ACKERMAN
CAPITAL MANAGEMENT

5956 Sherry Ln # 1600
Dallas, TX 75225
(214) 361-5383
www.ackermancapital.com

# ACM QUARTERLY MARKET COMMENTARY – FOURTH QUARTER 2024

## Capital Markets

The big news in the fourth quarter was the Trump election victory, which dramatically affected the capital markets. In the five weeks leading up to the election, the markets certainly discounted this outcome as stocks, the dollar, and interest rates all surged higher. The dollar and interest rates continued to move into year-end, which partly may explain why the market finished the year with a down December. Even so, 2024 proved to be another banner year for stocks.

Globally, stocks finished the year up 17.3%, and once again, the U.S. stock market led the way as the S&P 500 rose 24.9%. Also, in a repeat of 2023, large U.S. growth stocks were the real star, with gains of nearly 35%. Even though the rest of the market could not keep pace, returns were still respectable. U.S. value stocks returned 14.1%, and small-cap stocks gained 8.6%. International and emerging market stocks were the laggards, with returns of 3.3% and 6.5%, respectively, but this was in large part a result of currency adjustments. On a local-currency basis, international stocks were up 13.7%, and emerging markets rose 10.6%.

Long-term interest rates surged in the fourth quarter in a round trip of the third quarter decline. The yield on the ten-year U.S. Treasury finished the quarter around 4.6% from a mid-September low that was a full percentage point lower. Given this rate move, bond prices took a hit, and U.S. aggregate bonds retraced more than 50% of their near-record third-quarter return with a loss of 3.1%. As a result, what was shaping up to be a good year for bondholders became a disappointment as U.S. aggregate bonds finished the year with a total return of only 1.3%. Not surprisingly, given the upward move in rates and the resilient economy, a bias toward shorter maturities and corporate credit risk turned out to be the proper positioning for the year, though emerging market bonds (USD) also performed well.

Broad commodity prices were down slightly in the quarter but finished the year above their September lows. It is important to note that the Bloomberg Commodity Index (TR) has still not fallen below its low from June 2023. Meanwhile, gold prices (our only commodity holding last year) made new highs in the fourth quarter and finished the year up 26.7%, its third-best year since 1980. The behavior of gold and the broader commodity complex indicates that inflation is not likely to recede any further from the Fed's aggressive interest rate hikes in 2022-2023. Though it has a more risk-on profile and a more complex set of price drivers, Bitcoin is sending the same message as it gained more than 120% last year and made new all-time highs.

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## The Economy

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 us, the administration hopes to stimulate the economy with pro-growth policies. The Federal Reserve's rate cuts have further supported credit conditions, ensuring that the expansion continues. Forward-looking indicators of economic growth show almost no near-term recession risk. However, we expect growth to moderate a bit in 2025 due to a more challenging economic environment marked by higher inflation, higher interest rates, budget deficits, and significantly higher government debt.

Worldwide economies showed resilience last year, with real GDP growth projected at over 3%, although momentum slowed in the year's second half. Europe and China, in particular, experienced softer growth. However, signs of recovery emerged late in the year, including back-to-back increases in the global Purchasing Managers' Index (PMI). 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. However, stimulus measures from China and an easing monetary stance across three-quarters of central banks should help near-term stability. We look for global GDP to grow close to 3% in 2025 and will benefit from easier monetary policy and fiscal stimulus. Notably, more than 70% of central banks around the world are in interest rate reduction cycles, versus just about 20% one year ago.

Inflation remains our primary concern. The strength in gold and sticky prices across the rest of the commodity complex could portend a resurgence in inflation readings. In fact, the annual growth rates of the CPI and the PCE Price Index have bottomed out in recent months and have been modestly ticking upward. This action further confirms our macro thesis that the era of abnormally low inflation and interest rates that persisted since the 2008 financial crisis has ended. In the coming years, we could see both interest rates and inflation range-bound between 3% and 6%, barring an unexpected economic shock. The Federal Reserve has indicated it will be very patient with additional rate cuts this year. If inflation measures continue to float back up, the Fed's quarter-point cut in December may be the last one we will see for some time.

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## Portfolio Management

Our portfolios performed well last year in absolute terms, given the strength in the global equity markets. On a relative basis, our taxable accounts generally outperformed benchmarks due to our modest overweight to equities and tilt toward large U.S. growth stocks. Tax-advantaged accounts led benchmarks through much of the year but finished more or less in line as the election results upended the tactical adjustments we made heading into the fourth quarter.

In tax-managed accounts, we have stayed the course with a modest overweight to stocks and an emphasis on large U.S. Growth stocks, partly to avoid generating unnecessary capital gains. However, we are closely paying attention to our trend models and may do some profit-taking there if prices begin to falter. In tax-advantaged accounts, the marginal tactical adjustments we made at the end of the third quarter proved ill-timed. Stocks rallied, bonds retreated, growth stocks outperformed value stocks, credit spreads narrowed, and the U.S. dollar surged in the fourth quarter. Fortunately, these moves have mostly been reversing in the first quarter of this year. Given the Trump tariffs, we are inclined to hedge our foreign bond exposure to the dollar again. However, we are holding course for now regarding our modest underweight to equities, generally, and large U.S. growth stocks specifically. We will continue to monitor our trend models and will not be out of sync with the market for any extended period.

## Looking Forward

The secular bull market for stocks that began in 2009 is still healthy, but it is starting to get late in the game, and valuations are a concern. For historical comparisons, the secular bull market from 1942 to 1966 lasted 24 years with a 40x total return (dividends reinvested), and the secular bull that began in 1982 and ended in 2000 was 18 years in length with a gain of 24x on a total return basis (dividends reinvested). In comparison, the current secular bull market is 16 years in the making with a total return of 12x so far, about where the market was at the end of 1996. Subsequently, the S&P 500 rose another 100% in that secular bull market's final three years in what would later be termed the "dot-com bubble." This bull market would require a similar price crescendo to ultimately reach a 24x return. Still, the excitement around artificial intelligence and cryptocurrency could certainly be the driving narrative for such a move.

In addition to these historical comparisons, this secular bull market remains solid, given its healthy breadth. While it is true that the broader market has not been able to match the torrid pace of U.S. growth stocks, performance has still been solid. Value stocks reached new all-time highs on a 14% gain last year. Small-cap stocks also made new all-time highs with an increase of more than 8%. International stocks made new highs last year, up almost 14% in local currencies.

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Only emerging markets did not make a new high last year but were still up more than 10%. In addition, every sector of the S&P, except real estate, notched a new high in 2024 – another sign of market health. The strength in financials was particularly bullish as more than 90% of S&P 500 financial stocks closed within 5% of their one-year high in October. This type of broad strength in financials has only occurred 11 times since 1950, and in all cases, the S&P 500 was higher one year later.

Despite this bullish signal from financials, this year could be challenging for investors. First, the market has not experienced a 10% correction since August to October 2023. Statistically, we are simply overdue. The U.S. stock market is also very expensive, as the median P/E of the S&P 500 is 26 at present. Excluding the depressed earnings periods post-2000 and post-2020, the only time that we have seen comparably high readings was during the late 1990's dot.com bubble. With the 10-year U.S. treasury yield recently approaching its highs from 2023, the U.S. stock market could easily get a case of the jitters at these levels. Another concern is the valuation of the "hyperscalers" (Alphabet, Amazon, Apple, Meta, Microsoft), which account for 25% of the market weight of the S&P 500. These five stocks trade at an average P/E ratio of around 30 times but with average projected earnings growth of only 15% for 2025-2026. We think the valuations of the companies will come under pressure this year. In addition, these companies will be investing staggering amounts of capital in developing their AI capabilities, which will eat into cash flow that otherwise could be returned to investors in the form of more aggressive stock buybacks or dividend increases. These five stocks constitute an even more significant percentage of U.S. growth stock indices, making us doubtful that growth stocks can maintain market leadership. In the U.S., we think value stocks and small-cap stocks will perform better this year, which so far has already been the case. International stocks have also outperformed U.S. growth stocks to start the year despite market concerns over the Trump tariffs. Overall, we think positive returns in the single digits will be a good outcome for diversified stock portfolios this year.

As for bonds, we started the year with interest rates at higher levels than we did in 2024, which bodes well. However, the surge in gold prices and the recent uptick in inflation readings is a concern. The Fed will do everything it can to keep the yield on the 10-year U.S. treasury under 5%. Still, unless the economy hits a significant speed bump this year, we doubt that interest rates will move significantly lower. As a result, we should be content to simply make our yield this year, which is about 5% for U.S. aggregate bonds and 3.5% for municipal bonds.

Finally, we remain bullish on gold and will look to build a more meaningful position on any price weakness. The last time the Federal Reserve cut short-term interest rates as gold made new highs was in 2007, and prices tripled over the next four years. Gold prices are up 50% since the Fed turned dovish in 2024, so there could be plenty of upside left. Similarly, we cannot help but be

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bullish on Bitcoin, especially given the "crypto-friendly" Trump administration. Our private investment partnership, A/Y Digital Holdings, LP, is our recommended vehicle for clients interested in Bitcoin and related investments.