Economic & Market Commentary

Winter 2025

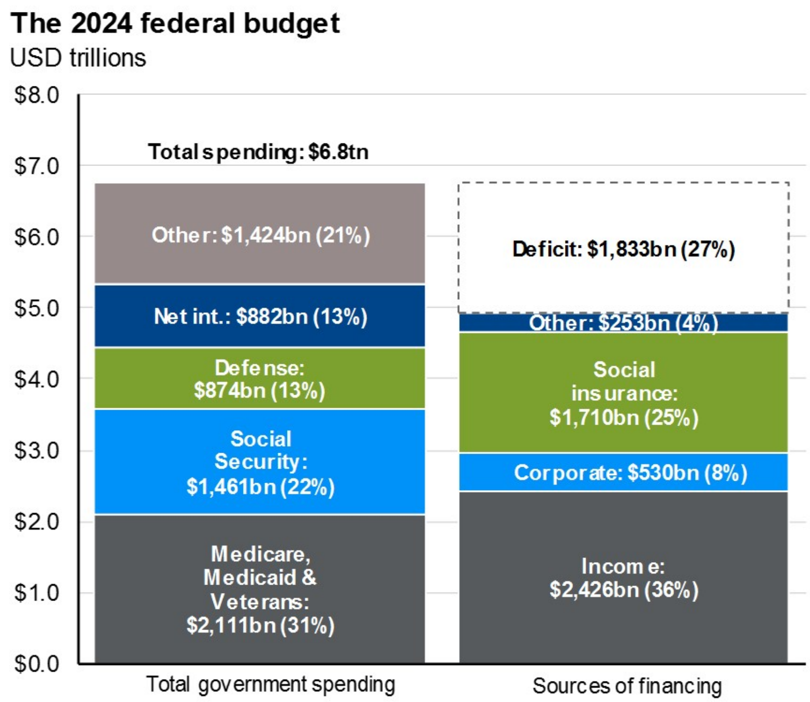
The four most dangerous words in investing are 'This time it's different.'
- Sir John Templeton

John Marks Templeton (1912-2008) was a Tennessee-born British investor and one of the pioneers of global equity investing. Money magazine tagged him as 'arguably the greatest global stock picker of the century' in 1999. He relied on a value-oriented, fundamental analysis. His flagship portfolios often trailed peers in bull markets but excelled in challenging times – the true mark of a disciplined, value-oriented philosophy.

His quote is important to keep in mind. As we will see, valuations are stretched in most U.S. equity classes – 2024 was a very good year. Perhaps this pattern will continue with expected policy changes from the new Administration. Post-election market behaviors reflect this optimism, regardless of price. Other asset classes, particularly fixed income and international equities, lag far behind and stand statistically cheap to their own histories. While we do not ignore momentum, and recognize that valuations (high or low) may be justified today, we are also firm believers in the concept of 'reversion to the mean'. An emphasis on quality, diversification, and valuation remains appropriate.

The Deficit Handcuffs

We generally support the pro-growth agenda thus far introduced by the incoming Administration. At the same time, it is unlikely that our current fiscal position will allow dramatic changes in tax and spending patterns. Note the data below:



CBO's Baseline economic assumptions

	2024	'25-'26	'27-'28	'29-'34
Real GDP growth	2.9%	2.0%	1.7%	1.8%
10-year Treasury	4.5%	4.0%	3.6%	4.0%
Headline inflation (CPI)	3.2%	2.4%	2.2%	2.2%
Unemployment	3.8%	4.0%	4.3%	4.5%

Source: CBO, Treasury Department, J.P. Morgan Asset Management (Numbers may not sum to 100% due to rounding)

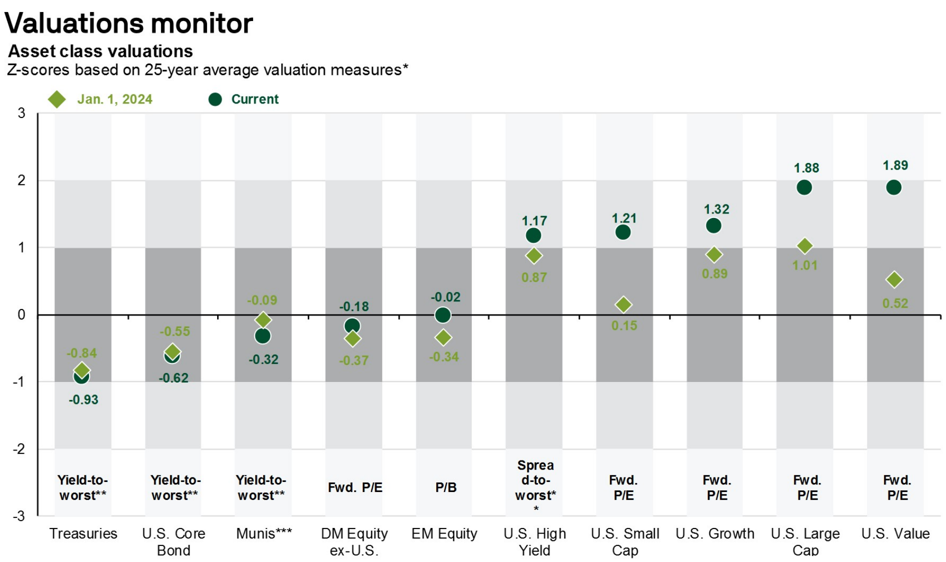
J.P.Morgan ASSET MANAGEMENT

Debt sales to finance the fiscal 2024 federal deficit of almost $2.0 trillion accounted for over one-quarter of government receipts. Net interest costs on accumulated debt (now about $36.0 trillion) are essentially equal to total spending on national defense, non-defense discretionary, and other government expenditures. Only the untouchable categories of Social Security and Medicare/Medicaid absorb more of our national resources.

This suggests progress toward accelerated economic growth and deficit reduction will be much more incremental than sudden. And, given the Treasury Department's front-loading of debt maturities during a period of record low interest rates, the expense of rolling over and servicing this debt burden will only grow with time. In the short run, deficit spending is stimulative. In the long run, it is a pernicious drag on our economy, pulling resources away from future productivity to pay for a profligate past. The non-partisan Congressional Budget Office projections of future growth reflect this reality.

Where Are the Opportunities?

In past *Commentaries,* we have emphasized relative valuations – large versus small stocks, growth versus value, and domestic versus international sectors. A different way of determining where value lies is with z-scores – comparing different asset classes to their own histories. The z-score is measured in standard deviations from the asset class historic return range. One standard deviation encompasses about two-thirds of recorded values over a specified period (the dark gray section of the charts below). Two standard deviations include about 95% of the value range. In the chart below, the time measured is the last twenty-five years. Current readings above the mid-point suggest overvaluation versus history; below the mid-point readings show undervaluation.



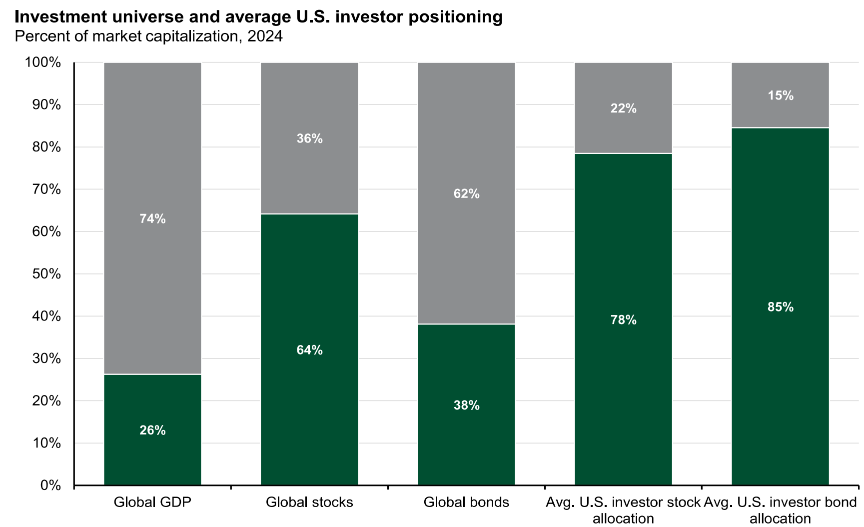
Source: Bloomberg, BLS, CME, FactSet, MSCI, Russell, Standard & Poor's, J.P. Morgan Asset Management.
U.S. Large Cap: S&P 500, U.S. Small Cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, U.S. Value: Russell 1000 Value, U.S. Growth: Russell 1000 Growth, U.S. High Yield: J.P. Morgan Domestic High Yield Index, U.S. Core Bond: Bloomberg US Aggregate, Treasuries: Bloomberg U.S. Aggregate Government – Treasury, Munis: Bloomberg Municipal Bond. *Averages for U.S. High Yield and U.S. Small Cap are since January 1999 and November 1998, respectively, due to limited data availability. **Yield-to-worst and spread-to-worst are inversely related to fixed income prices. ***Munis yield-to-worst is based on the tax-equivalent yield-to-worst assuming a top-income tax bracket rate of 37% plus a Medicare tax rate of 3.8%.
Guide to the Markets – U.S. Data are as of November 30, 2024.

J.P.Morgan ASSET MANAGEMENT

In addition to earlier comparisons between sectors, this view shows us that most U.S. stocks – particularly large capitalization issues – are expensive when compared to their own histories. And, note their dramatic advance since the beginning of 2024. Smaller U.S. sectors are reasonably valued today. More importantly, developed international markets and all fixed income sectors stand well below their historic valuation ranges.

We have noted in the past that sometimes sectors appear cheap for good reasons. Many international economies – particularly in Europe – are facing significant challenges. And, related to this, just because a market sector or individual stock is expensive today doesn't mean it won't continue this path. Momentum is a powerful part of market behavior. That said, let's remember our opening comments. This time is not different; attention to valuation – between *and* within sectors – will produce favorable results for patient investors.

In support of this view, let's take a step back and look at the bigger picture. The U.S. is about one-quarter of the world's GDP, but its equity markets represent about two-thirds of the global stock market capitalization. The same pattern exists (to a smaller extent) for fixed income.



Source: BIS, FactSet, IMF, MSCI, J.P. Morgan Portfolio Insights, J.P. Morgan Asset Management.
Global GDP are from IMF WEO Outlook and are in current prices (USD) using 2024 GDP estimates as of April 2024. Global stock market data are as of September 2024. Global bond market data are as of December 2023. Average U.S. investor allocation is based on proprietary portfolio screenings of advisor portfolios and are aggregated as of June 2024.
Guide to the Markets – U.S. Data are as of September 30, 2024.

J.P.Morgan ASSET MANAGEMENT

We also see that U.S. investors are heavily weighted in domestic markets. This is known as a 'home country bias', a longstanding phenomenon and perfectly understandable. After all, we are more comfortable in environments we know best. That said, there are good reasons to be cautious. A continued concentration in already-expensive market sectors is not a formula for long term success.

Our Position

Prudent diversification is the cornerstone of our investment philosophy. Following this is an attention to valuation. And, while most of our broad risk exposure is in the U.S., we are comfortable holding less-favored international issues – *if* prices reflect the challenges present. We believe they do. In addition, high quality fixed income now produces positive inflation-adjusted returns for the first time in several years. A strong fixed income foundation now provides safety *and* a positive real return. Overall, broad diversification is a path to consistent, long term success. We're here to make it work for you – attainment of your goals matters to us.

Economic & Market Commentary is written by the Investment Services Department at Security National Wealth Management.