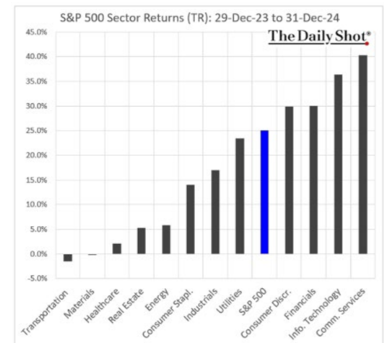
FIRST FINANCIAL TRUST

YOUR FUTURE FIRST

EQUITY MARKET UPDATE

As of 12/31/24 | Volume 13, Issue 12 | FFTAM.com

Stocks had a successful 2024; however, the year ended on a sour note as investors sold many of the companies that had rallied post-election due to rising interest rates. December proved that old habits are hard to break as once again technology stocks linked to the rollout of artificial intelligence were in hot demand. As we enter 2025, several items are in focus including: narrow market leadership, elevated valuations, high interest rates, and the unknown effects on inflation from Mr. Trump's views on tariffs, immigration, and taxes.



The S&P 500 fell 2.39% in December. The sell-off was broad based with every sector decreasing in value, except technology, communications, and consumer discretionary. The results would have been much worse without large gains in Broadcom, Tesla, Apple, and Alphabet. To put things in perspective, the index fell 2.39%, but the average stock dropped 6.28%, while the median stock declined 6.70%. This illustrates the severity of the sell-off, especially in areas like energy, utilities, real estate, and materials. For the full year, the S&P 500 was up 25.00%. Every economic sector posted gains, except materials. Communications (+40.23%), technology (+36.61%), financials (+30.50%), and consumer discretionary (+30.15%) were the only sectors to outperform the index. Once again, big tech was a major influencer of returns with the Mag 7 accounting for 63.91% of the money made in 2024. These names were such outliers that the average stock in the S&P 500 gained 15.46% last year, while the median stock only rose 12.49% (only half the index return)!

The Dow Jones Industrial Average dropped 5.13% for the month. Large declines in United Healthcare, Caterpillar, and Sherwin Williams negatively impacted results. For 2024, the Dow was up 14.99%. Disappointing performance from Boeing and Intel weighed on the index all year.

The NASDAQ increased 0.56% in December. It was the only major index to post a monthly gain. It continued to march higher

Not FDIC Insured | May Lose Value | No Bank Guarantee

given its large exposure to the big tech firms. In 2024, the NASDAQ was the best performer, up 29.60%, as investor enthusiasm surrounding artificial intelligence remained intact.

Mid and small-sized stocks were the clear losers last month. The S&P 400 Mid Cap (-7.12%) and S&P 600 Small Cap (-7.96%) indexes fell as interest rates rose and investors took profits from November's rally. High finance costs, along with worries about structural competitiveness, weighed on these names all year. The two indexes finished up 13.89% and 8.65%, respectively. They still trade at massive valuation discounts compared to their large-cap peers.

The US economy remains on solid footing; however, segments that are interest rate sensitive, like housing, are relatively weak. Consumer spending is strong, but many metrics show stress building among lower-income households. Labor, which has been the bright spot for the past two years, appears to be returning to more normalized conditions. December payrolls showed that another 256,000 jobs were created. Unemployment ticked down to 4.1%. Wages were up 3.9% from one year ago, an amount that continues to exceed both the Fed's expectations and the pay raises seen pre-COVID. The labor market is tight, but competition to recruit and retain employees has obviously waned. The JOLTS report showed that there are 8.1 million jobs open but unfilled. There are currently 1.12 job openings for every unemployed person. This is below the levels seen pre-COVID, and it indicates that getting a new job is becoming harder for people on unemployment.

Consumer inflation continues to be stubborn with prices increasing 2.7% from one year ago. Core inflation that removes food and energy held steady at 3.3%. PCE data, the Fed's preferred measure of inflation, showed total prices climbing 2.4%, while prices ex-food and energy rose 2.8%. These statistics are much better than the high-water marks seen in 2022, and they are within reach of the Fed's 2% target. However, the pace of improvement has slowed dramatically the past few months. This is fueling a large debate among investors on how much room the Fed has left to lower interest rates.

Despite wage growth and relatively low unemployment, clouds are forming over select segments of the consumer population. Personal income grew 0.3% in December. Total spending rose 0.4%, while retail sales climbed 0.7%. The savings rate remains well below pre-COVID levels. Consumers have increasingly funded their expenditures with the use of debt. Credit card balances are at record amounts, and debt delinquency has climbed from one year ago in both credit cards and auto loans, especially among people with lower credit scores. Recent credit reports indicate appetite for consumer debt is decreasing as many households find themselves financially stretched. The brunt of the weakness is in the lower-income areas of the economy that overwhelmingly voted for Donald Trump seeking relief from multiple years of rising prices. Until Mr. Trump provides greater details on his economic policies, monthly job reports and weekly unemployment claims are vital pieces of information to watch to gauge the strength of the consumer.

Higher interest rates have cooled business investment. The ISM Manufacturing PMI Index (49.3) contracted once again. This index has fallen in 25 of the last 26 months. Employment data (45.3) showed manufacturers have cut workers in 20 of the last

ABILENE
400 Pine Street
Suite 300
Abilene, TX 79601
325-627-7100

BEAUMONT
3515 Dowlen Road
Beaumont, TX 77706
409-600-6460

BRYAN/COLLEGE STATION
2445 Harvey Mitchell Parkway South
College Station, TX 77840
979-260-2134

FORT WORTH
1000 Forest Park Blvd
Suite 200
Fort Worth, TX 76110
682-703-6404

HOUSTON
24080 Hwy 59 N
Kingwood, TX 77339
281-318-4625

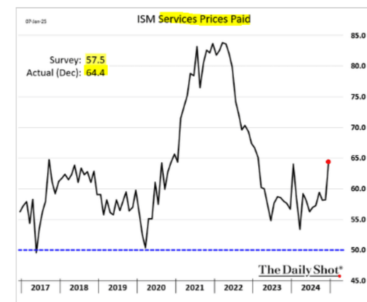
ODESSA
3555 Billy Hext Rd
Odessa, TX 79765
432-367-8912

SAN ANGELO
222 S. Koenigheim St San Angelo, TX 76903 325-659-5987

STEPHENVILLE
2201 W. South Loop
Stephenville, TX 76401
254-918-6262

SWEETWATER
201 Elm Street
Sweetwater, TX 79556
325-235-6644

Not FDIC Insured | May Lose Value | No Bank Guarantee

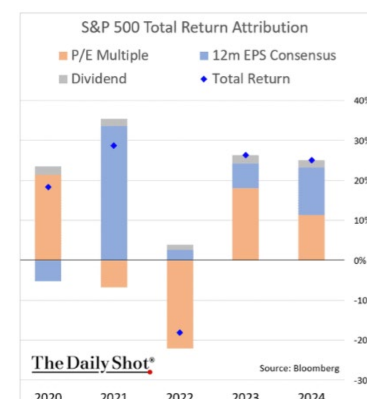


23 months, something that historically happens only during recessionary periods. On the bright side, new orders (52.5) expanded for the second straight month signaling future demand for products is stabilizing, although some wonder if this number could be skewed by businesses ordering products and components before the proposed tariffs from President-elect Trump take effect. Services have been the engine powering the economy, although data has been softening the past few months. The ISM Service PMI Index improved to 54.1 from 52.1 the previous month. Service employment (51.4) signals labor needs have normalized. New orders (an indicator of future demand) were 54.2, a very strong reading. Prices paid for services (64.4) was especially hot and continues to be the epicenter of inflation.

Collectively, the data shows the Fed is winning the battle with inflation, although as stated above, the pace of improvement, especially in services, has waned. They lowered the Fed Funds rate by 0.25% at their last meeting to a range of 4.25% to 4.50%. Dot plots indicate the central bank believes rates will be between 3.50% and 3.75% by the end of 2025. This is higher than the previous plots and implies rates will only be cut twice in 2025. This resulted in a sell-off in both stocks and bonds with investors now in-line with the Fed's projections given the recent stubbornness in inflation readings, along with concerns about increased government deficits from the Trump administration to make the proposed tax cuts permanent.

Equity valuation finished 2024 near its peak. The S&P 500 currently trades at 22.2x forward earnings estimates. This is up from 18.6x one year ago, and it is above both the 5-year (19.7x) and 10-year (18.2x) averages despite the higher interest rate environment. The equity risk premium that compensates investors for the excess risks associated with stocks compared to bonds remains historically thin.

We are near the start of another earnings season. Analysts remain very bullish about the future. They are currently forecasting a 11.9% jump in 4th quarter earnings. If this comes to fruition, it would be the sixth consecutive quarter of profit growth, and it would be the highest growth rate since the 4th quarter of 2021. However, the number is heavily skewed by five industries. When you back out those industries, the projected growth in profits falls to only 1.6%! Looking forward to 2025, analysts believe earnings will rise by double-digits each quarter with a full-year forecasted growth rate of 14.8%.



With the market trading at higher valuations than the past decade, it is fair to say plenty of good news has been priced into stocks. The S&P 500's return in 2024 exceeded the full-year profit growth forecast for both 2024 and 2025 combined, which resulted in another year of PE multiple expansion. This tells us investors are fully convinced that inflation and interest rates will be coming down while overall demand for goods and services will remain intact (i.e., soft landing or "Goldilocks" scenario). This is not impossible, but it sets a very high hurdle for both the Fed and the market. It also makes stocks highly sensitive to tariff announcements from President-elect Trump and possible tax negotiations within Congress next year.

It is also important to keep in mind that the market's projected valuation is heavily skewed by

ABILENE
400 Pine Street
Suite 300
Abilene, TX 79601
325-627-7100

BEAUMONT
3515 Dowlen Road
Beaumont, TX 77706
409-600-6460

BRYAN/COLLEGE STATION
2445 Harvey Mitchell Parkway South
College Station, TX 77840
979-260-2134

FORT WORTH
1000 Forest Park Blvd
Suite 200
Fort Worth, TX 76110
682-703-6404

HOUSTON
24080 Hwy 59 N
Kingwood, TX 77339
281-318-4625

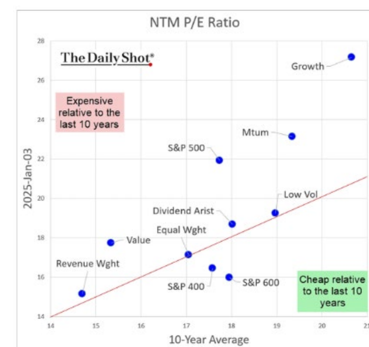
Not FDIC Insured | May Lose Value | No Bank Guarantee

ODESSA
3555 Billy Hext Rd
Odessa, TX 79765
432-367-8912

SAN ANGELO
222 S. Koenigheim St San Angelo, TX 76903 325-659-5987

STEPHENVILLE
2201 W. South Loop
Stephenville, TX 76401
254-918-6262

SWEETWATER
201 Elm Street
Sweetwater, TX 79556
325-235-6644



the premiums being assigned to the big tech companies at the top of the index. If you equal weight the names inside the S&P 500, the forward PE ratio drops from 22.2x to 17.3x, a much more reasonable valuation but still not exactly cheap. The struggle for investors is the big tech companies are experiencing the largest growth rates as they roll out artificial intelligence; meanwhile, economically sensitive sectors like energy and financials trade at deep discounts but need the economy to remain strong for an extended period to justify a prolonged re-rating in their shares. Healthcare also looks attractively valued, but investors are leery of potential policies pursued by Bobby Kennedy Jr. if confirmed by the Senate. With those dynamics at play, we are seeing a massive divergence in performance between winners and losers.

At a time in which the risk-to-reward outlook appears challenging, we are focusing on quality companies with lower valuations, strong balance sheets, and growing dividend streams to enhance returns. For several months, we have been incorporating a barbell strategy to capture the discounts being applied to both interest rate-sensitive (banks and REITs) and defensive (utilities and healthcare) areas. Our conviction remains high in these areas as we enter the new year.

Scan the QR Code to subscribe to our Monthly Equity Market Update. It will be delivered to your email inbox.

ABILENE
400 Pine Street
Suite 300
Abilene, TX 79601
325-627-7100

BEAUMONT
3515 Dowlen Road
Beaumont, TX 77706
409-600-6460

BRYAN/COLLEGE STATION
2445 Harvey Mitchell Parkway South
College Station, TX 77840
979-260-2134

FORT WORTH
1000 Forest Park Blvd
Suite 200
Fort Worth, TX 76110
682-703-6404

HOUSTON
24080 Hwy 59 N
Kingwood, TX 77339
281-318-4625

ODESSA
3555 Billy Hext Rd
Odessa, TX 79765
432-367-8912

SAN ANGELO
222 S. Koenigheim St San Angelo, TX 76903 325-659-5987

STEPHENVILLE
2201 W. South Loop
Stephenville, TX 76401
254-918-6262

SWEETWATER
201 Elm Street
Sweetwater, TX 79556
325-235-6644

Not FDIC Insured | May Lose Value | No Bank Guarantee