

# With New Risks Surfacing, How Should Investors Position Portfolios in 2025?



## Equities Post Strong Year as S&P 500 Hits 57 All-Time Highs in 2024

Despite still stubborn inflation, a brief growth scare, less than expected interest rate cuts, and a pullback in December, US equities were up notably in 2024 on the back of a strong economy, accelerating earnings growth, US election results, and AI/mega-cap-related strength. The S&P 500 Index gained 25% for the year and recorded 57 all-time highs in 2024, the fifth highest of any year in history. US growth (+36.0%) was among the best performers, followed by US large-caps (+24.9%) and US mid-caps (+13.9%). Bonds were mostly up as high-yield credits increased 7.7%, investment grade corporates gained 2.6%, and Treasury inflation-protected notes rose 2.3%. Commodities fared well as both gold and silver were up over 20% (+26.7% and +20.9%, respectively), crude oil increased 13.4%, and broad-based commodities gained 5.5%.

**Exhibit 1: Trailing Returns as of December 31, 2024**

Index/ETF	1-Mo	3-Mo	1-Y	3-Y	5-Y
<b>Equities</b>					
US Growth (SPYG)	0.81%	6.18%	35.99%	7.66%	17.06%
US Large-Caps (SPY)	-2.41%	2.49%	24.89%	8.84%	14.46%
US Mid-Caps (SPMD)	-7.17%	0.40%	13.90%	4.84%	10.28%
US Value (SPYV)	-6.85%	-2.60%	12.23%	9.11%	10.47%
Broad-based Emerging Markets (SPEM)	-1.07%	-5.57%	11.40%	0.36%	3.29%
US Small-Caps (SPSM)	-8.09%	-0.68%	8.54%	1.86%	8.33%
International Developed Equities (SPDW)	-3.40%	-7.88%	3.53%	0.81%	4.64%
<b>US Fixed Income</b>					
High Yield Credit (JNK)	-0.87%	-0.22%	7.70%	2.06%	3.01%
Investment Grade Corporate Bonds (SPBO)	-2.01%	-2.98%	2.58%	-2.01%	0.47%
Treasury Inflation Protected Notes (SPIP)	-1.74%	-3.10%	2.34%	-2.78%	1.60%
Municipal Bonds (MUB)	-1.34%	-0.92%	1.26%	-0.32%	1.01%
US Aggregate Bond Index (SPAB)	-1.80%	-3.17%	1.24%	-2.41%	-0.40%
US Treasury 7-10 Year (IEF)	-2.26%	-4.60%	-0.64%	-4.40%	-1.46%
<b>Commodities</b>					
Gold (GLD)	-1.41%	-0.38%	26.66%	12.30%	11.12%
Silver (SLV)	-5.69%	-7.32%	20.89%	6.97%	9.56%
Crude Oil (USO)	5.50%	8.05%	13.35%	11.59%	-5.91%
Broad-based Commodities (BCI)	1.17%	-0.11%	5.46%	3.48%	6.28%

Source: FactSet. Data as of December 31, 2024. 1Y, 3Y, and 5Y numbers are annualized.

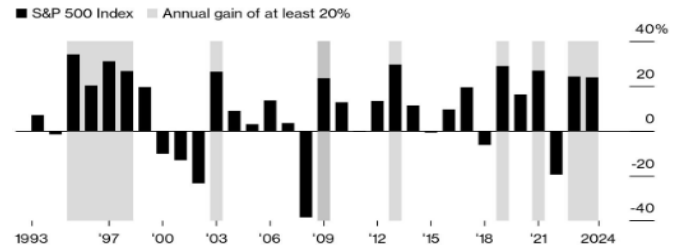
## Fed Cuts, But Signals Less Easing Ahead

The Federal Reserve decreased interest rates by 25 bps at the December FOMC meeting, dropping the fed funds rate to the 4.25–4.50% range. The move marks the third consecutive meeting in which the Fed eased monetary policy. However, the Summary of Economic Projections revealed that policymakers see less easing ahead amid lower but still elevated inflation and a strong economy. Relative to September, the updated dot plot indicated only two 25 bps cuts next year, down from the four previously expected. For 2025 year-end projections, both Core PCE inflation and GDP growth were revised upwards to 2.5% from 2.2% and to 2.1% from 2.0%, respectively, while that for the unemployment rate was lowered to 4.3% from 4.4%. Currently, an 89% chance for a pause in January is priced in per the CME FedWatch Tool.

## Rally On, Or Correction Ahead?

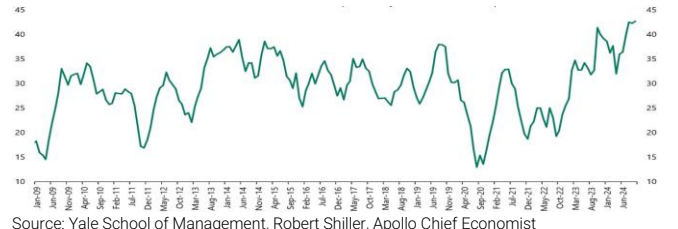
The S&P 500 Index returned over 20% in each of 2023 and 2024, marking a rare back-to-back annual rally that last occurred in the late 1990s. Additionally, sentiment has been very bullish as a record high percentage of investors see less than a 10% chance of a stock market correction occurring over the next six months. Can the rally continue, or is a drawdown likely?

**Exhibit 2: S&P 500 Index – Annual Returns**



Source: Bloomberg. Data as of December 30, 2024.

**Exhibit 3: Percentage of Investors Predicting <10% Chance of Stock Market Crash in Next 6 Months**

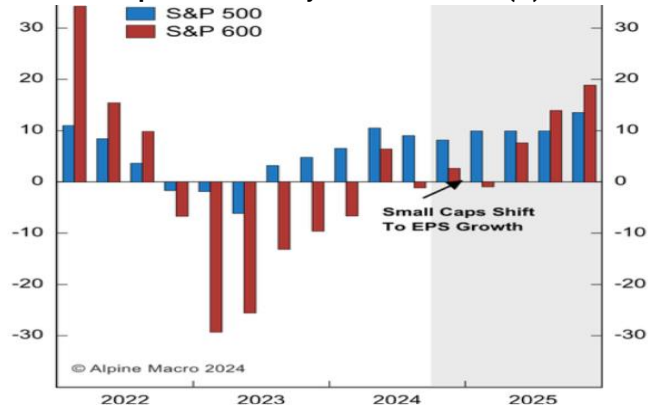


Source: Yale School of Management, Robert Shiller, Apollo Chief Economist

## Anticipated Small-Cap Earnings Recovery

Using Bloomberg data, Alpine Macro points out that small-cap earnings growth via the S&P 600 is expected to improve relative to that of large-caps per the S&P 500 over the next year. In Q3 and Q4 of 2025, the former is forecasted to outpace the latter.

**Exhibit 4: Expected Quarterly EPS Growth YoY (%)**

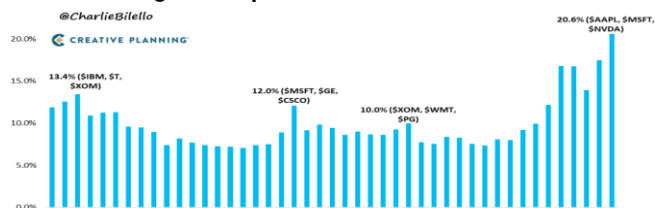


Source: Alpine Macro, Bloomberg Finance L.P. Shaded area denotes estimate period.

## The S&P 500 is No Longer Diversified

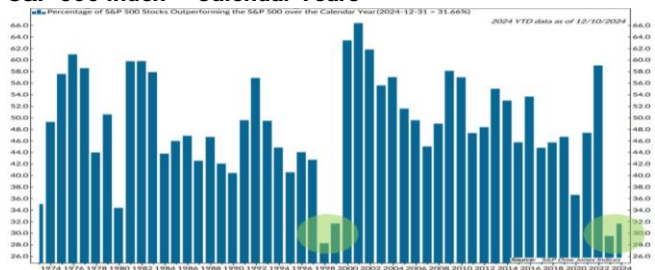
With the top 3 stocks in the S&P 500 making up a record high of over 20%, it is hard to deem the index as diversified. Moreover, when concentration risk is elevated, as seen in the late 1990s, 2023, and 2024, it has historically been difficult for individual stocks in the S&P 500 to outperform the index as a whole.

**Exhibit 5: Weight of Top 3 Stocks in the S&P 500 – Annual**



Source: Twitter @CharlieBilello, Creative Planning. 2024 YTD data as of December 20, 2024.

**Exhibit 6: Percentage of S&P 500 Stocks Outperforming the S&P 500 Index – Calendar Years**



Source: Ned Davis Research, Inc., Day Hagan Asset Management, The Daily Shot. 2024 YTD data as of December 10, 2024.

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## 2025: Risks and How to Position Portfolios

As mentioned in our previous commentary, we are taking our bullishness down a notch for 2025. We believe markets will be vulnerable, and the distribution of outcomes next year is much wider given:

- Valuations are expensive in US large-cap space
- Fixed income spreads remain tight
- Multiple ongoing wars/strained relations between the world's two largest economies
- Looming deficit concerns
- Non-linear growth risks
- A possible resurgence of inflation
- Asymmetric political risks

The US economy was improving before Trump's red sweep, so the question becomes how does the administration shift back to a pro-domestic policy without further increasing the deficit, sending bond term premiums higher, and reigniting inflation? It's no small feat, and we believe it's easy to see a scenario where left tail risks surface in 2025.

Our view is a reduction in tariff risk is required for multiples to expand and for markets to move higher. Sentiment has been high and investors' allocations to risk assets have been close to full. It feels like markets may undergo a significant correction. Nonetheless, here are various ideas that we believe may be beneficial to include in portfolios for 2025:

- Equal weight strategies to diversify concentration risk and own more attractively priced growth stories within the 493
- Real assets/inflation-linked assets, which trade at a discount and may bode well given a resurgence of inflation
- Tilt to the US over Non-US; although cheaper, countries outside the US face nuanced headwinds and many lack a catalyst for growth
- Banks/M&A/IPOs/crypto (Ethereum), which may benefit from potential deregulation
- Small-caps as the environment changes from late to early cycle and their earnings growth recovers
- Mortgage-backed securities (attractive spreads, low prepayment risk), as well as being active in fixed income