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# Markets get Scrooged by the Fed

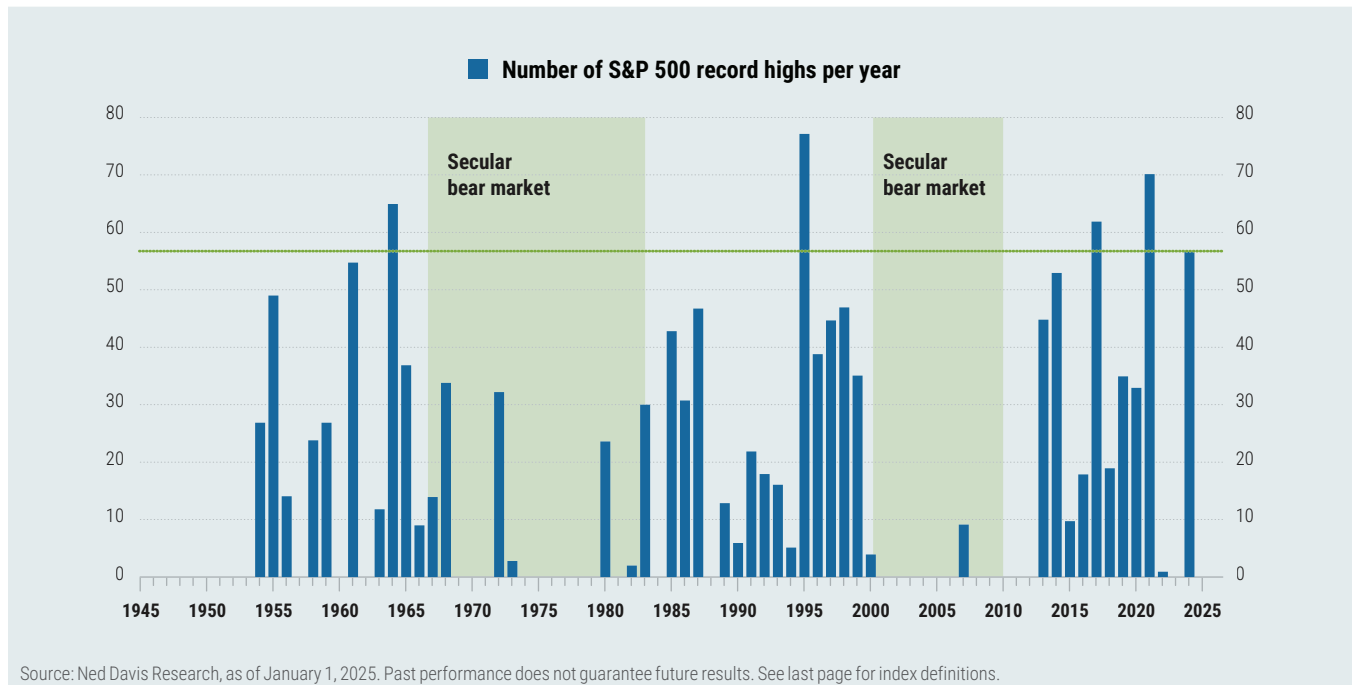


**Michael A. Mullaney**  
Director of Global Markets Research

Another policy pivot from Jerome Powell and the U.S. Federal Reserve at its December 18 Federal Open Market Committee (FOMC) meeting derailed what had begun as a good month for stocks. The board reversed its September focus on maintaining a healthy job market to make combating inflation once again its primary objective. This was evidenced by the Fed's so-called "dot plot." In September, the Fed reduced the four interest rate cuts it projected for 2025 to just two at the December meeting, taking market participants by surprise. The S&P 500 Index fell 2.38% for the month, accompanied by a 1.64% drop for the Bloomberg U.S. Aggregate Bond Index (Agg). Budgetary friction out of Washington, D.C., only added to the confusion.

There was better news for the S&P 500 for the quarter and year with gains of 2.41% and 25.02%, respectively. However, the reduced number of rate cuts, sticky inflation, and a burgeoning fiscal deficit made for insurmountable headwinds for bonds, with the Agg dropping 3.06% for the quarter and managing a scant 1.25% gain for the year. Income of 3.94% was needed to offset a principal loss of 2.69% for the index, as interest rates rose by an average of 50 basis points during the year for Treasury securities, with maturities ranging from two to 30 years.

During 2024, the S&P 500 hit a record high 57 different times, a tally only exceeded four other times since WWII.



### Limited gains across sectors during December and Q4, but only one loss for 2024

SECTOR RETURNS					
	DECEMBER		4TH QUARTER		YTD
Communication Services	3.58%	Consumer Discretionary	14.25%	Consumer Discretionary	40.23%
Consumer Discretionary	2.39%	Communication Services	8.87%	Technology	36.61%
Technology	1.16%	Financials	7.06%	Financials	30.50%
Consumer Staples	-4.97%	Technology	4.84%	Consumer Discretionary	30.14%
Financials	-5.46%	Industrials	-2.41%	Utilities	23.43%
Health Care	-6.21%	Energy	-2.44%	Industrials	17.30%
Utilities	-7.93%	Consumer Staples	-3.26%	Consumer Staples	14.87%
Industrials	-7.98%	Utilities	-5.51%	Energy	5.72%
Real Estate	-8.60%	Real Estate	-7.94%	Real Estate	5.23%
Energy	-9.47%	Health Care	-10.30%	Health Care	2.58%
Materials	-10.72%	Materials	-12.42%	Materials	-0.04%

Source: Bloomberg, as of December 31, 2024. Past performance does not guarantee future results.

Communication Services led all other sectors in December, with the gain coming almost exclusively from one company, Alphabet, whose two classes of stock returned more than 12% on average, while making up 42% of the sector. During the month, the company unveiled its new quantum computing chip, Willow, which is expected to power numerous artificial intelligence (AI) process applications.

The Materials sector pulled up the rear in December as President-elect Donald Trump's proposed tariffs are expected to have a major impact on supply chains and costs for the sector.

For the quarter, the Consumer Discretionary sector took the lead. In this case, two stocks dominated returns: Tesla, which gained more than 54%, and Amazon, which was up by more than 17%. Tesla was aided by the Trump victory in the presidential election, as investors anticipated that Elon Musk and his companies would receive favorable treatment from the incoming administration. Amazon continued to gain strength as an industry leader in both e-commerce and in cloud computing through its Amazon Web Services division. Together, the two stocks comprise 53% of the sector's weight.

The Materials sector also lagged for the quarter.

Year-to-date, Communication Services once again took the pole position, with three stocks contributing to approximately 91% of the sector's return: Alphabet (up almost 36%), Meta Platforms (up 66%), and Netflix (up 83%).

The Materials sector made it an unfortunate trifecta as the only sector to finish in the red for the year.

RISK FACTOR RETURNS			
	DECEMBER	4TH QTR	YTD
<b>Quality</b>			
S&P B+ or Better	-6.76%	-3.39%	8.79%
S&P B or Lower	-6.72%	0.73%	19.29%
<b>Beta</b>			
S&P 500 Lowest Quintile	-6.78%	-7.76%	9.51%
S&P 500 Highest Quintile	-2.43%	9.24%	50.71%
<b>Size</b>			
Russell 1000	-2.79%	2.75%	24.51%
Russell 2000	-8.26%	0.33%	11.54%

Source: BofA, Bloomberg, as of December 31, 2024. Past performance does not guarantee future results. It is not possible to invest directly in an index. See last page for index definitions.

STYLE RETURNS ACROSS MARKET CAPS			
	DECEMBER	4TH QTR	YTD
Russell 1000 Value	-6.64%	-1.98%	14.37%
Russell 1000 Growth	0.88%	7.07%	33.36%
Russell Mid-Cap Value	-7.32%	-1.75%	13.07%
Russell Mid-Cap Growth	-6.22%	8.14%	22.10%
Russell 2000 Value	-8.33%	-1.06%	8.05%
Russell 2000 Growth	-8.19%	1.70%	15.15%

Source: Bloomberg, as of December 31, 2024. Past performance does not guarantee future results. It is not possible to invest directly in an index. See last page for index definitions.

### Mixed results for risk factors in December, while small caps lagged in all periods

While down markets usually favor risk-off factors, December was different in that low quality inched past high quality and high beta beat low beta. Only the size factor played out as one would expect, with the Russell 2000 Index of small-cap stocks lagging behind the Russell 1000 Index of large-cap stocks. For the quarter and year, the risk-on trade dominated, except for the size factor once again.

### Growth continued to lead value

Growth continued to lead value in December by an average of 2.98% across the small-, mid-, and large-cap ranges of the Russell style benchmarks, though the most pronounced performance deficit was in the large-cap space. While the Russell 1000 Value Index lagged the Russell 1000 Growth Index across all eleven sectors, stocks within seven sectors of the 1000 Value Index actually outperformed their counterparts in the 1000 Growth Index. The underperformance of the value index as a whole can be attributed to the sector weighting differences between the two benchmarks. For example, the Energy sector of the 1000 Value Index fell by 8.72% during December compared with a loss of 14.25% in the 1000 Growth Index. But the Energy sector had a weighting of 6.54% in the Russell 1000 Value Index, versus just 0.38% in the Russell 1000 Growth Index.

INTERNATIONAL MARKET RETURNS			
	DECEMBER	4TH QTR	YTD
<b>EAFE</b>			
Local Currency	0.43%	-0.57%	11.84%
U.S. Dollars	-2.25%	-8.06%	4.35%
<b>Emerging markets</b>			
Local Currency	1.23%	-4.24%	13.70%
U.S. Dollars	-0.09%	-7.84%	8.05%
<b>Currencies</b>			
U.S. Dollar Index (DXY)	2.60%	7.65%	7.06%
MSCI EM Currency Index	-1.20%	-3.60%	-0.73%
<b>United States</b>			
S&P 500 Index	-2.38%	7.65%	25.02%
S&P 500 Equal Weight Index	-6.28%	-3.60%	12.98%

Source: MSCI, Bloomberg, as of December 31, 2024. International markets are represented by MSCI indexes. Past performance does not guarantee future results. It is not possible to invest directly in an index. See last page for index definitions.

For the quarter, value lagged growth by an average of 7.23% across the three capitalization ranges, while for the year, value fell behind by an average of 11.71%, though the bulk of that performance differential once again can be attributed to what occurred in the large-cap space. There, the so-called Magnificent Seven stocks—which make up 51.7% of the Russell 1000 Growth Index—were responsible for 68% of that benchmark’s return. Nvidia alone was responsible for more than 28% of the Russell 1000 Growth Index return for the year.

The Russell 1000 Growth Index has outperformed the Russell 1000 Value Index by more than 50% over the past two years, only the second time that has happened since 1979. The last occurrence was in 1999, during the height of the Dot-Com Bubble. Then, the Russell 1000 Growth Index went on to lag the Russell 1000 Value Index for the next seven years.

### Non-U.S. stocks fared better in December, but lagged over other time periods

Returns for developed-market international stocks and emerging-market stocks finished December in positive territory in local currency terms, though currency declines pushed both into negative territory in U.S. dollar terms. The dollar was particularly strong during the quarter, having gained support from the increase in U.S. interest rates, which compounded the losses for both developed- and emerging-market stocks.

For the year, while both markets produced solid results in local currencies, they once again failed to keep pace with the S&P 500 on a cap-weighted basis, though both generally held their own against the equally weighted S&P 500 Index when measured in local currency terms.

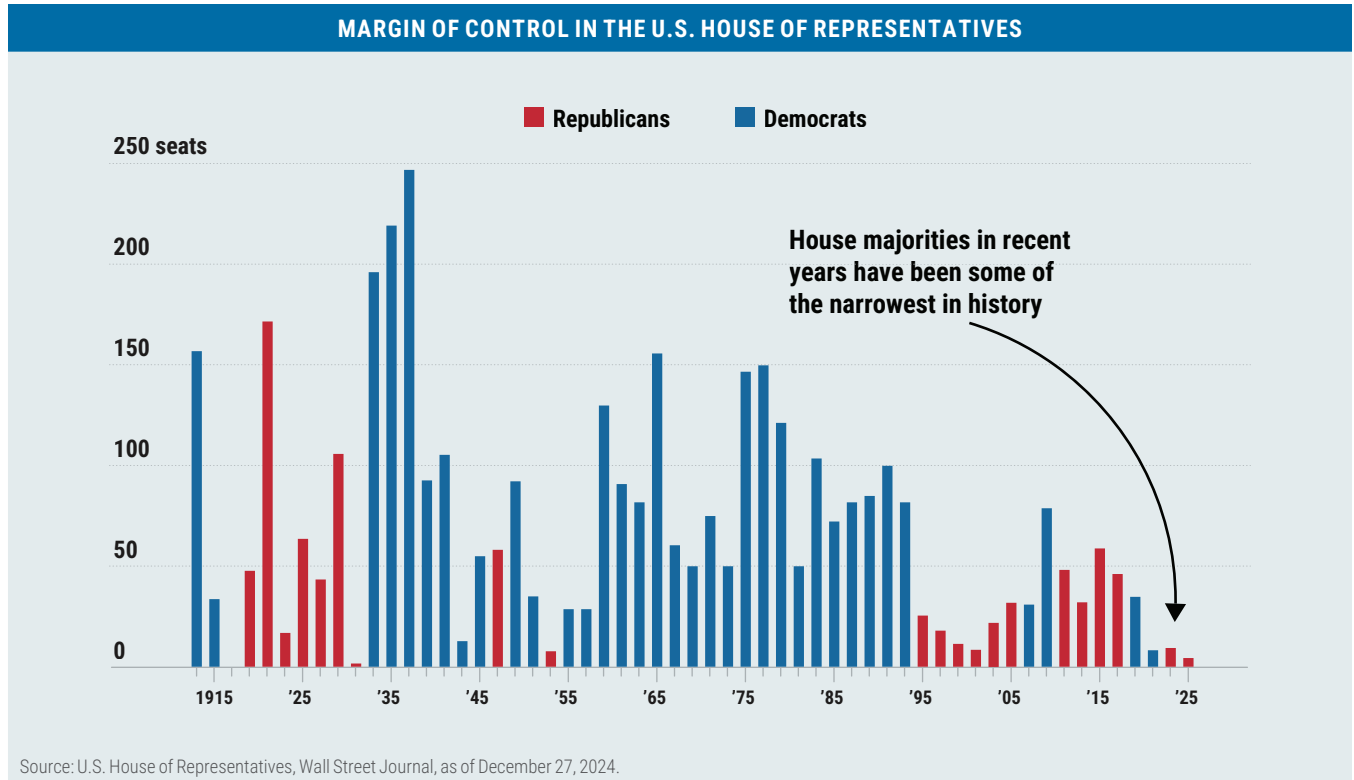
### Looking ahead to 2025

Accommodative financial conditions should continue to support both the U.S. economy and S&P 500 earnings growth in 2025. The Bloomberg consensus estimate for GDP growth in the U.S. for the coming year stands at 2.10%, above the Congressional Budget Office estimate of 1.75%, a number derived from two factors: 1) the percentage increase in the U.S. labor force, and 2) the increase in worker productivity, or how efficiently goods and services are produced compared with the inputs required to produce them.

While the potential labor force growth on a year-over-year basis remained sluggish at just an estimated 0.50%, productivity is projected to grow at a positive 1.25%, with perhaps an upside surprise coming from advancements in AI technology. That said, it’s worth noting that President-elect Donald Trump’s proposed policies on immigration and deportations could have negative consequences for labor force growth.

The FactSet’s bottom-up analysts’ estimate for S&P 500 earnings growth for 2025 comes in at a robust 14.8%, while the top-down Bloomberg strategists’ forecast comes in at 11.9%; both sets of forecasts expect margins to remain at peak levels. Trump’s tariff proposals could reduce margins and thus earnings growth, and a lack of improvement on the inflation front could bring into question whether the Fed follows through with its two planned rate cuts. Either way, the S&P 500 forward P/E multiple of 22.4x leaves little wiggle room for negative surprises.

Seeing just how many of President-elect Trump’s policy proposals pass remains a wild card due to the razor-thin voting margin the GOP holds in the House of Representatives, as evidenced recently by the three attempts needed to pass a continuing resolution bill to fund the federal government through March 2025.



The Santa Clause Rally (a phrase coined by Yale Hirsch at the Stock Trader’s Almanac) encompasses the last five trading days of December and the first two trading days of January. It failed to materialize, with the S&P 500 dropping by 0.53% over the period. This may cause traders some concern: Since the 1999, just before the peak of the Dot-Com Bubble, there have been five years when Santa didn’t show up (to Wall Street) at Christmas, leading to losses for the S&P 500 in three of the following years. A loss for the entire month of December for the S&P 500 is less foreboding: Since WWII, there have been 19 down Decembers, but only four instances when the index went on to post a negative return in the following year.

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### Terms and definitions

**Beta** is a measure of a portfolio's market risk relative to its benchmark. In general, a beta higher than 1.00 indicates a more volatile portfolio and beta lower than 1.00 indicates a less volatile portfolio in relation to its benchmark. **Bond credit ratings** are measured on a scale that generally ranges from AAA (highest) to D (lowest). **Capital expenditures (CapEx)** are investments made by a business to obtain or improve physical assets. The **Dot-Com Bubble** was a stock market bubble that formed in Internet-related securities during the late 1990s and peaked in early 2000. The **Federal Open Market Committee (FOMC)** is a rotating group of 12 members of the Federal Reserve system tasked with setting and implementing monetary policy. **Forward P/E** is a ratio that compares the current share price of a company to its estimated earnings per share over the next 12 months. **The Magnificent Seven** stocks are a group of high-performing and influential companies in the U.S. stock market: Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla. A **secular bear market** is a longer-term downtrend in stock prices, typically lasting several years.

**The Bloomberg U.S. Aggregate Bond Index** tracks the performance of intermediate-term investment-grade bonds traded in the United States. **The Chicago Fed's National Financial Conditions Index (NFCI)** provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets, and the traditional and "shadow" banking systems. Positive values of the NFCI indicate financial conditions that are tighter than average, while negative values indicate financial conditions that are looser than average. **The MSCI Emerging Markets (EM) Currency Index** tracks the performance of emerging market currencies relative to the U.S. dollar where the weight of each currency is equal to its country weight in the MSCI Emerging Markets Index. **The MSCI EAFE Index** tracks the performance of large- and mid-cap equities traded across global developed markets, excluding the United States and Canada. **The MSCI Emerging Markets Index** tracks the performance of large- and mid-cap equities traded in global emerging markets. **The Russell 1000 Index** tracks the performance of the 1,000 largest companies traded in the United States. **The Russell 2000 Index** tracks the performance of the 2,000 smallest companies traded in the United States. **The Russell 1000 Growth and Value Indexes** track the performance of those large-cap U.S. equities in the Russell 1000 Index with growth and value style characteristics, respectively. **The Russell 2000 Growth and Value Indexes** track the performance of those small-cap U.S. equities in the Russell 2000 Index with growth and value style characteristics, respectively. **The Russell Midcap Index** tracks the performance of the roughly 800 smallest U.S. companies in the Russell 1000 Index. **The Russell Midcap Growth and Value Indexes** track the performance of those mid-cap U.S. companies in the Russell 1000 Index with growth and value style characteristics, respectively. **The S&P 500 Index** tracks the performance of the 500 largest companies traded in the United States. **The U.S. Dollar Index (DXY)** is used to measure the value of the dollar against a basket of six foreign currencies. The value of the index is a fair indication of the dollar's value in global markets. It is not possible to invest directly in an index.

**Market capitalization breakpoints** The breakpoints for capitalization ranges should be viewed only as guideposts and will change over time. In general, FTSE Russell (which maintains a number of stock-market indexes based on company size) considers small-cap stocks to have market caps of between \$150 million and \$7 billion, mid caps to have market caps between \$7 billion and \$150 billion, and large caps to be those companies with market caps above \$150 billion.