Fourth Quarter Market Update

January 2025

PLAN WITH PURPOSE.

INVEST WITH CONFIDENCE.

POWER
WEALTH MANAGEMENT

In November, Power Wealth Management hosted a special event for clients, featuring hometown hero, John Smoltz of the Atlanta Braves, where he discussed passion, purpose and life after retirement.

In keeping with the recent baseball theme, Ted Williams, in 1941 batted .406, and was the last player to hit over .400 in a single-season. Mr. Williams famously published a book called 'The Science of Hitting', where he described his method of dividing the strike zone into 77 cells. By swinging only at pitches in his sweet spot, he improved his chances of success, and went down in history as one of the best hitters of all time. Warren Buffett thinks this is similar to successful investing. By waiting for the 'fat pitch', and importantly, avoiding the outside corners, we believe there is an opportunity to tilt the odds of success in our favor. Currently, we believe that many investors who are hyper-focused on speculative tech, and companies with highly uncertain long-term profitability, are swinging at the equivalent of a John Smoltz slider.

At PWM, we continue to focus on our 'sweet spot', which includes an emphasis on prudent portfolio construction and a long-term orientation, grounded in each client's bespoke financial plan.

2024 Market Performance, Key Drivers, & Go-Forward Outlook

The US stock market was up an astounding 23.9% in 2024, led by large growth companies, and benefitting from enthusiasm for artificial intelligence. International developed and emerging market stocks lagged meaningfully, and were up just 3.6% and 12.6%, respectively. Fixed income, as measured by the US Aggregate Bond Index, was up 1.3%, as the economy was more resilient than expected, and disinflation progressed at a slower pace. As a result, the Fed cut rates less than expected, which impacted bond prices. **See Figure 1.** for total returns in the fourth quarter, as well as the full-year.

Figure 1. Market Performance, Total Return

	Q4'24	2024
Equities		
US Total Market[1]	2.7%	23.9%
International Developed[2]	-7.9%	3.6%
Emerging Markets[3]	-6.3%	12.6%
Fixed Income		
Aggregate Bond[4]	-3.1%	1.3%

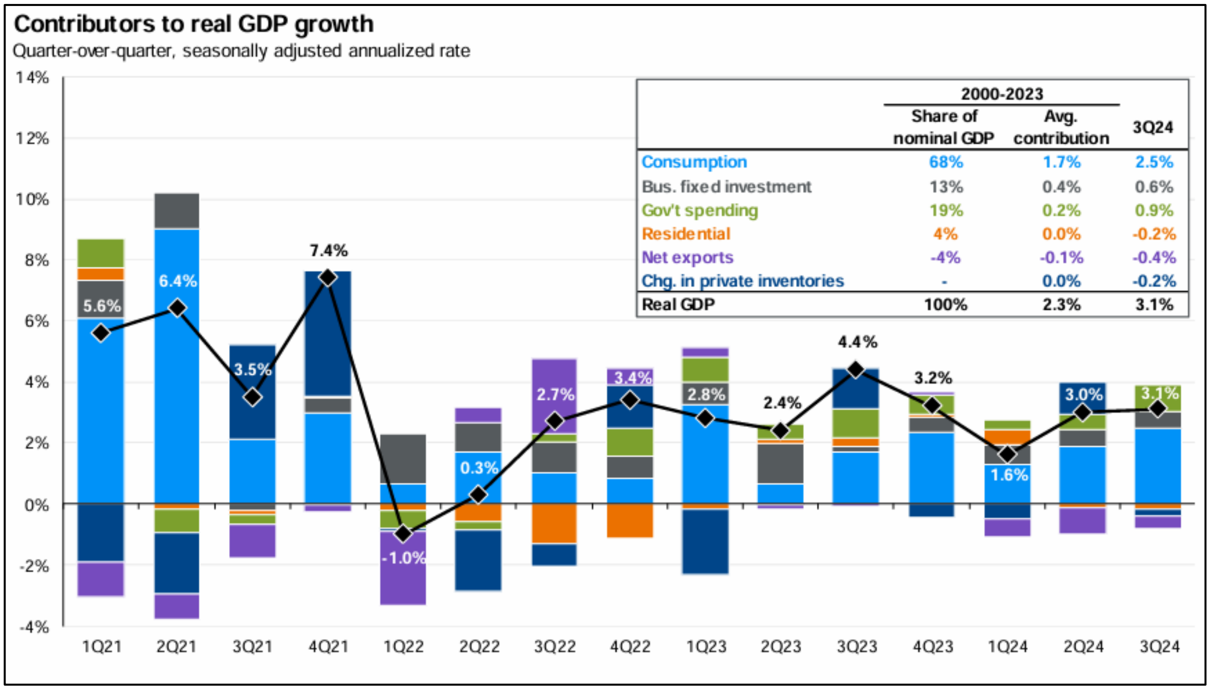
Source: Bloomberg
1. S&P Total Market Index, 2. FTSE Developed ex US Index, 3. FTSE Emerging Index,
4. Bloomberg US Aggregate

Our outlook is cautiously optimistic. The economy continues to perform well, powered by a resilient US consumer sitting on record wealth. Corporate profits are also expected to continue to climb in 2025, which bodes well for US equities. That said, there remains considerable uncertainty regarding the ultimate path for policy, and inevitably, the economic cycle will continue, resulting in periodic recessions. Rather than make short-term forecasts, we concentrate on constructing well-diversified portfolios built for the long-term. Importantly, these portfolios move beyond the S&P 500, which has grown increasingly concentrated. This includes a greater focus on mid caps and small caps, options-based strategies, and real assets, including real estate and natural resources. Our strategy also involves avoiding investments where we think there's too much 'sizzle' and not enough 'steak'.

US Economic Trends

GDP continued to grow at a stronger than expected pace through 2024, buoyed by a resilient consumer**.** See **Figure 2.** for contributors to real GDP growth. In the most recently available data for the third quarter, consumption drove the far majority of GDP growth, or more specifically, 2.5% of the 3.1% increase.

Figure 2. Historical GDP Growth by Contributor



Source: BEA, FactSet, J.P. Morgan Asset Management

Going forward, we continue to be bullish on the US economy. The labor market continues to be strong with low unemployment and meaningful wage growth. While we recognize the economy has been 'K' shaped, with lower-income parts of the population faring relatively worse, American households, particularly those responsible for much of the consumption, are sitting on record wealth and are continuing to spend.

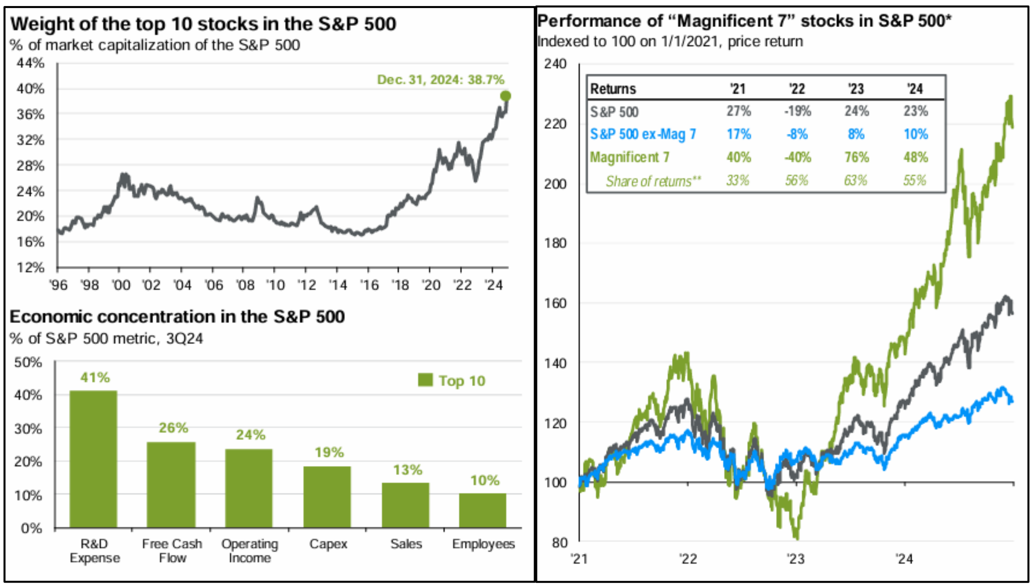
Additionally, uncertainty regarding the US election has now been resolved. That said, a new layer of uncertainty has been introduced regarding the path for policy. While we continue to think that investors over-emphasize the impact of government on markets, from an economic perspective, we're encouraged by the prospects for de-regulation and lower taxes. We also think the incoming administration may serve to unleash 'animal spirits' that serves to boost growth. On the other hand, these meaningful positives may be partially offset by tariffs, to the extent they raise the cost of doing business, as well as reduced immigration, based on the related drag to the working-age population.

US Stocks

The US total stock market was up an astounding 23.9% in 2024, led by large growth companies, and benefitting from enthusiasm for artificial intelligence. This was the second consecutive year of 20% plus performance.   As a matter of context, the S&P 500 hasn't posted two consecutive years of 20% plus returns since the late-90's.   While we continue to be bullish on US stocks, this has been an unusually strong two-year period, and in our view, investors who extrapolate recent performance into the future will likely be disappointed.

Importantly, the S&P 500 has grown more concentrated. The top 10 stocks now make up almost 40% of the index. The 'Magnificent 7' stocks were up 48%, as measured by price. Excluding these seven stocks, the S&P 500 would have been up just 10%. See **Figure 3.** for information regarding S&P 500 concentration and Magnificent 7 price performance.

Figure 3. S&P 500 Concentration & Magnificent 7 Price Performance



**Magnificent 7 includes AAPL, AMZN, GOOG/GOOGL, META, MSFT, NVDA, and TSLA*
***Top 10 include AAPL, AMZN, GOOG/GOOGL, META, MSFT, NVDA, TSLA, AVGO, BRK.B, and JPM*
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

We believe that many investors continue to think of an investment in the S&P 500 as equivalent to owning a large basket of stocks (e.g., owning a small slice of five hundred businesses), assuming the diversification associated with the index reduces risk. With the top ten stocks representing almost 40% of the index, this is increasingly not the case. We think this leaves investors who are overly exposed to the S&P 500 vulnerable to sell-offs, particularly if recent enthusiasm for mega-cap tech wanes.   Consistent with this view, and what we believe to be prudent risk-management, we have diversified clients well-beyond the S&P 500, with a greater focus on mid caps and small caps, options-based strategies, and real assets, including real estate and natural resources.

Encouragingly, with the US economy continuing to perform well, we expect corporate earnings to grow, which sets up positively for US stocks. See **Figure 4.** for historical and forecast quarterly earnings by sector. Note that healthcare has some of the strongest expected earnings growth. Healthcare also stands to benefit from an aging population, and we think there's the potential for an innovation super-cycle, fueled by AI and machine learning.

<u>Figure 4. Earnings by Sector, Historical and Forecast</u>

S&P 500 sector pro forma EPS growth

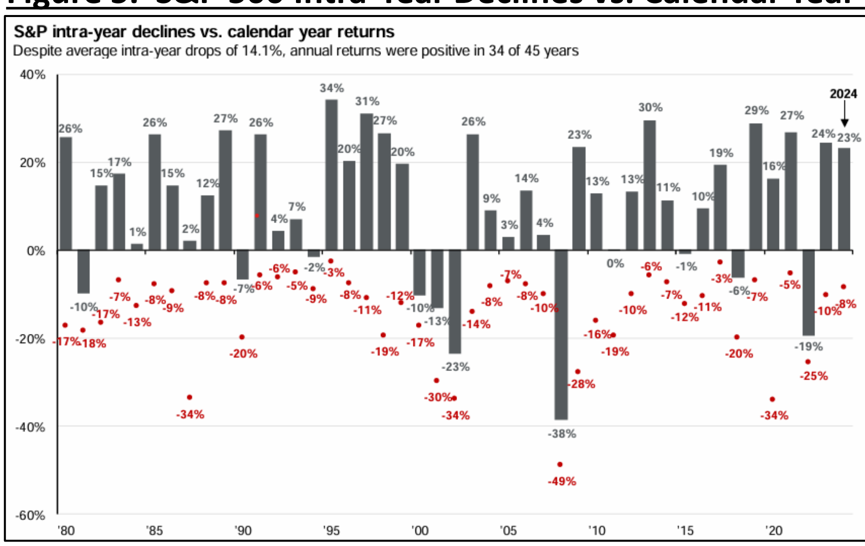
Year-over-year

		2022				2023				2024				2025			
	Weight*	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QF	1QF	2QF	3QF	4QF
Tech.	32%	14%	1%	-1%	-9%	-8%	4%	14%	23%	25%	20%	8%	15%	17%	20%	31%	20%
Financials	14%	-19%	-21%	-18%	-13%	-5%	-2%	12%	-21%	9%	17%	7%	39%	6%	2%	7%	16%
Health Care	10%	15%	8%	0%	-4%	-15%	-27%	-18%	-15%	-25%	19%	14%	13%	42%	13%	14%	18%
Cons. Disc.	11%	-29%	-16%	7%	-19%	38%	48%	38%	27%	21%	10%	8%	11%	10%	7%	8%	16%
Comm. Services	9%	-1%	-21%	-23%	-26%	-14%	20%	44%	44%	42%	8%	26%	23%	9%	33%	5%	13%
Industrials	8%	38%	33%	20%	40%	24%	12%	9%	4%	2%	-3%	-11%	-4%	10%	10%	29%	19%
Cons. Staples	5%	8%	2%	1%	1%	3%	8%	7%	6%	6%	4%	4%	0%	0%	4%	6%	9%
Energy	3%	282%	301%	140%	58%	19%	-49%	-34%	-23%	-24%	0%	-28%	-29%	-13%	-3%	15%	23%
Utilities	2%	27%	-4%	-8%	10%	-23%	-3%	10%	31%	28%	21%	-2%	-2%	9%	3%	16%	11%
Materials	2%	47%	17%	-12%	-18%	-20%	-24%	-16%	-21%	-21%	-8%	-11%	0%	5%	7%	27%	27%
Real Estate	2%	19%	6%	11%	8%	-1%	5%	-1%	3%	6%	0%	2%	2%	1%	3%	6%	6%
S&P 500		10%	7%	3%	-3%	-1%	-4%	6%	4%	6%	11%	5%	11%	11%	11%	15%	17%

Source: FactSet, J.P. Morgan Asset Management

Additionally, while the last several weeks have been somewhat rockier for US stocks, investors should understand that volatility is a normal part of investing in equities. While the long-term trend has historically been 'up and to the right', draw-downs are a regular feature of markets. See **Figure 5.** for annual returns since 1980, including intra-year declines. As can be seen below, despite average intra-year declines of 14.1%, annual returns were positive in 34 of 45 years. While 'historical results are not necessarily an indicator of future performance', we think this provides important perspective.

<u>Figure 5. S&P 500 Intra-Year Declines vs. Calendar Year Returns</u>



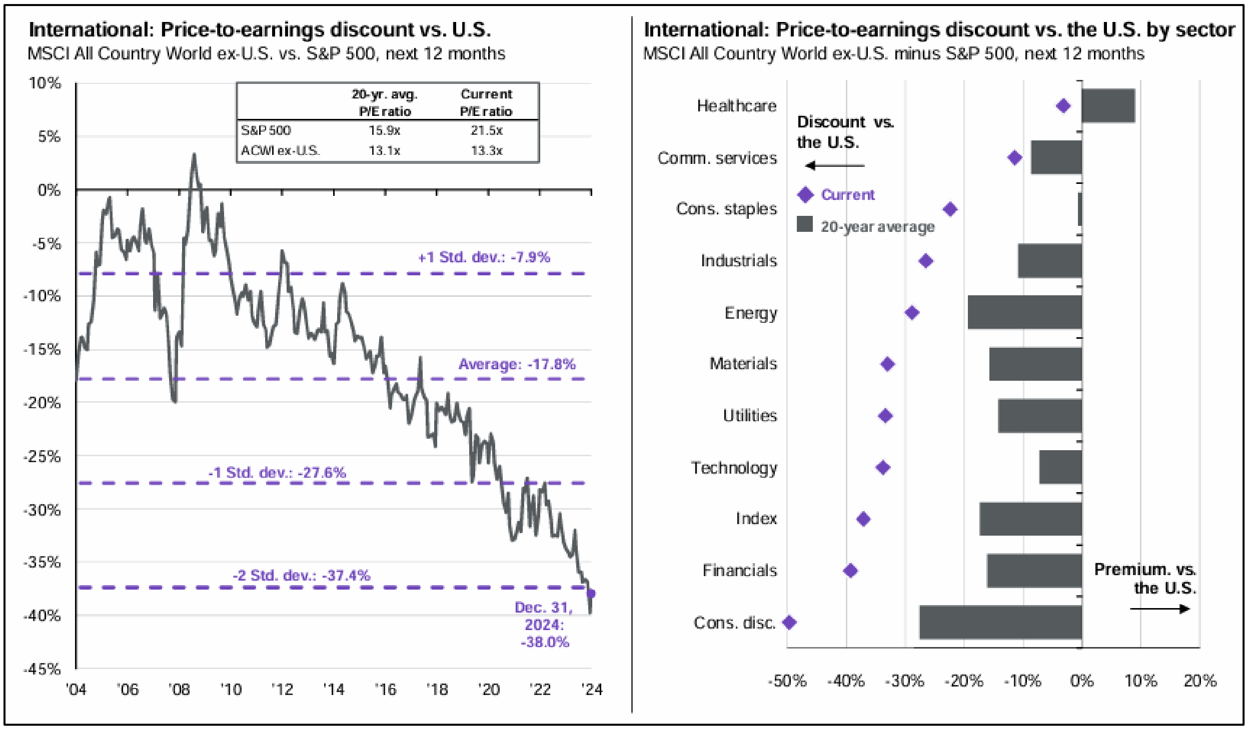
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

International Stocks

International developed and emerging market stocks lagged meaningfully in 2024, and were up just 3.6% and 12.6%, respectively.   While international markets are diverse, and therefore should be analyzed more granularly, there continues to be several over-arching themes, including multiple geopolitical conflicts, less exposure to big tech, and higher energy prices impacting manufacturing and industrial activity. The US Dollar has also been strengthening following the US presidential election, representing a further headwind for international stocks.

International stocks are also extremely discounted vs. their domestic counterparts, representing a compelling case for patient investors. See **Figure 6.** for a line chart showing the relative price-to-earnings ratios of international stocks to US stocks. The price-to-earnings ratio of international stocks is now 38% less than the price-to-earnings ratio of US stocks. While a common explanation is that the discount is a result of less tech exposure, the bar chart on the right-hand side shows the discount persists even on a sector-to-sector comparison.

Figure 6. International Valuations



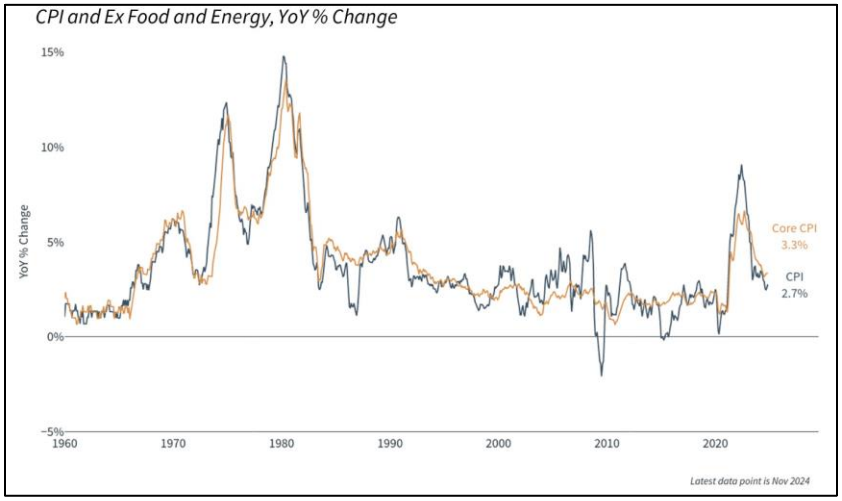
Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management

We remain underweight international stocks relative to global benchmarks, but continue to believe that geographic diversification plays an important role in portfolios. We also continue to leverage institutional asset managers to help us identify the most attractive opportunities in international markets (e.g., India, Brazil).

Fixed Income

Fixed income, as measured by the US Aggregate Bond Index, was up a modest 1.3% in 2024. The economy was more resilient than expected, and as a result, disinflation progressed at a slower pace. In response, the Fed only cut rates 100 basis points (i.e., one percentage point) in 2024, which was less than initially anticipated. This negatively impacted intermediate and long-term bond prices. See **Figure 7.** for a historical chart of the Consumer Price Index (CPI). While a great deal of progress has been made to tame inflation, the CPI remains well above the Fed's 2% target.

Figure 7. Consumer Price Index



Source: Clearnomics, Bureau of Labor Statistics

Looking forward, throughout 2025, the Fed has signaled that the pace of cuts is expected to be slower. This bias towards fewer cuts was further bolstered by a strong jobs report last week. However, the Fed's 'crystal ball' is far from perfect, and they remain data dependent. To the extent the economy weakens, we'd expect additional rate cuts. Ideally, this 'reaction function' helps to provide a floor, albeit imperfect, for US stocks.

While portfolios differ by account, we shortened duration for fixed income sleeves late last-year, reducing exposure to further spikes in long-term interest rates. This was based on both expectations for stronger economic growth, and the potential for stickier inflation. From a supply and demand perspective, we also remain concerned about budget deficits and related to that, a greater issuance of Treasuries, as well as a Fed that's shrinking its balance sheet.

We continue to find fixed income attractive, but with greater selectivity, particularly in the shorter to intermediate parts of the yield curve. We are also biased towards higher quality fixed income, since credit spreads (i.e., the additional yield earned from investing in riskier fixed income) remains historically narrow. As a reminder, higher starting yields have been highly correlated to subsequent 5-year returns.

As always, we continue to monitor financial markets and invest on your behalf, with a long-term orientation, consistent with the PWM investment philosophy. We continue to emphasize financial planning, and take a holistic approach to helping you manage your wealth. We consider it a privilege to help our clients reach their financial goals.

Thank you for your continued trust, and as always, we remain available to address any questions or concerns.

Sincerely,

Power Wealth Management