Podcast Transcript: Investment Committee Video Discussion: 2025 Outlook

Richard S. Brown:

I am Richard Brown, Chairman and CEO of JNBA Financial Advisors in Minneapolis, Minnesota. We're recording this discussion on January 7th, 2025. I'm with two members of our investment committee, Mark Rosenkranz, an Investment Strategist, and John Foster, a Senior Advisor and Investment Strategist. Happy new year, John and Mark.

Mark Rosenkranz:

Happy new year.

John Foster:

Happy new year, Richard.

Richard S. Brown:

Good to see you guys. Before we dive in, what could be on the horizon for 2025, let's take a few minutes and recap the key events in 2024.

John Foster:

Yeah, Richard, I think there's three main things that really drove a lot of the market returns in 2024. One was yields and there were almost distinct periods of rising yields and falling yields, and when yields were rising, we saw a market that got very narrow, very focused on what people call the Mag 7 stocks, but really, it's companies that have a lot of cash, generate a lot of cash flow, don't have any debt, and they did really well during periods of rising yields, which was the first third of the year. We entered the year, 10-year treasury was at 4%. It got all the way up to 4.7% beginning of May, and that period was really dominated by narrow leadership from those Mag 7 companies and the rest of the stock market really languished behind.

Then we saw yields from the beginning of May through September drop from 4.7 to 3.6%. The dollar was weak during that time period and that really lit a fire under all equities where we saw small-caps, mid-caps, international, emerging market stocks, everything really participated during that stretch. And then, curiously enough, the fed starts cutting interest rates. They cut interest rates by 100 basis points the last part of the year, and we saw yields tick back up from that 3.6% in the middle of September, up to 4.7% here today. And we've seen the market narrow again, and it got focused back to companies that don't have a lot of debt, are self-financed. The dollar strengthened, that hurt international shares. And where we ended the year, was large cap equities performed really well, up about 24%. Small cap stocks did about a third of that at 8%. And international equities, they were left behind on that real strong dollar that we saw as yields rose into the end of the year, and they gained only 3%.

Bonds, too, they were hurt by these rising yields, because we entered the year with a 10-year treasury at 4%. The fed cut rates, yet bond yields went up. They ended the year at 4.6% and bonds, despite having a yield over 4% for the bulk of the year, they ended up with a total return of just 1.3% for the aggregate index. So a bit more of a narrow market to end the year, where things were heavily focused on large cap and a bit narrow with small and international lagging behind. But it was really a story of periods of rising yields and dollar strength, a pretty narrow

market, and then a big broadening through the middle third of the year, and then a bit more narrowness here to end the year, what was kind of the tale of the year, where rising yields and a strong dollar hurt international and smaller companies.

Richard S. Brown:

Yes, the markets sure do have a way of writing their own path. And that brings us to a start of a new year. With the markets, again, around all-time highs, many are wondering what 2025 could look like after two strong years of market performance. Mark, what insights can you share with us?

Mark Rosenkranz:

Yeah, I think a lot can go into such a small question like that. And so, why don't I touch on the equity side and maybe John can tackle the fixed income component? But a lot of what John talked about in terms of the narrow and broader leadership, that has been a big driver for not only the last year, but really since the start of 2023. And especially this year, not only has there been a yield component that's impacted large-caps versus mid, smaller, international, there's also been an earnings story behind that. And the big story with the Magnificent 7 is, some component of AI growth is really fueling rapid earnings growth. You look at the year for 2024, the official earnings aren't in yet as companies are still finishing up their accounting work, but the Magnificent 7 grew earnings by about 33%, and the remaining 493 of the S&P 500 grew about 3%.

So that 30% gap paints a pretty big picture in terms of where earnings growth is coming from. It's been a pretty remarkable story that the largest companies in the world have been the fastest growing. That's pretty much unheard of. It's usually the typical, you reach maturity and you have that more stable, slow growth business. And it's just been the opposite for the last two years. And that's really driven not only some strong performance from the Magnificent 7, but really lagging performance, that 3% earnings growth rate is a pretty tight premium to see more growth in a valuation neutral environment. The only way to grow your stock price is really through earnings.

Now, looking forward into 2025, you still see that earnings gap between the Magnificent 7 and the remaining, whether it be the 493 in the S&P, but really mid- and small-cap as well. But that is starting to narrow. Right now, the 2025 forecast for that Magnificent 7 is around 18% earnings growth, and the remaining of the market is 12%. So you're taking a gap that goes from 30% to 6%, and that could indicate some broadening of some sort. Adding on the layer of valuations, where the Magnificent 7 has obviously been bid up to pretty higher valuations where the rest of the market has lagged, you have a more compelling earnings growth story for the remaining companies, whether it be in large-cap or mid-, smaller, international, coupled with a more favorable valuation.

So we could start to see a little bit more broadening just in terms of the fundamentals of how these companies are performing. Now, I think for 2025, it could be an interesting year. For several years now, we've talked about the three broad pillars of what we're trying to look at for the broader market outlook, and it really comes down to corporate earnings, inflation, and unemployment. And we touched on how the earning situation has changed for 2025, but

inflation and unemployment could play a big role and that's not coincidentally the mandate from the fed. So before we dive into fixed income, John, anything you'd like to add on the equity outlook?

John Foster:

No, I think you hit the nail on the head in terms of the other factor for narrowness. I talked about yields and dollar strength, but it was to an earnings story. And if that earnings gap does narrow, if you look at valuations today, S&P 500 trades at, on average, about 22 times earnings, with a 1.4% dividend yield. Certainly not overly expensive, but on the higher end valuation wise. You compare that to small cap or international, that around 13, 14 times earnings with dividend yields in the 2 to 3.5% range, you have a pretty compelling valuation case if the earnings can come in anywhere close to double-digit growth on what are pretty low multiples for those asset classes.

Mark Rosenkranz:

And then on the fixed income front, the markets, we always seem to focus on what the stock market is doing, but for the longest time, there wasn't a lot of available options. And there has been some noise across the USA and just the bond market in general, but John, what are your thoughts on how the fixed income is positioned throughout the year?

John Foster:

Yeah. I think for the first time in a while here, really, we had an inverted yield curve. For the last couple of years, really, first time in a while we have a normal yield curve. And what that means is that short-term interest rates are actually lower than intermediate and long-term rates, as you have cash right now or T-bills paying around 4.25%. You have a five-year treasury getting up close to 4.5%. And then as mentioned earlier, a 10-year treasury at 4.7. So you have that normal sloping yield curve that we're seeing in fixed income. And it really feels, with the fed about done, inflation has been coming in in the 2 to 3% range, so you still have yields above the rate of inflation.

As long as policy keeps inflation pretty close to where we're at today, it does feel like a bond market where you should be able to at least pocket that yield with the aggregate bond index having a blended yield of about 4.7% today, or pocket the yield with maybe a little bit of price appreciation, but maybe a total return for bonds or for the bond index this year, somewhere in that 4.5 to 5.5% range seems most likely. And to your point, Mark, we're talking about a war on savers that lasted almost two decades, where yields were 2% or less. So something in the 4 or 5% range for bonds, that's certainly a lot more attractive than what fixed income investors are used to.

Mark Rosenkranz:

Yeah.

Richard S. Brown:

Great feedback, Mark and John. Good information. Maybe we should touch on the November elections. What are the one or two key things our investment committee is focusing on as we move throughout this year?

John Foster:

Yeah, Richard, I certainly think we've seen the market already react a bit to the election and election results. One of the concerns that the market has, is probably over tariffs and deportation, increasing costs as tariffs get passed along to consumers. That can certainly increase the cost of goods, as well as if there's some amount of tougher immigration or deportation that can reduce lower cost labor. And we've seen the bond market probably the fastest to react, where we have interest rates that have ticked up from 3.6% in the fall, as I mentioned earlier, to about 4.7% today. Mark, maybe if you want to touch on taxes, deregulation, maybe some of the things that look real positive here, maybe, moving forward?

Mark Rosenkranz:

Yeah, yeah. I think you've painted a good picture of how certain companies in certain sectors can do well in a higher inflation environment. But on the flip side, you also have some benefits from the new administration in terms of deregulation, potential extension of the tax cuts that we saw in the first Trump administration, where you have this push and pull of a more business-friendly environment, so to speak, coupled with some higher inflationary concern. So it's really that dynamic of what wins out and how that impacts the earnings. We talked about the narrowing of an earnings gap. The small- or mid-cap companies, international companies, they could be more sensitive to those ebbs and flows, where you could see a little bit more height and volatility in those. But in the overall static environment, it still seems to paint the picture of better earnings for those less healthy balance sheets that are more debt sensitive, so to speak.

Richard S. Brown:

Wow, a lot of moving parts in 2025. So how are we positioning our portfolios to optimize this?

Mark Rosenkranz:

Yeah, it's an important question, especially when we're at all-time highs of how good can things stay, so to speak. And one of the main tactical levers we have at JNBA is our broad asset class positioning, going overweight or underweight, equities versus fixed income, in any given environment. The last time we went overweight equities was right at the end of 2023, and that performed very well throughout 2024. I think the S&P was up about 25% versus, as John pointed out, the USA around 1%. So that has been a very healthy trade and we rely on a very good macro model for that, as well as internal investment committee discussions.

And recently, that model has painted a little bit more of a neutral environment, and it's a little bit more of an uncertain outlook, not surprisingly. And I think in that type of scenario, we rely on that model fairly extensively, as well as our investment committee of really keeping a pulse on

that. And that factors not only into positioning going forward, but the art around managing the positions. And a good example of that was, even in June of this year, when we saw a little bit of a pullback in the S&P 500, that model was still fairly bullish, and that allowed our trading team to be more advantageous about potentially buying some weakness, or not letting things ride a little bit further. In a more neutral to slightly bearish environment on some of those models, there may be more positioning where we look to let things not go so much further ahead of themselves and keep closer to targets.

And if we were to see that model flip fully to bearish, the party's been going on for a while and I wouldn't say that the party's over by any means, but it may be getting a little later. And at this stage in the game, we want to make sure we know where our coats are, we know where our shoes are, we have the Uber lined up and dialed up and ready to call home. And when that event were to occur, I could imagine being a little bit more of an Irish goodbye than a Minnesota goodbye, so to speak, of being ready to know that we have a good fixed income environment that we can shift more defensive very quickly should the environment start to change.

Richard S. Brown:

Well, it sure is a lot of moving parts, and thank you both, John and Mark, for a great discussion today. And thank you to our listeners. We hope you'll visit jnba.com and tune into our other podcasts and videos, where we cover both investment and financial life planning topics. Thank you for your continued trust in JNBA, not only as your financial advisor, but also as your advocate. Please reach out if you need anything at all. You can find our contact information at jnba.com.

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