Air Out of the Ball

12.20.2024

With the S&P 500 up over 24%, it has been an exceptional year. However, participation has increasingly narrowed over recent weeks, and the average stock has taken a notable step back. The S&P 500, when equally weighted, is down a little more than 5% from the start of the month. Commentary dialing back expectations for future cuts to the Federal Funds rate has also increased pressure on the broader market. Still, the foundation for stock performance remains strong. Consumers are working and spending, and earnings expectations are robust. If companies meet their growth targets, markets can continue to rise in the coming year.

The Federal Reserve moved forward with another 0.25% point cut to the Fed Funds rate this week. Although this move was expected, a shift in the outlook for 2025 surprised many. With inflation proving more persistent than anticipated, Federal Reserve Chair Jerome Powell cautioned against expecting a series of additional cuts next year. Inflation is well off its highs but has stalled above the Fed's 2% target in recent months. Housing and services remain the trouble spots. With rates likely to stay higher for longer, the mix of leading stocks has begun to change. Money is moving towards companies with the most visible growth opportunities. Mega caps, the largest companies worth over $200 billion, are back in favor.

Though higher rates are a tougher challenge, 2025 still has potential catalysts. Tax cuts are at the top of the list. President-elect Trump prioritizes extending the individual and small business tax cuts from the 2017 Tax Cuts and Jobs Act (TCJA). He also supports further cuts to the corporate tax rate for U.S.-based companies. These measures could meaningfully boost profits for a wide array of companies. Deregulation is also a key theme for the incoming administration. Several industries could see an earnings boost from less red tape. Artificial Intelligence (AI) continues to drive business activity, with investments in infrastructure and early adoption representing growth opportunities for many companies.

If one thing is certain in 2025, execution is critical. Valuations are not extreme, but stocks are not cheap. Stocks can rise if the S&P 500 hits its 14% earnings growth target, but there is a near-term risk if they fall short. We remain focused on the management teams we believe are consistently building fundamental value over the long run.

Thanks,
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Research Analyst