Birch Hill
INVESTMENT ADVISORS

Market View

January 2025

TECH GAINS DRIVE MARKETS

In 2024, US equities delivered very strong gains, with the S&P 500 Index returning +25.0%. Technology stocks were a significant driver of this performance, led by the "Magnificent 7" – Apple, Amazon, Alphabet, Meta Platforms, Microsoft, Nvidia, and Tesla. A JP Morgan analysis notes these companies collectively gained +48%, and contributed 55% of the S&P 500 Index's price return. Other broad market indices produced lower but still strong results, with the S&P 500 Equal Weighted Index and the Dow Jones Industrial Average returning +13.0% and +15.0%, respectively. Smaller and mid-capitalization equities also had solid returns for the year (as seen in the market indicators box to the right).

Market Indicators		12/31/2024
TOTAL RETURN		
US Stock Markets	4th Qtr	2024
S&P 500 Index	2.4%	25.0%
S&P 500 Equal Weight Index	-1.9%	13.0%
DJ Industrial Avg.	0.9%	15.0%
S&P 400 Mid Cap	0.3%	13.9%
Russell 2000 Small Cap	0.3%	11.5%
Int'l Stock Markets		
ETF Returns in US$		
EAFE Index (Europe, Australia, Asia, Far East)	-8.4%	3.5%
Japan (MSCI Index)	-4.7%	7.0%
China (FTSE 50)	-2.8%	28.9%
Emerging Mkts Index	-7.3%	6.5%
US Fixed Income Yields	12/31/2023	12/31/2024
6 Mo US T-Bill	5.26%	4.24%
2 Yr US T-Note	4.23%	4.25%
10 Yr US T-Note	3.88%	4.58%

CAN MARKET GAINS CONTINUE?

Since 2019, the S&P 500 Index has consistently achieved double-digit returns, except in 2022, with four years surpassing 20%. As we enter 2025, optimism remains high among economists, analysts, businesses, and consumers. The US economy is projected to produce solid growth in the 2.0% range, supported by above-average productivity gains. Market strategists anticipate continued equity market growth and stock analysts forecast double-digit earnings growth for the S&P 500.

Political developments have also bolstered sentiment. A Republican sweep of Congress and the White House has raised domestic businesses' hopes for pro-growth policies, including deregulatory efforts and tax reforms. Declining inflation, lower interest rates, and the potential extension of the 2017 Tax Cuts and Jobs Act have further boosted consumer confidence. Additionally, technology companies' robust investment in artificial intelligence is expected to sustain sector momentum. Provided that economic growth, corporate fundamentals, and consumer confidence remain strong, the equity market's growth trajectory could extend into 2025.

POLICY UNCERTAINTY AND VALUATIONS ARE KEY RISKS

Despite this optimistic outlook, risks bear watching. The timing and impact of new policy measures from the incoming administration are uncertain. While some initiatives, such as deregulation and tax cuts, could stimulate

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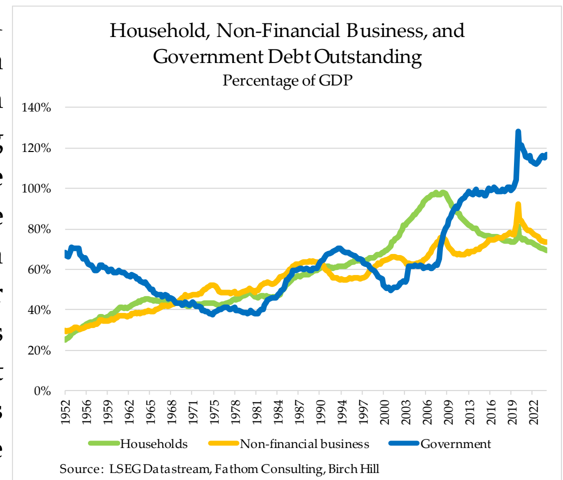
growth, others—including restrictive trade or immigration policies—may pose challenges. Moreover, policies that reignite inflation could prompt the Federal Reserve to maintain elevated interest rates, potentially dampening economic growth.

Valuations are another area of concern. The S&P 500 Index trades near historical peaks seen during the dot-com bubble and in 2021. While high valuations do not reliably predict short-term returns, they often correlate with the onset of lower long-term performance.

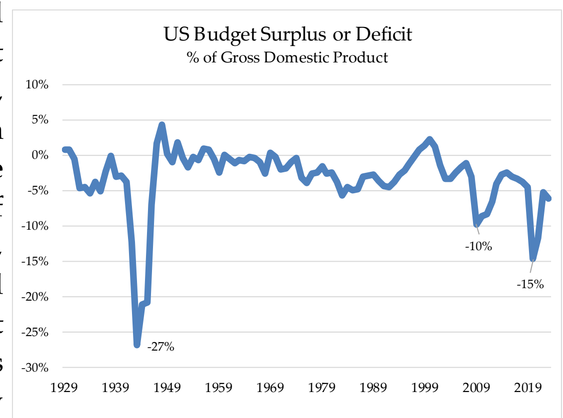
STRENGTH IN HOUSEHOLD AND BUSINESS BALANCE SHEETS

Since the 2007-2009 Great Financial Crisis, US households and businesses have improved their financial positions. Scars from a severe economic contraction, equity market losses, high unemployment, falling home prices and tighter post-crises lending standards likely led households and businesses to become more cautious and shore up balance sheets even while interest rates were low. As seen in the chart to the right, debt levels, as measured as a percentage of US gross domestic product (GDP), have declined for both households and non-financial businesses. Household debt has fallen from 98% to 69% of GDP, while non-financial business debt has decreased from 76% to 73%. In contrast, government debt has surged, rising from 78% to over 100% of GDP during the same period.



US GOVERNMENT DEBT LEVELS POSE LONG-TERM RISKS

Federal debt levels, already high by historical standards, continue to rise due to widening budget deficits. Budget deficits or surpluses measure the difference between annual government revenues and expenses. As the chart to the right shows, deficit spending in the US has worsened in recent years, leading to US debt levels growing faster than the economy. High debt levels and large budget deficits may not pose an immediate problem, but they could create challenges in the long term. If investor confidence in the government's fiscal discipline erodes, there could be far-reaching implications for the economy, financial markets, and government operations. Higher long-term interest rates are one potential consequence, which some investors fear has already started. Federal Reserve Chairman Jerome Powell recently expressed concerns about the unsustainability of current fiscal trends.



MARKET AND ECONOMIC MOMENTUM LIKELY TO CONTINUE, BUT RISKS BEAR WATCHING

The US economy is on solid footing, and market momentum could continue into the new year. Household and business balance sheets are strong. Disruptive policies and elevated valuations are risks to the positive outlook. High federal debt levels pose a longer-term risk. We believe investors should stay the course and continue holding high-quality stocks for the long run. Investors can protect themselves against volatility by ensuring that they hold adequate cash for their anticipated spending during 2025.

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