MARKET
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Market Review and Outlook

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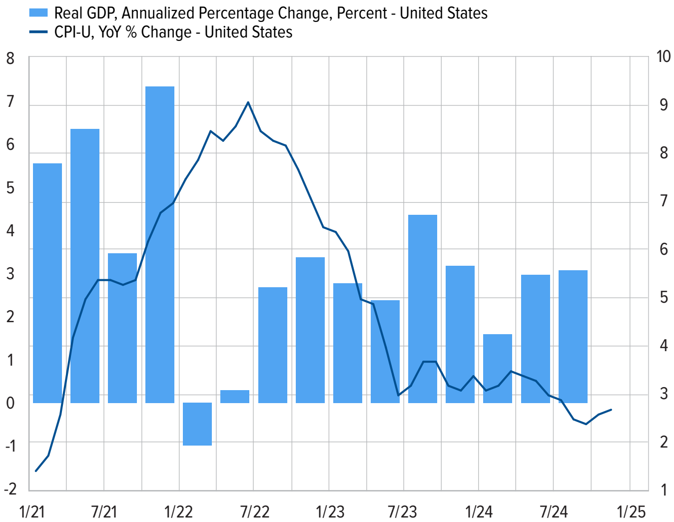
Equity markets finished fourth-quarter 2024 on a positive note with the S&P 500® index up 2.41% for the period, making all quarters positive for the year. Growth stocks regained the lead, although mid-cap growth outpaced large-cap growth in the final quarter. Though the Federal Reserve (Fed) cut interest rates twice during the fourth quarter, a healthy labor market combined with stubbornly sticky inflation weighed on market sentiment. This dampened the momentum toward value stocks, especially as President-Elect Donald Trump touted his desire to materially increase tariffs across the board. Additionally, Trump's acute focus on tariffs throughout his campaign dragged international stocks (both developed and emerging markets). Nonetheless, markets swung back and forth as market participants tried to decipher how Trump's inflationary and stimulative policies would be implemented.

Within fixed income, short-duration bonds outperformed their longer-duration counterparts, as the yield on the 10-year Treasury surged higher during the quarter. Credit-spread sectors performed relatively well, as bank loans and high-yield bonds outperformed core bonds.

Outlook

With the sweeping results of the U.S. presidential and Congress elections in November, we now know that Republicans will have more control to pass and implement their fiscal policies over the coming years. While history suggests that markets prefer mixed parties within the White House and U.S. Congress (which tend to lead to fewer policy changes due to disagreements), the markets could benefit from some of the policies endorsed by Trump. However, market reactions to these policies will depend highly on the scale and degree of their implementation.

Under former President Joe Biden's administration, certain sectors and companies continued to thrive while others remained stagnant under a tough regulatory environment. Furthermore, inflation spiked during his term, forcing the Fed to aggressively tighten monetary policy. Among several other factors, Biden's stimulus package (the American Rescue Plan Act of 2021) may have further accelerated inflation, as it injected nearly $2 trillion on top of the vast sum approved by Trump. On a positive note, the U.S. economy continued to remain solid and avoided a recession throughout Biden's term.



Source: FactSet

From the market's perspective, large technology-related companies thrived (mainly fueled by enthusiasm for artificial intelligence (AI) products), but high interest rates burdened many small companies that were indebted with floating-rate loans. Additionally, banking institutions continued to face headwinds from strict regulation, constraining liquidity as well as mergers-and-acquisitions activity. In terms of asset-class styles, large growth performed exceptionally well, while small value struggled.

Economic conditions are likely to change under Trump's second presidential term, which could foster an environment that may benefit sectors that have struggled for some time. Inflation has noticeably decelerated from its recent peak levels—though it has remained modestly above the Fed's target level of 2%. This deceleration should allow the Fed to continue easing monetary policy as we move into 2025. Falling interest rates, in turn, should help small-cap stocks recover and build some upward momentum for the asset class, especially as valuations on large tech stocks appear particularly stretched. Nonetheless, this will be determined by how much the Fed can ease monetary policy under Trump's policy risks.

Trump's fiscal policies will play a vital role on how the market shapes up throughout 2025. Thus far, Trump's four main proposed policy changes focus on tariffs/trade, immigration/border control, deregulation, and tax cuts. The first two policies are expected to be inflationary, which could hinder economic growth. However, this will depend on the aggressiveness of the implementation. While Trump touted that he would vigorously increase tariffs on Chinese goods as well as many from U.S. allies, many analysts and economists believe this threat is more of a negotiation tactic and will end up being more modest than initially suggested. The same may be true of Trump's commitment to the mass deportation of immigrants. However, if Trump moves forward with his threats of tariffs and mass deportation, U.S. citizens will certainly face a resurgence in inflation due to labor shortages and higher prices on various goods—which would negatively affect the market and the economy.

During Trump's first presidential term, he seemed to have used performance of the S&P 500 index as a gauge of his economic "report card." If he continues this trend during his second term, his threats may be more muted than he has suggested so far. Many of those who voted for Trump likely made their decision based on hopes for better economic conditions. However, many economists and analysts agree that his policies on tariffs and immigration (if implemented aggressively) would hinder overall economic growth rather than boost it through reshoring of supply chains.

On the other hand, if Trump's stimulative policies such as tax cuts and deregulation outweigh the effects from the inflationary policies, then we could end up with a net positive boost for the U.S. economy. Tax cuts have the potential to help U.S. companies across the spectrum. Deregulation would likely be a boon for the banking industry, which could lead to easier flow of credit and liquidity throughout the system. After all, liquidity serves as the bloodline for the economy. Nonetheless, this will depend on how Trump implements this balancing act.

A widening breadth of economic policy changes has the potential to support the rotation in the market, as previously suppressed sectors and industries could benefit from tailwinds from stimulative policies. While these new policies will likely influence the market and economic activity, the implementation will shape how everything evolves. We will continue to monitor these changing environments and adjust our allocations accordingly.

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