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Economic & Market Summary
January 2025

On balance, the US economy exits 2024 on solid footing. Economic growth has belied expectations for a recession or even a slowdown. The labor market is cooling, not collapsing, as labor demand and supply come back into balance. After surging in the pandemic, job openings and the rate of workers quitting their jobs are returning to 2019 levels. Labor force participation for prime-aged workers continued its upward trend in 2024, briefly touching 84.0%, the highest level since 2001. Wages are growing faster than inflation, boosting consumer purchasing power. On a cautionary note, most of the economic strength seems to be coming from high income households while lower income households continue to struggle.

Fiscal policy should remain supportive but with a shift in emphasis toward lower taxes, deregulation, and efficiency and away from targeted subsidies and income support. That said, the government's budget deficit needs to be addressed. It's about 6% of the economy, which is high considering we're neither fighting a major war nor in a recession. If the deficit worsens, bond market vigilantes may decide the US government's credit worthiness has deteriorated and start demanding higher interest rates. Efforts to increase efficiency and tackle the deficit may negatively impact growth in the short-term but should provide long-term benefits. Tariffs could be another headwind since they amount to a tax on consumption. However, we suspect reality will fall short of campaign rhetoric as negotiations with other countries unfold. A crackdown on immigration could disrupt labor markets though there's some sign a reasonable middle ground could be found.

Inflation continued its downward trend towards the Federal Reserve's 2% target. The CPI and PCE price index, two popular measures of inflation, are 2.7% and 2.4% respectively, down from 3.1% and 2.7% in November 2023 and peaks of 9.0% and 7.2% in 2022. We expect this trend to continue albeit slowly and unevenly. Sticky components, housing in particular, have kept inflation elevated, but there's some evidence this could reverse in the near future. Though there's wide regional variation, real-time measures suggest national rents are moderating. Outside of housing, the money supply (as measured by M2) is growing at a rate slower than before the pandemic when fiscal and monetary stimulus swelled the money supply and contributed to the inflationary outburst of 2022-2023. Slower M2 growth should help contain inflation.

While inflation is receding, stronger recent readings and continued economic strength led the Fed to take a more cautious stance on future rate cuts. At the December meeting, policy makers signaled two quarter point rate cuts in 2025, down from four in September. In the Fed's eyes, the balance of risks has tipped away from a recession and towards a resurgence in inflation. Given the strong economy and persistent inflationary pressure, it seems reasonable to take a measured approach.

The S&P 500 finished the year up 25% including dividends driven mostly by the seven largest companies and rising valuations. The forward price-to-earnings ratio is around 22x, which is well above historical norms of mid to high-teens. We're seeing evidence of exuberance such as the runup in stocks associated with AI and the parabolic upswing in cryptocurrency. Given the S&P 500's valuation, unusual concentration, and exuberance, we wouldn't be surprised to see a correction. However, we're still finding pockets of value. Despite some short-term concerns, we remain comfortable owning quality companies at reasonable prices.

Mark J. Sprtel, CFA

If your financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.