THE FINANCE COUPLE™

TWO PERSPECTIVES WITH ONE FOCUS... YOU

A Review of 2024 and Preview of 2025

January 2025

"You must be able to walk firmly on the ground before you start walking on a tightrope."
– Henri Matisse

A year ago, we wrote that it was possibly the best of times as well as the worst of times. The widening contrast in seemingly every realm of life (political, economic, etc) was not something we were terribly happy about. However, even though we worried, and continue to worry, about whistling past the graveyard, we believed 2024 could be another good year in the markets. If nothing else, we thought the presidential election cycle, and/or FOMO (Fear Of Missing Out), and/or TINA (There Is No Alternative), could help the equity markets climb even higher on the so-called "wall of worry". And climb it did; the S&P 500 went up well over 20% in 2024, as it did in 2023. But the dichotomies still catch our attention.

For instance, the U.S. stock market had another great year, but returns were heavily bolstered by just a few stocks, nicknamed the Magnificent Seven. President Biden finished his term with a historically low approval rating yet oversaw one of the largest GDP and stock market increases on record. The dollar ended 2024 at a historical high while short-term interest rates declined (the dollar typically declines when the Federal Reserve lowers rates). It's these dichotomies, and other issues, that cause our concerns to remain elevated, believing we may be walking a narrower tightrope without having sound footing underneath.

First, so as not to worry you too much, we do remain optimists - but we balance it with a healthy dose of cynicism so as not to be blinded by short-term events that may or may not impact long-term plans. As for that cynicism applied to the markets, we remind everyone not to mistake the means with the end; i.e., just because the markets went up does not necessarily mean low or even fair equity market valuations were the drivers. We are not being pessimists here, we just believe markets go up and down in the short-term based on emotion or momentum, whereas fundamentals tend to be justified over longer periods of time.

Accordingly, our forecast for 2025 is more optimistic than for the next five years. Though we think 2025 could be a very volatile year, wherein the equity markets correct 10-20%, maybe more than once, we wouldn't be surprised by another positive total return for 2025. LPL Research looks for a positive equity return in 2025 as well. "Assuming a forward P/E multiple of 23 times 2026 EPS (earning per share) of $275, LPL Research estimates a fair value target range of 6,275-6,375 for the S&P 500 at the end of 2025."

But the cynic in me has to point out three caveats: one, a 23x forward multiple is not only aggressive in my opinion but historically high as well. Two, the S&P 500 closed January 19th at 5,996, so an increase to 6,375 by the end of 2025 entails only a 6.32% increase (or 8.4% from where the S&P 500 ended 2024). Third, never forget that the more you get in the short term the more you may need to give back later;

you can only vary from long-term averages for a period of time until there is a reversion to mean. As John C. Bogle, founder of Vanguard Funds, said, "reversion to the mean is the iron rule of the financial markets". If the long-term average of the stock market is still 10-11% and you get 20% or more for a few years, simple math says you will give back some sooner or later. Speaking of averages, we'd be remiss if we didn't highlight the S&P 500's current CAPE of 38 (Cyclically Adjusted PE is based on average inflation-adjusted earnings over the previous ten years); depending on your timeline, that average is usually 15 to 17.

There will be other interesting issues to deal with this year (as a note, we tend to dislike interesting and prefer boring, just as we think gridlock is preferable to having any one party or person have their way). Let's start with the Tax Cuts and Jobs Act of 2017 which are set to expire at the end of 2025. Extending these tax cuts would most likely boost the stock market. However, if there's no concurrent spending cuts, the bond market may react badly as the deficit would only get worse (by acting badly, we mean the bond market would push up rates which would cause fixed income values to fall). And the deficit is in bad shape to begin with; the national debt is currently over $36 Trillion, which not only eclipses the size of the U.S. economy but will now also cost over $1 Trillion in annual interest payments. The flip side of the bond market coin is that if yields go up then, among other things, savers may be better rewarded and a flat to inverted yield curve normalizes (whereby long-term rates are higher than short-term rates).

Another balancing act may come from proposed tariffs. They've been proposed to balance a number of different issues, one of which is to counter the strong dollar. The strong dollar benefits the U.S. consumer with cheaper goods from overseas (which is important since personal expenditures represent approximately 70% of our GDP) but hurts American manufacturers by making our exports more expensive. The question to be asked here is whether the rhetoric actually begets policy, and if so then to what degree and to what consequence. Most economists seem to believe higher prices will simply be passed on to consumers, but this has never been answered definitively.

So, as always, what to do? Well, another favorite quote of mine by John Bogle is that "the stock market is a giant distraction from the business of investing", much less financial planning (the last part is my addition). Make sure you participate in the markets, but don't get distracted by them; securities are but just one piece of your overall financial puzzle. And the proper balance between risk and return, and optimism and cynicism, may help you remain on solid footing without ever having to walk a tightrope.

Have a wonderful 2025, and thanks so much for your friendship, your trust, and your referrals!

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