CURBSTONE FINANCIAL MANAGEMENT CORPORATION

From the Curb

Letter to Clients

Quarter Ending December 31, 2024

We may not have closed the year with a Santa Clause rally, but 2024 was a strong year for both stocks and bonds. While the economy remained on a solid footing and the Fed continued to cut interest rates, the election results raised expectations for tax cuts and other pro-growth policies in 2025. The result, a S&P500 return of 25.02% for 2024, well above the long-term average annual return of 10.2% (1926 – 2024).

In fact, the decade of 2020, which is now five years old, has been a terrific time to be invested in stocks, specifically the S&P500. Over this time frame, the index has produced returns of 18.4% (2020), 28.7% (2021), -18.1% (2022), 26.3% (2023) and 25.02% (2024) resulting in an average annual return for the five-year period of 14.5%. Again, above the long-term average annual return for the S&P500 of 10.2%. We're not sure this meets the definition of a Blue Moon, but it is eye-catching.

At the same time stocks have had above-average returns, bonds are beginning to generate returns above 2.5%. We have to go back to the decade of 2000 when intermediate-term government bonds produced an average annual return for that ten-year period of 5.5%. It seems that we have finally arrived at a point in time where bonds can add meaningful returns to overall portfolio returns.

We share this background information as context to help explain how we are thinking about investing as we move into 2025. We know that investors are eagerly awaiting the development and implementation of pro-growth policies expected to accompany the Trump administration. The extension of the 2016 tax cuts, the possibility of additional tax cuts for corporations and individuals along with sweeping deregulations, if executed, should result in increased corporate earnings and profits, a rise in personal incomes and sustained spending levels, all of which are positive for stocks.

The Federal Reserve appears to have achieved the elusive economic soft landing, as economic activity remains solid, unemployment is historically low and inflation has declined substantially from COVID highs. This backdrop allowed the Fed to aggressively cut interest rates in 2024 and may allow them to continue to reduce rates in 2025, which would further support continued economic growth.

Politically, Republicans hold small majorities in the House and Senate and large, complicated tax cut bills could easily be delayed by prolonged negotiations. Additionally, while investors have focused on potential positives of pro-growth policies, increased trade tensions and possible tariffs could create unanticipated headwinds.

We believe that the economy remains in a "sweet spot", although interest rates and inflation seem stuck at current levels and stock valuations are elevated. If bond investors think aggressive tax cuts or fiscal spending will dramatically increase the deficit or national debt, bond yields will rise and may force a revaluation in the equity markets.

Geopolitical issues are far from resolved. Tensions remain while hope for progress on a long-term resolution are high. There are no guarantees, however, and it is possible that either or both conflicts spread in 2025, giving investors continuing concerns.

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Bottom line, the outlook is positive as we start the new year, yet there are a number of risks that could derail the strong return trend that has been in place so far this decade. As we consider the management of your assets, we are committed to following a disciplined approach. This means trimming winners and right-sizing positions in order to maintain a well-diversified portfolio. Unlike the S&P500, your top ten holdings will not represent 40% of the value of your equity portfolio. We will continue to think about return net of fees relative to what you need to support your life style. And, we will off-set stock market risk by holding high quality bonds or bond funds to create cash flow and help stabilize principal during times of high downside volatility in the stock market. Having a balanced approach, especially when both stocks and bonds are contributing to returns, helps spread the risk across multiple asset classes, thus improving your prospects for achieving your financial goals.

It is unclear as to whether this is a period of irrational exuberance or realistic optimism about the growth that awaits us in the future driven by artificial intelligence. As such, while we are prepared for the positive outcome currently expected by investors, we are also focused on managing both risk and return potential. Experience suggests that markets and the economy don't always perform according to Wall Street's expectations.

We thank you for your ongoing confidence and trust.

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