Janney

INVESTMENT PERSPECTIVES

JANUARY 2025

Key Takeaways —

- A look at what will shape the economy in 2025.
- A trip down memory lane to revisit last year's market themes.
- What's ahead? History may hold the answer.

ECONOMIC TRENDS THAT COULD SHAPE 2025

Mark Luschini, Chief Investment Strategist

There are several positive trends shaping the U.S. economy that are likely to carry well into the new year. They include falling inflation, looser monetary policy, and stout consumer spending. Just like in 2024, their evolution will heavily influence the pace of economic activity in 2025 and whether investors can benefit from another year of rising stock prices.

While the deceleration in inflation is not just a 2024 story (after all, it has been declining for two and a half years since its peak in June 2022), it has inched closer to the Federal Reserve's (the Fed) target of 2%. Perhaps equally important is that its glide path lower has been consistent enough for monetary officials to shift from an interest rate hiking campaign to one of rate cutting. Some components of the inflation calculation, however, have remained somewhat sticky at a level that warrants caution that the battle to tame it has been won. Indeed, policymakers at the most recent Federal Open Market Committee meeting penciled in an expectation of a 2.5% rate of inflation for 2025, which was higher than the FOMC's projection last issued in September. Still, unless inflation reaccelerates due to a pickup in demand spurred by fiscal policy or a sudden upturn in consumer or business spending, it is likely that inflation will continue to recede toward a more benign level over the coming quarters.

In the meantime, the Fed has moved to a less restrictive monetary setting while acknowledging the goal of one of its mandates—price stability—has not yet been achieved. The Fed reduced its short-term interest rate three times in 2024 (the first time in September) by a total of 1.0%. While still considered tight, it has not had a deleterious effect on the labor market, a critical support in negotiating a soft landing for the economy and avoiding a recession. At present, Fed officials believe there is room for several more rate cuts in 2025, which, if accompanied by a cooperative trend in inflation, should anchor interest rates within a non-threatening range.

Consumer spending has been bolstered by a sturdy labor market. Although the unemployment rate has risen, it is not uncomfortably high, and job growth is occurring at a reasonably healthy pace. To be sure, employment has softened some, as evidenced by the enormous number of excess job openings that have all but evaporated, and those collecting unemployment insurance are not finding new jobs as readily as in months past. Still, wage gains are accruing above the level of inflation, rising home and equity prices have conspired to drive household net worth to an all-time high, the savings rate has held steady around 4% - 5%, consumer credit facilities are not eliciting nefarious signals, and consumer sentiment has perked up a bit. Altogether, that should sustain the positive impulse consumption has had on the economy over the last year to carry well into 2025.

Investors have been treated by a meteoric rise in stock prices, as 2024 marked the second consecutive year of gains exceeding 20% (as measured by the S&P 500 index, a common stock market proxy). While corporate profits have risen, valuations have climbed faster. About half the increase in the S&P 500 index in the last two years has been due to an expansion of the market's P/E ratio, the multiple investors apply to stock prices above that of

earnings. That has, in turn, driven the market's valuation to a rather demanding level. That tends to invite more scrutiny by market participants when discerning whether economic, corporate, or fiscal news is good enough to justify current stock levels. Usually, that induces bouts of volatility, which we expect more of in 2025, even as economic trends point to fundamental conditions that should help stocks advance once again. ■

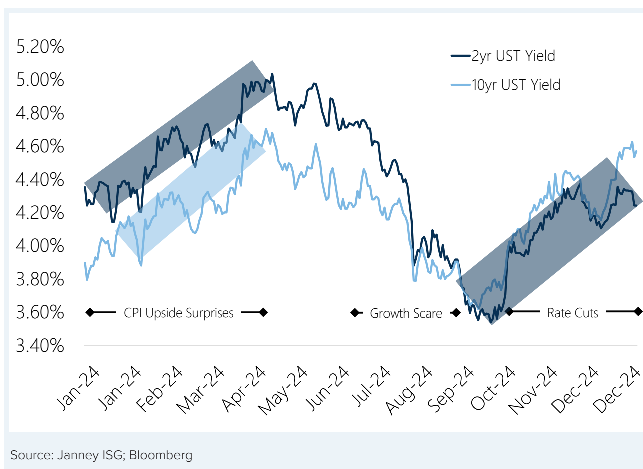
YEAR IN REVIEW

Guy LeBas, Chief Fixed Income Strategist

Once again, we are taking the first Investment Perspectives of the new year to reflect on major market themes from the prior year. The level of interest rates has once again been a defining force in 2024, shaping valuations across bonds, equities, and commodities. While this interplay remains foundational, the nuances of rate-driven market dynamics were particularly striking. In particular, the dominance of CTAs (essentially rules-based trading vehicles) in exacerbating natural market trends was on display. As discussed in Janney ISG's Outlook 2025, we anticipate some continuation of these themes, albeit with narrower trading ranges but more policy risks than 2024's experience.

In early 2024, the Federal Reserve's commitment to a data-driven approach amidst higher inflation prints pushed expected rate cuts later and yields higher. By mid-year, a sharp reversal occurred, driven by (ultimately unfounded) fears of a sharp global economic slowdown. Finally, even as the Fed began to cut, renewed fiscal concerns—exacerbated by record Treasury issuance and the election of a unified government—sent long-term yields sharply higher. The net result? A year marked by oscillations rather than a single trend, leaving 10-year Treasuries to close at 4.57%, up from 3.88% at the start of the year. Short-term yields experienced a similar arc, ending the year at 4.24%, unchanged from 2023's finish. These results were, incidentally, close to our projections released in December 2024 of 4.46% and 4.18% for the 10-year and 2-year note yields, respectively.

Chart 1: Interest Rate Traced Wide Ranges in 2024



Source: Janney ISG; Bloomberg

Despite a wide trading range for the interest rate markets, credit proved remarkably resilient in 2024. We came into the year with spreads on both investment grade (IG) and high yield (HY) corporate bonds below their long-term average and with a constructive outlook. What happened blew that outlook away. Strong corporate profit growth, plentiful liquidity, and moderate issuance had IG spreads tightening to the lowest level in more than two decades by the fall of 2024. HY put in a directionally similar performance, leading both sectors to vastly outperform their Treasury counterparts. In hindsight, we can attribute some of this strong relative performance not to credit spreads improving but rather to the heavy U.S. Treasury issuance, which arguably caused Treasury yields to rise more than corporate counterparts.

Chart 2: Credit Spreads Narrowed to Historically Tight Levels in 2024

Source: Janney ISG; Bloomberg

For 2025, as we discussed in much more depth in the Outlook, we expect that rules-based trading strategies like CTAs will be less of a force but that the U.S. Treasury Department itself will be more of one. The incoming government has a wide range of potential policy proposals, some of which will require heavier Treasury issuance and some of which may stoke inflation or growth fears. While the private sector economy is far more meaningful than public policy choices, in the short term, the wide range of policies under discussion creates a risk for markets that is hard to handicap. Once again, however, the key will be to remain nimble to react to over-extended market moves rather than to guess at them in advance.

A LOOK BACK TO LOOK AHEAD

Gregory M. Drahuschak, Market Strategist

The typically positive month of December had a loss of 2.50%, which was the ninth worst loss for the month since 1950. Nonetheless, 2024 ended with solid gains across most market measures as the S&P 500 posted rare back-to-back 20%-plus gains (24.23% and 23.31%, respectively, in 2023 and 2024).

Some wise advice suggests that you can't know where you might be heading unless you know where you have been. The start of a new year offers time to reflect on where we have been through the last 56 years, which in turn offers a good idea of what might be ahead.

Late 1968 came in the aftermath of the assassination of Martin Luther King, Jr. in April, the Vietnam War's "Tet Offensive," police confrontations with anti-Vietnam War protesters in Chicago outside the 1968 Democratic National Convention, and presidential candidate Robert Kennedy's assassination, which led some publications to call 1968 the most turbulent year in modern American history. **BUT** the S&P 500 ended 1968 at 103.86 with a gain of 7.66%.

Watergate and the eventual resignation of Richard Nixon, two oil crises that rocketed the price of oil and related products higher, the massacre at the Munich Olympics, the Iran hostage crisis, and the Soviet invasion of Afghanistan, plus a severe mid-decade recession provided plenty of turmoil in the 1970s. **BUT** the S&P 500 was at 107.94 at the end of 1979, with a gain of 12.31% for the year, with the index posting gains in seven of the 10 years.

Investors fondly look back at the '80s, but the decade had to endure unsettling elements like the Soviet-Afghan War, the Iran-Iraq War, and the war in Lebanon. On October 19, 1987, "Black Monday" saw the Dow Jones Industrial Average drop 22.6% for the largest one-day stock market decline in history. It also marked the sharpest market downturn in the United States since the Great Depression. **BUT** the S&P 500 ended 1989 at 353.40, with a gain that year of 25.75%. The S&P 500 ended the decade with annual gains in nine of the 10 years and an annual average gain of 13.21%.

The '90s also holds a positive spot in investors' memories, but the decade had its share of concerns. The Persian Gulf War, the Oklahoma City Bombing that claimed 168 victims, which was the deadliest terrorist attack in U.S. history at the time, and a recession tipped off by the culmination of the S&P loan crisis that began in the late 1980s all provided investors with periodic concerns. **BUT** the S&P 500 nearing the close of 1999, was at 1464.47, with a gain of 19.53% and gains in eight of the decade's 10 years for an average annual gain of 16.13%.

The next decade was rocked by the September 11, 2001, terrorist attack. The NYSE and the Nasdaq remained closed until September 17, which was the longest shutdown since the Great Depression. On the first day of NYSE trading after September 11, the Dow Jones fell 7.1%. The close of trading that Friday ended the week that, up to that point, saw the biggest losses in NYSE history. The Dow Jones Average was down more than 14%, the S&P 500 Index dropped 11.6%, and the Nasdaq fell 16%. The second Gulf War added to international concerns, and then the economy and the stock market had to endure the Great Recession, which was the worst economic contraction since the Great Depression. The holiday season in 2009 saw the S&P 500 at 1075.51. **BUT** the S&P 500 ended 2009 with a gain of 23.45% and annual gains in six of the decade's 10 years. Considering the unprecedented events of the decade and respective losses of 10.14%, 13.04%, and 23.37% in the first three years of the decade, the average annual S&P 500 loss of 0.58% for the 10 years felt like relief as investors exited what has become known as the Lost Decade.

The 11.8% average annual gain for the S&P 500 in the next 10 years provided welcome relief even though the decade began at the tail end of the Great Recession. The decade, however, had its share of worrisome items. In October 2017, a mass shooting at a Las Vegas music festival was the deadliest mass shooting in modern U.S. history. North Korea conducted multiple missile tests. France suffered a terrorist attack that killed 86 people. The Boston Marathon bombing was a stark reminder that terrorism remained a major worry. **BUT** the S&P 500 ended 2019 with a gain of 28.88%, as the S&P posted gains in seven of the 10 years for an average annual gain of 11.8%.

For many people, no set of worries tops the pandemic and its fallout, which included a near-total shutdown of the U.S. economy and a massive jump in the inflation rate. **BUT** so far, the S&P 500 has had an average annual gain of 14.84% for the past five years, with only one annual loss of 19.44% in 2022 spoiling the record, as the Federal Reserve raised interest rates nine times between March 2022 and March 2023.

An applicable cliché advises that anytime you read or hear comments separated by "but," ignore everything before the "but." This is why, in the paragraphs above the word **BUT** is capitalized and bold—what comes after the **BUT** (excluding all wars, disasters, and unfortunate human events), financially speaking is more important.

Regardless of what might develop in 2025, remembering the financial lessons of the **BUT**s would be wise.

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