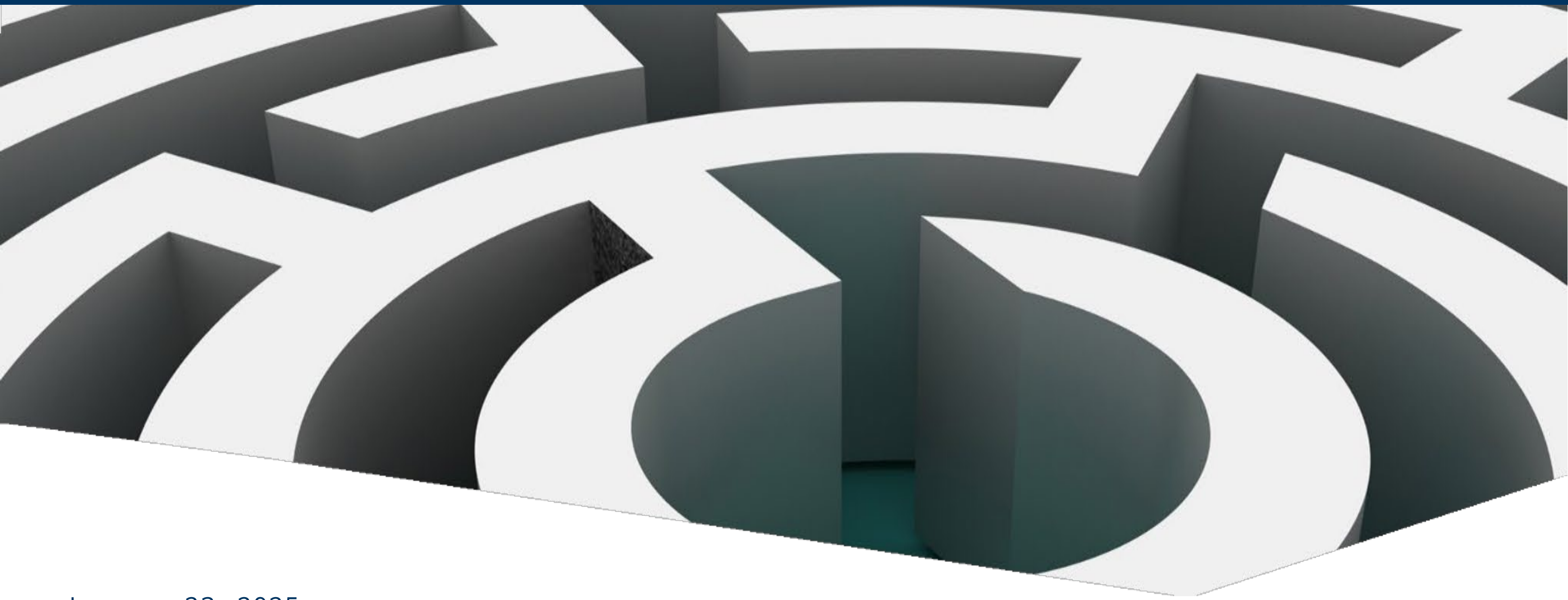

January 23, 2025

# A ROUND OF APPLAUSE FOR 2024! DO WE GET AN ENCORE?

| Benchmark | 4th Quarter | 2024 |
|---|---|---|
| S&P 500 | 2.41% | 25.02% |
| NASDAQ | 6.35% | 29.57% |
| Russell 2000 | 0.33% | 11.54% |
| MSCI EM | -7.84% | 8.05% |
| MSCI EAFE | -8.06% | 4.35% |
| BBgBarc Agg | -3.06% | 1.25% |
| BBgBarc Muni | -1.22% | 1.05% |
| BBgBarc Tbill | 1.19% | 5.32% |

*Source: Y Charts*

While the 4th quarter was a volatile ride, US equity markets finished the month higher, capping off another year of 20%+ returns. Not all markets were created equal, however, as international markets saw large declines in the quarter, ending the year with single digit positive returns. Finally, fixed income markets were the focus towards the end of the year as yields moved rapidly amidst election results and Federal Reserve rhetoric. Fixed Income markets saw contractions in the 4th quarter, finishing the year just slightly above 1%.

## GOOD NEWS IS BAD NEWS?

Macroeconomic data points continued to be strong at the end of the year. Year over year inflation (CPI) reached as low as 2.4% in September, and despite the small pick up at the end of the year (2.9% December reading), remains trending towards the Fed's long-term target. Third quarter GDP continued to show strength, growing at a 1.2% rate from the prior reading. Finally, the employment market has been remarkably resilient with the unemployment rate sitting at 4.1%, and the economy adding 256,000 jobs in December.

On paper, this has given a nice backdrop for the Fed to continue on their rate cutting cycle throughout 2025. However, markets have not been so sure of this. Throughout the 4th quarter, we saw the 10-year treasury rate move from 3.81% to 4.58% at the end of the year. This has extended into early 2025, with the 10-year treasury now sitting just shy of 4.8% as we write this.

**So why the rally in interest rates? Two factors: the election and the Federal Reserve.**

- The results of the election were well received by the equity markets as the plans of deregulation and hopes of growth led to rallies within highly regulated sectors and growth-oriented stocks. However, projected policy decisions around trade/tariffs, immigration, and government spending led to a repricing of inflation expectations. At face value – these campaign promises increase deficits and are inflationary. This concern over any reacceleration of inflation led to a rise in interest rates and a renewed assessment of what is expected from the Fed in 2025.

- The Federal Reserve essentially confirmed market's fears of a more patient rate cut path following their December meeting. They stressed a more patient and data dependent path throughout 2025, backing down off of four projected rate cuts throughout the year. The market is largely expecting the Fed to now pause in January and possibly only implement 25-50 bps of rate cuts for the whole year.

**The Trump Plan**
**(billions, 2026-2035)**

| Policy Proposals | Low | Central | High |
|---|---|---|---|
| Extend and Modify the Tax Cuts & Jobs Act (TCJA) | -$4,600 | -$5,350 | -$5,950 |
| Exempt Overtime Income from Taxes | -$500 | -$2,000 | -$3,000 |
| End Taxation of Social Security Benefits | -$1,200 | -$1,300 | -$1,450 |
| Exempt Tip Income from Taxes | -$100 | -$300 | -$550 |
| Lower Corporate Tax Rate to 15% for Domestic Manufacturers | -$150 | -$200 | -$600 |
| Enact or Expand Other Individual and Small Business Tax Breaks | -$150 | -$200 | -$350 |
| Strengthen and Modernize the Military | -$100 | -$400 | -$2,450 |
| Secure the Border and Deport Unauthorized Immigrants | $0 | -$350 | -$1,000 |
| Enact Housing Reforms, Including Credits for First-Time Homebuyers | -$100 | -$150 | -$350 |
| Boost Support for Health Care, Long-Term Care, and Caregiving | -$50 | -$150 | -$300 |
| **Subtotal, Tax Cuts and Spending Increases** | **-$6,950** | **-$10,400** | **-$16,000** |
| | | | |
| Establish a Universal Baseline Tariff and Additional Tariffs | $4,300 | $2,700 | $2,000 |
| Reverse Current Energy/Environment Policies and Expand Production | $750 | $700 | $550 |
| Reduce Waste, Fraud, and Abuse | $250 | $100 | $0 |
| End the Department of Education and Support School Choice | $200 | $200 | $0 |
| **Subtotal, Revenue Increases and Spending Reductions** | **$5,500** | **$3,700** | **$2,550** |
| | | | |
| **Net Interest** | **-$200** | **-$1,050** | **-$2,100** |
| | | | |
| **Total, Net Deficit Impact** | **-$1,650** | **-$7,750** | **-$15,550** |

*Figure 1: CFRB.org*

## HOT TOPICS AND LOOKING AHEAD

Now that we know where we stand today, we wanted to go rapid fire with some questions we are discussing internally and hearing from our clients heading into 2025.

- **What's Procyon's outlook for the rates and Fed policy in 2025?**
  - We anticipate the Fed will slow its pace of reducing the Fed Funds rate due to slowing gains in the reduction of inflation. Due to this slower pace along with a growing budget deficit, we expect a more normal, positively sloped, yield curve. We believe that the 10-year treasury will be range bound 4.25%-4.75% throughout the year, with possible pressure to the upside.

- **Will 2025 be the 3rd consecutive year of 20%+ returns for the S&P?**
  - Nothing is guaranteed and nobody knows the future. Look no further than wall street's 2024 market projections where the average forecast level for the S&P was 4,861. The S&P closed to end the year at a level of 5,881, 21% higher than the average projection. What we can say is that the backdrop for equities remains strong – a pro-growth political regime, a relatively stable economic picture, and a more accommodative Fed should all serve as tailwinds to equities. We continue to hold an overweight to equities relative to fixed income but have taken opportunities throughout last year to capture profits amidst a rising stock market.

- **What's the outlook for the Magnificent 7?**
  - The narrow leadership in the market remained throughout 2024, with the Mag-7 (MSFT, AMZN, META, AAPL, GOOG, NVDA, TSLA) accounting for 60% of the S&P 500 returns in the year. These names continue to boast some of the strongest balance sheets, while also benefiting from the secular tail winds of artificial intelligence. We expect these names to continue to be market leaders but are wary of valuations and market concentration. We maintain a healthy allocation to these companies but have looked to diversify into some lower market cap companies and maintain a balance between growth and value styles.

- **What about international markets?**
  - International equities have continued to trail domestic equities, with a large divergence in the 4th quarter following election results. A strengthening US dollar continues to be a material headwind to the success of international markets. From a macroeconomic standpoint, international markets continue to be in a tough position with lower growth, hot wars, and the potential for increased tariffs. Company fundamentals remain strong, valuations are at historic lows and opportunities do exist, but active management is important here. We currently are underweight international in favor of domestic equity markets relative to our long-term targets.

- **What are some of the risks to the outlook?**
  - **Valuations –** simply put, valuations have not been important to investors in the current market cycle. Over the long term, valuations are a good predictor of future returns. S&P valuations remain much higher than historical averages and now sit at levels last seen in 2021 and 2000.
  - **Macroeconomics –** a reacceleration of inflation would be a large headwind to both equities and fixed income. While not as impactful as a 2022 scenario, where rates moved off 0%, it would still have an adverse impact on markets.

- **Counting Chickens –** market movement over the last couple of months has been largely driven by *anticipated* policy action stemming from campaign promises. We will now start to see if those promises turn into action, with the Trump administration taking office.

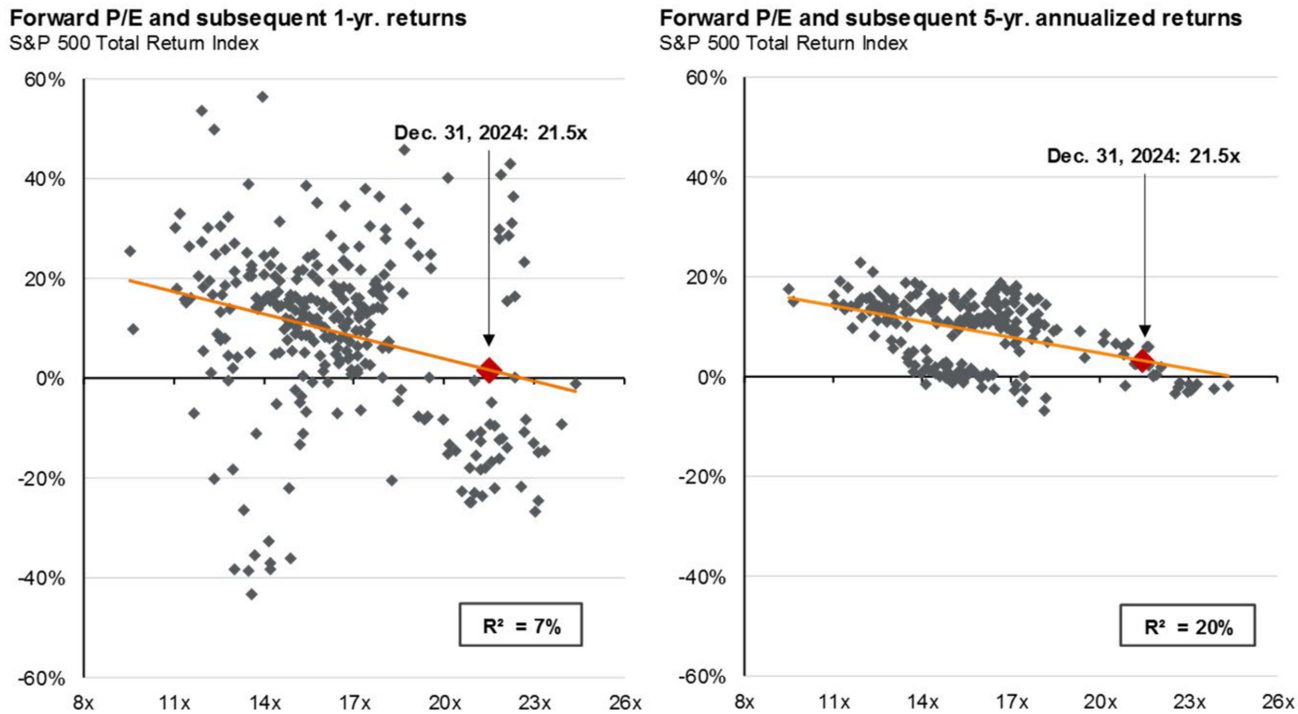


*Figure 2: JPM GTM*

These are just some of the many topics we are discussing at our investment committee meetings. We would love to answer your questions as well! As always, please reach out to your advisor with any comments or questions. Thank you for the continued trust that you put in us!