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2025 Outlook

Market Digest, January 2025

Editors: Owen Haffey, Technical Writer and Amy Lubas, CFA, VP, Investment Solutions

Executive Summary

The U.S. economy enters 2025 in a strong position, with real GDP expected to grow 2.0%-2.5%, following a better-than-expected 2.7% increase in 2024. The labor market is close to full employment, productivity has surpassed pre-pandemic trends, and credit conditions remain favorable. Despite a positive outlook, uncertainty around President Trump's policies remains a key risk.

We're maintaining a bullish outlook on U.S. stocks to start 2025, with our research supported by the pillars of disinflation, earnings growth, and broad market participation. Investors thrived in 2024, with most asset classes exceeding long-term averages. Large-cap U.S. growth stocks, led as the S&P 500 hit 57 record highs, making consecutive 20% gains for the fifth time.

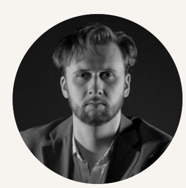
Looking ahead in the new year, global GDP is expected to grow 3.1%, sustained by easier monetary policy, rising real incomes, and fiscal stimulus, especially in the U.S. and China. Risks to this outlook include potential U.S. tariffs, geopolitical instability, and structural challenges in Europe.

Policy takes center stage in our sector outlook, with Trump's initiatives likely to drive market leadership trends. Monetary policy also plays a critical role in shaping sector trends for 2025. Historically, slower Fed easing cycles have supported cyclical sector leadership. Risks include unanchored inflation expectations, which could disrupt rate cuts and push long-term yields higher, favoring defensive sectors. To get aligned, we downgraded Energy to marketweight and slightly raised our allocations in Technology and Communication Services.

Our fair value model for the 10-year U.S. Treasury suggests a theoretical range of 4.00%-5.25%, with a midpoint of 4.625%. With yields currently near the lower end of this range, we see limited value in U.S. Treasuries below 4.00%, but find them attractive around 5.00%.

We upgraded our commodity outlook to bullish, driven by strong momentum indicators, breadth, and energy sector resilience. While risks like slower global growth persist, improving fundamentals and potential U.S. dollar weakness support a positive outlook.

> "The U.S. economy enters 2025 in a strong position, with real GDP expected to grow 2.0%-2.5%, following a better-than-expected 2.7% increase in 2024."



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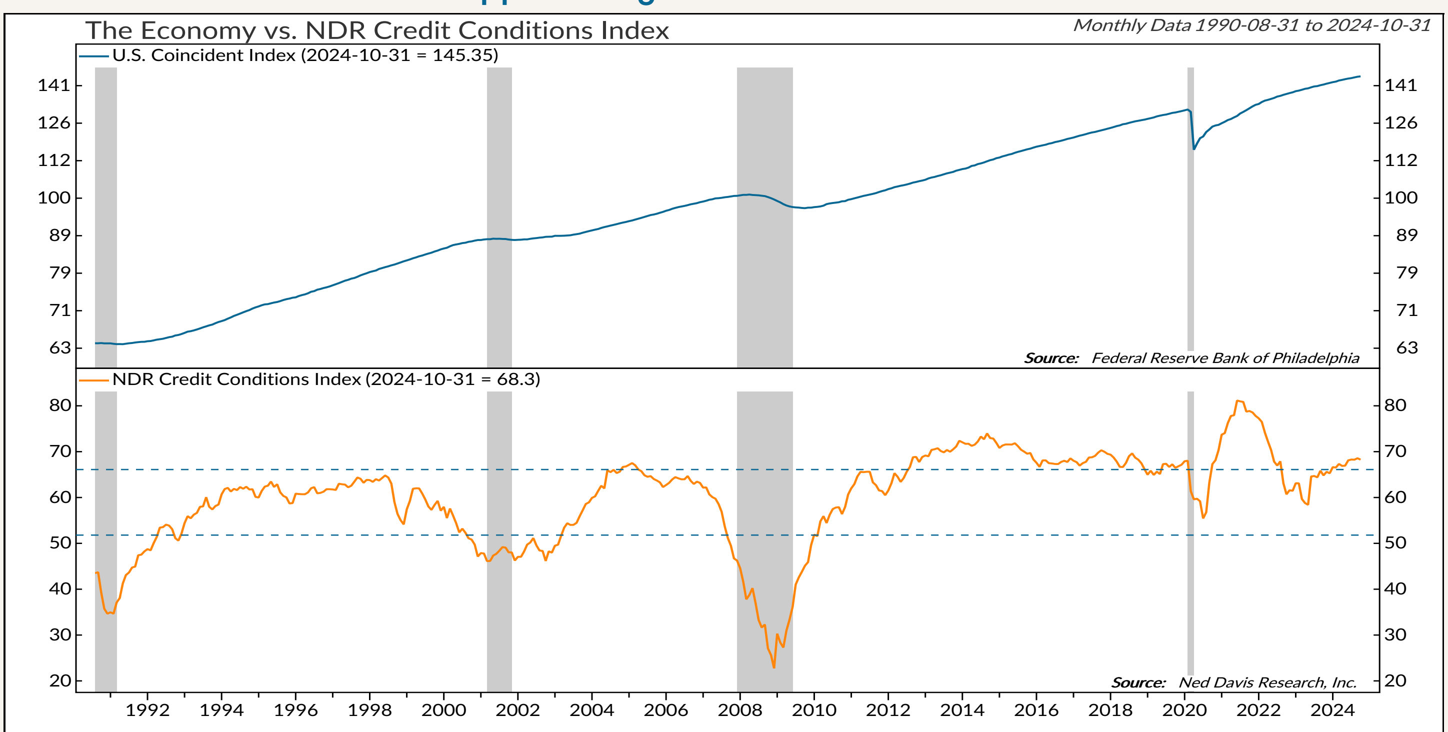
U.S. economy: Economy flexing its muscles

The U.S. economy enters 2025 in a strong position, with real GDP expected to grow 2.0%-2.5%, following a better-than-expected 2.7% increase in 2024. The labor market is close to full employment, productivity has surpassed pre-pandemic trends, and credit conditions remain favorable (chart below). Consumer and business confidence have risen, and with the election uncertainty behind, pro-growth policies are expected to stimulate the economy. The Federal Reserve's rate cuts have further supported credit conditions, ensuring that the expansion continues. None of the indicators on the Recession Watch Report signal an imminent downturn, indicating low near-term recession risk. **However, growth is expected to moderate in 2025 due to a more challenging economic environment compared to 2016-2017, marked by higher inflation, higher interest rates, a larger budget deficit, and significantly higher government debt.**

Despite a positive outlook, uncertainty around President Trump's policies remains a key risk. While tax cuts and deregulation could boost investment, tariffs could harm trade and inflation. Although the U.S. is less dependent on international trade, higher tariffs would still have adverse effects on supply chains and prices. Additionally, mass deportations and labor force reductions could exacerbate wage pressures and inflation. While these policies may not be fully implemented in early 2025, they could weigh on the economy in the second half of the year. The impact of proposed government efficiency reforms, led by Elon Musk, may also be felt later.

Favorable credit conditions support the growth outlook



Shading indicates NBER-defined recessions.

U.S. Coincident Index Performance **Full History:** 1990-08-31 to 2024-10-31		
NDR Credit Conditions Index	% Gain/ Annum	% of Time
Above 66.1	3.33	30.24
51.8 - 66.1	2.85	49.51
Below 51.8	0.08	20.25
Buy/Hold = 2.43% Gain/Annum		

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U.S. equities: Staying the course for 2025

We're maintaining a bullish outlook on U.S. stocks to start 2025, with our research supported by the pillars of disinflation, earnings growth, and broad market participation. Investors thrived in 2024, with most asset classes exceeding long-term averages. Large-cap U.S. growth stocks led as the S&P 500 hit 57 record highs, achieving consecutive 20% gains for only the fifth time. Despite uncertainties about inflation and Fed policy, these factors have driven strong market performance over the past two years. Our year-end S&P 500 target is 6600, reflecting a 9% gain, in line with historical averages (table below). Earnings per share (EPS) are projected to grow by 8.4%, supported by 2.0%-2.5% GDP growth and 5.9% sales growth. While this marks a slight deceleration from 2024's 9.5% EPS growth, it aligns with the typical earnings trajectory in the later stages of bull markets.

Key risks to stocks in 2025 include rising inflation, which could force the Fed to end its easing cycle, and challenges in fiscal policy. Historically, markets gain momentum early in post-election years, driven by economic relief and easing monetary policy, but gains often slow in the second half due to tightening fiscal and monetary conditions. Overall, while we anticipate a favorable environment in the first half, caution is warranted as the bull market matures and economic risks increase.

2025 SPX price target of 6600, or +9%

NDR S&P 500 Index Target for 2025

Cycle	Metric	Comment	S&P 500 Target
Earnings & P/E	EPS slows, P/Es contract slightly	8.4% EPS Growth & -0.6%pt P/E	6422
Stock Market Cycle	Months 27-39 of cyclical bull	Post-war median of 5.5%	6386
Monetary Cycle	Months 3-15 of easing cycle	Post-war median of 15.0%	6961
Presidential Cycle	Post-election year	Post-war median of 9.1%	6604
Target		**Round to 6600**	**6593**
Target % (from current level of 6053)			**8.9**

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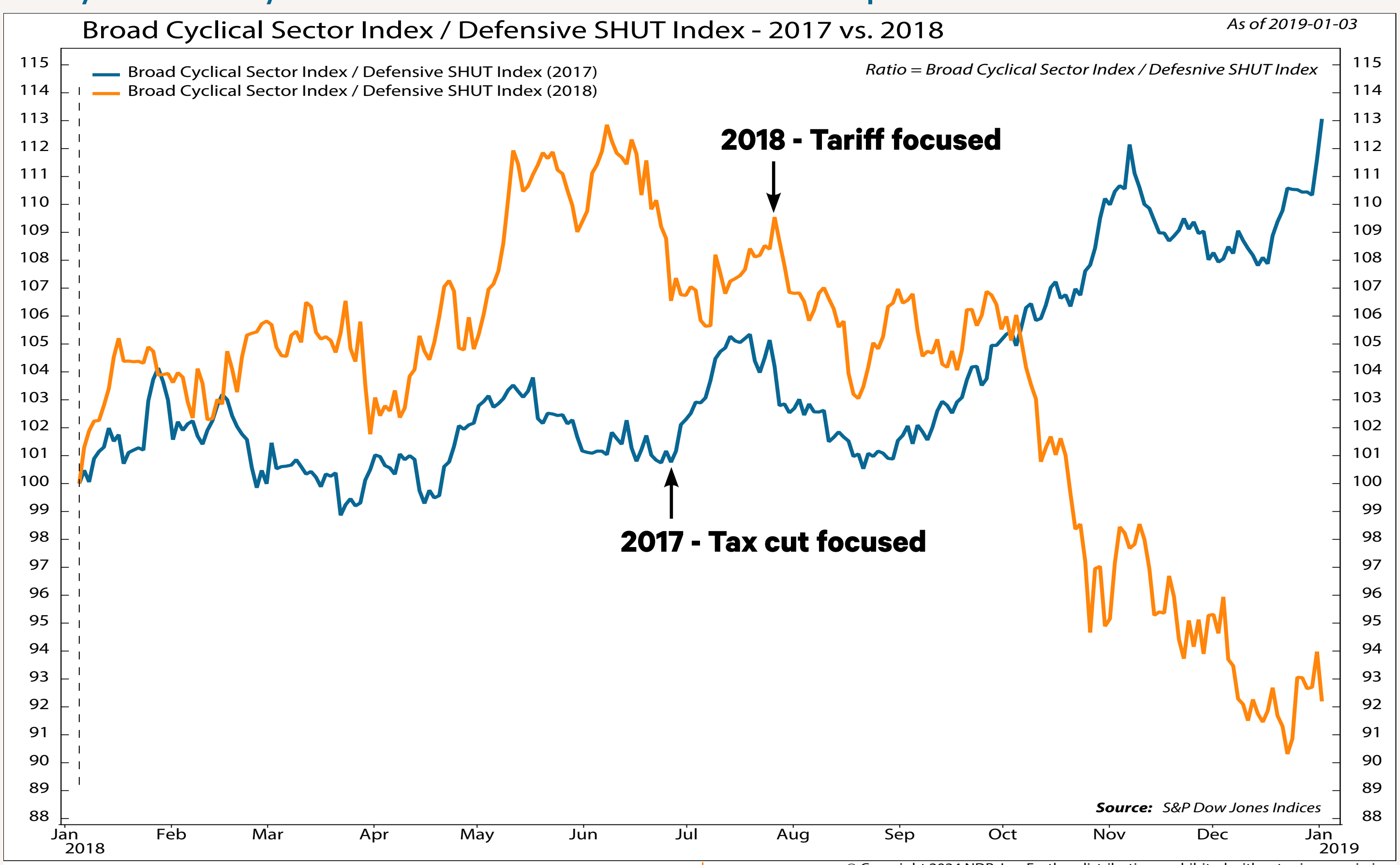
U.S. sectors: Trump policy clouds outlook

For 2025, policy takes center stage in our sector outlook, with Trump's initiatives likely to drive market leadership trends. While tax cuts dominated in 2017, tariffs and immigration may be prioritized in 2025, alongside a potential extension of the Tax Cuts and Jobs Act (TCJA). Historical trends show that policy shifts often bring volatility and influence sector performance. For instance, the TCJA boosted cyclical sectors in 2017, with Technology leading gains, while trade tensions in 2018 saw defensive sectors outperform as markets turned negative. The initial response to Trump's 2024 election victory mirrors 2016, with cyclical sectors and Value stocks outperforming (chart below). However, structural changes since 2017, including Technology's increased weight in the S&P 500 and the deceleration of Mag 7 earnings growth, suggest more balanced leadership between cyclical and defensive sectors in 2025. To get better aligned, we downgraded Energy to marketweight and slightly raised our allocations in Technology and Communication Services last month.

Monetary policy also plays a critical role in shaping sector trends for 2025. Historically, slower Fed easing cycles have supported cyclical sector leadership. **However, risks include unanchored inflation expectations, which could disrupt rate cuts and push long-term yields higher, favoring defensive sectors.** While the interest rate environment is expected to remain supportive of cyclical leadership, narrowing earnings growth between the Mag 7 and the broader market may limit Growth sector dominance. Overall, we expect balanced sector performance, with volatility likely increasing mid-year as monetary and fiscal risks evolve.

Policy uncertainty could lead to more balanced leadership



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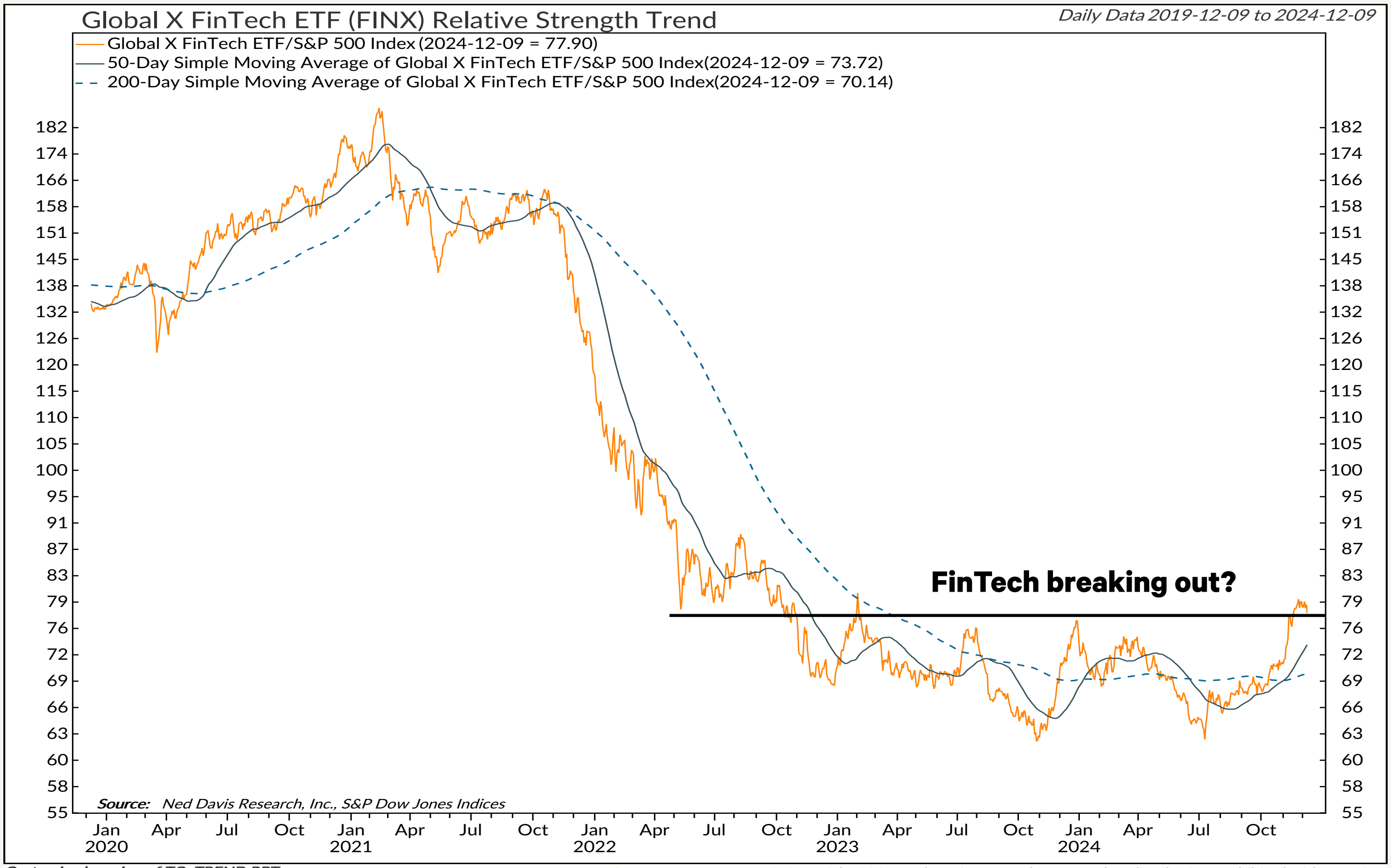
Themes: Regulation & AI to impact 2025

As we analyzed our top 10 themes in 2024, there were really three broad themes that stood out in 2024 — Consumer, Tech Titans, and Crypto. Before the year concluded, we also moved Video Games to overweight, as we believe the post-pandemic bottom is in for sales growth and profit margins. Coming in at number three among our broad themes was Consumer Spending. Number two among our broad themes was Tech Titans. Nvidia, Apple, Amazon, Meta, Microsoft, and Alphabet alone accounted for nearly two-thirds of the S&P 500's 24% return. The launch of Bitcoin ETFs, bullish comments by Trump at a crypto conference, and Trump looking to appoint a crypto-friendly SEC chair all helped Bitcoin soar over 100% and make Crypto-related the top broad theme for 2024.

In 2025, thematic investing will focus on key trends driven by political shifts, technology, and demographics. Crypto and FinTech are poised for growth, fueled by a pro-innovation stance and leadership changes in regulatory bodies (chart below). AI spending is transitioning from hardware to software, with datacenter build-out paving the way for application development and implementation. Big Tech remains a key beneficiary, but software-oriented AI investments could gain traction. Consumer trends are shifting as durable goods spending stabilizes, with Millennials entering prime home and auto-buying years. Services, boosted by strong consumer confidence, continue to thrive, while sectors like housing and home improvement show signs of recovery. ETFs in Blockchain, FinTech, AI, and consumer themes offer compelling opportunities as momentum builds across these areas.

A new SEC chair could lift FinTech



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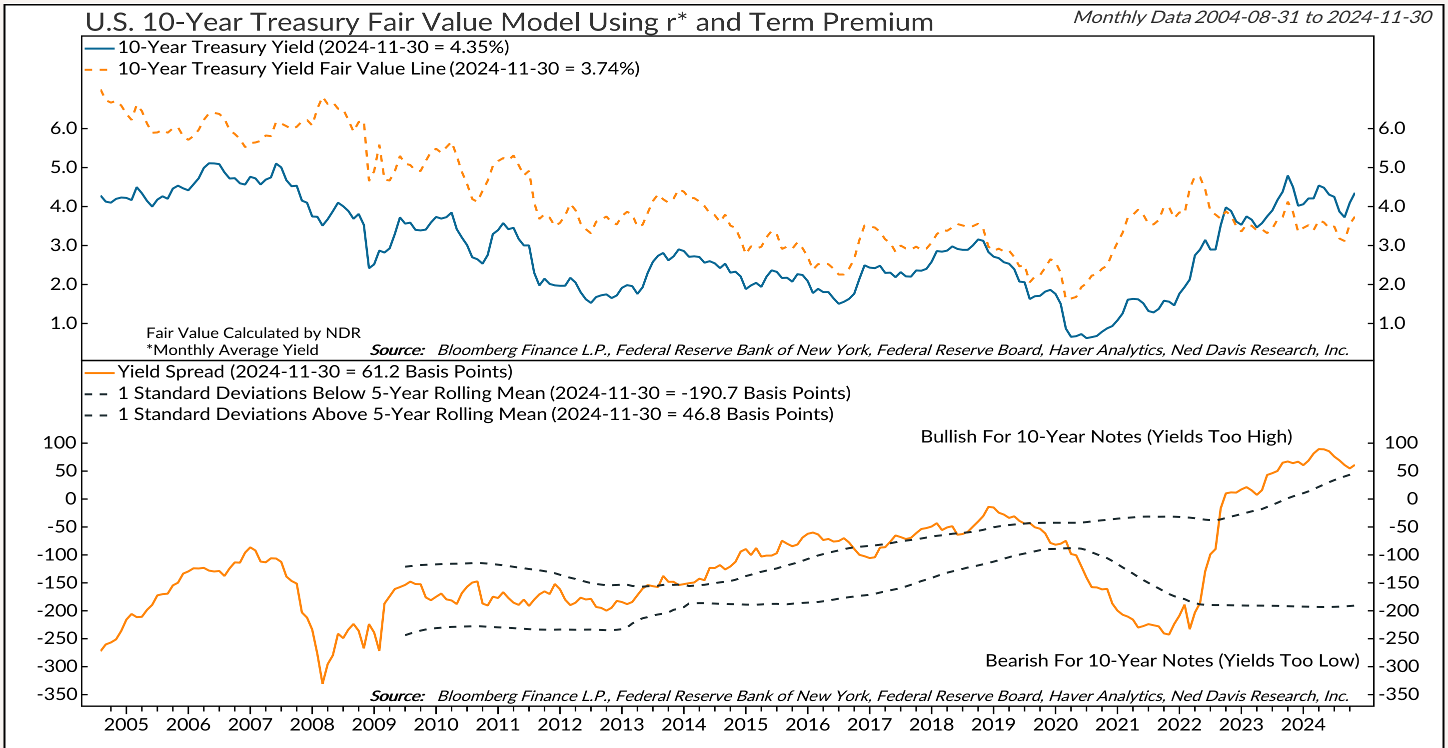
U.S. Fixed Income: A year of uncertainty

Policy and market uncertainty are expected to rise in 2025, driven by proposals from the incoming Trump administration. Our fair value model for the 10-year U.S. Treasury suggests a theoretical range of 4.00%-5.25%, with a midpoint of 4.625% (chart below). With yields currently near the lower end of this range, we see limited value in U.S. Treasuries below 4.00% but find them attractive around 5.00%. Sustained yields above 5.25% would likely signal inflationary concerns exceeding 3.25%. **Historical trends tying Treasury yields to nominal GDP support our midpoint target, given projected nominal growth of 5.00%.** Fed rate cuts are expected to total 75 basis points in 2025, with a modest steepening of the yield curve likely in the second half of the year.

Credit markets remain favorable compared to the U.S. Aggregate Index, though valuations appear stretched. We prefer loans over fixed-rate debt due to strong economic growth, limited Fed rate cuts, and higher carry. The yield curve steepened in 2024 post-election, achieving our 50-basis-point target, and could steepen further if the Fed continues its gradual policy normalization. If the curve inverts, a reimplementation of steepener trades may be considered. Overall, while the fixed-income outlook remains supportive, rich valuations and policy uncertainties could weigh on market dynamics as the year progresses.

A 5% 10-year Treasury?



Determinants of Fair Value	Latest Reading
HLW Natural Rate of Interest (r*)	0.84
10-Year Inflation Swap	2.53
10-Year Term Premium (ACM/KW Mean)	0.37

Bloomberg Barclays LT Treasury
Analysis Dates: 2004-08-31 - 2024-11-30

Signal	Mean Return After:		
	6 Months	12 Months	18 Months
After > +1SD	-4.50	-5.47	0.88
After < -1SD	-8.77	-23.64	-21.75

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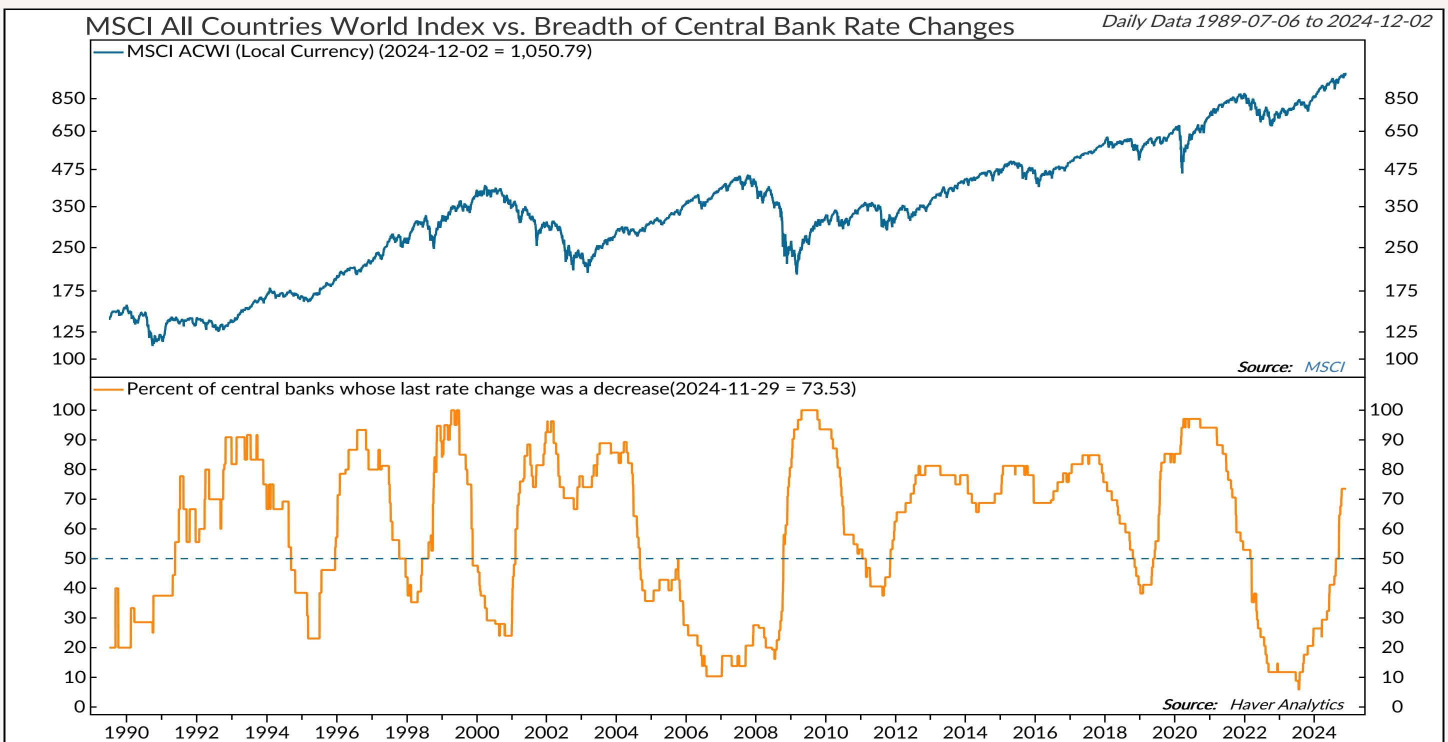
International economy: Maintaining a strong pace

In 2024, the global economy showed resilience, with real GDP growth projected at over 3%, although momentum slowed in the year's second half. While the U.S. economy remained strong, Europe and China experienced softer growth. However, signs of recovery emerged late in the year, including back-to-back increases in the global composite PMI and a declining Global Recession Probability Model. Inflation subsided significantly compared to post-pandemic peaks, supported by normalized supply chains and subdued goods inflation. Despite these positive fundamentals, uncertainties linger, particularly regarding U.S. trade policies. Proposed broad-based tariffs by President-elect Trump could disrupt global supply chains, stoke inflation, and slow economic growth, particularly for trade-dependent nations like Mexico, Canada, and Vietnam. However, stimulus measures from China and an easing monetary stance across three-quarters of central banks have bolstered near-term stability (chart below).

Looking ahead to 2025, global GDP is expected to grow 3.1%, sustained by easier monetary policy, rising real incomes, and fiscal stimulus, especially in the U.S. and China. Risks to this outlook include potential U.S. tariffs, geopolitical instability, and structural challenges in Europe. The U.S. is expected to remain a global growth leader, while China's growth may moderate to 4.5% amid demographic and productivity headwinds, and Europe is forecast to expand at a modest 1.1%, constrained by political turmoil and external risks. Inflation risks persist, particularly in services and from potential trade disruptions.

Most of the world's central banks are easing



ACWI Performance
Full History: 1989-07-06 to 2024-11-29

Share of Central Banks Easing is	% Gain/ Annum	% of Time
Above 50.0	8.57	63.53
Below 50.0	1.37	36.47

Buy/Hold = 5.89% Gain/Annum

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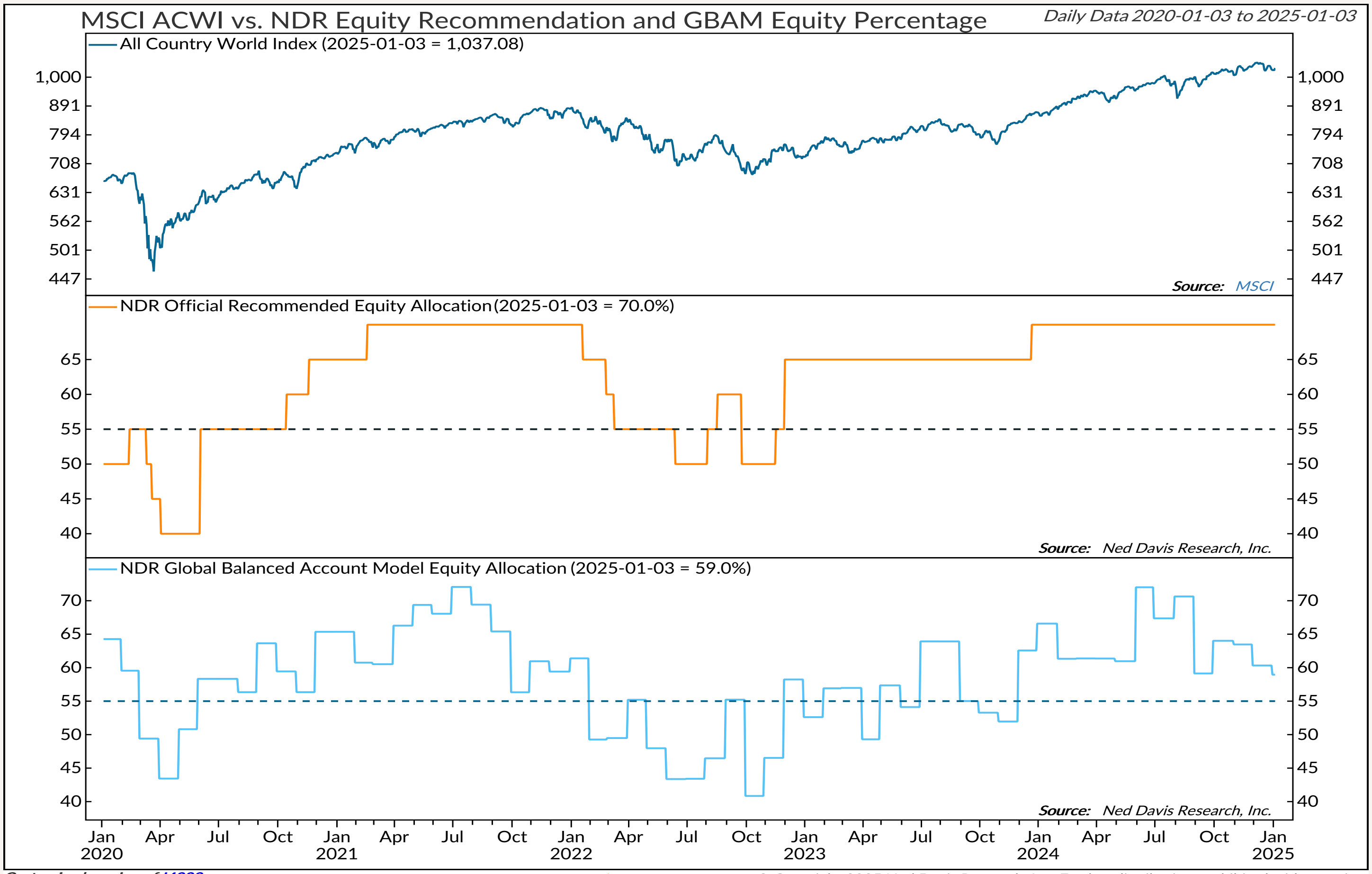
Global equities: Less predictability, more risk

Entering 2025, global stocks face a more uncertain environment compared to the start of 2023 and 2024, which were marked by strong bullish expectations. Instead, parallels with the lead-up to 2022 are emerging, with rising volatility and concerning breadth, sentiment, valuations, earnings trends, and macro risks. Developments in 2024 were reminiscent of 2021, where concentrated leadership by a handful of mega-cap stocks masked underlying market fragility. As in 2021, equity allocation within our Global Balanced Account Model peaked mid-year and has since trended downward (chart below). If this pattern persists, a reduction in equity exposure may be warranted, similar to early 2022 when mega-cap declines signaled the start of a bear market. Historical norms also suggest caution, as the current bull market has already surpassed the median duration of cyclical bulls within secular trends.

For 2025, the outlook hinges on several factors, including the risk of a global trade war disrupting supply chains, reigniting inflation, and necessitating tighter central bank policies. This could replicate the dynamics of 2022, where unexpected monetary tightening pressured stocks. Rising bond yields, a strengthening dollar, and geopolitical tensions could further challenge markets, particularly for emerging markets. However, if inflation remains controlled and easing policies persist, the bull market could extend with another year of double-digit gains. While maintaining a maximum overweight stocks position for now, we remain prepared to shift defensively if indicators decisively weaken.

Peak in model's equity allocation



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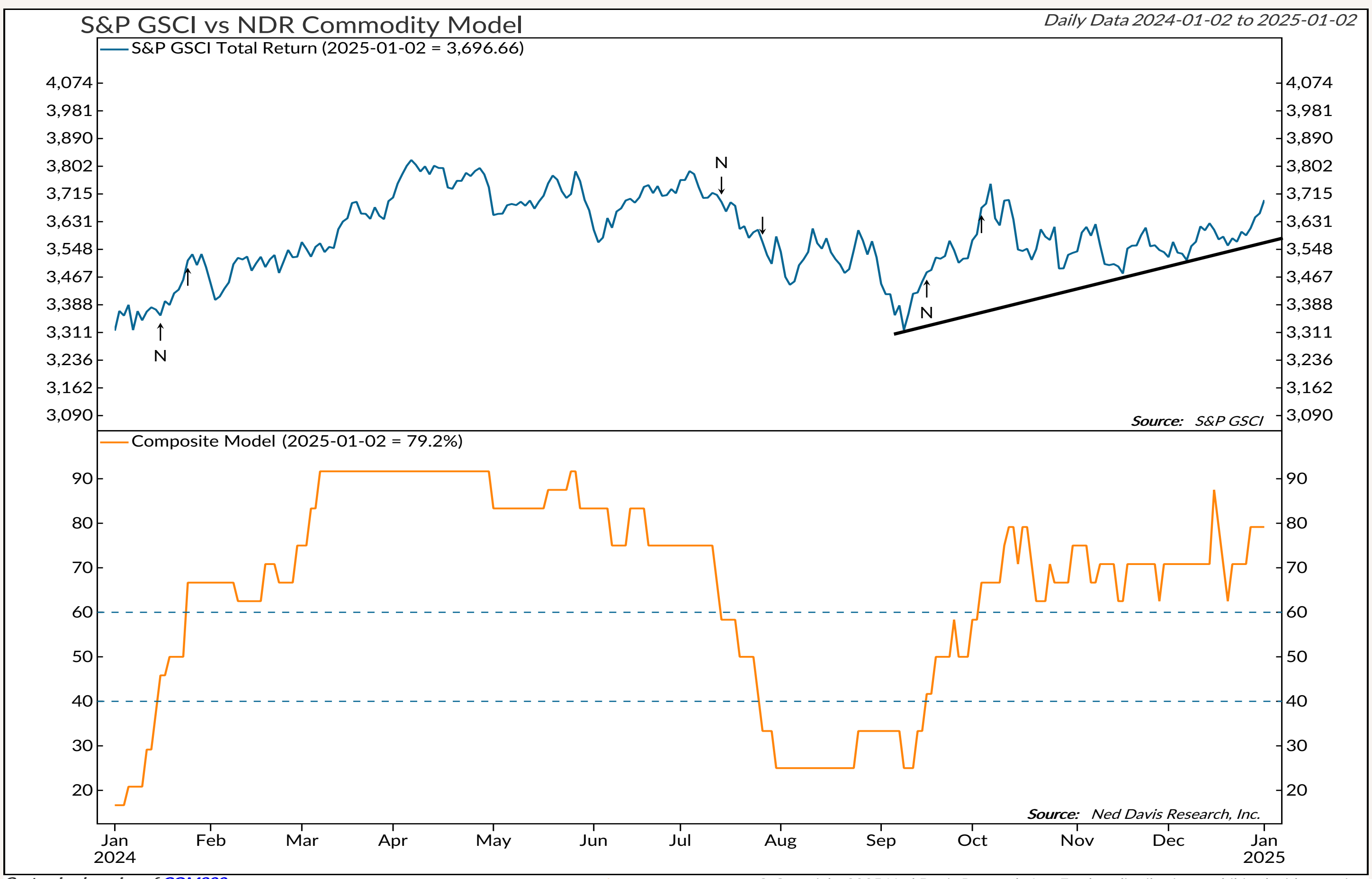
Commodities: Upgraded to bullish

The S&P Goldman Sachs Commodity Index (GSCI) ended 2024 with a 2.61% gain, largely due to a strong 2.6% rally in December that prevented the index from finishing flat for the year. Notably, 2024 exhibited the highest annual return dispersion among the 19 commodities tracked, with cocoa surging 173%, soybeans falling 22%, and a standard deviation of returns exceeding 44%. This wide divergence reflects dynamic market conditions across commodities. Key bullish indicators, including the GSCI Trend indicator and improved breadth (over 50% of commodities now trade above their 126-day average), signal strengthening momentum. Energy commodities such as crude oil, natural gas, and heating oil ranked among December's top performers, marking the first time since June that all three posted positive monthly returns. This resurgence is supported by factors such as capital discipline in the energy sector, geopolitical tensions, reduced Russian gas flows to Europe, and OPEC+ supply cuts.

Given these developments, we've upgraded our commodity outlook to bullish. The model composite moved to its most bullish monthly reading since May 31 (chart below). **All but two of the model's technical indicators are bullish and there are no bearish sentiment, fundamental, or macro indicators.** While risks such as lower global growth and a stronger U.S. dollar (USD) remain, recent data suggest improving fundamentals. Historically, commodities and the USD are inversely correlated, and any weakness in the greenback would further bolster the case for commodities heading into 2025.

Model's most bullish monthly reading since May



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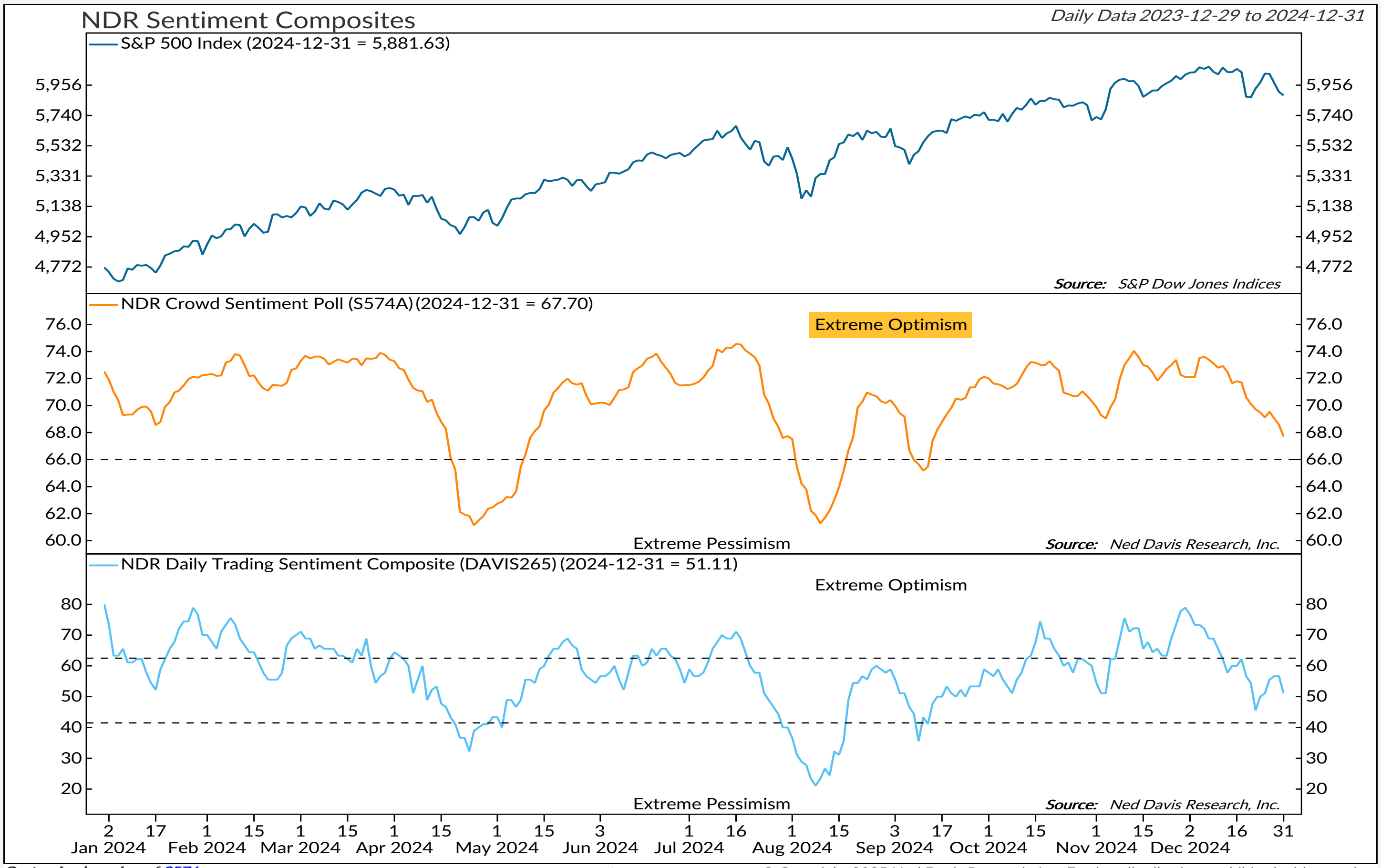
2024 was a year of investor optimism & risk

- The NDR Crowd Sentiment Poll, an intermediate-term measure, reflected sustained investor optimism, spending record time at extremely optimistic levels and avoiding extreme pessimism altogether. **This marked the seventh-longest streak of optimism, comparable to bullish cycles in 2017 and 2021 before corrections.**
- The NDR Daily Trading Sentiment Composite highlighted shorter-term sentiment fluctuations, with periods of pessimism during market pullbacks in spring and summer 2024. Currently, it indicates a neutral stance despite near-record stock allocations relative to bonds and cash.
- Elevated optimism, coupled with high stock allocations and bubbly valuations, poses risks for the coming year. Technical deterioration and recent weak performance in a typically strong seasonal period raise caution.

Investor sentiment was extremely optimistic for most of 2024



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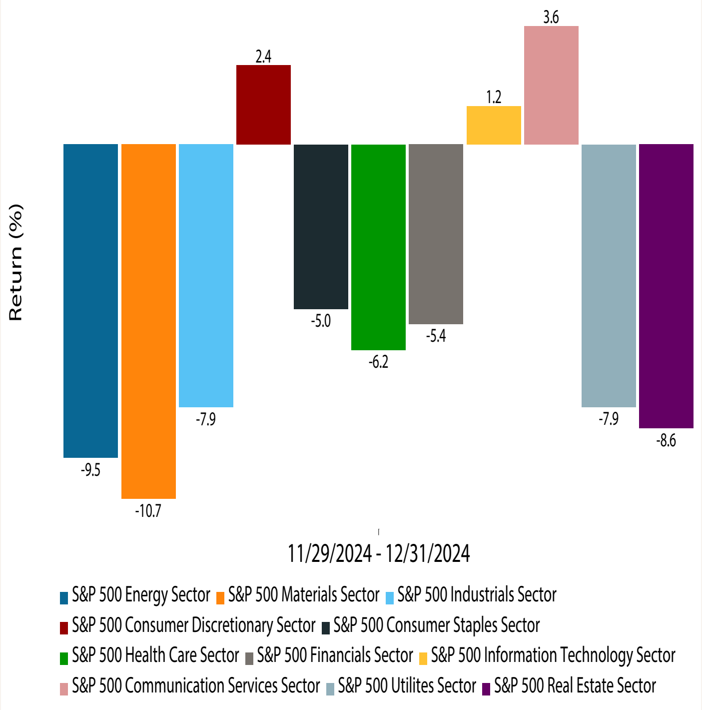
December Returns

S&P 500 Monthly Sector Returns



Chart's date range is 11/29/2024 to 12/31/2024. U.S. sector returns are based on S&P 500 GICS sectors and calculated using total return indices.

Source: *S&P Capital IQ and MSCI, Inc. (GICS)*

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Asset Class Benchmark Performance

2024 Q4	2024 October	2024 November	2024 December	Year 2024
Dollar 7.65	Gold 3.89	DJIA 7.54	S&P GSCI 2.60	NASDAQ 28.64
NASDAQ 6.17	Dollar 3.10	NASDAQ 6.21	Dollar 2.55	Gold 27.53
S&P GSCI 3.15	T-Bills 0.38	S&P 500 TR 5.87	EM 1.19	S&P 500 TR 25.02
S&P 500 TR 2.41	S&P GSCI 0.25	S&P 500 5.73	NASDAQ 0.48	S&P 500 23.31
S&P 500 2.07	NASDAQ -0.52	Dollar 1.82	EAFE 0.41	EM 13.12
T-Bills 1.11	S&P 500 TR -0.91	T-Bonds 1.82	T-Bills 0.36	DJIA 12.88
DJIA 0.51	S&P 500 -0.99	Bond Agg 1.03	Gold -0.94	EAFE 11.28
Gold -0.15	DJIA -1.34	EAFE 0.58	Bond Agg -1.60	Dollar 7.01
EAFE -0.62	EAFE -1.59	T-Bills 0.37	S&P 500 TR -2.38	T-Bills 5.09
Bond Agg -2.99	Bond Agg -2.42	S&P GSCI 0.28	S&P 500 -2.50	S&P GSCI 2.61
EM -4.42	EM -2.87	EM -2.74	DJIA -5.27	Bond Agg 1.33
T-Bonds -8.62	T-Bonds -5.21	Gold -2.97	T-Bonds -5.32	T-Bonds -6.41

All data in local currency and price only unless specified as total return (TR). Sources: MSCI,Barclays, Commodity Systems, Inc. (CSI) www.csidata.com, IDC, Ned Davis Research, Inc., S&P Dow Jones Indices.

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S&P 500 Sector Benchmark Returns

2024 Q4	2024 October	2024 November	2024 December	Year 2024
Cons. Disc. 14.06	Financials 2.55	Cons. Disc. 13.24	Communications 3.49	Communications 38.89
Communications 8.60	Communications 1.80	Financials 10.16	Cons. Disc. 2.33	Tech 35.69
Financials 6.67	Energy 0.71	Industrials 7.33	Tech 1.12	Cons. Disc. 29.13
Tech 4.67	Tech -1.00	Energy 6.28	Cons. Stpls. -5.24	Financials 28.43
Industrials -2.74	Utilities -1.07	Tech 4.57	Financials -5.58	Utilities 19.58
Energy -3.20	Industrials -1.39	Cons. Stpls. 4.55	Health Care -6.36	Industrials 15.64
Cons. Stpls. -3.84	Cons. Disc. -1.57	Real Estate 3.98	Utilities -8.07	Cons. Stpls. 11.98
Utilities -6.17	Cons. Stpls. -2.94	Utilities 3.16	Industrials -8.10	Energy 2.31
Real Estate -8.75	Real Estate -3.41	Communications 3.09	Real Estate -9.15	Real Estate 1.73
Health Care -10.67	Materials -3.55	Materials 1.45	Energy -9.56	Health Care 0.90
Materials -12.82	Health Care -4.73	Health Care 0.13	Materials -10.91	Materials -1.83

Source: S&P Capital IQ and MSCI, Inc. (GICS).

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Citations

Excerpts from the following NDR publications:

“Benchmark Review: Rising tide lift most boats” by Ed Clissold, January 2, 2024

“2025 U.S. Outlook” by Ed Clissold, December 10, 2024

“Downgrading Energy to marketweight” by Rob Anderson, December 19, 2024

“Top Themes of 2024” by Pat Tschosik, December 31, 2024

“Model update – upgrading to bullish” by Matt Bauer, January 3, 2024

“2025 Global Outlook” by Tim Hayes, December 5, 2024

“2024 — A year of investor optimism and higher risk” by London Stockton, December 31, 2024

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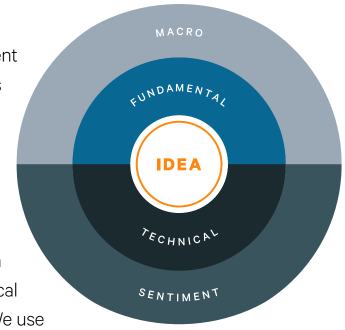

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