Summit Trail Advisors

Monthly Download December 2024

Summary

A Santa Claus Rally did not materialize to end 2024 with most equity markets closing out a negative month despite delivering strong gains for the year. The Federal Reserve cut rates by 25 basis points in December as expected but signaled a plan to slow rate cuts going forward which caused the markets to lose momentum. Equity markets saw a reversal of the "Trump trade" in December, driven primarily by higher rate expectations after the Fed meeting. Non-US equity performance was also weak as political uncertainty and a stronger US dollar put pressure on foreign markets.

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Market Overview

- **Equity markets** sold off after the December Federal Open Market Committee (FOMC) meeting, as market participants were caught off guard by the magnitude of the rate reduction change projected by FOMC members. The Technology and Software concentrated Nasdaq Composite finished the month in positive territory while smaller companies were most negatively impacted by the expectations for higher rates. Growth significantly outperformed Value as concerns about higher interest rates also weighed on sectors like Materials, Energy and Real Estate.
  - US Large Cap stocks (S&P 500) fell 2.4% in December, with eight of the 11 sectors finishing in negative territory. Higher rate expectations and uncertainty regarding the new administration's tariff and immigration policy weighed on the market. US Large Cap stocks delivered 25.0% for the full year 2024 for the best two calendar year performance since 1997 to 1998.
  - US Small Cap stocks (Russell 2000) declined 8.3% for the month as smaller companies tend to have higher exposure to floating-rate debt and are more negatively impacted by higher rates. Financials, Materials and Healthcare sectors led the losses. Year 2024 gains decreased to finish at 11.5%.
  - Non-US stocks (MSCI EAFE Net) fell 2.3% during the month as political uncertainty, slowing growth and a stronger dollar all weighed on international stock performance. Year 2024 delivered a return of just 3.8% in US dollars.
  - Emerging Markets (MSCI Emerging Markets Net) ended the month down 0.1%. China and Taiwan contributed positively but were offset by weakness from South Korea, India and Brazil. Year 2024 performance for Emerging Markets ended at 7.5%.
- **Interest rates** rose sharply as the market priced in the slower rate cut scenario messaged by the Fed and concerns about Trump policies delivering a second wave of inflation. The 10-Year Treasury began December at 4.18% and ended the month at 4.57%. The two-to-ten-Year Treasury spread reached 0.33%, the highest spread level since

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June 2022 shortly after the last Fed hiking cycle started. The US dollar index gained 2.6% in December, staging the best annual return since 2014.

- High Grade Taxable bonds (Bloomberg US Aggregate) declined 1.6% in December as the longer end of the interest rate curve rose sharply. High Grade Taxable bonds finished the year up 1.2% in 2024.
- Municipal bonds (Bloomberg 1-10 Year Muni Bond) fell less than their taxable counterparts during the month, detracting 0.7%. Municipal bond performance for 2024 delivered 1.1%.
- High Yield spreads widened slightly in December but remained at historically tight levels and higher coupon payments cushioned the decline caused by rising rates more than Investment Grade bonds. Investment Grade bonds (Bloomberg Corporate Investment Grade) and High Yield bonds (Bloomberg Corporate High Yield) returned -1.9% and -0.4% in December, respectively. Year 2024 gains for Corporate Investment Grade and High Yield bonds out-performed broad High Grade taxable bond indexes at 2.1% and 8.2%, respectively.

◆ **Commodities** recorded a modest monthly gain of 1.0% in December, led by the energy sector. Natural Gas rose 8% on the colder January weather forecast, and Crude Oil also rallied on stronger demand in December, while precious metals weighed on performance. Gold and Silver fell 1.1% and 5.6% respectively. Year 2024 performance for commodities ended with a return of 5.4%.

Economic Commentary

The Federal Reserve delivered a quarter point rate cut in its December Federal Open Market Committee (FOMC) meeting and signaled a plan to slow the pace of rate reduction, forecasting fewer than expected rate cuts in 2025. The ten-year Treasury yield surged, peaking at 4.64% on the 26th from 4.18% at beginning of the month. As the Fed began signaling rate cuts in late 2023, the market has consistently priced in a higher number of cuts and sooner than what the Fed has messaged. The most recent FOMC reduced the Fed's forecast on the number of rate cuts by the end of 2025 to two instead of four compared to their September forecast. In addition to stubborn inflation data and a resilient US job market, the Fed is likely factoring in uncertainty around the incoming Trump administration's tariff and immigration policy. The FOMC members raised their inflation forecast in 2025 to 2.5% compared to the 2.2% projection made in September. Treasury bonds initially enjoyed a rally on Scott Bessent's nomination to the Secretary of the US Treasury Department given his experience in capital markets. November Personal Consumption Expenditures ("PCE") and Core PCE rose 2.4% and 2.8% year over year respectively, evidencing the move closer for inflation to the Fed's long term target of 2%. The US job market has proven to be sturdier than expected with the headline unemployment rate at 4.2%. The two important data points provide little justification for the Fed to continue the pace of rate reduction. The shift to fewer rate cuts by the Fed reflects increasing interest rate uncertainty in 2025 given pro-growth (taxes, deregulation) and inflationary (immigration, trade) economic policies. The pause in easing could help prevent the Fed from being forced to raise rates again too soon.

2025 Market vs Fed Rate Cut Expectation
Notes: Market reflects January 2026 fed-funds futures. Fed reflects median of officials' forecasts.
Source: Wall Street Journal

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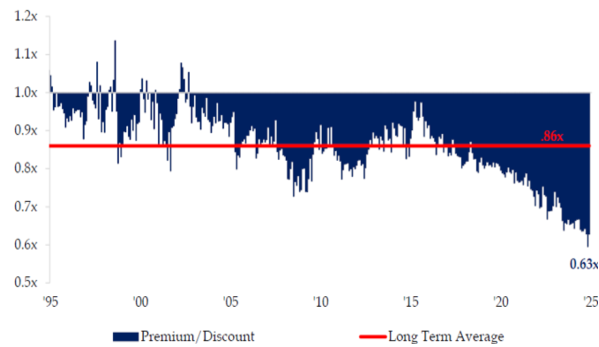
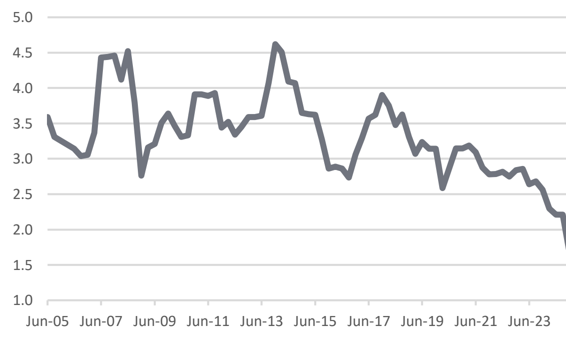
European Equities materially underperformed U.S. markets in 2024, widening the disparity between the two regions further. The MSCI Europe index only rose 2.2% for 2024 measured in US dollars compared to the S&P 500 's 25.0% rally. The valuation gap between the two indices is at a historical wide level measured by Price to Earnings (P/E) ratios. In addition to the near-term continued US Dollar strength, a major headwind is the political instability and the associated difficulty to rein in European budget deficits. France, the second largest economy in the Eurozone, saw their equity market finish the year down 8.5% compared to Germany's DAX index rising 12.0% in 2024. In December, the French government collapsed after Prime Minister Michel Barnier was ousted in a no-confidence vote. Without a prime minister, the government's ability to pass legislation is limited and France needs to urgently address its enormous budget deficit issue which is tied to the turmoil that has taken place in the country's parliament. The European Union (EU) has set its fiscal deficit limit at 3% of GDP and the French government has repeatedly run higher deficits than the limit. PM Barnier tried to pass a budget plan that would include cuts to pension and healthcare spending to reduce the budget deficit from 6.1% in 2024 to 5.0% in 2025. The plan failed to gain support from both the left and right wings of the parliament. With a plurality system relative to the US and no majority by any one party at the parliament, it is difficult for the French government to manage the fiscal crisis. Moody's has moved to downgrade French government debt following S&P and Fitch in December and the spread of 10-year French government bonds to German government bonds widened to the highest levels since 2012. Germany, the largest economy in Europe, has also struggled to revive economic growth and joined France as its current ruling party also received a no confidence vote in December, triggering an early election in February 2025. Some analysts argue the negative European news has been priced into markets and a sentiment change could deliver strong returns from this low valuation level. Weaker Chinese consumer demand for European goods, intensifying manufacturing competition from China in industrial sectors like electronic vehicles, energy dependency on Russia, and potential U.S. tariff hikes could all maintain headwinds for the trajectory of European economic growth in 2025.



NTM PE Premium/Discount: MSCI Europe to S&P 500
Source: Strategas

Chinese Equity Markets and Government Bonds both had a positive year in 2024. The MSCI China Index returned 19% while Government Bonds measured by Bloomberg Chinese Government Total Return Index delivered a 9% return for the year. Equity market returns snapped a three-year losing streak with almost all of the returns coming in September (+22%) alone when the index shot up on the announcement of a slew of stimulus measures totaling 3% of GDP within one week. However, since then, market expectations for further stimulus and the lack of effectiveness of the existing programs has made the market trend down 6.7%. Despite striking a positive tone at its decision-making Politburo meeting in December, the government has failed to boost consumer spending as the Chinese Consumer Price Index in November rose just 0.2% year-over-year and consumer confidence readings remain at multi-year low levels. In addition, the country's government bond yield declined to the lowest levels in history at 1.67%. The stimulus measures released so far are focused on monetary policies, which have limited impact on consumer demand, while fiscal stimulus has yet to increase consumer spending in 2024. Current



10-Year Chinese Government Bond Yield: 2005 to 2024
Source: Bloomberg

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government bond yields and low inflation point to the possibility of an ominous deflationary spiral that would require massive fiscal stimulus to solve. Non-mainland China investors remain unconvinced to bring assets into China or be bullish on Chinese assets especially after Trump's victory back to the White House. Trump campaigned on plans to impose a 60% tariff on Chinese goods, much higher compared to the tariffs imposed in 2018. After the first round of tariffs, both currency depreciation and supply chain workarounds by moving goods through Mexico and Southeast Asia countries helped to alleviate the negative overall impact. Further currency depreciation for China given current levels has limited room to go without triggering capital outflow concerns. There are also likely limits on how much further supply chain adjustments from China to other countries can continue. Some investors are predicting the Chinese government bond yield to continue its decline in 2025 as a sign of weak economic growth prospects and the need for further stimulus. With the US central bank pausing rate cuts while further easing continues in China, it makes reviving the economy much tougher for the Chinese government, not to mention the looming trade war with the US that is likely to intensify.

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