First Citizens Wealth™

Making Sense

December 16, 2024

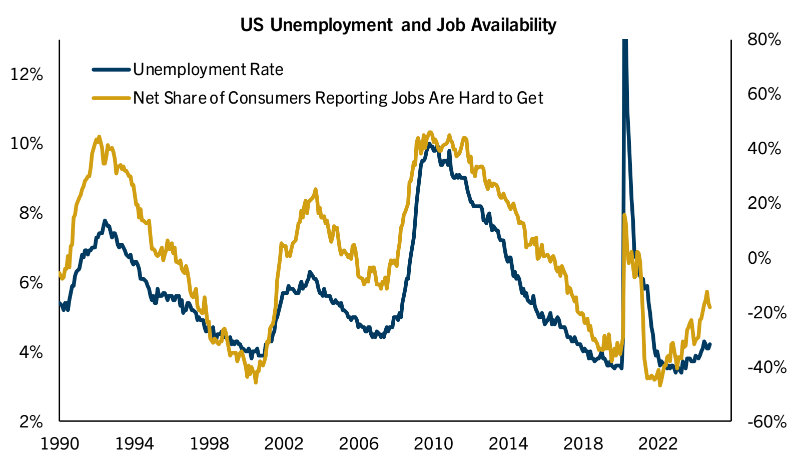
2025 Market & Economic Outlook

1. Fundamentals: Still in Place?

The US economy and financial markets proved resilient this year. Many expected economic growth would falter in 2024 and market returns would disappoint. But going into 2025, many fundamental factors remain in place: the labor market is still healthy, GDP growth is outperforming, and corporate earnings are strong.

We see plenty of reasons for this resilience to continue next year, but with markets already pricing in another strong year of economic and corporate earnings growth, there is little room for error in 2025. For example, economists forecast unemployment will be unchanged next year at around 4.2%, and market strategists expect corporate earnings will grow at a strong 15% pace. A repeat of 2024's resilience is certainly possible but likely only if these fundamental factors remain strong even in the face of any unexpected headwinds 2025 may bring.

Exhibit 1: After Holding Up in 2024, the Labor Market Is a Wild Card Next Year



Source: Bloomberg

The post-pandemic inflation surge remains unresolved, with several inflation metrics still printing significantly higher than the Federal Reserve's 2% target. And while the annual inflation rate has come down significantly from its peaks (see the bars in Exhibit 2), price levels remain elevated and have outpaced wages since 2021. **We are optimistic that inflation can continue its trend down to the Fed's 2% target next year, but like the labor market and corporate earnings examples above, there is little room for error on this metric as any further upside surprise to inflation would likely disrupt markets that are priced for good news.**

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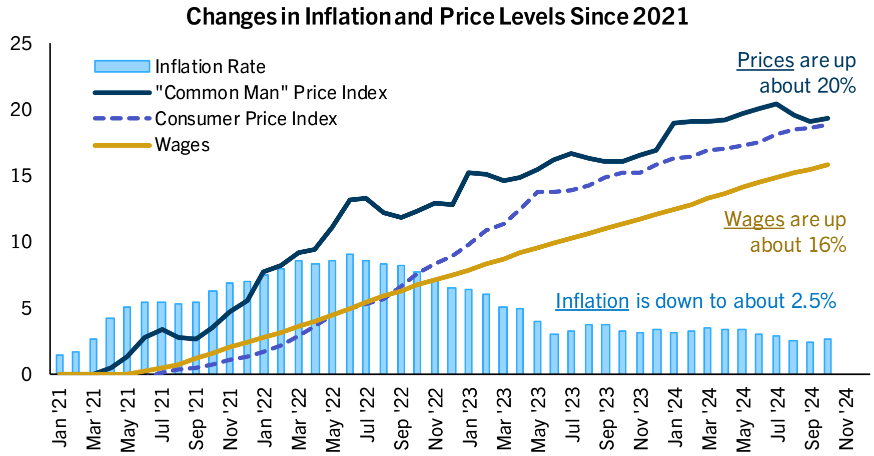
Watch the **2025 Market Outlook** discussion.

Exhibit 2: Inflation Is Still Elevated, and Price Levels Are High



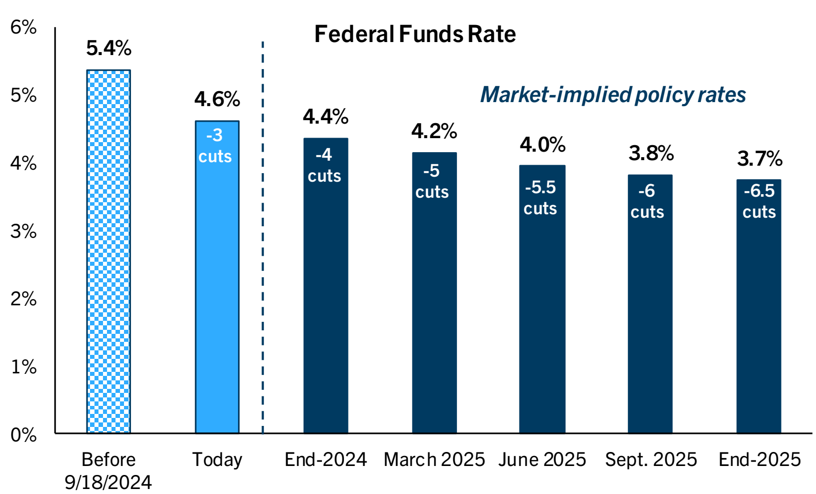
Source: Bloomberg, Strategas

2. The Fed May Slow the Pace of Rate Cuts

We were skeptical this year when markets priced as much as 2.5% in easing (10 quarter-point cuts) to the Fed's policy rate. Such steep cuts seemed more befitting a recession than the "midcycle adjustment" the Fed was looking to pull off. **Going into 2025, markets expect the Fed will shave a total of roughly 1.5% (6 quarter-point cuts) from its peak, which we think is more reasonable given recent economic and financial resilience.**

Next year, Fed policymakers will likely be more cautious wielding their rate cutting tools. It is less clear now that the Fed's policy is restrictive, and inflation is not moving obviously closer to 2%. Markets may focus on the base-case outcome of 2-3 more cuts, but it is also important to consider the tail risks. If 2025 kicks off with firmer data, like last year, the Fed could signal a pause in their rate cuts altogether. And if the labor market falters, like it did in August, the Fed could move back toward an accommodative policy stance. The outcomes are far from clear, but it is apparent that policymakers will operate on a month-to-month basis, and guidance and market expectations will fluctuate, potentially significantly.

Exhibit 3: Markets Expect the Fed to Cut Rates 2-3 Times Next Year

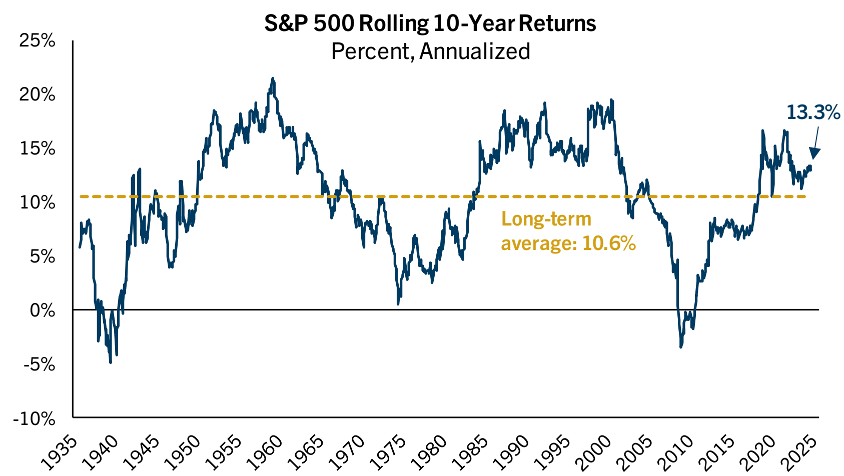


Source: Bloomberg

3. We Expect Lower Future Returns from Here

Multiples remain elevated—not a good indicator of near-term return but much better over longer-term. We expect lower returns over the next decade than the last (13.3% annualized trailing 10 years). **Does that mean an investor should flee equities? No. It means diversification is key.** Even in the lost decade (2000-2009), during which the S&P 500 had a -1.0% annualized return, strategies with diversified asset classes (i.e. mid-cap, small-cap, international, fixed income) outperformed.

Exhibit 4: Recent Years' Stock-Market Returns Have Exceeded the Long-Term Average



Source: Strategas

Our updated S&P 500 price target is 6,400, representing a roughly 6% upside from the current index value. Our base case assumes a modest downward revision to next 12-months earnings estimates, followed by moderately above average earnings growth the following year. We are assuming the price-to-earnings multiple is somewhat stable. **Our price target represents modest returns over the next 12-months, but we do expect more volatility in the interim as markets digest both fiscal and monetary policy uncertainty. We might be cautiously optimistic but do not expect a repeat of 2024's remarkable return.**

Exhibit 5: We Expect Modest S&P 500 Returns Next Year in Our Base Case

Next Twelve-Month S&P 500 Price Target

	NTM Price Level	Percent Change from 12/9/24
Bear	4,600	-24.0%
Base	6,400	5.7%
Bull	6,900	14.0%

Source: First Citizens Wealth

4. Portfolio Balance Remains Essential

Given the level of fixed income yields, balance in a portfolio is much more attractive today. Using a hypothetical two-security portfolio of the S&P 500 and the US aggregate bond index, a portfolio of 80% stocks and 20% bonds returned 11.0% per year over the last decade while a portfolio weighted equally with stocks and bonds returned a lower but still healthy 7.4% per year. Given consensus long-term capital market assumptions[i], these same hypothetical portfolios are poised to deliver more balanced returns over the next decade. An 80:20% hypothetical portfolio would return 6.2% given consensus assumptions, whereas a 50:50% portfolio would return 5.7%, a far tighter spread than what investors experienced over the prior decade. **Portfolio balance consistent with investors' goals and objectives is always important, but looking over the next 10 years, it might be even more essential than during the recent past.**

Exhibit 6: Portfolios Could Deliver More Balanced Returns Over the Next Decade

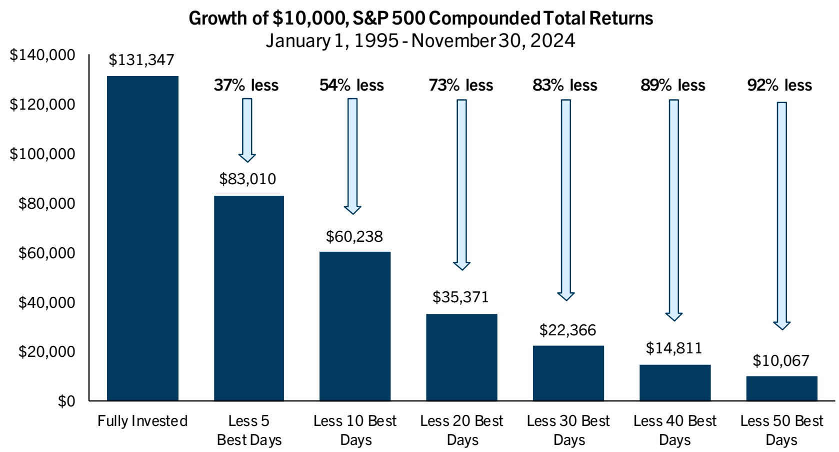
	10 years ended Nov. 2024	Next 10 years*
80:20% US Portfolio	11.0%	6.2%
50:50% US Portfolio	7.4%	5.7%
Annualized Spread	**3.6%**	**0.5%**

Source: Horizon Actuarial, First Citizens Wealth

5. Market Tenets to Remember

Time in markets, rather than timing markets, pays-off in the long-run. As Exhibit 7 shows, if one invested $10,000 in 1995 and simply let it grow, compounded return yielded a balance of over $131,000 as of November 30th of this year. If an investor missed just five of the best trading days over this 30-year period, the value of their portfolio is 37% less, at $83,000. If the investor attempted to time the market and was on the sidelines for each of the 20 best days of market returns, the value of their portfolio would be 73% less, at $35,000. How is this possible? As Albert Einstein is credited as saying, **"Compound interest is the eighth wonder of the world. He who understands it earns it; he who doesn't pays it."**

Exhibit 7: Time in Markets Matters



Source: First Citizens Wealth

i Horizon Actuarial, "Survey of Capital Market Assumptions: 2024 Edition."

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