Quarterly Market Commentary

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The Open Window

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"I not only use all the brains I have, but all I can borrow."

\- Woodrow Wilson

In the final days of the year, my family and I enjoyed the beautiful Elk Mountains in central Colorado. Surrounded by the snowy, jagged peaks, I was reminded of the climber's mantra – "*The mountains never end.*"

The phrase is intended to humble and inspire, challenging the imagination to figure out how to tackle something so enormous and enduring. It also, however, serves as a cautionary reminder to pace oneself, and to only push for the summit if the conditions allow. Skill, strength, and tenacity are demanded, but so too is evaluating the right temperature, winds, and visibility. Without these in place, the trek can end, quickly.

Looking at year-end market index returns rarely tells the full story. When reviewing the economic, political, social, and geopolitical challenges faced in 2024, the year was marked by many difficult crosscurrents. Declining but persistently high inflation, restrictive monetary policy, hot geopolitical conflicts in Europe and Asia, a weakened but resilient US consumer, and contentious election cycles in democracies across the globe, to name a few. On their own, each posed risk to investors. Taken together, many investors opted to sidestep these risks and sit in cash.

As we always reinforce with our clients, this is why maintaining a long-term view is critically important. By consistently and resolutely focusing on the end objective, whether that be personal, financial, commercial, or professional, the short-term crevasses and cliffs along the journey can be navigated – perhaps not with ease, but certainly with greater clarity – and usually with far greater success.

The Enormous and Enduring US Economy

US economic data remained robust in 2024. When the Federal Reserve began raising interest rates in March 2022, most FOMC committee members and investor commentary focused on the long and variable lags of restrictive monetary policy. Historically, it has taken 12-18 months for the economy to slow following the onset of higher interest rates. Through 30 months of this hiking cycle, however, there has been no evidence of a slowdown.

The primary reason for persistent growth despite higher interest rates is that US consumers and businesses have been far less sensitive to changes in rates relative to history. With 15 years of near-zero interest rates, the majority of consumers and businesses had frequent opportunities to lock in low-rate, long-term debt on mortgages, auto loans, and fixed-rate notes. The rapid rise in interest rates, therefore, only impacted a small subset of consumers and businesses.

While higher-cost debt did present an economic headwind, investment in the artificial intelligence (AI) boom provided a significant growth tailwind. The scope and impact of AI is transformational. Here are a few examples:

- The Magnificent 7 technology companies (Apple, Microsoft, Alphabet, NVIDIA, Amazon, Meta, and Tesla)

invested a combined $50 billion just last year.[1]

- $1 trillion in investment spending is expected across the AI ecosystem over the next 10 years.[2]
- There are currently more data centers in New York City than in the rest of the world combined.

We have yet to see how this massive technological advance will impact the economy (and humanity), but like the advent of the internet 30 years earlier, the knock-on effects will ripple for decades.

Lastly, many market participants have underestimated the impact of extraordinarily supportive fiscal policy. Since the onset of the pandemic, policies such as the CHIPS Act, the Inflation Reduction Act, and the Infrastructure Act have all directed public dollars toward investment and construction activities unlike any period since Eisenhower's Federal-Aid Highway Act of 1956. From semiconductors to alternative energy technologies to repairing our older roads, bridges, and transportation systems, the US has experienced a boom in infrastructure spending.

The darker side of this story is that most fiscal spending – amounting to over $5 trillion – has been supported by the issuance of US Treasury debt. At some point the bill will come due, but for now, the US continues to ride the wave.

As a result of these major tailwinds, the S&P 500 recorded its second 20%+ return in a row – the first time this has happened since the late 1990s.

Quarter To Date as of December 31, 2024[3]	
S&P 500 Total Return Index	2.4%
Dow Jones Industrial Average	0.9%
Nasdaq Composite Index	6.2%
Russell 2000 Index	0.3%
MSCI EAFE Index	-8.1%
MSCI Emerging Markets Index	-8.0%
Bloomberg Aggregate Bond Index	-3.1%

Year To Date as of December 31, 2024[4]	
S&P 500 Total Return Index	25.0%
Dow Jones Industrial Average	15.0%
Nasdaq Composite Index	28.6%
Russell 2000 Index	11.5%
MSCI EAFE Index	4.4%
MSCI Emerging Markets Index	7.5%
Bloomberg Aggregate Bond Index	1.3%

A key takeaway from the data above is the dramatic decoupling between US markets and International markets. Put simply, stimulative fiscal policy, insulation from higher interest rates, and the AI boom were uniquely American phenomena. Europe and Asia largely did not participate, and conversely, have been significantly disrupted by the economic, geopolitical, and security risks at their doorstep. (A too often-neglected feature of our country is its protective natural geography. The security our oceans provide is yet another uniquely American competitive advantage.)

2025 Outlook: Can't Break Our Stride

Despite the ever-present risks, the broader picture remains favorable. US economic strength continues to be underpinned by a resilient consumer. Higher home and stock

[1] Apollo 2025 Economic Outlook
[2] Goldman Sachs
[3] Black Diamond
[4] Black Diamond

prices, increasing wages and job gains, and low-rate debt, all add up to the consumer being in solid shape. Personal consumption expenditures as a percentage of GDP have continued to climb, despite higher interest rates and reduced excess savings from the pandemic. Consumer spending has been broad-based across most categories, with declines last quarter only occurring in electronics and home furnishings. Spending in the services sector – restaurants, travel and leisure, and retail spending – remain at pre-pandemic highs and show no sign of slowing.

As strong as the consumer is, large US corporations may be even stronger. Corporate profits are hovering near all-time highs, and like households, balance sheets are healthy.

Despite our optimistic view, we are always carefully scanning for risks. The primary risk in 2025 is that inflation reaccelerates. With the Fed reducing interest rates by 1.00%, high asset prices, and robust consumer spending, CPI has crept up over the past few months. Additionally, the prospect of tariffs will likely fan inflationary pressures on imported goods.

Following years of relative stability, geopolitics is a growing risk to inflation, investor confidence, and global markets. We live in, and invest in, an increasingly interconnected and complex world. The past five years of pandemic, technological revolution, and war have only reinforced these trends. Three regions of heightened tensions – China/Taiwan, Russia/Ukraine, and the Middle East – each pose a considerable risk to global commodity production, global supply chains, and global trade.

Lastly, concerns about the large and increasing US budget deficit and Treasury debt are beginning to garner more attention. We start the new year with higher net interest costs relative to GDP than any time since World War II. So far, the Treasury market has been resilient, but with the prospect of higher inflation, higher-for longer interest rates, and perhaps even higher deficit spending, risks to a disrupted bond market remain.

The Final Word

Risk, uncertainty, and opportunity are all essential ingredients to successful investing – as they are to any worthy endeavor. As asset allocators, our job is to analyze the information available and assess the opportunities relative to the risk. As we launch into the new year, we contend the window remains open for further advances in markets. Given the outstanding returns for US equities in 2023 and 2024, we do expect volatility to be heightened in 2025. However, for those who accept near-term uncertainty in the pursuit of long-term success, the rewards remain as worthwhile and enduring as ever.

As always, we thank you for your trust and your partnership. We are excited for continued growth and progress together in 2025. We wish you happiness and good health in the year ahead.

Respectfully,

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