January 15, 2025

Dear O'Brien Client-

Last year was a good year to be an investor. Global stocks rose 17.5%, led once again by the U.S. – where the S&P 500 rose 25%. U.S. bond returns were up a modest 1%, leaving cash (up 5%) king in that market after the pullback that occurred in 4Q. The combination of global stock and U.S. bond performance last year put a 60% stock/40% bond investor up double-digits for a second consecutive year.

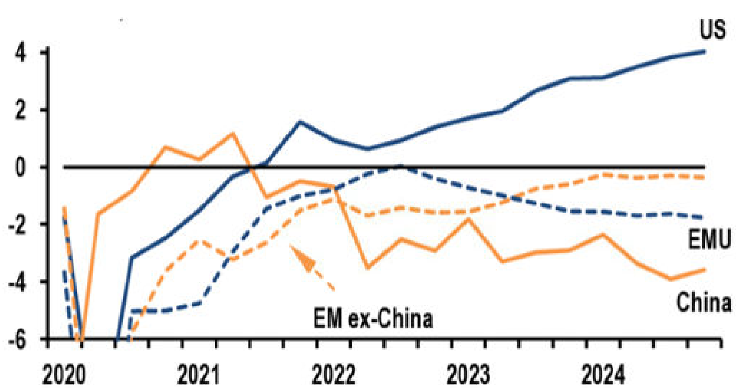
	4Q 2024	2024	3 Years	5 Years		4Q 2024	2024	3 Years	5 Years
U.S. Large Cap Stocks	2.4%	25.0%	10.1%	14.8%	Investment Grade Bonds	-3.0%	2.0%	-1.8%	0.1%
U.S. Mid Cap Stocks	0.6%	15.3%	5.0%	10.2%	**U.S. Aggregate Bond Index**	**-3.1%**	**1.3%**	**-2.1%**	**-0.4%**
U.S. Small Cap Stocks	0.3%	11.5%	2.4%	7.8%	Treasuries	-3.1%	0.6%	-2.5%	-0.8%
High Yield Bonds	0.2%	8.2%	3.3%	4.1%	Mortgage-Backed Bonds	-3.2%	1.2%	-1.9%	-0.8%
Commodities	-0.4%	5.4%	3.7%	6.7%	Non-U.S. Stocks	-7.6%	5.5%	1.3%	4.3%
Gold	-0.5%	26.6%	13.3%	9.8%	Emerging Market Stocks	-8.0%	7.5%	-1.4%	1.8%
Global Stocks	**-1.0%**	**17.5%**	**6.4%**	**10.3%**	Non-U.S. Developed Market Stocks	-8.1%	3.8%	2.1%	5.0%
Municipal Bonds	-1.2%	1.1%	-0.3%	0.9%	Real Estate Stocks	-8.2%	4.9%	-3.5%	3.2%

Past performance is no guarantee of future returns. You cannot invest in an index. 3-year & 5-year returns are annualized. Source: Morningstar Direct, O'Brien Wealth Partners, as of 12/31/24.

Stepping back to a longer-term perspective, 2024 continued the theme of U.S. market exceptionalism. Global stocks have risen double-digits in five of the past six years (2022 being the lone exception). In each of those years, the S&P 500 outperformed the rest of the world. The last time international stocks outperformed the S&P 500 over a calendar year was 2017 (when *The Big Bang Theory* was still the most popular show in America)[1]. Since the end of the Global Financial Crisis, international stocks have outperformed in just three of the 16 calendar years.

There are solid reasons behind this persistent U.S. dominance. For example, as shown below, since COVID the U.S. (solid blue line) is the only major part of the world to exceed the pace of growth it was on track to experience had COVID never happened. Every other major global economy/region has yet to fully recover from the impact COVID shutdowns.

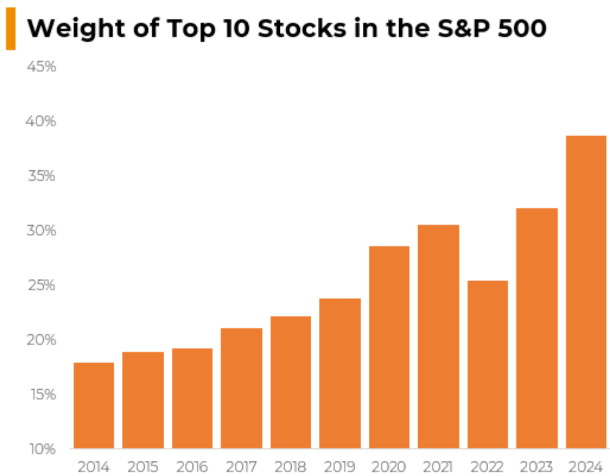
Real GDP Relative to Pre-Pandemic Potential Path (% Deviation from Trend)

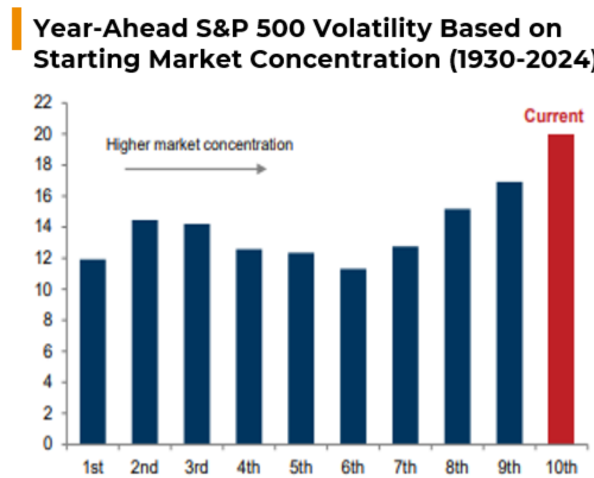


EMU: European Monetary Union. EM: Emerging Markets. Source: JPMorgan, O'Brien Wealth Partners, as of 12/6/24.

[1] Source: Nielsen Media Research, O'Brien Wealth Partners, as of 12/31/17.

This consistent exceptionalism of the U.S. – and within the U.S. a small group of mega cap stocks – has left U.S. stock markets historically concentrated, however. We have shared the chart on the left below previously, but the point bears repeating – the 10 largest stocks in the S&P 500 accounted for almost 40% of that index at year-end, more than double their share from a decade ago.





Past performance is no guarantee of future returns. You cannot invest in an index. LEFT: The top 10 companies are based on the 10 largest index constituents as of the end of each year. Source: Bloomberg Finance, LP, O'Brien Wealth Partners, as of 12/31/24. RIGHT: Source: Goldman Sachs, O'Brien Wealth Partners, as of 11/25/24.

Historically, there have been a couple of implications from this level of concentration in stock markets to keep in mind entering 2025.

First, concentrated markets have been associated with higher return volatility (compare the size of the red bar to that of the blue bars in the chart on the right that illustrates the level of market volatility relative to the level of market concentration). The pick-up in market choppiness in 4Q of last year may have been indicative of this dynamic and a potential sign of things to come in 2025.

Second, high concentration also increases the importance – and "cost" – of diversification. Diversification is meant to reduce the volatility of overall returns by spreading investments across asset markets that are expected to perform differently simultaneously. When there are relatively few winners the overall market becomes more impacted by news around those few winners. Today, for example, it can be argued that NVIDIA's quarterly earnings reports matter as much for overall market performance as the monthly employment reports. This dynamic heightens the need for exposure to markets that are not tied to those companies.

But when there are relatively few winners, the gap in performance between those winners and other asset markets tends to be larger – essentially increasing the "cost" of that diversification. Over the past three years, the S&P 500 outperformed non-U.S. stocks by 9% a year and the U.S. Aggregate Bond Index (AGG) – a benchmark for high quality U.S. bonds – by 12% a year. In the two decades preceding the last three, the S&P 500 outperformed non-U.S. stocks and the AGG by closer to 3% and 5%, respectively.

The point of this is not to overwhelm you with statistics or sound any alarm bells. If anything, we continue to believe in the U.S. as a long-term growth driver for the global economy and see justifications for the exceptionalism of its markets to continue in 2025. We merely aim to illustrate why we continue to believe the best course of action for long-term investors is to remain diversified both across and within asset markets, even though it may seem like a diversified portfolio is underperforming the NVIDIA's of the world in the short run.

Turning to economic performance, 4Q 2024 was largely a continuation of the dynamics experienced earlier last year. The global economy continued to expand and be driven by the U.S. Within the U.S., the pace of growth showed some signs of slowing at the end of the year, but there are still no real signs of imminent recession risk. U.S. inflation remained stubbornly elevated into year-end, forcing the Federal Reserve to reduce both its pace and outlook for rate cuts. The key development during the quarter was the narrow Republican Party sweep of the elections.

Control of both the Oval Office and Congress allows the Republican Party to implement more meaningful policy changes than are likely possible under divided rule. How that authority plays out remains to be seen, but the fact that the ability to make such changes now exists likely means that monetary policy will take a backseat to fiscal policy changes in 2025.

Legislatively, two topics will likely be the focus of Congress in 2025: extending/making permanent the 2017 tax cuts and the debt ceiling (which we will initially hit in January). The latter will likely take priority over the former due to its timing, but the former will need to be accomplished before year-end. Unsustainable deficit spending is another important long-term topic, but markets focus more on the short-term which probably means addressing it falls once again on the back burner.

The executive orders most likely to be implemented initially revolve around deregulation, immigration, and tariffs/trade policy. What these orders will ultimately be is unclear but based on the way President-elect Trump handled executive orders during his first administration our suspicion is they will – at least initially – be more modest than what was expressed on the campaign trail.

The economic implications of this agenda depend on how much these policies impact the historic drivers of our economy into and out of recessions – corporate profit cycles, the ease of credit access, the pace of hiring, and monetary policy trends (to name a few).

Lower tax rates and deregulation are positives for corporate profits and labor market demand. Tighter immigration and tariffs are drags on growth and inflationary (fewer workers increases demand for remaining workers, for example).

Put it all together, and our best guess for 2025 is that the U.S. expansion continues, inflation may reaccelerate slightly, and the Fed may end its rate cut cycle at a higher level than previously anticipated. Increased spending from the corporate sector is an upside risk to that outlook, while significant deportations, broad-based tariffs, and a harsher trade stance represent downside risks.

From a market perspective, stocks are expensive and expectations for corporate profit growth are lofty. The economic backdrop outlined above is conducive to further gains, but likely at a more modest pace. Remember, expensive markets tend to be more volatile, which could be a positive for returns if the economy and corporate profits exceed those expectations or a negative if they disappoint.

Bond markets, by comparison, are cheap and income is still readily available without taking on significant default risk. But at the same time inflation risks can matter more than the growth outlook for bonds. It is still too early to say definitively which dynamic will drive performance next year.

While the fiscal picture for 2025 is starting to gain clarity, there are still many questions that remain to be answered. In such uncertain times, the best approach to investing is to remain in the markets and utilize diversification to reduce the potential impacts unknown risks can have on an overall portfolio.

If there are any changes in your personal or financial situation that might impact your investment objectives, or if you have any questions and would like to talk, please contact your Advisor.

Your O'Brien Team

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