PENOBSCOT
FINANCIAL ADVISORS

MARKET COMMENTARY

Q4 2024

MARKET REVIEW

Wall Street concluded the fourth quarter of 2024 with mixed results, reflecting investor uncertainty surrounding Federal Reserve policy, slowing global growth, and geopolitical tensions. A boost to market sentiment followed the November election, with a brief rally in equity markets, although this may have been more an indication of relief that there was a clear, uncontested outcome and less a broad-based sign of policy optimism. The weeks leading up to and following the election showed slightly higher volatility than we saw in Q3, but remained at historically 'calm' levels.

Inflation metrics showed improvement but remained elevated compared to the Federal Reserve's target. The Consumer Price Index (CPI) ended the quarter at 2.9% year-over-year, and the Personal Consumption Expenditures (PCE) price index reached 2.6%. While inflation was moving in the right direction, it was still above the Fed's 2% goal. In response, the Federal Reserve implemented two quarter-point rate cuts during the quarter bringing the Fed Funds rate range to 4.25%–4.50%. Equity markets responded with a cautious tone, as the S&P 500 closed the quarter flat, the Dow Jones Industrial Average fell by 1.8%, and the NASDAQ eked out a modest gain of 1.2%. Despite .5% cuts to the Fed Funds rate, bond yields increased during Q4, with the 10-year Treasury yield ending the year at 4.58%, up from 4.1% at the start of the quarter.

Commodities exhibited varied performance. Gold prices rose another 7%, ending the year at $2,735.50 per ounce, as global uncertainty and demand from central banks supported its role as a safe haven. In contrast, crude oil prices fell 9%, finishing at $65.80 per barrel, amid continued concerns over weakening global demand and ample supply. The U.S. dollar remained steady against major currencies, reflecting balanced sentiment between resilient domestic data and expectations of further rate cuts in the coming year. And we'd be remiss if we ignored big gains in Cryptocurrency, with Bitcoin flirting with $100,000 per token, more than doubling in price over 2024 and a 50% increase in Q4 alone.

Heading into 2025, investors face a complex environment. While inflation appears to be under better control and interest rates are lower, risks remain, including a cooling labor market, uneven global growth, and geopolitical tensions. Market participants will closely watch Federal Reserve policy, corporate earnings, and economic data to navigate the year ahead.

LOOKING FORWARD

MORE CONCENTRATION IN BIG STOCKS

The S&P 500 has experienced an increase in concentration as a result of the outsized influence of the “Magnificent 7” or the top 7 market-cap stocks, which include major tech giants like Apple, Microsoft, and Amazon. These companies now make up a significant portion of the index’s overall weight, amplifying its exposure to a narrow segment of the market. However, this growing concentration also introduces heightened volatility risks. The index becomes more vulnerable to sharp swings in the performance of just a few companies, making it less reflective of the broader market's performance.

Market cap of largest 7 companies in S&P 500

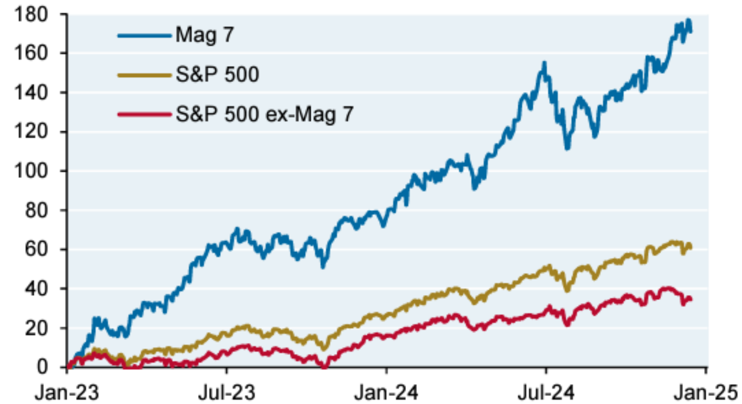
Percent of total index market cap

Source: FactSet, JPMAM, November 30, 2024

This concentration has driven the index’s performance higher, as these stocks have delivered exceptional returns due to their dominance in innovative sectors like cloud computing, artificial intelligence, and consumer technology

S&P 500 and Mag 7 cumulative total return

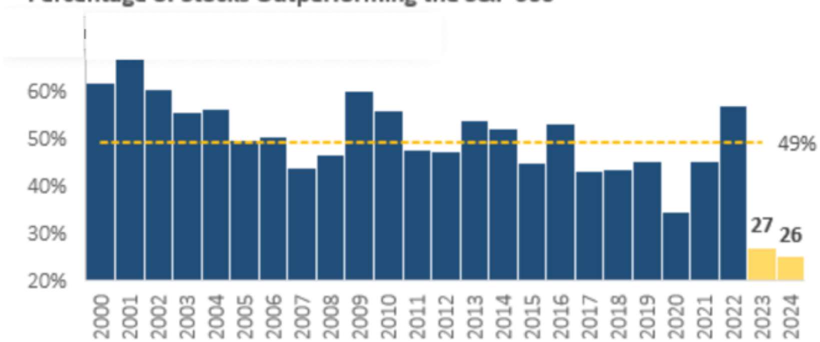
Cumulative total return, Jan 2023 = 0



Source: Bloomberg, JPMAM, December 27, 2024

While these stocks have outperformed, the majority of the stocks in the S&P 500 have delivered relatively modest or flat returns, creating a disparity between the index's headline gains and the underlying breadth of its components. This dynamic underscores the importance of diversification and the potential risks of overreliance on a small group of market leaders.

Percentage of Stocks Outperforming the S&P 500



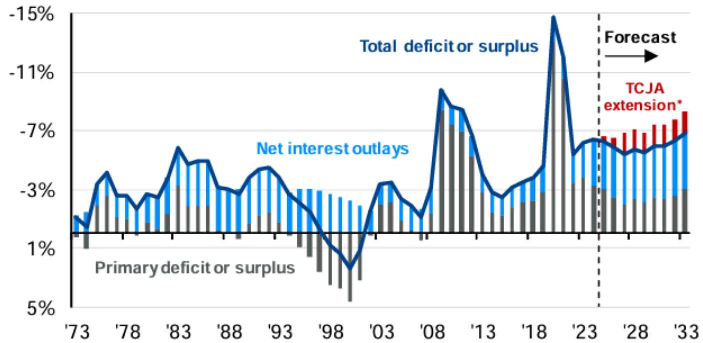
Source: Standard & Poor's. Past performance is no guarantee of future results. All performance data represents price returns. Latest available data as of 12/31/24.

DIVERGENCE IN INTEREST RATES

In 2024, the Federal Reserve reduced the Fed funds rate by about 1%, yet the 10-year Treasury yield paradoxically rose by over 1% during the same period. This divergence reflects market dynamics that extend beyond short-term rate adjustments. The rise in 10-year yields is largely driven by increased expectations for long-term economic growth, persistent fiscal deficits requiring higher debt issuance, and concerns about inflation's staying power. While Fed rate cuts typically lower borrowing costs across the curve, bond investors have priced in higher risk premiums and a steeper yield curve, anticipating that looser monetary policy may fuel inflationary pressures or signal economic resilience that could sustain higher long-term rates. This disconnect highlights the complex interplay between monetary policy and market expectations.

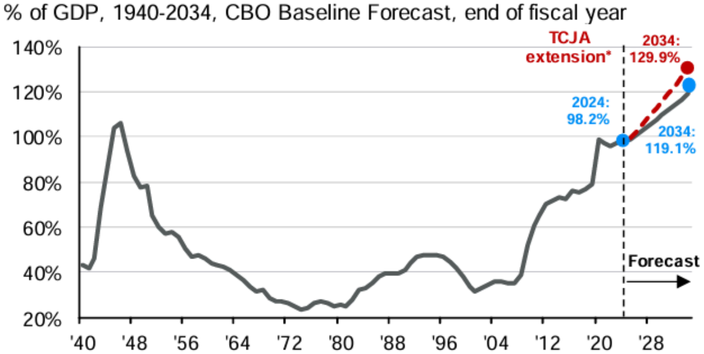
Federal deficit and net interest outlays

% of GDP, 1973-2034, CBO Baseline Forecast



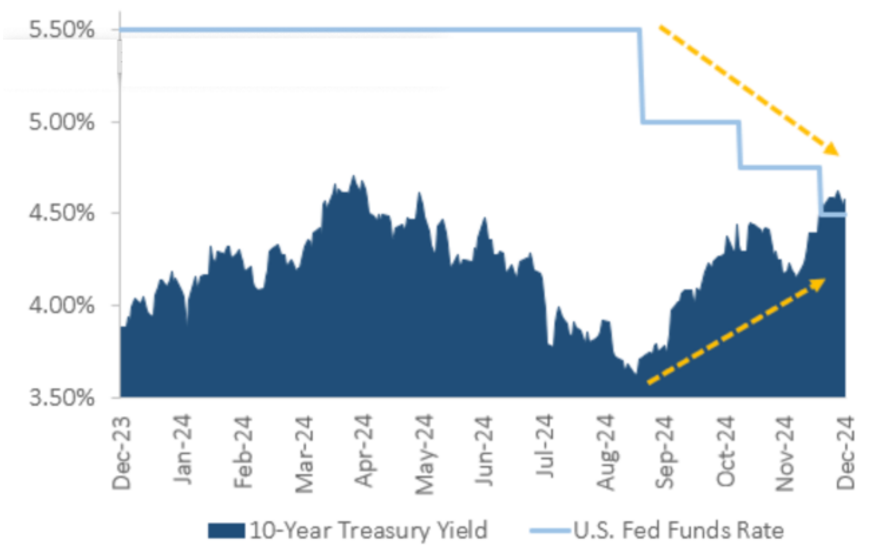
Federal net debt (accumulated deficits)

% of GDP, 1940-2034, CBO Baseline Forecast, end of fiscal year



Source: JP Morgan Guide to the Markets 12/31/2024

While the Fed has taken steps to loosen monetary policy, these rate movements could offset some of the impact of the Fed's moves by keeping the cost of capital high and continuing to punish consumers with higher borrowing costs.

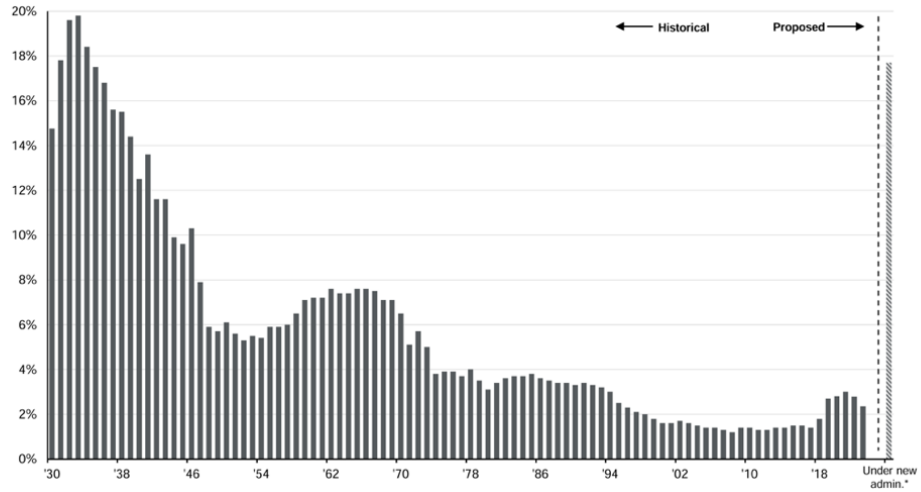


Source: U.S. Treasury, Federal Reserve. Latest available data as of 12/31/2024.

WHERE DOES INFLATION GO FROM HERE?

The incoming Trump administration has reignited rhetoric around raising tariffs, with proposed measures targeting key trading partners and sectors such as technology, manufacturing, and agriculture. These recommendations echo earlier periods of significant tariffs, such as the Smoot-Hawley Tariff Act of the 1930s, which contributed to reduced trade volumes and economic stagnation.

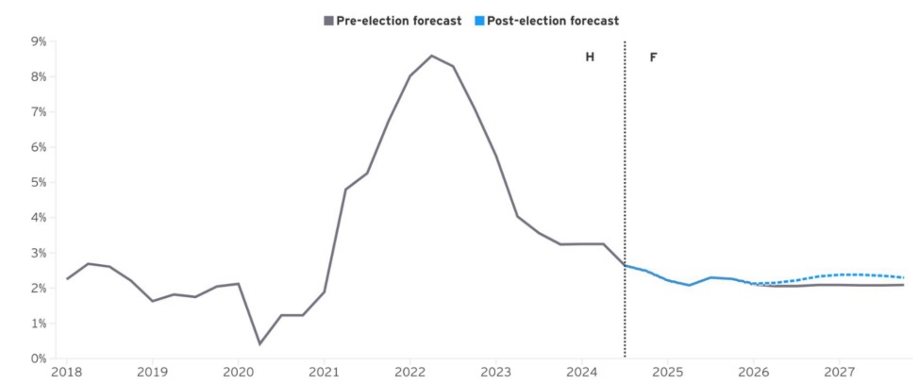
Average tariff rate on U.S. goods imports for consumption
Duties collected / value of total goods imports for consumption



While the stated goal is to protect domestic industries and address trade imbalances, higher tariffs could lead to increased costs for imported goods, potentially driving up consumer prices and fueling inflation. This risk is particularly acute in an environment where supply chains are already under pressure, and global input costs remain elevated. Markets have recently priced inflation-protected securities in such a way as to indicate expectations of an increase of 0.34% to ongoing inflation. We'll be watching closely for movement in these expectations.

US y/y percentage change in headline CPI

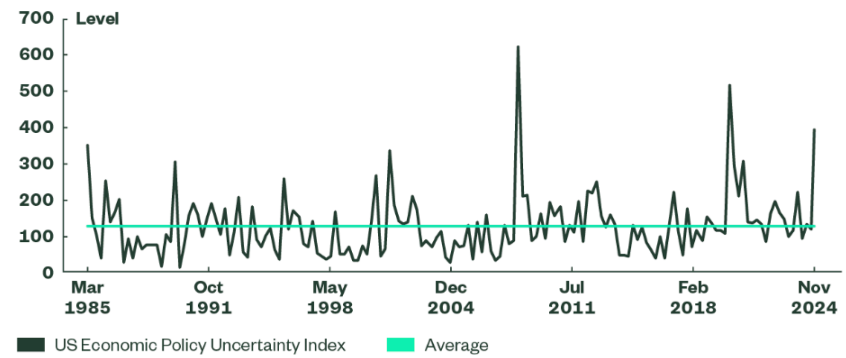
2018 Q1 - 2027F Q4



Source: EY-Parthenon

Importantly, history bears out the fact that campaign rhetoric often differs from policy proposals, and that not all policy proposed by a President clears its way through congress and results in enacted law. The prior Trump administration saw less than quarter of its policy proposals being enacted. With a closely divided congress, uncertainty around policies is at a relatively high level.

US Policy Uncertainty Spikes

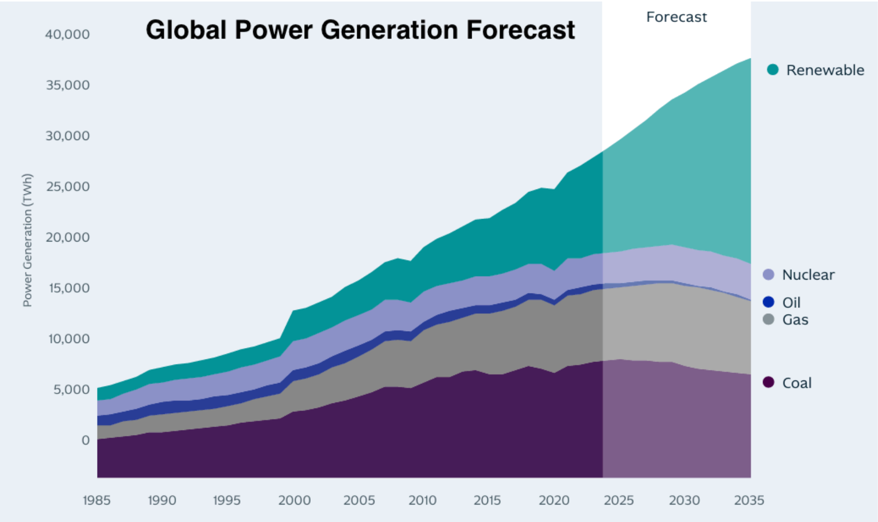


Source: Bloomberg Finance, L.P., as of November 15, 2024. **Past performance is not a reliable indicator of future performance.**

ALTERNATIVES TO STOCKS AND BONDS

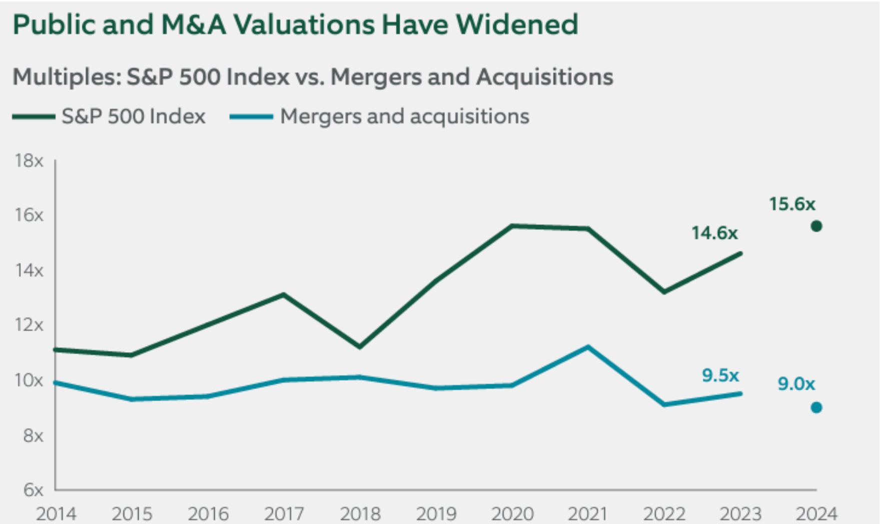
Periods of uncertainty, such as those marked by shifting trade policies and volatile markets, often present opportunities for investors to diversify risk through alternative investments like private equity and infrastructure funds. These asset classes tend to exhibit lower correlation with public markets, providing a hedge against volatility. Private equity offers access to long-term growth opportunities in companies not subject to the daily fluctuations of public markets, while infrastructure investments, including energy, transportation, and utilities, typically provide stable cash flows and the potential for inflation protection.

Areas like renewable energy, data facilities and transportation and energy infrastructure are particularly interesting, given increased demands placed on the existing infrastructure by Artificial Intelligence and other technological innovations.



Source: Enervus Intelligence Research as of October 31, 2024

Further, the extended valuations of the publicly traded equity markets have not, by and large, found their way into private companies going through acquisitions and IPOs



Source: 2025 Global Market Outlook, Northern Trust

OUR TAKE

Despite strong economic conditions marked by a robust labor market, a favorable inflation trajectory, and resilience in key sectors, the current environment calls for a prudent approach to investing. Extended market valuations, driven by concentrated performance in a handful of stocks, highlight the potential for volatility, especially if growth expectations are revised downward.

Additionally, uncertainty surrounding the incoming administration's policy direction, particularly on trade and fiscal measures, could introduce new risks to market stability. While economic fundamentals remain strong, investors would be wise to balance optimism with caution, focusing on diversification and risk management to navigate potential headwinds.

With 2025 projecting lower earnings growth of the high-flying technology stocks, but potentially higher earnings growth of some of the more value-oriented companies, we believe it is more important than ever to resist chasing recent performers, to focus on fundamentals and to diversify across industries, geography and asset classes.

We wish you all a happy and healthy 2025!