Karbon Koch Group at Morgan Stanley

MACRO VIEW

Macroeconomic Opinions and Strategic World Views

December 31, 2024

OVERVIEW

This time of year, it's popular to make predictions on how 2025 markets will perform. The truth is no one knows for certain how the year will pan out. That doesn't stop big investment firms from making forecasts anyway. Although no one has a crystal ball to see into the future, we believe history can provide helpful context; and if you look closely, often you can find clues laying around to help point you in the right direction. Piecing everything together, we think an investor can narrow down the realm of possibilities for future outcomes. In all reality, this is likely the best anyone can do. In this month's Macro View we will share a couple of our clues, as well as the historical context we find helpful as we enter the new year.

BOTTOM LINE: No one can predict the future, yet Wall Street attempts every year. We believe astute investors can narrow down the realm of possible future outcomes by looking for clues within the market.

U.S.

Wall Street loves forecasts. Can these predictions help investors gauge if the coming year will be bullish (mostly up) or bearish (mostly down)? Here are a few 2025 S&P 500 forecasts from different investment firms: Oppenheimer: 7100, Bank of America: 6666, Goldman Sachs: 6500, Stifel: 5500, and BCA Research: 4,450. [1] Converting these into percentage return numbers, Oppenheimer (on the top end) is expecting gains of more than 20%, while BCA Research (on the bottom end) is expecting a loss of over 25%. The full list we reviewed had forecasts from 25 investment firms, 22 of them (or 88%) showed a gain of 10% or more next year. [2] In isolation, these forecasts suggest a bullish outcome for 2025.

As exciting as this sounds, history tells us it's rare for the S&P 500 to have three consecutive years of strong returns. Going back to 1928 there were only five instances where the index produced returns of 10% or more, three years in a row. [3] As far as Oppenheimer's rosy forecasted return of over 20%, only one other time has there been three straight years of such returns (1995-1998) . [4] In other words, despite the overwhelming optimism from 88% of Wall Street firms, history suggests it would be rare to get a return of greater than 10% in 2025.

Other clues we are looking at include the numerous market reactions surrounding the US Federal Reserve (Fed) meeting on 12/18/2024. First, the S&P 500 fell 2.95% on 12/18 the day the Fed suggested 2025 may have fewer rate cuts than previously expected. This was the worst "Fed-Day" ever (since 1994 when the Fed began announcing its rate decision on the same day of its meetings). [5] Second, as we looked a little deeper, we noticed 96% of all stocks in the S&P 500 finished lower on 12/18. [6] Said differently, the negative reaction to the Fed announcement caused a broad sell off affecting many stocks across the entire index. The S&P 500 wasn't the only index that underperformed that day. The Dow Jones Industrial Average (DJIA) declined 2.6% as well. [7] Interestingly, this was the indexes 10th straight daily decline, which was the longest streak in more than 50 years. [8] This implies markets were starting to selloff well in advance of 12/18 meeting. Lastly, the volatility index (VIX) jumped by 11.8 points that day. Looking back to 1990, this was only the 20th time the VIX produced a one-day surge of 10 points or more. [9] All this market turmoil for one announcement from the Fed – which wasn't even that bad? Is it possible we see overreactions like this as other data points are released next year (i.e. earning reports, inflation data, etc.)? What if actual bad news surfaces? All this tells us we could see more excessive levels of volatility next year.

Attempting to pull this all together we looked at the 40-year historical performance of the S&P 500 during years with excessive volatility. Subjectively, we chose calendar years that produced an intra-year decline of 13% or greater for our measurement of "excessive." Over the last 40 years (1983-2023) this type of volatility has occurred 13 times. [10] The average year-end return for these instances was -3%. [11] Although it was in the minority, there were four instances where the S&P 500 produced a return of 10% or more. [12] Putting all the pieces together we still believe the S&P 500 can produce a positive return this year. However, given the possibility for higher volatility – we think a high single digit number could be more likely than the consensus numbers from Wall Street.

BOTTOM LINE: We believe markets will go higher in 2025, but given the possibility for increased volatility, we think yearend returns will be more subdued than 2023 and 2024.

Nicholas S. Karbon, CEPA® Financial Advisor

Bradley W. Koch, CFP® Financial Advisor

Morgan Stanley

270 Main Street N, Suite 100, Stillwater, MN 55082 | Nick: (651) 472-8098 Brad: (651) 472-8099

[1] Tom Essaye, “What does Wall Street Expect for 2025” Sevens Report, January 7, 2025
[2] Tom Essaye, “What does Wall Street Expect for 2025” Sevens Report, January 7, 2025
[3] Tom Essaye, “What does Wall Street Expect for 2025” Sevens Report, January 7, 2025
[4] Tom Essaye, “What does Wall Street Expect for 2025” Sevens Report, January 7, 2025
[5] Beyond the News, MFS, December 23, 2024
[6] Beyond the News, MFS, December 23, 2024
[7] Beyond the News, MFS, December 23, 2024 - via CNBC
[8] Beyond the News, MFS, December 23, 2024 - via CNBC
[9] Beyond the News, MFS, December 23, 2024
[10] S&P 500 Index intra-year declines vs. calendar year returns (1983-2023), Standard & Poors, Thrivent
[11] S&P 500 Index intra-year declines vs. calendar year returns (1983-2023), Standard & Poors, Thrivent
[12] S&P 500 Index intra-year declines vs. calendar year returns (1983-2023), Standard & Poors, Thrivent