Practical | Tactical

December was a dud, but 2024 was a solid year for stocks and our portfolios. The S&P500 index fell -2.4% in December but gained +24.9% for the year. Global stocks dropped -2.7%. Bonds lost -1.7% as yields rose. Declines were significantly worse for small caps -8.4%. Our portfolios declined in line with benchmarks in December but generally outperformed for the year (see charts Page 2).

After 2 solid years, we enter 2025 with stocks nearly priced for perfection. Risk is elevated when valuations are stretched but stocks remain resilient, and we view recent weakness opportunistically. We tactically increased equity exposure into recent weakness, reflecting our optimistic outlook even as we acknowledge that it's premature to call the end of the current pullback/consolidation.

Economic data remains strong. This is constructive for earnings, employment and consumer health but raises concerns about the path of inflation and interest rates. One trigger for recent market weakness was the Fed's acknowledgement that they expect rates to stay higher for longer than prior forecasts. Higher interest rates impact profit margins and slow consumer spending.

We think it's important to note that the economy is complex. Costs and benefits are unevenly distributed. Inflation and interest rates impact businesses and consumers differently from investors. Retirees relying on investment income benefit from higher interest rates while those reliant on credit for significant purchases face higher interest expenses. Both are hurt by inflation, but asset owners benefit from price appreciation while renters have no such luck.

As investors, our goal is to increase purchasing power over time. We invest for both asset appreciation and interest income, seeking the most efficient way to outpace inflation within the context of each client's goals, resources, risk preferences and time horizon.

We welcome any updates, questions or concerns. Open and frequent communication is our best defense against losses in volatile times.

# What to Expect in Portfolios

Last month we wrote: "Seasonal tailwinds persist through year-end. Stocks are due for some consolidation but any weakness would likely be a buying opportunity and we expect to see further gains through year-end."

This proved wrong as the Santa Claus rally failed to lift stocks through year-end.

We also wrote "The reason we remain neutral to our benchmark as opposed to overweight stocks is prudent risk management…"

This paid off, allowing us to incrementally buy into weakness. It's premature to call a bottom, but we expect stocks to remain resilient in 2025.

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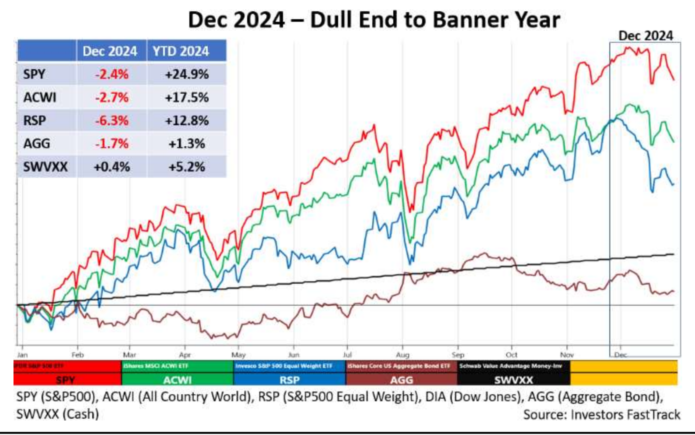
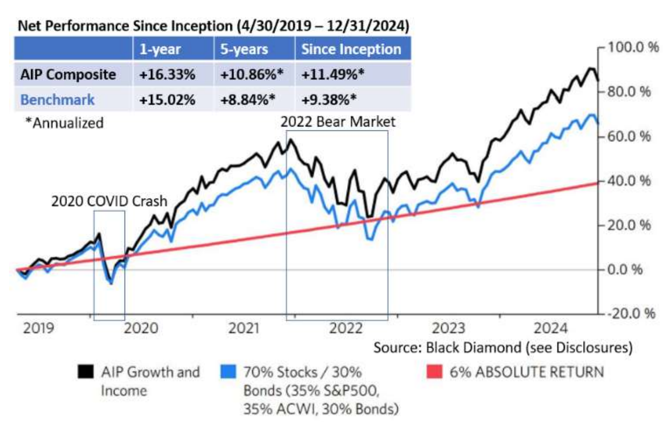
**December was disappointing**, especially for small caps (note the stark difference between equal weight and cap weighted S&P500). That said, **2024 was a great year.**
It helped to focus domestically, favor cash over bonds and maintain significant exposure to large cap tech.

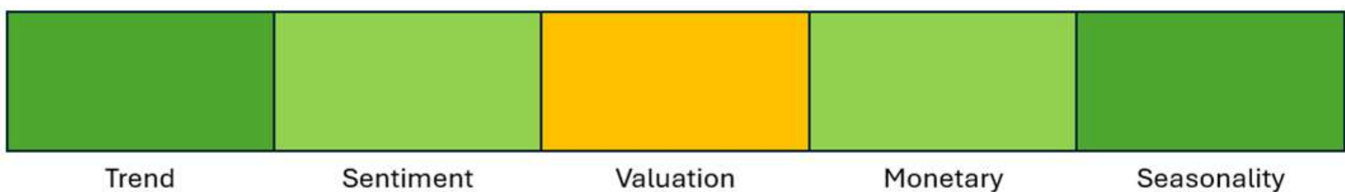
The chart below shows the net performance of our **most popular composite** since inception (120 accounts – see disclosures on page 4). The 5+ years shown have been volatile including COVID and the 2022 Bear market. **Our strategy and discipline led to greater participation in gains than declines, allowing us to add value through this volatile time.**




# Insights and Commentary

*Investing can be an emotional roller coaster, leading to costly mistakes. To navigate effectively as we seek greater participation in advances than declines, we have found it helpful to monitor a series of indicators and models based on 3 key tenants, (Don't Fight the Fed, Don't Fight the Trend, Follow Sentiment Except at Extremes) The tiles below summarize current conditions:*




## 2024 Lessons

**Don't Fight the Fed**: It's natural to second guess the Fed based on economic data hoping to benefit by getting in front of moves. Our experience, however, helps us align with the Fed's overall direction (tightening / easing) and avoid the whip saws that come from overreacting to swings in economic data – at times, using countertrend volatility to buy dips or sell rallies. **Much of the volatility in 2024 was attributed to concerns that inflation was sticky and opinions that the Fed should maintain high rates.**

**Don't Fight the Trend**: Investors are emotional and it's painful to watch one's portfolio decline, especially when negative news headlines / stories reinforce fears by offering plausible explanations often alongside dire outlooks. **2024** included wars, political conflict/uncertainty, yet **serves as a reminder that it is much more profitable to monitor and align with market and leadership trends and assume most news events are widely known** and therefore priced into markets very efficiently.

## 2024 Leadership

**Large Caps stocks continued to outpace small** by a wide margin, especially in December. This is partly attributable to a large percentage of unprofitable small companies that may prove dependent on low interest rates. Profitable small caps and mid-cap value stocks are interesting, especially if America First policies increase demand for domestic production.

**Growth dominated Value**. If economic growth slows, this may continue, but if economic growth sustains or improves, value stocks offer an interesting opportunity.

**Foreign stocks were more assertive in 2024 but failed to keep pace with US stocks.** We expect this to continue despite foreign valuations that are increasingly compelling.

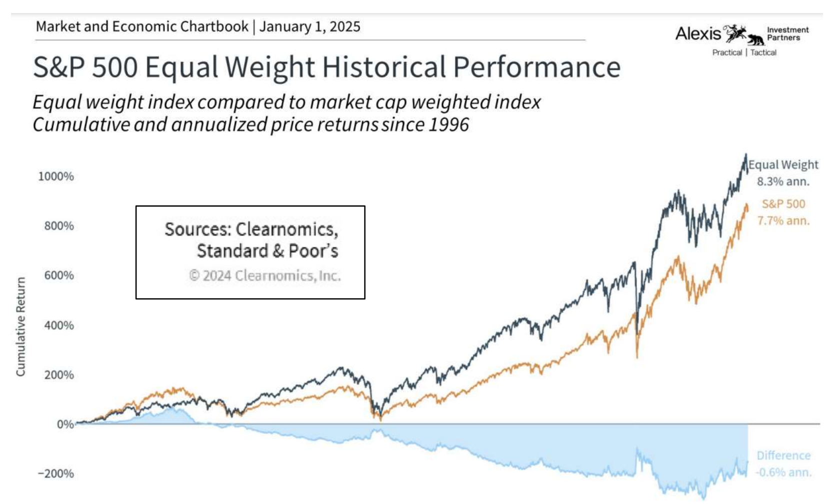
**Cash beat bonds in 2024 as yields rose.** There is roughly $6 Trillion in money market funds. We believe lower cash yields may prompt a rebalance into higher yielding bonds and potentially into stocks.

## Update, Observations, Indicators and Outlook:

In terms of our current Market Pulse (right), **the Bull Market remains intact.** That said, December weakness was broad and significant.

**Pullbacks are normal** and typically happen several times per year. Some deteriorate into corrections while others serve to consolidate outsized gains. **We believe the current pullback is a healthy consolidation** but can't know for sure until it runs it course (leading to new highs or a fresh breakdown).

It may surprise some of you to know **the equal weight S&P500 has outpaced the more widely known cap-weighted index over the long-term.** The chart below shows 1996 to present.




**We see several parallels between today and the late 1990s.** Valuations are high, leadership has been narrowly focused on large cap US tech / growth stocks, interest rates are approaching similar levels, volatility is increasing as stocks soar.

The themes that drove the late 1990s boom (internet and globalization) proved fruitful to long-term productivity but investors who anchored their portfolios to leading tech names at sky-high valuations paid a horrible price.

**The late 1990s tech boom was followed by a period favoring value stocks, small caps, REITs and gold. It's worth noting that these asset classes did relatively poorly throughout the tech boom** – like what we've seen over the past few years, but even more extreme. We continue to like leading tech names but believe an eventual broadening of leadership is inevitable if not imminent.

We appreciate your confidence and welcome any feedback.

## Market Pulse:

*We try to avoid jargon, but a few terms are helpful when describing financial conditions.*

**Bull Market**: markets trending up (making higher highs on rallies and higher lows in periods of decline). **We can expect periodic pullbacks and corrections, but these should be relatively short and shallow – followed by resumption of the up-trend.**

**Consolidation**: after a period of strong gains or steep declines sometimes markets become range bound, moving up and down by 3-5% over several weeks. After consolidation, the prior trend resumes.

**Pullback**: a decline of 3-5% that generally happens at least twice per year. Pullbacks often resolve within a few weeks.

**Correction**: a decline of 5% to 10% that typically happens once per year. Like pullbacks, markets recover quickly after corrections, generally within 3- 6 months.

**Bear Market**: a decline of 20% or more. Many bear markets are fully recovered within 18- 24 months, but severe bear markets like 2000-2003 and 2007-2009 can take 5-7 years or longer to recover from.

**Bottoming Process**: After a correction or bear market, stocks often bounce and re-test lows multiple times before recovery.

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## Closing Comments:

Several clients have recently been speaking with friends who are looking to make a change either because they are nearing a life transition or have been unhappy with their current advisor.

We appreciate your referrals and are pleased that our company continues to enjoy steady growth. Our focus is always on providing exceptional service and performance and we are very grateful for your confidence and support!

Although our focus is on financial planning and investments, we also have relationships and resources to help with life and LTC insurance and annuities.

AIP acts as a 3(38) Fiduciary Advisor to 401k plans and has been able to help several small business owners reduce costs, significantly improve their plans and offload some of their liability as plan sponsors while creating a better experience for employees.

Please call and/or email me personally for most of your account servicing needs and especially when you have questions or concerns.

*Disclosures*

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