



2024 Recap by Robert Sokolowski



2024 was an excellent year for US stocks, with the S&P 500 posting a 25% total return. Performance was strongest in the technology and communications services sectors, as investors showed enthusiasm for the prospects of artificial intelligence and cutting-edge technology. The enthusiasm is not unwarranted—these companies are delivering substantial earnings growth.

The economy continued to chug along nicely in 2024. It appears GDP expanded by about 2.6%, while inflation fell throughout the year. The labor market is also very healthy—the unemployment rate has been around 4% for the past nine months, and the number of people looking for work roughly equals the number of job openings. Remember that in early 2022, nearly everyone predicted a recession. This is a huge testament to the strength, resiliency, and dynamism of the US economy.

The Bond Market

The bond market remains a substantial part of the narrative for financial assets. One of the major expectations heading into 2024 was that inflation would continue to fall and interest rates would ease in response. That assumption turned out to be only partially true. Despite the inflation rate (CPI) falling from 3.1% to 2.8% over the past year, the benchmark 10-year treasury rate rose from 3.9% to 4.6%. This means that interest rates (on the longer end of the spectrum) are now substantially more restrictive than a year ago despite the Fed cutting rates on the short end.

Why are we seeing persistently higher interest rates? Market pricing represents a weighted average of the expectations of millions of investors, and it's impossible to determine exactly what their concerns or motivations are at any point in time, but there are several potential factors they are considering:

- While inflation fell over the past year, we didn't make as much progress as some expected. There is also evidence that inflation may be stalling at a higher level than desirable. Investors expecting higher inflation will demand a higher interest rate.
- As baby boomers retire and birthrates fall worldwide, we are likely entering a period of substantial labor shortages, barring significant technological advancement. Labor shortages are inflationary.



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SPECIAL POINTS OF INTEREST

- If you would like to schedule a meeting for planning or portfolio questions, don't hesitate to contact us!
- Thursday, January 9th, 2025 is a National Day of Mourning for former President Carter. The stock market will be closed.
- Q1 Market Holidays & Office Closures:
 - MLK Day Jan. 20th, 2025
 - Presidents Day Feb. 17th, 2025

- The US is experiencing a structural housing shortage without a quick fix. Shelter represents over 40% of the inflation basket. This also flows through to categories like home insurance and home services. Unfortunately, higher interest rates exacerbate the housing market's issues. The 30-year mortgage rate finished the year up 0.24 percentage points.
- The Federal government spent a tremendous amount of money responding to the pandemic. Since 2019, federal debt has increased by about \$7.5 trillion, or 16 percentage points, as a percentage of GDP. Investors worried about the government's ability to repay debt in the future will demand a higher interest rate.
- The incoming administration has proposed three policies that are potentially inflationary- tariffs, mass deportations, and tax cuts. I'll address these issues below.

Regardless of the causes of persistently higher or rising interest rates, we must remember that rising rates are a headwind for stock and bond performance. Nevertheless, we continue to be pleased with our bond strategy of keeping our core holdings high in quality and short in duration. Our high-yield and senior loan ETF holdings have also performed nicely.

Potential Policies in Washington

In discussions with clients since the election, many have expressed concern about the impact of future policies on inflation and, consequently, on the markets and the economy. The three policy proposals causing the most concern are tariffs, mass deportations, and tax cuts. I could write an entire newsletter about each of these proposals, but they share some commonalities.

- They can potentially increase price levels or the rate of inflation and, therefore, interest rates.
- There are possible offsets to some of the ill effects of each of these policies
 - The strengthening dollar could offset tariffs.
 - Automation and technology could offset mass deportations.
 - Spending cuts could offset any inflationary effects of tax cuts.
- The specifics of all these proposals are somewhat fuzzy.
- They could all be used as bargaining chips in one way or another.
- They could be campaign talking points, not serious proposals.

Index	Q4 Total Return	YTD Total Return	1 Year Total Return
S&P 500	3.4%	25.0%	25.0%
DJIA	1.3%	15.0%	15.0%
Nasdaq Comp	8.0%	29.6%	29.6%
MSCI EAFE	-7.8%	3.3%	3.3%
Russell 2000	1.8%	11.5%	11.5%
US Aggregate Bond	-3.4%	1.3%	1.3%

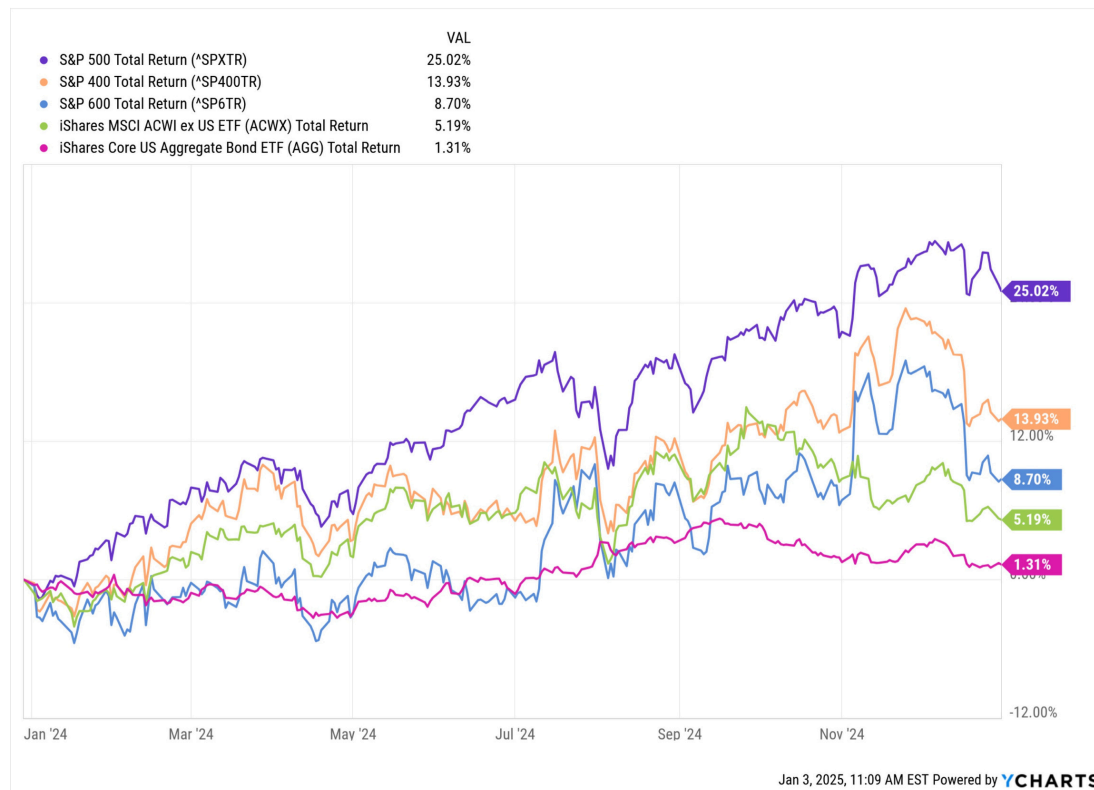
Our best advice is to remember that none of these policies are set in stone until bills actually pass or executive orders are issued. Executive orders can also easily be rolled back. The market is highly attuned to the potential issues these proposals could cause, and so far, it is telling us not to worry about them too much.

We are more than happy to discuss these or any other political issues with you at any time!

Looking Forward

2023 and 2024 were banner years for US stocks, reflecting investors' expectations of continued economic growth and corporate earnings growth. While market strength tends to beget market strength, we must also be cognizant of how much the market has risen and the degree to which positive outlooks are baked into asset prices.

In 2024, we found very few opportunities to harvest tax losses. We also struggled to pare back positions that had grown substantially without generating large realized capital gains. We believe other portfolio managers are facing similar scenarios. Considering all these factors, we would not be surprised to see some sort of pullback after the beginning of the year. However, given the strength of companies and the economy, this would not raise broader concerns. The dominant themes of a robust labor market, a strong economy, and a healthy business environment are likely to continue, barring an unforeseen exogenous event.



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Common HSA Mistakes by Jenn Sokolowski

Health Savings Accounts (HSAs) are among the most powerful savings tools available. If you save and invest diligently during your working years, you will amass a large pot of money that can be spent on healthcare expenses 100% tax-free. This is because HSAs are triple-tax-advantaged:

1. You receive an income deduction when you contribute.
2. If invested, the earnings grow tax-free.
3. If spent on eligible health care expenses at any time, the distributions are tax-free.

Unfortunately, when working on financial plans, I often see common HSA mistakes. While it is great to see more people with HSAs, they are not being maximized. Here are four common mistakes people make with their HSAs and what I recommend they do instead:

1. Not Investing—The second tax advantage is tax-free investment gains. However, most HSAs I have seen are 100% in cash. With a very high deductible plan, I don't mind seeing some cash available if you need to tap the HSA for a health emergency. However, if you have tens of thousands saved in the account, it should be invested in line with your risk tolerance. This is even more true for younger savers because they are more likely to be healthy, and they have time to ride out market volatility.

2. Spending HSA Funds on Small Expenses – Using an HSA for health-related expenses is the goal of this type of account. If you need to tap the account to pay for a large, unexpected medical bill, that is fine. What I see more often is people using the debit cards provided with the HSA for Advil or Ace bandages from the drugstore. I don't recommend nickel-and-diming the account with small health-related expenses. Let the account grow and save it for a rainy day or a time in your life when medical expenses are larger. The funds in an HSA can move with you if you change jobs; they don't expire. It is your money forever, so don't feel you must spend it.

3. Not Contributing the Catch-Up for Both Spouses – If you are 55 or older, you can contribute an additional \$1,000 a year. Your spouse can also do the same. The kicker is that you can only make one catch-up contribution per HSA account. This is typically what people do: they only have one family HSA. When you are younger, the contribution limits are the same whether you have two separate accounts or one. When you turn 55, it is more beneficial to have two accounts, so you both can contribute the catch-up contribution.

4. Not Prioritizing HSA Contributions – Personal finance “experts” talk a lot about maxing out your 401(k). This is a great goal, and it's not bad advice. In my opinion, there should be more focus on maxing out the HSA before the 401(k). This does not mean you should forfeit the employer match or let your emergency fund suffer to achieve this goal. If you are receiving the full match, have plenty of cash in your savings account, and have minimal debt, I recommend putting the next dollars toward maxing out the HSA before the 401(k). This is because these accounts are triple tax-advantaged, and the 401(k) is only double tax-advantaged. Also, healthcare is expensive, and having a pot of money set aside could be a game changer.

The biggest mistake is not contributing to your HSA if you have the means. So, if you are contributing, give yourself a pat on the back! If you have any Health Savings Account related questions don't hesitate to contact us!

Happy
New Year

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