Q4 2024

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MARKET VIEW QUARTERLY

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Entering 2024, many investors expected moderate global equity market performance, swiftly declining interest rates boosting bond returns, and a softer US dollar supporting international and emerging market equities relative to domestic stocks. Surprisingly, robust US economic growth in the face of higher interest rates and stubborn but declining inflation propelled domestic equity markets ahead of all other major averages. Strong consumer spending and a resilient, but softening, labor market supported this momentum and fueled enthusiasm for Artificial Intelligence (AI), which drove tech valuations higher (Nasdaq +29.60%), and speculative assets like Bitcoin to new records (+122.49%).[1] Between September and December, the Federal Reserve (Fed) lowered the benchmark federal funds rate by a full percentage point, but the final "hawkish cut," indicating the future path of interest rates would decline more gradually and potentially settle higher than originally anticipated, quelled some of the excitement over the incoming administration's planned deregulation, potential tax cuts, and pro-growth agenda. Many have declared the soft landing achieved, and forecasters have drawn parallels to the impressive stock returns following the cutting cycle of the mid-1990s. While it may be hard to point to any sign of a major slowdown at the moment, higher volatility and substantial market risks — both known and unknown — may lie ahead, so investors should remain diversified and stick to a plan in 2025.

DOMESTIC EQUITIES

The S&P 500 returned 25.02% marking the second consecutive year in which index returns exceeded 25% for the first time since 1997/1998. Like 2023, the Technology, Consumer Discretionary, and Communication Services sectors all notched strong performance. In 2024, however, market leadership broadened with sectors like Financials and Utilities leading the market higher. Market exuberance spread beyond the mega-cap Tech stocks deemed the 'Magnificent Seven' (Apple, Microsoft, Google, Amazon, Tesla, Meta, Nvidia) as the transformative theme of artificial intelligence expanded beyond software and hardware. Despite increasing market breadth, Growth stocks again outpaced Value stocks in a continuation of 2023 relative performance, and small-cap companies continued to underperform their larger peers. The spread between large-cap and small-cap performance decreased as market participants sought more attractively valued opportunities than expensive mega-cap Tech shares. The near-consensus forecast that earnings growth for small-cap companies will surpass that of large-cap firms in 2025 further fueled the rotation as the idea took hold with investors. The Federal Reserve (Fed) also played a role in influencing equity returns last year. The central bank began cutting interest rates in September with a jumbo, 50-bp (basis point) cut, and subsequently issued 25-bp cuts in November and December, ultimately totaling a full percentage point decline in interest rates for the year. Lower interest rates mean lower borrowing costs for corporations, entrepreneurs, and individuals, who have begun increasing lending and facilitating business investment across the economy, supporting growth and fueling the stock market. Both factors acted as a tailwind for equity performance throughout the year. The strong performance across domestic equities saw the NASDAQ, Dow Jones Industrial Average, and S&P 500 all close within 5.6% of all-time highs.

INTERNATIONAL EQUITIES

International equities underperformed U.S. stocks in 2024 with the S&P 500 returning 25.02% while the MSCI EAFE Index returned 5.27% and the MSCI Emerging Market (EM) Index returned 9.04%. Within international developed markets, the Eurozone economy remains in long-term decline relative to the U.S. Economic growth has been weak in Germany — Europe's largest economy — and is now expected to expand just 0.6% in 2025 after the largest reduction in forecast growth for any major industrial economy midway through this year. The country has committed to rigorous fiscal austerity since 2021 despite a substantial over-saving problem and relative economic stagnation. Tight fiscal budgets are common across the continent and institutionalized by the Maastricht Treaty, which prevents euro-area economies from providing the fiscal stimulus needed to offset meaningful over-saving issues.[3] Over-saving means lower consumer confidence and less consumer spending. Interestingly, Germany's blue-chip stock index has risen 18.72% (12.68% in USD terms), easily beating British and French bourses and far surpassing the region-wide Stoxx Europe 600 (9.12%; 3.57% in USD terms) in another clear example that the market and the economy are not the same.[2] France has struggled with a significant budget deficit weighing on its bond market while its major stock index is negative on the year. Paltry economic growth and a dramatic exodus from the London Stock Exchange (LSE) continue to plague the UK. Japanese stocks were another relative bright spot among developed international equity markets, but a deeply undervalued Yen limited USD returns.

Broad emerging market benchmarks produced more robust returns than developed international equities, but performance was mixed across this disparate basket of economies. For example, betting on Javier Milei's successful implementation of drastic spending cuts, economic reforms, and ultimately, a significant recovery in Argentina produced some of the best returns anywhere in the world in 2024. An ETF tracking the MSCI Argentina index is up 67.86% this year and government bond prices have skyrocketed.[3] China, on the other hand, still struggling with a beleaguered property sector and a substantial investment-saving imbalance, has been forced to run increasing fiscal deficits due to price deflation, rising unemployment, and slowing growth.[4] Although a coordinated stimulus package sparked a 30% tactical rebound for Chinese stocks in the third quarter alone,[5] investors appear underwhelmed with the government's plans (or lack thereof) for further fiscal stimulus as Chinese growth will likely continue to disappoint. Generally, emerging markets handled the fading bout of global inflation rather adeptly, generating solid growth and meaningful returns in 2024, but additional risks including potential tariffs, mixed outlooks for commodities, weaker Chinese growth, and a strong US dollar still loom over the asset class.

FIXED INCOME

Several key developments impacted Fixed Income markets in 2024. First, the Federal Reserve (Fed) began reducing the benchmark federal funds rate for the first time since the beginning of the pandemic in 2020. The central bank cut rates in September by 50 bps and then by 25 bps in November and December, bringing their target rate range to 4.25% – 4.50%. Cooling labor market data and growing concern that the long and variable lags of monetary policy may restrict economic activity too aggressively provided the initial impetus to lower rates. Higher interest rate volatility in 2023 continued into and throughout 2024 as stronger economic data defied expectations and inflation continued to moderate (until very recently). The yield on the 10-year Treasury bond started the year around 4.05% and dipped to a low of 3.60% in September before ending the year at 4.57%. Throughout the fourth quarter, yields continued to move higher, accelerating after President Donald Trump won re-election in November, highlighting potential inflationary effects brought on by tariffs and stronger economic growth. Additionally, the yield curve, which had been inverted since 2022, started to normalize as measured by the spread between the 2-and 10-year Treasury yields. Reducing the Fed funds rate effectively lowered short-term rates, but stronger economic data and inflationary concerns kept long-term rates elevated. Although an inverted yield curve is usually a sign of an impending recession, the fact that the curve has been able to normalize without negatively impacting economic growth, i.e., long-term bond investors once again earn more than short-term bond investors, indicates that the most recent inversion was likely a false positive. Despite the U.S. Aggregate Bond Index only returning 1.25% in 2024 (performance was impacted by interest rate volatility and longer-term interest rates moving higher), several sectors in the fixed income market generated more attractive returns. Low corporate default rates and solid economic growth drove high yield and investment-grade credit spreads to their narrowest level since 2007. Investment-grade corporate bonds returned 2.13% and high-yield bonds posted an 8.19% return.[1]

ALTERNATIVES AND REAL ESTATE

Gold and midstream energy stood out as some of the strongest-performing asset classes in 2024, with gold prices surging over 27.22% and midstream energy keeping pace with the S&P 500.1 Gold began the year around $2,000 per ounce before hitting its all-time high of $2,790.15 on October 31st, driven by robust central bank purchases, escalating geopolitical tensions, and monetary policy easing by major central banks. However, since its peak, gold has experienced a sell-off as easing geopolitical concerns, stronger economic data, and a rising U.S. dollar have reduced its appeal as a safe haven asset.[1] Midstream energy, bolstered by strong yields and investor confidence in infrastructure assets, became a standout performer in a volatile energy market. Oil prices started 2024 at around $80.00 per barrel, driven by stable expectations for demand recovery in key economies.[1] The market's strongest point came in early summer when Brent crude rose past $85 per barrel due to supply disruptions from geopolitical conflicts and OPEC+ production cuts.1 The weakest point came towards year-end when concerns over slowing global demand and a strong U.S. dollar pushed prices below $70.[1]

Housing struggled to keep pace with these top-performing asset classes as high mortgage rates, around 7%, weighed on affordability and market activity. The average home price reached approximately $420,400 in the third quarter. At the same time, the Housing Affordability index stood at 102.30 (an index value of 100 means a median income family can exactly afford a home; above 100 qualifies, below 100, does not qualify) in October, reflecting tight conditions for buyers. The market's softest point came early in the year with record lows in home sales and new listings as economic uncertainty deterred participation. A modest recovery occurred in late fall, with mortgage rates easing and inventory increasing, creating more opportunities for buyers.

CONCLUSION

While most investors anticipated US equity market leadership to fizzle and rapid interest rate declines to drive meaningful fixed income returns, resilient US economic growth and strong corporate earnings, despite elevated interest rates, pushed domestic stock indices to new highs and back-to-back years of 20%+ returns on the S&P 500 for the first time in more than two decades. That resilient growth forced the Fed to hold interest rates at higher, more restrictive levels and led fixed-income assets to underperform. Yields even backed up in response to the central bank's latest "hawkish cut" and lower rates, which would have driven bond prices higher, simply never materialized. Robust growth in the face of higher rates propelled the US dollar higher relative to other currencies, further entrenching the concept of "US exceptionalism" in the minds of investors. Flagging economic growth and political turmoil across Europe, likely rising interest rates in Japan, and ongoing issues in many areas of the Chinese economy weighing on both developed and emerging markets will likely continue the theme of domestic dominance into 2025. One of many prominent economists anticipating yet another strong year for US markets went so far as to title his annual economic outlook, "Firing on All Cylinders," and in the few historical examples of successful soft landings (1968, 1985, 1995, and now, in 2024), economic growth has accelerated in the years that follow. However, a word of caution with a recent example of a time when market prognosticators aligned as closely as they do currently. Just this time last year, and for the first time since 1999, the average market strategist's S&P 500 forecast for the end of the year was negative.[7] Of course, essentially the exact opposite occurred. Widespread agreement among market participants can be a risk in and of itself, but the time-tested principle of diversification and sticking to an investment plan will continue to serve investors well in 2025.

Economic Definitions

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Existing Home Sales: This concept tracks the sales of previously owned homes during the reference period. Total existing home sales include single-family homes, townhomes, condominiums and co-ops. All sales are based on closings from Multiple Listing Services. Foreclosed homes are only counted in the inventory if the bank is working with a realtor. Foreclosed homes that sell via auction (or other closings outside of the Multiple Listing Services) are not included.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States of America.

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

West Texas Intermediate (WTI): West Texas Intermediate (WTI) is crude stream produced in Texas and southern Oklahoma which serves as a reference or "marker" for pricing a number of other crude streams and which is traded in the domestic spot market at Cushing, Oklahoma.

Index Definitions

S&P 500®: The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

S&P 500® Equal Weight Index (EWI): The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization-weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight — or 0.2% of the index total at each quarterly rebalance.

NASDAQ: The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

Dow Jones Industrial Average: The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Russell 1000 Growth: The Russel 1000 Growth measures the performance of the large-cap growth segment of the US equity securities. It includes the Russell 1000 index companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value: The Russell 1000 Value measures the performance of the large-cap value segment of the US equity securities. It includes the Russell 1000 index companies with lower price-to-book ratios and lower expected growth values.

Russell Mid-Cap: Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

MSCI EAFE: The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

MSCI EM: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI China Index: The MSCI China Index captures large and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 717 constituents, the index covers about 85% of this China equity universe. Currently, the index includes Large Cap A and Mid Cap A shares represented at 20% of their free float adjusted market capitalization

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Alerian MLP Index: The index measures the performance of energy segment US equity securities. It is a composite of the 50 most prominent energy Master Limited Partnerships ('MLPs'). The index is calculated using a float-adjusted, capitalization-weighted methodology.

Dax 40: The DAX 40 (Deutscher Aktienindex) tracks the performance of the 40 largest German companies listed on the Frankfurt Stock Exchange. The constituents are picked by their free-float market capitalization.

STOXX Europe 600: The STOXX Europe 600, also called STOXX 600, SXXP, is a stock index of European stocks designed by STOXX Ltd. The index has a fixed number of 600 components representing large, mid and small capitalization companies among 17 European countries, covering approximately 90% of the free-float market capitalization of the European stock market.

CAC 40: The CAC 40 is the benchmark equity index for public companies traded on the Euronext Paris. The index is made up of the largest 40 companies listed in France screened by market capitalization, trading activity, size of balance sheet, and liquidity.

London Stock Exchange (LSE): The London Stock Exchange (LSE) is the primary stock exchange in the United Kingdom and its largest.

Housing Affordability Index: Housing Affordability Index measures whether or not a typical family could qualify for a mortgage loan on a typical home. A typical home is defined as the national median-priced, existing single-family home as calculated by NAR. The typical family is defined as one earning the median family income as reported by the U.S. Bureau of the Census. The prevailing mortgage interest rate is the effective rate on loans closed on existing homes from the Federal Housing Finance Board. These components are used to determine if the median income family can qualify for a mortgage on a typical home. To interpret the indices, a value of 100 means that a family with the median income has exactly enough income to qualify for a mortgage on a median-priced home. An index above 100 signifies that family earning the median income has more than enough income to qualify for a mortgage loan on a median-priced home, assuming a 20 percent down payment.

DISCLOSURES

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1 Data Obtained from Bloomberg as of 12/31/2024.

2 Germany's own 'magnificent seven' help Dax defy bleak growth outlook.

3 The Hedge-Fund Trade of the Year: Betting on Argentina's Chain-Saw-Wielding President.

4 Boom_Or_Bust_An_Investors_Playbook_For_2025_&_Beyond.pdf.

5 International equities: Focusing on structural rather than cyclical stories | J.P. Morgan Asset Management.

6 30-Year Fixed Rate Mortgage Average in the United States (MORTGAGE30US) | FRED | St. Louis Fed.

7 Data Obtained from Bloomberg as of 12/31/2023.

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