factors for the market's rise include a solid job market and healthy consumer spending, which resulted in an economy that grew at a 3.1% annualized rate in the third quarter. The fourth quarter GDP estimate calls for growth at about the same level. The unemployment rate at 4.2% remains low and job openings continue to exceed the number of those unemployed. The election of President-elect Trump also seems to have unleashed the "animal spirits" of business leaders, particularly small business owners who registered the highest degree of optimism in years regarding the economic outlook. A strong job market, healthy consumer spending and rising business optimism provide a positive backdrop for corporate earnings. Following an estimated gain of 10% in 2024, S&P 500 earnings are expected to increase 14% in 2025.

Another supportive factor for the market has been the continued moderation of inflation. Having reached a peak of ~9% in June 2022, the Consumer Price Index (CPI) has decelerated to a growth rate of 2.7% with the core rate (excluding food and energy) at 3.3%. The primary factor keeping the inflation rate above the Federal Reserve's target of 2% relates to the continued high cost of housing, which has remained stubbornly high, but is expected to begin to decline. Excluding housing, CPI inflation on a reported basis is running at 1.6%, below the Fed target, and at a 2.2% rate on a core basis.

With inflation declining to a level sufficiently close to their target, and with conditions in the labor market deemed to be balanced, the Federal Reserve moved to reduce the Fed funds rate by 25 basis points at its meeting on December 17. Since September, the Fed has reduced the Fed funds rate by a total of 100 basis points to a current level of 4.25-4.50%. Despite inflation remaining "somewhat above target," Fed officials have indicated they are confident that the rate of inflation is heading toward their 2% objective. Importantly, inflation has been improving in an environment where the job market remains solid. With respect to future rate cuts, Fed Chairman Jerome Powell indicated that monetary policy, going forward, would be primarily dependent upon ongoing improvement in inflation, assuming conditions in the labor market remain stable - i.e. healthy.

Despite the Fed easing short-term rates beginning in the Fall, long-term bond rates have been trending higher. The yield on the 10-year US Treasury Note has risen by about one percentage point since mid-September to a current level of ~4.6%. Fixed income investors are focused on the resilience in consumer spending with its positive implications for economic growth, as well as the stickiness in inflation. Market participants seem to be signaling the Fed not to ease too much too soon, particularly in a healthy economy where inflation has not been fully vanquished. At its recent meeting, the Fed raised its forecast for 2025 inflation from 2.2% to 2.5%, which caused investor consternation. Fed Chairman Powell stated that while he remains confident inflation will continue to moderate, the data must prove that out. He went on to say that "from here, it's a new phase and we're going to be cautious about future rate cuts." Will inflation continue its path of moderation? That is the big question for both the Federal Reserve and investors in the coming year.

Regarding the election of President-elect Trump, the initial market response has been positive as reflected in the 2% market rise since November 5th. The prospect of lower tax rates and reduced business regulation has fueled optimism among investors. However, there has been concern associated with several of the President-Elect's cabinet picks, and his views on trade policy that particularly relate to tariffs, have made investors nervous. While tariffs do raise revenue for the government, they also act as a tax on consumers and businesses. Additionally, tariffs have the ability to disrupt global trade flows and reintroduce inflationary pressures, which would seem to be anathema to Trump's pro-business stance. His stated trade and tariff policies may simply be a posturing or negotiating ploy directed to our international trade counterparties, but it is too soon to tell.

Internationally, geopolitical tensions remain high, although a cease fire has been reached between Israel and Hezbollah, and negotiations continue with respect to ending hostilities in Gaza. Economic trends in China remain weak reflecting the collapse of their real estate market, despite the government announcing various fiscal and monetary support policies. Economic conditions in Europe are also subpar, particularly in Germany reflecting weakness in the automobile market. To stimulate economic growth, the European Central Bank has been lowering interest rates.

In this market environment, we have remained true to our investment philosophy. Our aim is to invest in competitively advantaged companies which have the prospect of generating sustainable earnings growth. It is our belief that corporate earnings growth over time is the driver of long-term capital appreciation. We also look for companies with strong management teams and conservative balance sheets. This approach has led us to focus our investments in technology, healthcare, industrials, specialty financial and select consumer stocks that offer attractive growth prospects.

Within the Fixed Income asset class, we view our bond holdings as complementary positions to our stock holdings. Bonds provide a defensive attribute to portfolio construction. It is within this asset class where we focus on investing in investment grade securities, which include corporate bonds, government securities, as well as municipal bonds where appropriate. Our bond holdings are typically laddered by maturity dates, and that provides us with the ability to prudently consider optimal reinvestment opportunities once the proceeds become available. In addition to generating interest income, bond securities also help to mitigate portfolio volatility.

As always, we are grateful for your support and encourage you to reach out to us with any questions or concerns you may have regarding your investments or portfolio structures. We wish you and your family a healthy and prosperous New Year!