# CURB YOUR ENTHUSIASM?

### A Momentous 2024

There were plenty of reasons for enthusiasm as 2024 came to a close. The S&P 500 saw 57 record highs and closed above 6,000 for the first time. The index surged 23%, following a 24% gain in 2023. Consecutive years of 20%+ gains are not common, with the last occurrence in 1997 and 1998. Prices moved higher as corporate earnings were strong, inflation continued to slow, and interest rates moved lower as the Federal Reserve began easing monetary policy. The investment in and adoption of artificial intelligence, however, remained a main driver of momentum for mega-cap technology stocks and the broader market. This has contributed to a historically top-heavy index with a lofty valuation as the bull market enters its third year.

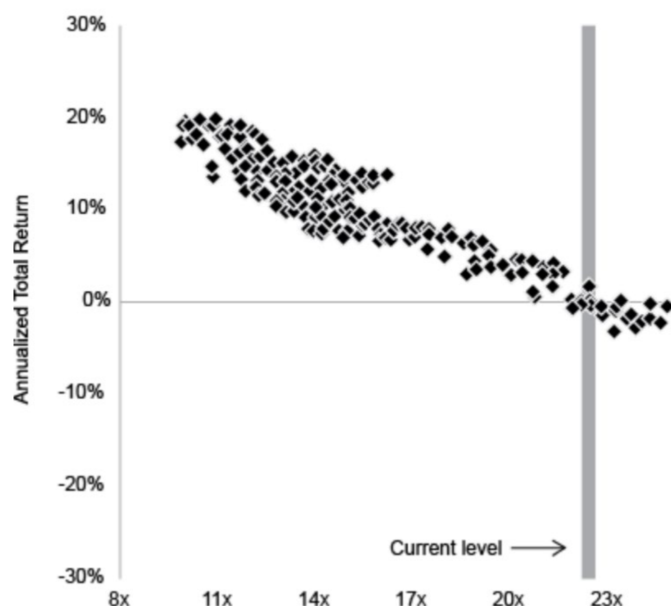
The S&P 500 finished 2024 with a forward P/E of 21.5x versus the 30-year average of 16.9x. This compares to 19.5x in 2023 and 16.7x in 2022, implying notable multiple expansion beyond corporate earnings growth. The weighting of the top ten stocks has reached 39%. For reference, this concentration was at a record ~40% in the 1960's, most recently peaked at ~27% in 2000, and has more than doubled from ~18% in 2015. The performance of the "Magnificent 7" accounted for 55% of 2024 returns. As shown here, this comes after three years of outsized impact from these companies (including 56% of the negative performance in 2022)[i]. This does not imply these were all the best performing stocks, just that their performance has an outsized contribution to the index. Concentration is not bad for the market, rather it is a characteristic of market cap weighted indices and is common in most developed markets. These companies have been rewarded for their technologies and contribute much more to earnings and cash flow growth than the companies that led to the dotcom bust. Looking "under the hood" of the index, only 19% of S&P 500 companies outperformed in 2024. When excluding the "Magnificent 7", the S&P 500 increased 10% last year, in line with the return of the equal-weighted S&P 500 index of 11%, which provides a better indication of typical stock performance.

### A Momentous 2025?

As is the case with momentum-driven markets, whether enthusiasm continues into 2025 may be dependent on potential surprises. Among others, these surprises include policy under a new Trump administration, higher than expected interest rates, and lackluster market returns even if "good news" materializes in 2025.

While a second Trump term likely brings a more business-friendly environment, he is no stranger to causing market volatility with unexpected policy announcements. His tariff, deportation, and immigration policies could push prices higher, with secular trends like deglobalization and supply chain reorganization

having a similar impact. If inflation is sticky or begins to move higher as a result, this may push the Fed to stop rate cuts, pushing stocks lower.




Investor anticipation of lower interest rates has been a key driver of higher valuation multiples and market momentum. The Fed cut its benchmark rate by 25 bps at its December meeting, lowering the Fed funds rate to 4.25% - 4.50%. Since the Fed funds rate was lowered from 5.25% - 5.50% in September, the 10-year treasury yield has moved higher. The 10-year rose from a 2024 low of ~3.6% to ~4.6% by year-end, even as the Fed lowered short-term rates. While this seems counterintuitive, expectations of higher growth, potentially higher inflation, and a high fiscal deficit have pushed long-term yields upwards. Stocks have recently come under pressure as the 10-year yield approached 5.0%, so this level bears watching in 2025.

Lastly, even with supportive policy from Washington, a resilient U.S. economy, and strong corporate earnings, the anticipated "good news" may already be factored into recent performance and the market could surprise to the downside. Rich valuations set the bar high and typically require continued good news to maintain market momentum. The chart here shows the strong relationship between starting valuations (horizontal axis) and subsequent annualized ten-year returns (vertical axis). This implies that higher starting valuations consistently lead to lower returns. The return on an investment is significantly a function of the price paid for it, thus further upside, absent a market pullback, may be limited.[ii]

**Remain Programmatic**

RMC constructs custom portfolios with individual stocks and focuses on risk mitigation and objective-based investing. This provides greater control over what is most important for your portfolio, like income production, diversification, or tax efficiency, all of which are unique to your financial situation. Active portfolio management plays a key role when market concentration and valuations are high. Notably, the S&P 500 has a 10% pullback every 34 weeks on average, yet hasn't seen one in 59 weeks (as of year-end)[iii]. Investing passively in the index can work well in such periods, yet this can lead to a lack of diversification that leaves investors over-exposed in market downturns. The market can remain concentrated and expensive for extended periods and the timing of inevitable corrections is unknowable. It is important to avoid short term prognostications and remain programmatic with your investment plan instead of attempting to "time" the market. This means staying invested when there is market enthusiasm, but especially when there is not. This also means maintaining your contribution or distribution schedule, whether saving for retirement or withdrawing to fund your retirement, and not adjusting them solely around unpredictable short term price swings. Famed investor Peter Lynch aptly summarized this idea with the statement, "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

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[i] JPMorgan Asset Management
[ii] Oaktree Capital Management, L.P. "On Bubble Watch"
[iii] Northern Trust Asset Management

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