J.W. Burns & Company

Investment Counsel

Quarterly Update and Annual Outlook

January 2025

Market Retreat Or Three-peat?

"It will fluctuate." - J.P. Morgan's answer when asked what the market will do.

Dear Clients and Friends,

2024 was a very good year for stocks, with all the major U.S. market indices finishing with double digit gains. The leader again was the S&P 500 Index, which ended 2024 with a 25% gain, driven by the "Magnificent Seven" technology stocks. The Dow Jones Industrial Average returned a solid 15%, while small and mid-cap stocks were up 11% and 15%, respectively. International stocks disappointed on an absolute and relative basis, with The Vanguard Total International Stock Market Index up 5.08%. Overall, we were quite pleased with our investment performance and remain optimistic that 2025 could be another good year for stocks – with higher volatility likely.

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Like 2023's rally, the S&P 500's strong showing in 2024 was largely driven by the excitement over artificial intelligence, as chipmaker Nvidia, which quite literally powers the transition to an AI centric future, surged 171% in 2024.[1] In fact, according to Howard Silverblatt, an index analyst at Dow Jones, Nvidia's return alone contributed more than 22% of the S&P 500's overall return.

Because the S&P 500's index is market cap weighted, the large technology companies that comprise the "Magnificent Seven" have an outsized impact on the broad market's total return. In fact, the largest ten companies in the S&P 500 index now represent 40% of its total value, and the "Magnificent Seven" alone was responsible for over 50% of the S&P 500's gains in 2024, according to Citigroup.

The concentration of the "Magnificent Seven" within the broad S&P 500 Index does represent a risk to the markets, especially if we see a material slowdown in AI spending – a distinct possibility. No question, these are hugely profitable businesses that are the key beneficiaries of the AI buildout, and your portfolio has solid exposure to the leaders within this industry. At the same time, we will continue to maintain reasonable diversification by positioning durable growth stocks along with index funds within your portfolio to mitigate AI concentration risk.

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In my January 2024 client letter, I was bullish, but not bullish enough. (I'm hoping for the same again this year). Final U.S. GDP results for 2024 are expected to come in at 3% growth – an impressive showing – earnings growth of S&P 500 companies is forecasted to finish 2024 around 9%, and interest rates during the year remained stable. Finally, the U.S. Presidential election was decided promptly and without controversy. It was a year in which almost anything that mattered to the stock market went right.

Also, in January of last year, my forecast of three interest rate cuts was well below the Wall Street consensus of six interest rate cuts; my bullish view then was based on corporate fundamentals – specifically earnings growth – not interest rate cuts. The Fed did in fact cut rates only three times, 50 basis points in September and 25 in November and December. This reinforced my often-stated principle that it is earnings power, not interest rates, that is the dominant driver of stock prices.

"Our view for the stock market in 2025 - that material interest rate cuts are not necessary for a robust stock market if the economy and corporate earnings remain resilient."

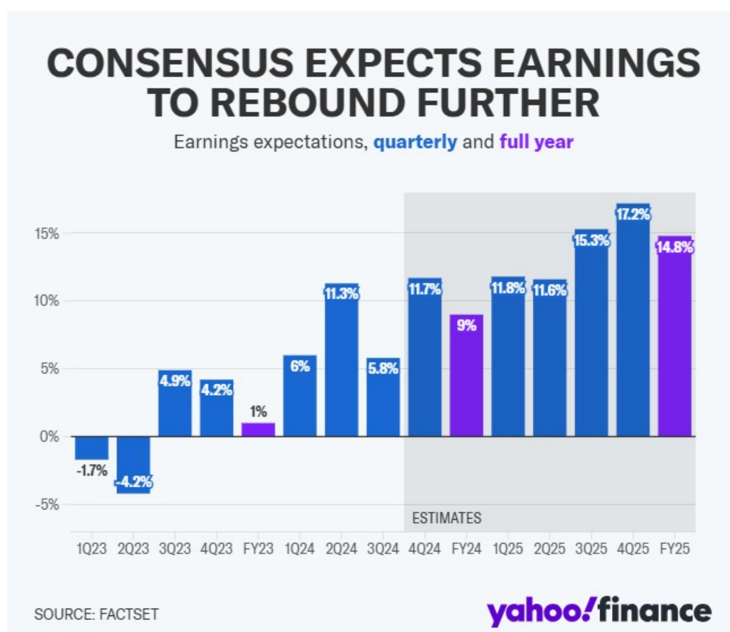
So, my view for the stock market in 2025 is similar to that in January 2024 – ***that material interest rate cuts are not necessary for a robust stock market if the economy and corporate earnings remain resilient.*** And I believe they will.

Here's why.

First, the U.S. has strong economic momentum as we start the new year. Chances for a recession heading into 2025 are quite low – standing at around 20% at the time of this writing per consensus, far lower than where we stood at the start of 2023 or 2024.[2] Consumer spending is up 4% over the last 12 months, the Purchasing Managers Index for both manufacturing and services came in better than expected, and GDP growth is expected 2.5% in 2025.[3] Most everyone who wants a job has one, and wages are now rising faster than inflation.[3]

Second, while I believe the Fed will probably be on the sidelines for much of the year, their stance towards monetary policy is likely to be more accommodative and supportive of the economy than in recent years past. The consensus forecast is for two quarter point interest rate cuts for the full year of 2025, and I'm comfortable with that. We'll see.

Finally, though valuations in the market are elevated, earnings growth continues to exceed expectations. Steady economic growth, falling inflation, and AI productivity gains are all boosting corporate earnings power.[4] In fact, corporate profit margins in 2025 are expected to average a near record 12% and full year earnings growth is expected to be 15%. See the chart below from FACTSET.



Our thoughts on Trump 2.0 - on November 4, Donald Trump won an electorally decisive victory and will return to the White House this month. Investors initially cheered the election's results, with the market popping 7.74% in November. December was another story, however, with the Dow falling over 5% to end the year as investors grew a bit nervous over some of his proposed policy changes.

I view a second Trump administration as a mixed bag with a positive tilt for stocks. On the one hand, President-elect Trump returning to the White House will bring a more business-friendly atmosphere, and I would expect 2025 to see a flurry of deregulation, tax cut proposals, and mergers and acquisitions activity. This should bolster investor confidence to support equities.

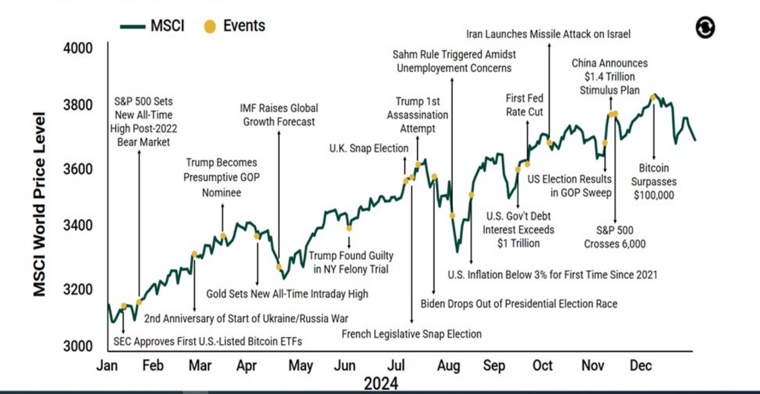
On the other hand, President-elect Trump's policies on trade, tariffs, and immigration are on the surface inflationary. And a resurgence in inflation is the biggest risk to the stock market in 2025. Simply put, higher inflation, leading to higher interest rates, certainly could derail this bull market.

Indeed, as I write this on January 10, the Dow is down over 600 points and starting the year in the red, specifically on a stronger than expected jobs report. While emblematic of a robust economy, it reinforces that inflation remains sticky.

No question, after logging two consecutive 20% annual gains for the S&P 500 Index, valuations are rich, and the margin of error for this market is slim. I would expect 2025 to be a transition year - from an incoming Trump administration with a complex set of policy goals as well as a broadening out of the market's strength, with less reliance on the "Magnificent Seven" technology stocks and more muted returns than we have experienced in the last two years.

They say a picture is worth a thousand words. Well, the chart below shows what usually happens every year – ***surprises and sensational headlines that can impact markets in the short run.*** 2024 witnessed two assassination attempts of Donald Trump, Iran launching a missile attack on Israel, the United States interest on the national debt exceeding $1 trillion, among others. And yet the beat goes on.

Exhibit 1: 2024 Was Not a Quiet Year in Headlines



It's important to recognize that 2025 will have its own set of surprises. One of Donald Trump's strengths – or weaknesses – is his unpredictability. Expect this trait to impact the headlines and inject volatility into the market. The most important thing, as always, is to stay focused on your long-term investment plan.

So, my answer to the title of this Client Letter: "Market Retreat or Three-peat" is probably somewhere in the middle. I think another 20%+ return in the S&P 500 Index is unlikely, however, I do believe that, absent a resurgence in inflation, the broad stock market can generate a solid mid-to-high single-digit return.

In summary:

- There is risk in the high concentration of the ten largest stocks in the S&P 500. A top-heavy market could exacerbate any market correction.
- The U.S. economy is strong and expected robust earnings growth can drive stock prices higher in 2025.

- A resurgence of inflation, and ultimately interest rates, is the biggest risk to markets in our view.
- Expect higher market volatility in 2025, uncertainty with Trump 2.0, and remember to keep focused on your long-term investment plan.

Finally, to close, we are pleased to share that we were voted as Central New York's Reader's Choice Best Investment Firm in Syracuse, New York. This included votes from readers of the Syracuse Post Standard, Syracuse.com, and local news social media. We were honored to receive this recognition and, most importantly, we will continue to work hard to be the best investment firm for you, our valued clients.

Thank you for your continued confidence, and Happy New Year!

Best wishes,

Jim

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J.W. BURNS & COMPANY, INC.

INVESTMENT COUNSEL
Important Disclosure Information

1 Statista. Nvidia Carried the S&P 500 to New Highs In 2024. 02 January 2025.
2 Forbes. Recession Risk for 2025 Is Estimated To Be Low. 07 January 2025.
3 Goldman Sachs. Outlooks Global Economic Growth. 15 November 2024, LPL Financial, Will 2025 Be Good for Stocks. 30 December 2024., and Trading Economics.
4 LPL Financial. Will 2025 Be Good for Stocks. 30 December 2024.
5 BlackRock. 2025 Global Outlook. January 2025.