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MARKET MUSINGS

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2024 Year in Review
Another Big Year for Big Tech

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SUMMARY

- The U.S. economy led global growth in 2024, fueled by a strong labor market, easing inflation, and resilient consumer finances. These key factors underscore continued growth and support an optimistic economic outlook for the year ahead.
- Led by the "Magnificent 7", the S&P 500 returned 25% in 2024. For the second year in a row, U.S. large-cap stocks were the top performing asset class, significantly outperforming other asset classes. The impact of Big Tech was substantial; without these seven companies, the S&P 500's gains would have been less than 10%, highlighting the unusually high concentration of market returns.
- While Wall Street forecasts average market returns for 2025, actual returns tend to deviate from analyst price targets, and calendar year returns are rarely in line with the long-term average.
- Significant market declines during periods of economic expansion are rare, occurring less than 4% of the time.
- Our current **micro**cast™ signal sits at a neutral allocation, unchanged from last month's stance. Overall, our tactical risk models reflect a constructive outlook for equity markets.

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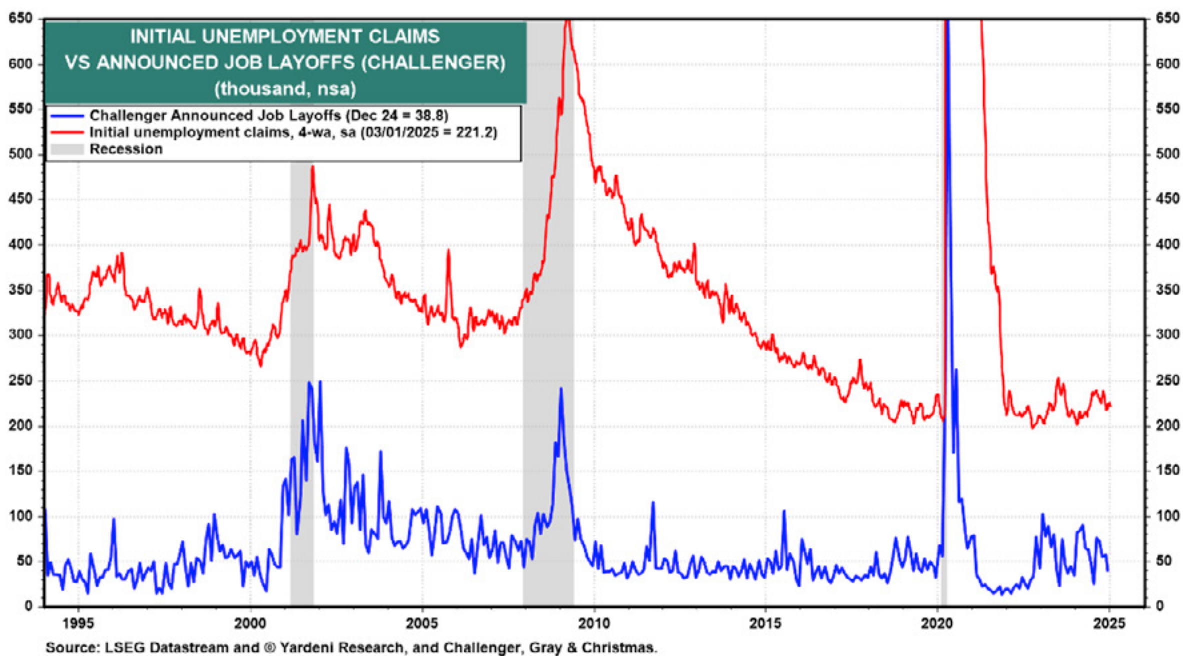
See content within for additional information on the summary items discussed above

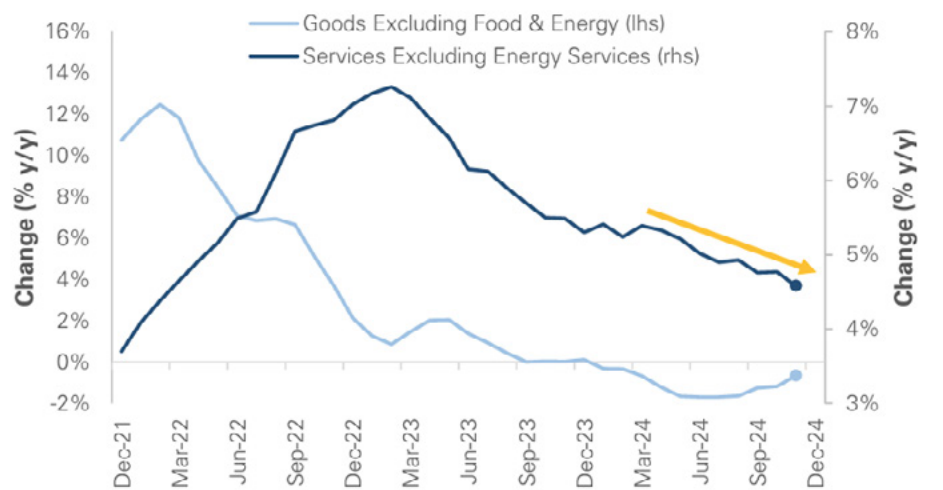
U.S. ECONOMY SHOWED **SOLID GROWTH IN 2024**

The U.S. economy led the world in 2024, fueled by a robust labor market, moderating inflation, and a healthy consumer.

The U.S. labor market continued to show resilience last year. The unemployment rate remained low throughout the year, ticking down to 4.1% in December. Initial jobless claims and announced layoffs are near record lows, indicating stability in employment despite a deceleration in job growth compared to the rapid pace of 2021-2023. This suggests the labor market is transitioning from a period of rapid expansion to a more sustainable growth trajectory (chart from Yardeni):



Inflation maintained its downward trend in 2024. Despite remaining above the Fed's target level, further progress on the inflation front allowed the Federal Reserve to confidently cut interest rates by 1% in the second half of the year (chart from MarketDesk):



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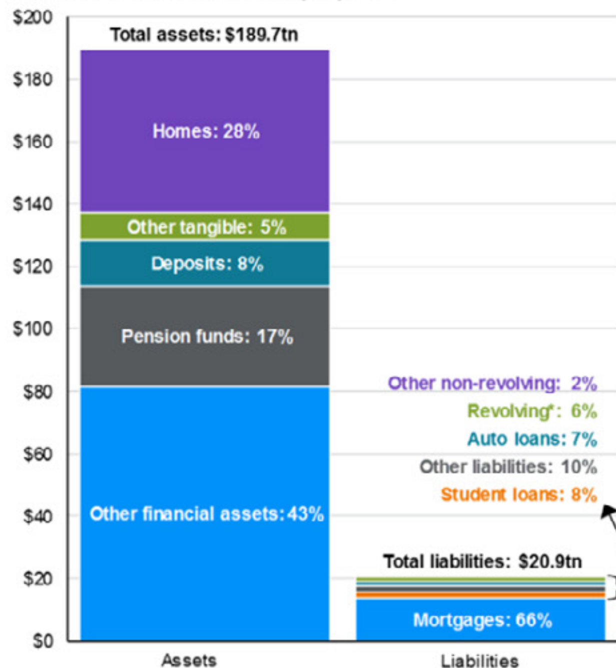
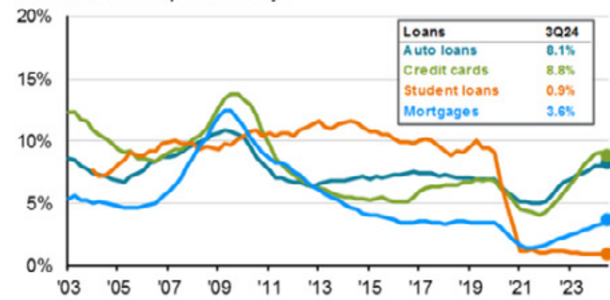
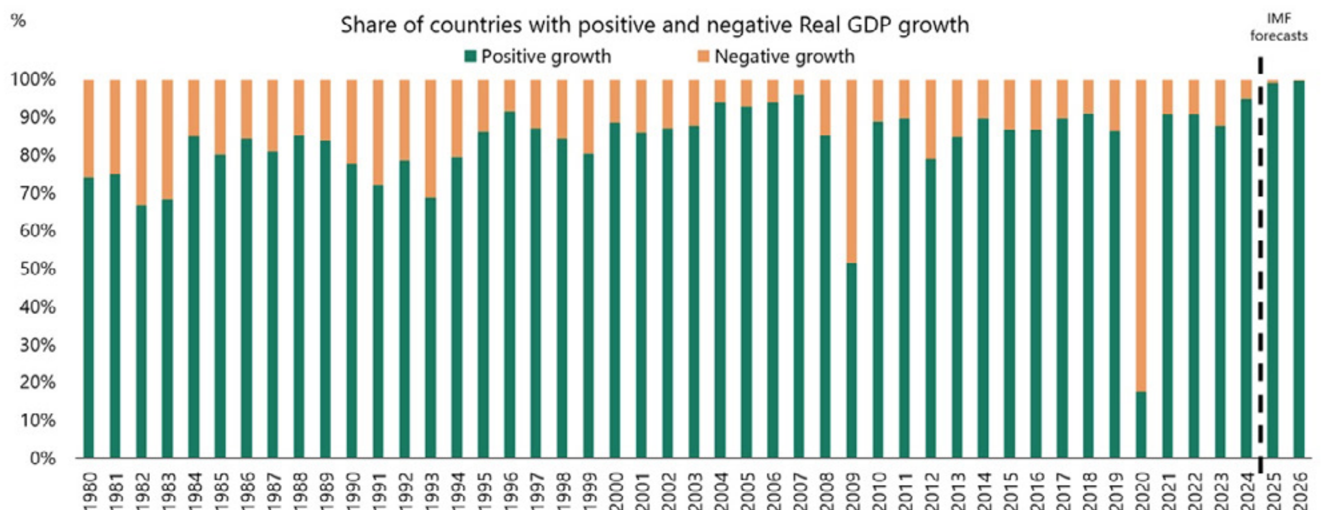
Consumer balance sheets remained healthy with manageable debt levels. While there has been a slight uptick in credit card and auto delinquencies, this is rising from historically low levels and does not yet signal broad financial strain (charts from JPM):





These data points support the optimistic economic outlook we presented in our 2025 Outlook last month. Encouragingly, this trend extends beyond the U.S., with a record low number of countries projected to enter recession over the next few years (chart from Apollo):

A record-low share of countries expected to be in recession in 2025 and 2026



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2024 ASSET CLASS **REVIEW**

The following table highlights major asset class returns over the past 15 years (from Novel Investor):

Asset Class Returns

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Ann.
REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%	Cash 1.8%	Lg Cap 31.5%	Sm Cap 20.0%	REIT 41.3%	Cash 1.6%	Lg Cap 26.3%	Lg Cap 25.0%	Lg Cap 13.9%
Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l 25.6%	HG Bnd 0.0%	REIT 28.7%	EM 18.7%	Lg Cap 28.7%	HY Bnd -11.2%	Int'l 18.9%	Sm Cap 11.5%	Sm Cap 10.3%
EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%	HY Bnd -2.3%	Sm Cap 25.5%	Lg Cap 18.4%	Sm Cap 14.8%	HG Bnd -13.0%	Sm Cap 16.9%	HY Bnd 8.2%	REIT 9.4%
HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.0%	EM 11.6%	Sm Cap 14.7%	REIT -4.0%	Int'l Stk 22.7%	AA 9.8%	Int'l Stk 11.8%	Int'l Stk -14.0%	HY Bnd 13.5%	EM 8.1%	AA 6.5%
Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%	Lg Cap -4.4%	AA 18.9%	Int'l Stk 8.3%	AA 10.9%	AA -16.5%	AA 12.8%	AA 7.4%	HY Bnd 6.4%
AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%	AA -5.6%	EM 18.9%	HY Bnd 7.5%	HY Bnd 5.4%	Lg Cap -18.1%	REIT 11.4%	Cash 5.3%	Int'l Stk 5.7%
Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%	Sm Cap -11.0%	HY Bnd 14.4%	HG Bnd 6.1%	Cash 0.0%	EM -19.7%	EM 10.3%	REIT 4.9%	EM 3.4%
HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%	Int'l Stk -13.4%	HG Bnd 8.7%	Cash 0.6%	HG Bnd -1.5%	Sm Cap -20.4%	HG Bnd 5.5%	Int'l Stk 4.4%	HG Bnd 2.3%
Cash 0.1%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6%	Cash 0.3%	Cash 0.8%	EM -14.3%	Cash 2.2%	REIT -5.1%	EM -2.2%	REIT -25.0%	Cash 5.1%	HG Bnd 1.3%	Cash 1.2%

Abbr.	Asset Class - Index	Annual	Best	Worst
Lg Cap	Large Cap Stocks - S&P 500 Index	13.88%	32.4%	-18.1%
Sm Cap	Small Cap Stocks - Russell 2000 Index	10.33%	38.8%	-20.4%
Int'l Stk	International Developed Stocks - MSCI EAFE Index	5.74%	25.6%	-14.0%
EM	EM Stocks - MSCI Emerging Markets Index	3.39%	37.8%	-19.7%
REIT	REITs - FTSE NAREIT All Equity Index	9.40%	41.3%	-25.0%
HG Bnd	High Grade Bonds - Bloomberg Barclays U.S. Agg Index	2.28%	8.7%	-13.0%
HY Bnd	High Yield Bonds - ICE BofA US High Yield Index	6.42%	17.5%	-11.2%
Cash	Cash - S&P U.S. Treasury Bill 0-3 Mth Index	1.19%	5.3%	0.0%
AA	Asset Allocation Portfolio*	6.45%	18.9%	-16.5%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/24. *Asset Allocation Portfolio is 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Some additional insights from the above table:

1. ***Large-cap stocks outperformed all other asset classes, once again.*** The S&P 500, led by the "Magnificent 7"—Apple, Amazon, Alphabet, Meta, Microsoft, NVIDIA, and Tesla—outperformed all other major asset classes in 2024 with a 25% return, marking its second consecutive year exceeding 20% gains.
2. ***Cash performed well again.*** Cash, represented by short-term treasury bills, delivered another year of solid performance with a 5.3% return, outpacing bonds and marking the second consecutive year of 5%+ returns. However, with the Fed's cumulative 1% rate cut since September, we anticipate lower cash returns in 2025. It should also be noted that cash is the worst performing asset class over the last 15 years.
3. ***Small caps rose double digits but there's still a big gap.*** Smaller company stocks were the second-best performer last year, but the gap between small and large was bigger than in 2023, with large caps outperforming small caps by 14%.

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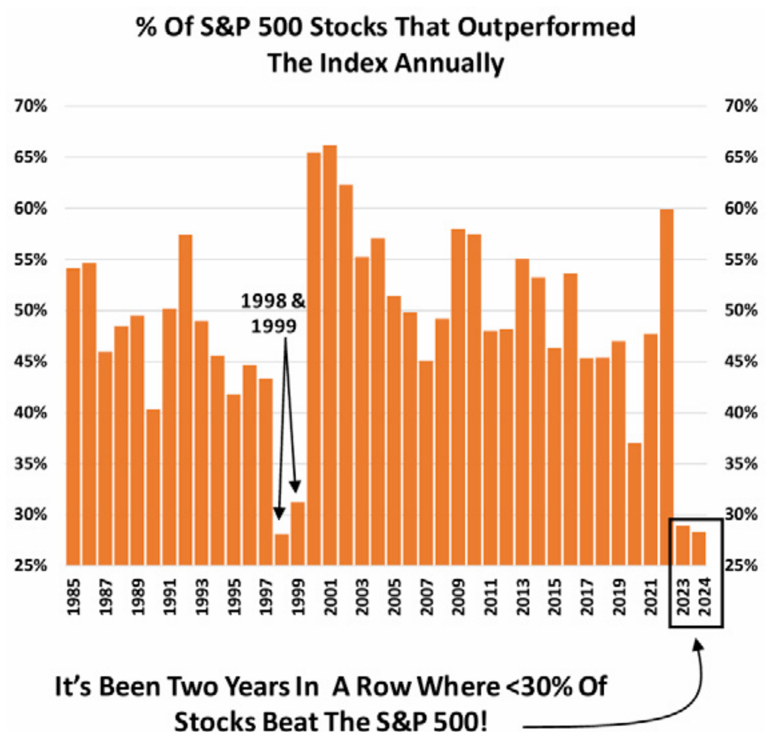
4. ***Novel's Asset Allocation portfolio lagged the S&P 500 by double digits.*** Novel Investor outlines a basic asset allocation portfolio, which they include in the above table as indicated by the gray box with the "AA" heading. This portfolio includes a mix of stocks and bonds. From 2000-2008, this portfolio consistently beat the S&P 500, but over the following 15 years, the diversified AA strategy lagged, primarily due to the rise of Big Tech stocks in the U.S. and weaker performance in emerging markets and Europe. The AA portfolio finally broke its losing streak in 2022, but that outperformance was short lived. In 2024, the AA portfolio lagged the market once again.
5. ***The effect of Big Tech on market performance cannot be understated.*** The following analysis, courtesy of DataTrek Research, illustrates the massive impact that Big Tech has had on U.S. large cap performance over the past two years:
    - Since the beginning of 2023, Big Tech has been the most important driver of annual return differentials between U.S. large caps and both domestic small caps and rest of world stock indices.
    - Without the "Magnificent 7," the S&P 500 would have only gained 4.1 percent in 2023 and 6.3 percent in 2024 on a price return basis. The index's actual price returns were 24.2 and 23.3 percent, respectively.
    - These "ex-Mag 7" S&P 500 returns were worse than the small cap focused Russell 2000's gains in 2023/2024, at 15.1/10.0 percent, respectively.
    - They are also worse than MSCI All-Country ex-US returns for 2023 (+12.2 percent).

The dominance of a few Big Tech stocks within the S&P 500 is further evident in the unusually low number of individual stocks outperforming the index. Typically, about half of S&P 500 components outperform the index, but this figure has fallen below 30% in the past two years, a level not seen since the late 1990s (chart from Piper Sandler):



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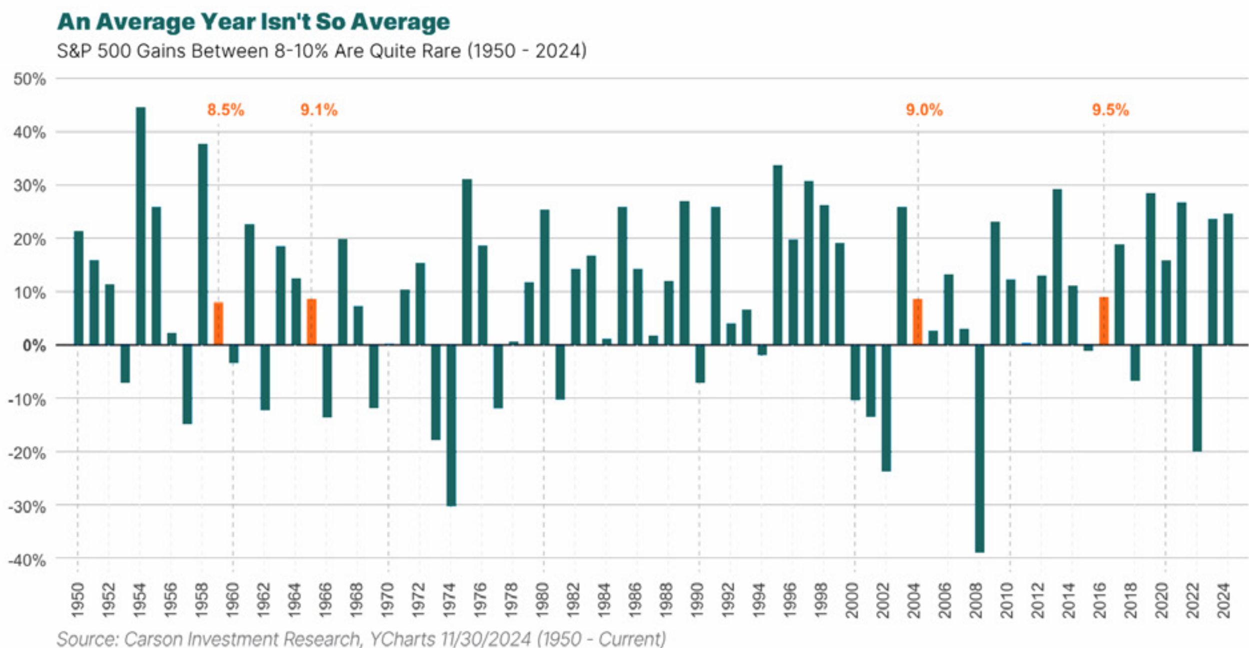
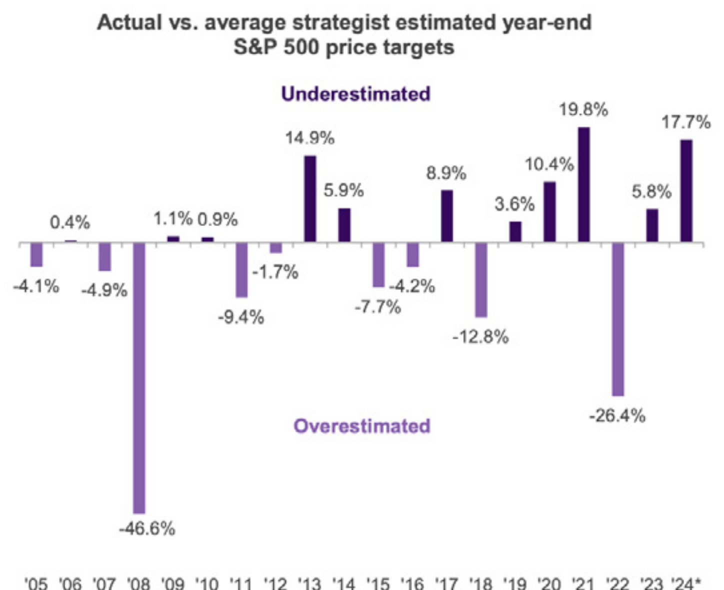
A HEALTHY ECONOMY TYPICALLY **SUPPORTS FAVORABLE MARKET CONDITIONS**

Wall Street firms are projecting an 8-10% return for the market in 2025, which closely matches its long-term average return.

The problem is that the market rarely delivers an average return in a calendar year (chart from Ryan Detrick):



This is one reason why Wall Street strategists don't have a great track record when it comes to predicting how the market will finish in a given year (chart from Truist):



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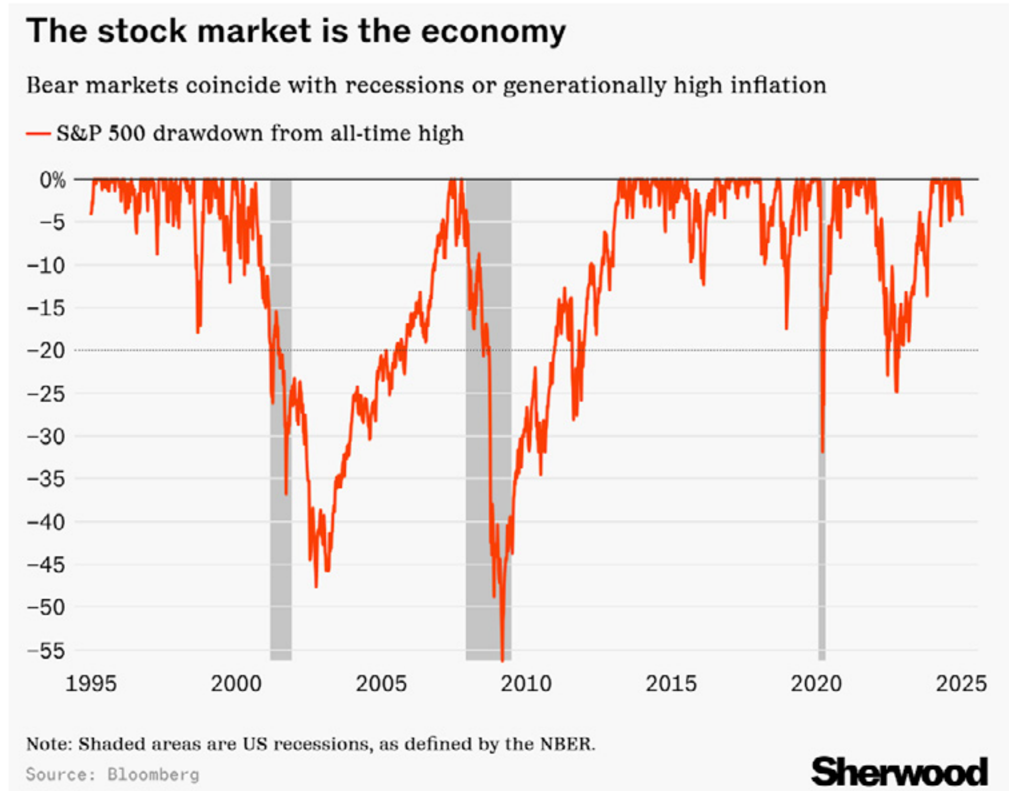
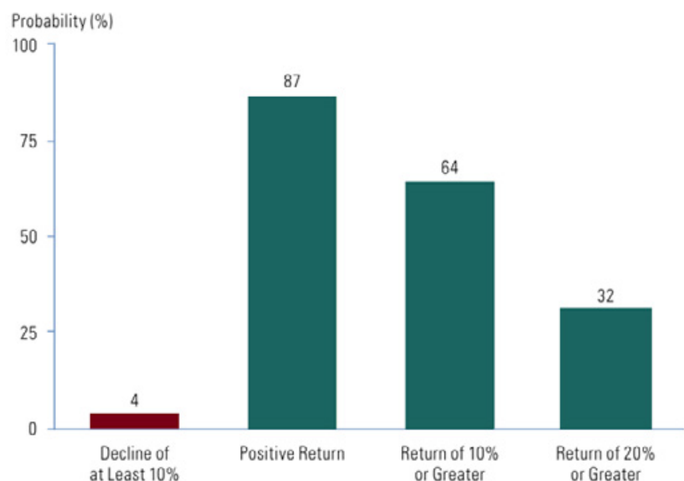
Instead of focusing solely on unreliable market predictions, a better approach is to identify the specific factors that differentiate sustained bear markets from typical volatility and corrections. This approach provides a more nuanced and insightful understanding of market dynamics.

In the last few decades, bear markets have been driven by two things: recessions and unexpected, high inflation (chart from Luke Kawa):



Further, double-digit market declines during periods of economic expansion are rare, with 2022 being the first such occurrence since 2002 (chart from Goldman Sachs):



Historically, when the economy is expanding, the market has been eight times more likely to rise by 20% than to decline by 10% or more. This pattern underscores the positive performance of U.S. equities over the past 80 years, reflecting their resilience and ability to generate strong returns during periods of economic growth.

In summary, 2024 was a strong year for the U.S. economy and markets, characterized by robust employment, declining inflation, and strong consumer balance sheets. Large-cap stocks, led by Big Tech, delivered exceptional performance, outpacing other asset classes and driving significant gains for the S&P 500. Wall Street projects average market returns in 2025, yet history shows that market performance often deviates from analyst price targets. With the economy expanding, historical trends favor continued positive equity performance.

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