4Q2024

Maclura Investments

4Q24 Review - Another Strong Year

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Major US equity benchmarks finished their second consecutive year of double-digit returns, with the exception of the Morningstar US Small Value benchmark (see Exhibit 1.). Although the divergence between growth and value stocks was wide at the end of the year, both styles were more evenly matched year-to-date at the end of the third quarter. With the election of President Trump in November, stocks rallied as the new administration's platform of deregulation and pro-growth was viewed favorably for the stock market and economy. As concerns of potential widespread use of tariffs and unbridled fiscal spending started to materialize, interest rates and the stock market started to be negatively impacted by the end of the year, and markets had a pullback from the all-time highs recorded in early November.

Exhibit 1. Investment-Style Returns

	Morningstar Index Market Returns	2016	2017	2018	2019	2020	2021	2022	2023	2024 1st Qtr.	2024 2nd Qtr.	2024 3rd Qtr.	2024 4th Qtr.	2024 YTD
Growth	U.S. Growth	3.16%	29.52%	0.78%	35.90%	44.65%	24.79%	-36.70%	38.48%	8.32%	2.42%	4.63%	6.32%	23.42%
	Large Growth	1.79%	31.15%	2.94%	33.81%	38.86%	21.47%	-40.36%	47.26%	9.59%	4.73%	2.22%	8.90%	27.75%
	Mid Growth	6.46%	25.67%	-3.16%	36.01%	46.17%	14.97%	-32.37%	25.38%	10.56%	-4.73%	5.98%	7.24%	20.33%
	Small Growth	9.61%	23.77%	-5.67%	27.60%	43.52%	-1.00%	-33.13%	26.65%	5.29%	-1.57%	7.01%	1.79%	12.89%
	US Market	12.44%	21.47%	-5.05%	31.22%	20.99%	25.78%	-19.43%	26.44%	10.24%	3.48%	6.06%	2.57%	24.09%
Value	U.S. Value	20.79%	14.23%	-7.51%	25.09%	-1.31%	23.98%	-0.72%	11.98%	8.41%	-1.47%	8.95%	-2.23%	13.77%
	Large Value	18.91%	15.09%	-5.90%	25.70%	-0.62%	21.49%	0.26%	11.82%	8.89%	-0.59%	8.67%	-2.51%	14.69%
	Mid Value	25.21%	13.02%	-10.63%	24.81%	-3.76%	29.02%	-2.39%	10.94%	8.19%	-3.05%	9.59%	-2.31%	12.28%
	Small Value	27.96%	8.40%	-16.61%	19.96%	1.01%	31.79%	-6.60%	14.58%	4.64%	-5.17%	9.69%	0.77%	9.67%

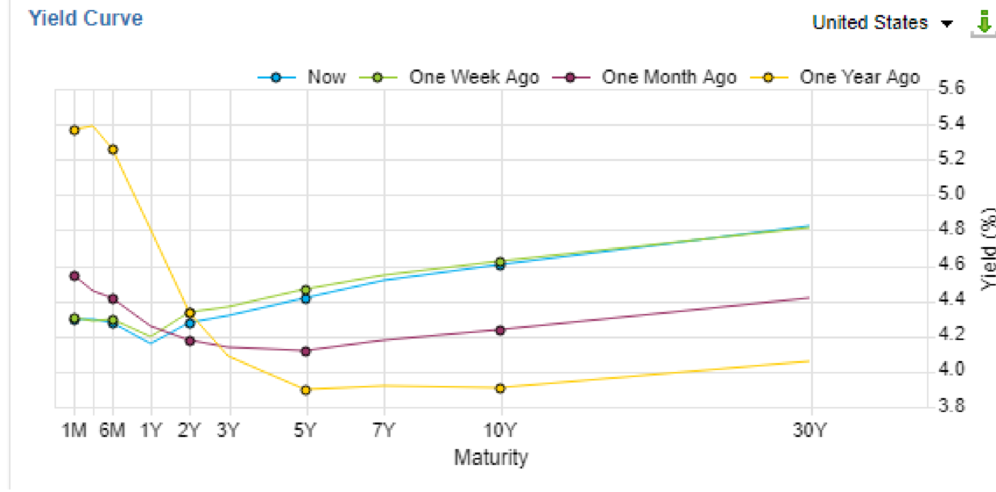
Source: Morningstar

During the fourth quarter, the Federal Reserve lowered its federal funds rate by 25 basis points twice, in November and December, after initiating its easing policy by 50 basis points in September. This lowered the Fed's targeted range goal for the federal funds rate from 5.25% - 5.50% to the new level of 4.25% - 4.50%. All of this was in line with expectations that investors had for the Fed. What caught the market by surprise at the December meeting was the more "hawkish" stance the Federal Open Markets Committee members were taking with decreasing their expected interest rate cuts in 2025 from 100 basis points to 50 basis points, thus raising expectations that interest rates would have a slower cadence in returning to a more "neutral" level.

Regardless of this cautious tone from Federal Reserve Chairman Jerome Powell, I'm reminded of the opposite tone he used in his more "dovish" call after the December meeting in 2023 when he announced that the Fed was going to start easing sooner than previously estimated, and the market rallied, only to have unfavorable inflation numbers in the early part of 2024 halt the Fed's rate cuts until unemployment numbers raised concern and the Fed started cutting rates nine months later in September.

As with economists and the Fed back in December 2023 projecting that interest rate cuts were imminent only to be wrong on the timing, the likelihood that the cadence and magnitude is unlikely set in stone and more surprises will arise before the end of 2025 leading to short-term market volatility. All things considered, with the resiliency of the US economy over the past two years, short-term rates are actually at a reasonable level. Additionally, as can be seen in the yield curve chart, the US Treasury yield curve has

Exhibit 2. Historical and Present US Treasury Yield Curve



finally reverted to a "normal" curve (long term rates higher than short-term rates) after being inverted since July 2022. As long duration bond yields increased during the quarter, it did have a negative impact on the long-duration bond returns. Nonetheless, the ramifications as long-term interest rates trend towards 5% (currently 4.6% on the US 10-year Treasury Bond) will be negative for high valuation stocks, particularly those that have a high risk in growing earnings. It has been quite a while since long-term bonds had interest rates sustainably above 5%, so this is perhaps the greatest risk facing the market going forward.

Offsetting that risk is the technological stairstep advancement that artificial intelligence (AI) is providing the economy. Not only is a massive amount of capital being invested into the AI infrastructure, but a new workforce is emerging that will take the U.S. economy to new levels, the digital agents. During 2025, the human workforce will be working along side a digital workforce that will provide increased productivity and operational efficiency.

But it takes an enormous amount of capital to participate in the AI race. Last week, Microsoft announced that it planned to spend $80 billion on AI data centers this year, up from $50 billion last year. While the digital workforce is in its infancy stage, the proving grounds are being established, and there will be significant financial rewards for companies able to commercialize their digital agents in a sustainable manner, and spectacular failures for those unable to execute a successful commercial strategy. AI software services will not only be a boon to those offering the products, but companies that are able to incorporate such offerings successfully in their operations should be able to accelerate productivity and operating margins and thus grow earnings faster than revenue, which is the primary driver of stock prices.

With the incoming Trump administration threatening to utilize tariffs to motivate trading partners to alter commercial trade practices, there is a concern that inflation will have difficulty decreasing to the Fed's goal of 2%, which would handcuff any future interest rate cuts by the Federal Reserve. What is often missed in the reporting is that tariffs collected on imported goods, particularly from China, have actually increased under the Biden administration. Most of the tariff news will likely be headline risk only, causing short-term swings in the market rather than an actual sustainable impact. Companies have been realigning supply chains and manufacturing well before the first Trump administration tariff moves.

Additionally, the globalization supply of products and services is much more complicated than most are aware of. Sanctions, port fees, tariffs imposed on US goods, etc…there isn't a true sense of "free trade" anywhere in the world. What has changed is the products that nations use to "weaponize" trade. In the 1970's and 80's, often commodities such as US grain and Middle East crude oil were embargoed to punish countries' behaviors. These commodities were the lifeblood of an economy. Nowadays, technology products, such as semiconductor chips and high-tech equipment used in the manufacturing of semiconductor chips are being used for such a purpose.

The economic burden of a smaller population of workers supporting an aging population is driven by low birth rates throughout the world. This development is causing societies to increase their productivity in order to address this problem. The transition to using technology products and services as a trade weapon versus commodity products reflects this dynamic shift in economies. This is one of the reasons why the digital workforce is so important going forward. Additionally, warfare has changed through technology, and thus, having access to and controlling advanced technology is becoming paramount for a country's defense.

In previous quarter reviews, I stated that I don't put too much credibility in the ability of politicians to have a lasting influence on the flow of capital. Though Republicans have majorities in both the House and Senate and with President Trump in the White House, there remains doubt that the policies laid out on the campaign trail materialize as actual law. The newly announced presidential advisory commission co-headed by Elon Musk and Vivik Ramaswamy, the Department of Government Efficiency (DOGE), is tasked to recommend reductions to the size of the federal fiscal deficit. Musk has discussed the possibility of recommending $2 trillion of cuts (the 2024 federal budget was approximately $6.8 trillion with nearly $3 trillion accounted for as Medicare, Medicaid, and Social Security).

While it's a noble cause to attempt to live within one's means, transitioning recommended expense cuts to actual action by politicians seems like a fairy tale plot for a new Disney movie. Governments have different motivations than businesses. Whereas shareholders (owners) mandate management to maximize shareholder's value by maximizing profits, a politician's constituents want maximized benefit to the district regardless of the impact to the whole. Politicians that cut funding to their constituents are rarely held up as heroes at the next election cycle. While the intention is there to cut, the likelihood of that happening is slim and in my opinion, is merely a marketing gimmick, but time will tell.

There are plenty of issues keeping investors on their toes during 2025, and while volatility will likely be higher than in the previous two years, it should be a positive year for investors, but perhaps not to the magnitude of the past two years. There are always those "left field" surprises that catch investors off guard, but for investors that have a long-term perspective, 2025 should be a rewarding year.

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