Happy holidays & new year! The 2024 year has been a rewarding one for investors with truly exceptional returns in the domestic equity market in particular. As the calendar turns to 2025, it's natural to contemplate what has been and re-evaluate the outlook. As I went through this exercise, the following observations struck me as notable. While certainly not an exhaustive list, I hope you find these thoughts and charts helpful as you consider your asset allocation and portfolio positioning for the year ahead.

Hope you have time to rest and reflect on the blessings in your life over the holiday season and wish you and your family a prosperous new year!!

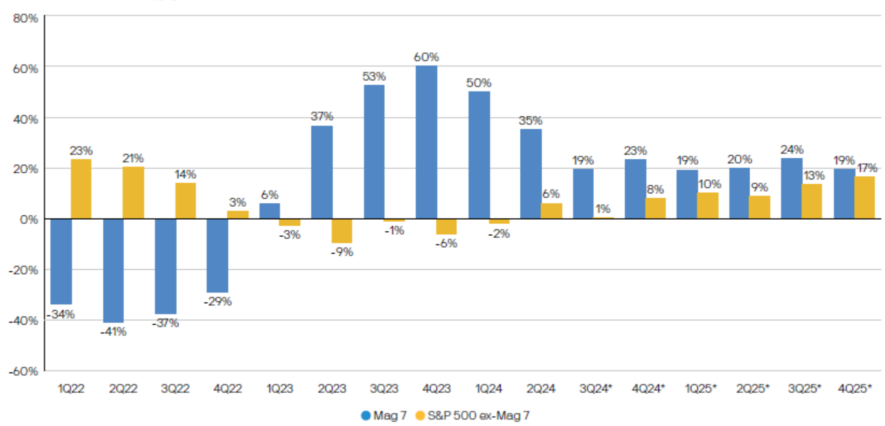
Matthew Hekman
Portfolio Manager

Earnings Recession likely over

The economy has weathered a difficult season of confusing crosscurrents. While most of the market has seen earnings contract as inflation impaired consumer spending and corporate profit margins, the tech sector is in the midst of a historic boom largely driven by spending to enable the use of artificial intelligence. Looking forward, there is growing optimism that earnings growth for the broad market will improve aided by the combination of Fed easing, deregulation and corporate tax cuts.

As Mag 7 earnings growth decelerates in 2025, the rest of the market catches up

Exhibit 3: Pro-forma EPS, y/y



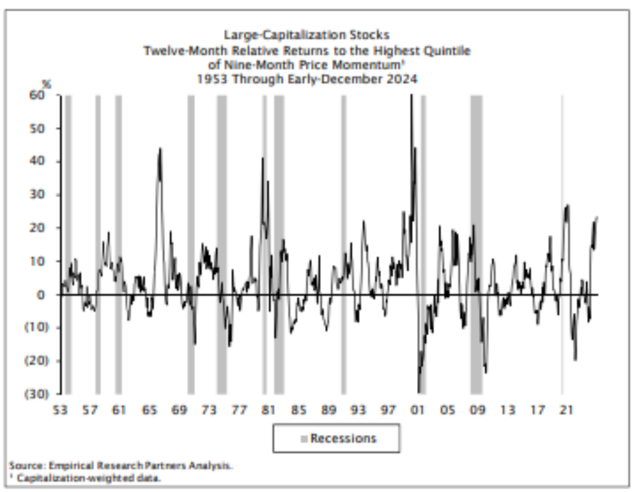
Source: FactSet, J.P. Morgan Asset Management. *Numbers are forecasts based on consensus analyst expectations. Data are as of November 15, 2024. Magnificent 7 includes AAPL, AMZN, GOOG, GOOGL, META, MSFT, NVDA and TSLA. Earnings estimates for 2024 are forecasts based on consensus analyst expectations.

Valuation will limit return potential for equities in 2025

A lot of anticipated good earnings news is embedded in the valuation of large cap stocks. The S&P 500 is up ~30% while the earnings of its constituents have posted a gain of ~8%. The current consensus forecast anticipates ~12% earnings growth in 2025 which suggests that any disappointments could prove costly as investors adjust both earnings and the earnings multiple lower. On the other hand, if investors' optimism is proved correct, the 'reward' is likely to be modest unless the earnings outlook is meaningfully better than already elevated expectations.

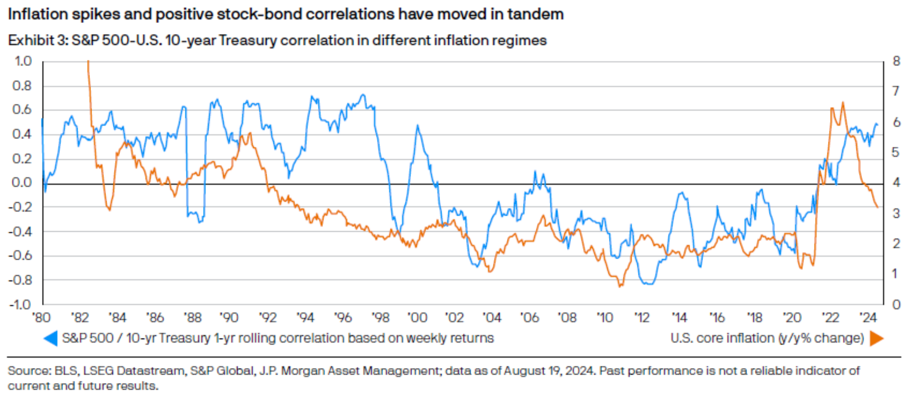
Momentum likely loses it's 'MO'

The Momentum Factor has been on an epic run in 2024 with the current streak ranking amongst the best in the last 70 years. This year's performance is comparable to the Meme Stock Mania in 2021; the Tech Bubble in 1999; and the Nifty 50 era in the late 1970's. The probability of that streak of outperformance continuing into 2025 is very low. History suggests that this factor is likely to surrender some of its relative outperformance over the next 12mo's. The value of diversification is likely to be reinforced in the year ahead.



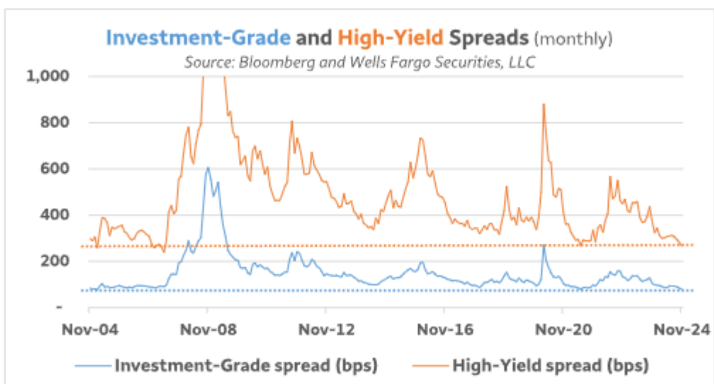
Stock / Bond Correlation will normalize

It has been a difficult and frustrating three years for fixed income investors. After several decades of falling interest rates, the pernicious effect of rising interest rates on fixed income securities was made painfully clear. In addition, as inflation rates spiked and remained elevated, the correlation of stocks and bonds flipped to positive, undermining the assumptions embedded in long term financial planning. As inflation rates fall, this relationship should normalize, reducing volatility for mixed asset portfolios.



Fixed Income Markets are Confident in the Outlook

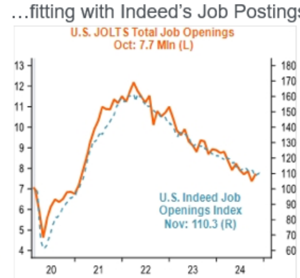
Credit spreads are behaving consistently with the equity market, exhibiting confidence in the outlook for corporate financial health. Spreads have consistently tightened since 2023 and are at levels that are quite low relative to history. The confidence seems well-placed and the yield levels are attractive from a historical perspective. However, given the starting point on credit spreads, any disappointments would be unwelcome.



Employment will weaken further, supporting further Federal Reserve rate cuts

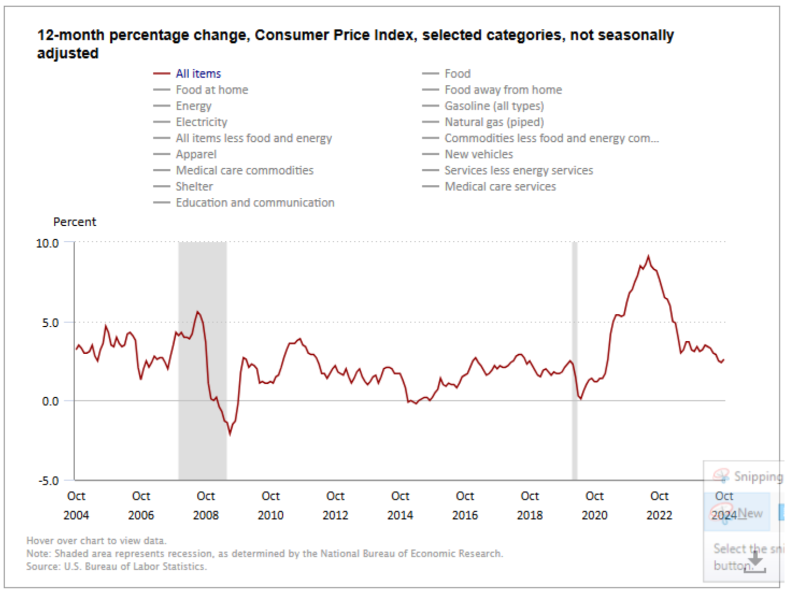
After a strong recovery in 2021 and 2022, employment is weakening. As economic growth has slowed and uncertainty has risen, employment trends have clearly softened. While unemployment claims have been subdued, employment growth has deteriorated. It is likely that risks to the labor market will increasingly be a factor the Federal Reserve weighs as it sets short-term interest rates.

…fitting with Indeed's Job Postings Index.



The outlook for Inflation is less clear…and could be problematic

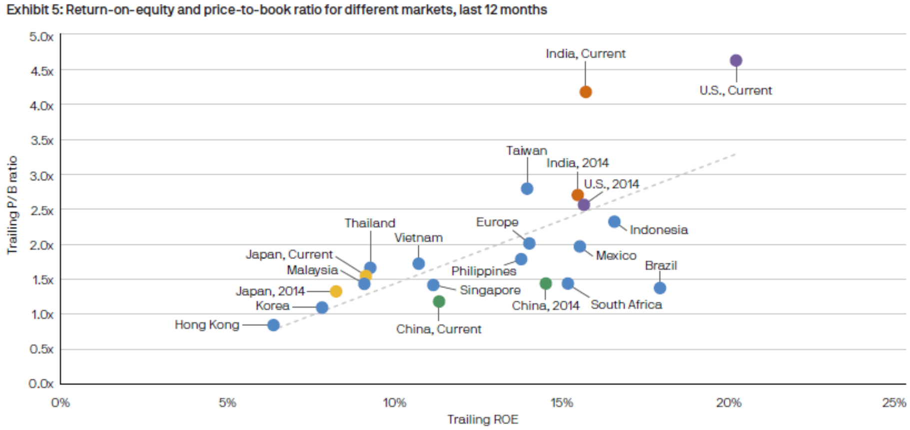
Inflation rates have steadily decreased as the pandemic effects wore off and consumers adjusted spend patterns and businesses increased inventories. In addition, the housing shortage is less acute primarily as a result of multi-family supply increasing which should allow rental rates to decline modestly, providing a meaningful relief to domestic inflation rates. However, businesses have been slow to lower prices on goods and services and there are pockets of sustained inflation like insurance and medical care. As countries embrace protectionist trade policy and more stringently enforce immigration regulations, an unintended consequence could be higher inflation rates as the cost of goods and labor remain elevated.



American Exceptionalism

For all of our flaws, the United States of America is a remarkable country. Over the last 10 years, the improvement in profitability of large-cap companies has been truly exceptional. In addition, these publicly traded companies have been good stewards of the growing cash flows produced by their businesses. Those improvements have been appropriately rewarded by investors with a higher multiple. While valuation is elevated, the quality of the largest publicly traded companies is truly world-class and likely to remain so.

Exhibit 5: Return-on-equity and price-to-book ratio for different markets, last 12 months



Source: FactSet, MSCI, J.P. Morgan Asset Management. Numbers are based on MSCI indices except for the U.S., which is based on the S&P 500 Index. ROE = return-on-equity and P/B = price-to-book. Historical data are shown for select markets to showcase progress. Data are as of November 15, 2024.