



January 17, 2025

Quarter Ending December 31, 2022

<u>Quarterly Performance</u>	<u>Q4 Index</u>	<u>YTD</u>	<u>Close</u>
Dow Jones Industrial Average	.51%	12.88%	42,544.22
NASDAQ Composite Price	6.17%	28.64%	19,310.79
Standard & Poor's Averages	2.41%	23.31%	5,881.63

In Q4, the equity markets continued to gain strength and capped off another strong year for the S&P 500, which finished up 2.4% for Q4, helping the index continue its five-quarter streak of positive returns. Developments in Washington, D.C. helped fuel the rally in the second half of 2024. The Federal reserve has cut its benchmark interest rate by a full percentage point since September, boosting confidence that the U.S. economy can sustain its recent growth. Stocks also rallied sharply following Donald Trump's election win in November with the prospect of deregulation and corporate tax cuts. Another key driver of performance was the continued enthusiasm surrounding AI and its potential productivity boost for the world economy.

Despite the strong annual performance and start to Q4, the year's finish was much more subdued. The Federal Reserve threw some cold water on the markets at their December meeting. They signaled plans to reduce rates only twice in 2025, a more conservative approach than the four rate cuts previously anticipated. Despite the strong year-to-date performance, equity indices struggled in December's final days, with investors taking profits. For December, the S&P 500 fell 2.5% and the Dow Jones Industrial Average ended the month down 5.3%. The S&P 500 ended the year with four-straight down days for the first time since 1966. More dramatically, the Dow entered the history books in December with its first nine-day losing streak since 1978.

As we move into 2025, we expect the market volatility to continue. The stock market starts 2025 at lofty valuation levels as the S&P 500's forward price-to-earnings ratio sits well above its historical average. Currently, the S&P 500 has a forward PE of 22.3. That is a material premium to the five-year average of 19.7 and 10-year average of 18.1. According to FactSet research, the stock market has not been this expensive since April 2021.

In fact, the S&P 500 has only reached a forward PE ratio above 22 during two periods since 1985. The first was the dot-com bubble of the late 90s. After valuations peaked in March of 2000, the S&P 500 ultimately declined 49%. The second was the Covid-19 pandemic. After peaking in January 2022, the S&P 500 eventually declined 25%. This may not seem like a dire warning, but remember: markets can trade a lofty valuations for extended periods of time. During the dot-com bubble, the forward PE multiple drifted above 22 in 1998 and stayed above that level for about three years. That said, markets always come back to normalcy and will trade based on fundamentals and rational valuations.



We'll end with a silver lining for our readers. In October, Goldman Sachs updated its 10-year outlook for the S&P 500. Analysts expect the benchmark index to generate a total return of 3% annually during the next decade, well below the long-term average of 11% annually. Although gloomy, Goldman attributed the outlook to historically high valuations of a handful of companies. Analysts wrote, "The premium valuation for the top 10 stocks is the largest since the dot-com boom in 2000." The good news? That means the other 490 stocks are priced more attractively, which implies there are still lots of investment opportunities. Consequently, Goldman analysts estimate an equal weight S&P 500 index will return 8% annually in the next decade. In short, the 10 largest stocks, with the highest valuations, will struggle to outperform in the coming decade.

Lastly, for those of you who don't know, we have moved our offices from Wayzata to Minnetonka. We are currently in our new building but working out of a temporary office while our new space is under construction. Once we are settled in our new space, we will send out our new mailing information. Our email and phone numbers are the same and will not change.

We wish you a happy and healthy New Year, and if you have any questions or thoughts, please reach out to us!

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