Wellington Shields

A NEW YEAR

The S&P 500 returned 2.4% for the fourth quarter of 2024 and over 20% for the year. Once again, most of the outperformance was in a handful of stocks known as the “Magnificent Seven”. On an equally weighted basis, the S&P 500 rose 13%. Unique to the year was the weakness during the last two weeks, or the lack of the “Santa Claus Rally”—primarily caused by an apparent shift in Federal Reserve policy, and a rise in interest rates.

At the Federal Reserve’s December meeting interest rates were lowered by 25 basis points, as expected. However, the statement and accompanying forecast of future rate cuts was anything but dovish. While only several weeks ago forecasters were expecting three or more rate cuts in 2025, the Fed forecast only one, indicating a renewed emphasis on fighting inflation, rather than unemployment. Could the Fed’s policy change be frontrunning the new Administration’s tax and revenue proposals, which are perceived to be more inflationary?

The U.S. economy appears to have grown at a 3% annual rate in 2024—a healthy rate, if sustainable. While stable growth is always welcome, we believe there are several reasons to be cautious about the outlook. Rates on 30-year fixed-rate mortgages are now well-above 7%, causing a sharp falloff of residential construction activity. Manufacturing has been struggling for quite some time and manufacturing capacity utilization has been contracting since 2022. State and local spending, which has lifted GDP growth over the last year is poised to moderate, and the U.S. Dollar exchange rate has surged, making U.S-produced goods less competitive.

It is too early in the year to hold firm convictions about 2025. Most market forecasters believe S&P corporate profits will advance on the order of 12%, yet most economists see a slowing in U.S. GDP growth to around 2%. A lot depends on the passage and ultimate success of the new Administration’s tax and spending policies. High interest rates are not good for the economy or corporate profits, and the growing budget deficit eventually must be addressed. There is great promise, however, in the concepts of reshoring, infrastructure spending, increased domestic production, and artificial intelligence applications. We expect 2025 will be a positive year for investors, but with more volatility than the one just ended.

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