

Client Commentary | November 22, 2024

# Market Commentary

Investing Insights

## After a Big Year, are Stocks Headed for a Big Drop?

As I write, the S&P 500 is up more than +20% for the year, and global stocks as measured by the MSCI World Index are up over 15%. Double-digit gains are prevalent elsewhere as well, across small-cap stocks, the Nasdaq, value stocks, growth stocks, and more. It's been a strong run for equity market investors.

Barring a major correction in the final six weeks of the year, it looks like 2024 will be a 'big up year' for stocks. And, if the 20+% return level holds, it would mark the first time since 1998 – 1999 that the S&P 500 delivered two consecutive years of greater than 20% returns. <sup>1</sup>

This fact has many investors convinced—and others concerned—that 2025 is poised to deliver lackluster or even negative returns. If the late 1990s serves as a historical precedent, the bursting of the tech bubble in 2000 could be replicated in 2025 with a sharp reversal of artificial intelligence enthusiasm. <sup>2</sup>

I've written recently that investors often get a 'fear of heights' when the market delivers a powerful rally, particularly when valuations are already elevated. This explains some of the skepticism as we head into 2025. Where concerns get misplaced, however, is in the assumption that weak markets are caused by strong bull market rallies, and/or immediately follow them.

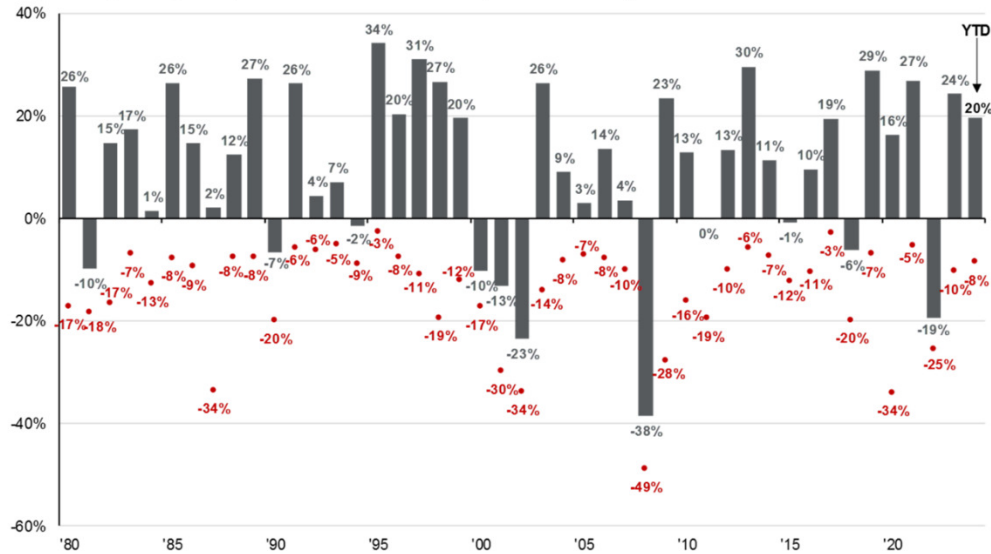
But that's not correct.

In fact, strong returns often happen in clusters within a bull market, and annual returns of 20+% are not an anomaly—they're actually quite common. If we look at just bull market years since 1932, the average annualized return for U.S. stocks is 23%, which puts 2023 and 2024 returns well within the norm.

The chart below shows S&P 500 returns since 1980. One thing readers may notice immediately is that there are far more positive years than negative ones, and a lot of them are big up years. Digging a little deeper into the data, we find that exactly one in four years from 1980 to 2024 has seen a return of 25% or greater. If we lower the bar to 20+% returns, the S&P 500 gone up that much roughly one-third of the time.

### S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.2%, annual returns were positive in 33 of 44 years



J.P. Morgan.<sup>3</sup>

I'm not arguing that investors should expect another 20+% year from the S&P 500 in 2025. But the opposite—a low single-digit or negative return—should not necessarily be expected either. From 1928 to 2023, the average return for U.S. stocks in the year following a 20+% year has been 8.92%. Not gangbusters, but not weak either.

As we look out to the end of the year and early next, we're seeing a high likelihood of earnings growth broadening beyond the tech giants, as the Federal Reserve continues to ease monetary policy. We've also been seeing strong consumer spending data via retail sales, and business cycle indicators continue to show signs of holding firm. In other words, the U.S. economy remains in strong shape, in my view.

The risks I see in the market today go the other way, i.e., the risk of economic overheating. Major tax cuts and efforts to deregulate in an otherwise strong economy could cause an acceleration of investment and activity, which could in turn tip investor sentiment into the realm of too optimistic. These are all just possibilities, however—we need to see actual policy before making any forecasts or projections. And we're not there yet.

### BOTTOM LINE FOR INVESTORS

Bull markets do not downshift significantly just because stocks have risen sharply for two years in a row. Stocks do not have a mean to revert to, and corporate earnings and profit margins do not expand or contract on any sort of timeline. If corporate earnings continue to grow at a brisk pace and cash flow accelerates from one year to the next, there is no reason to assume stocks 'need a breather' following two consecutive 20+% return years. 2025 could easily be the third.

<sup>1</sup> Yahoo Finance. November 18, 2024. <https://finance.yahoo.com/news/wall-street-forecasts-normal-year-for-stocks-in-2025-after-historic-rally-182124444.html>

<sup>2</sup> A Wealth of Common Sense. November 12, 2024. <https://awealthofcommonsense.com/2024/11/30-up-years-in-the-stock-market/>

<sup>3</sup> J.P. Morgan. Guide to the Markets. 2024. <https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/>

**STEADY INVESTOR  
WEEK**

- **The rise in home sales**
- **The decline in consumer demand for credit**

**The Housing Market Improves in October, but Remains in a Slump**

30-year fixed mortgage rates ticked lower over the summer and touched a two-year low in September (6.08%), which helped boost activity in the U.S. housing market. But not by much. Existing-home sales rose by 3.4% month over month in October, and 2.9% from a year earlier. This marked the first year-over-year increase in over three years, which underscores just how sluggish the housing market has been for some time. Since homes generally go under contract and then take a month or two to close, October sales data reflects a flurry of activity that took place in August and September. November existing-home sales may see a continuation of activity, but we wouldn't expect it to last through the end of the year. The winter months tend to be slower sales months generally speaking, but as seen in the chart below, 30-year fixed mortgage rates have climbed back up to 6.84% (as of this writing)—which is likely to give would-be buyers pause.<sup>1</sup>

**30-Year Fixed Mortgage Rates**



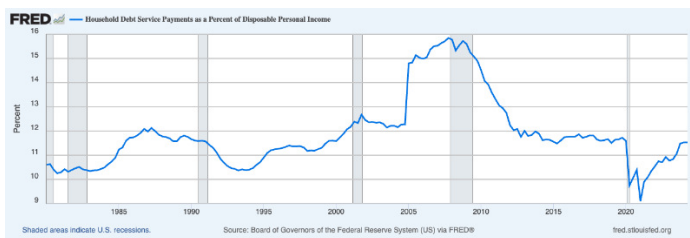
Source: Federal Reserve Bank of St. Louis<sup>2</sup>

Looking further into 2025, it appears unlikely that mortgage rates will make a substantial move lower. 30-year fixed mortgages tend to correlate fairly closely with yields on 10-year U.S. Treasury bonds, which have been experiencing upward pressure given investor expectations for accelerating economic growth, increasing deficits, and perhaps inflationary pressures if tariff policy resembles what was promised on the campaign trail. Elevated mortgage rates will make a tight housing market even less accessible for many households. As of October 2024, the national median existing-home price was \$407,000, up 4% year-over-year. Homes are relatively expensive, and there are not many of them—at the current sales pace, there is an approximately 4-month supply of homes on the market, which signals a supply and demand imbalance.

**U.S. Households are Borrowing Less Than Many Think**

There's been a narrative in the financial media that American households are wildly over-indebted—a problem that continues to worsen. Some have cited rising delinquencies as evidence that the problem is in a tailspin. A clear-eyed look at the data indicates otherwise. According to Moody's Ratings, household debt in Q3 grew at a slower pace than GDP—3.8% for debt growth and 4.9% for nominal (not inflation adjusted) GDP growth. While it's true that total household debt

has indeed risen in recent years, when you adjust for inflation total household debt is roughly \$1 trillion below 2008 levels. When we factor in population growth over that same period, the data looks even better. In the credit arena, households also look to be in fine shape—credit card debt for the average household is 13% below peak levels, and banks are reporting flat demand for loans over the past three months. The key indicator to watch, in our view, is household debt service payments as a percent of disposable income. This metric tells us how much of a strain credit and loan payments are having on U.S. households in aggregate. And by that measure, we can see that Americans overall are doing better than the media often suggests<sup>3</sup>:



**Source: Federal Reserve Bank of St. Louis<sup>4</sup>**

<sup>1</sup> Wall Street Journal. November 21, 2024. [https://www.wsj.com/economy/housing/home-sales-rose-in-october-following-decline-in-mortgage-rates-edd27898?mod=economy\\_lead\\_story](https://www.wsj.com/economy/housing/home-sales-rose-in-october-following-decline-in-mortgage-rates-edd27898?mod=economy_lead_story)

<sup>2</sup> Fred Economic Data. November 21, 2024. <https://fred.stlouisfed.org/seriesBeta/MORTGAGE30US>

<sup>3</sup> Wall Street Journal. November 19, 2024. <https://www.wsj.com/economy/consumers/things-are-quiet-in-consumer-credit-too-quiet-42f22610>

<sup>4</sup> Fred Economic Data. September 26, 2024. <https://fred.stlouisfed.org/seriesBeta/TDSP#>

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