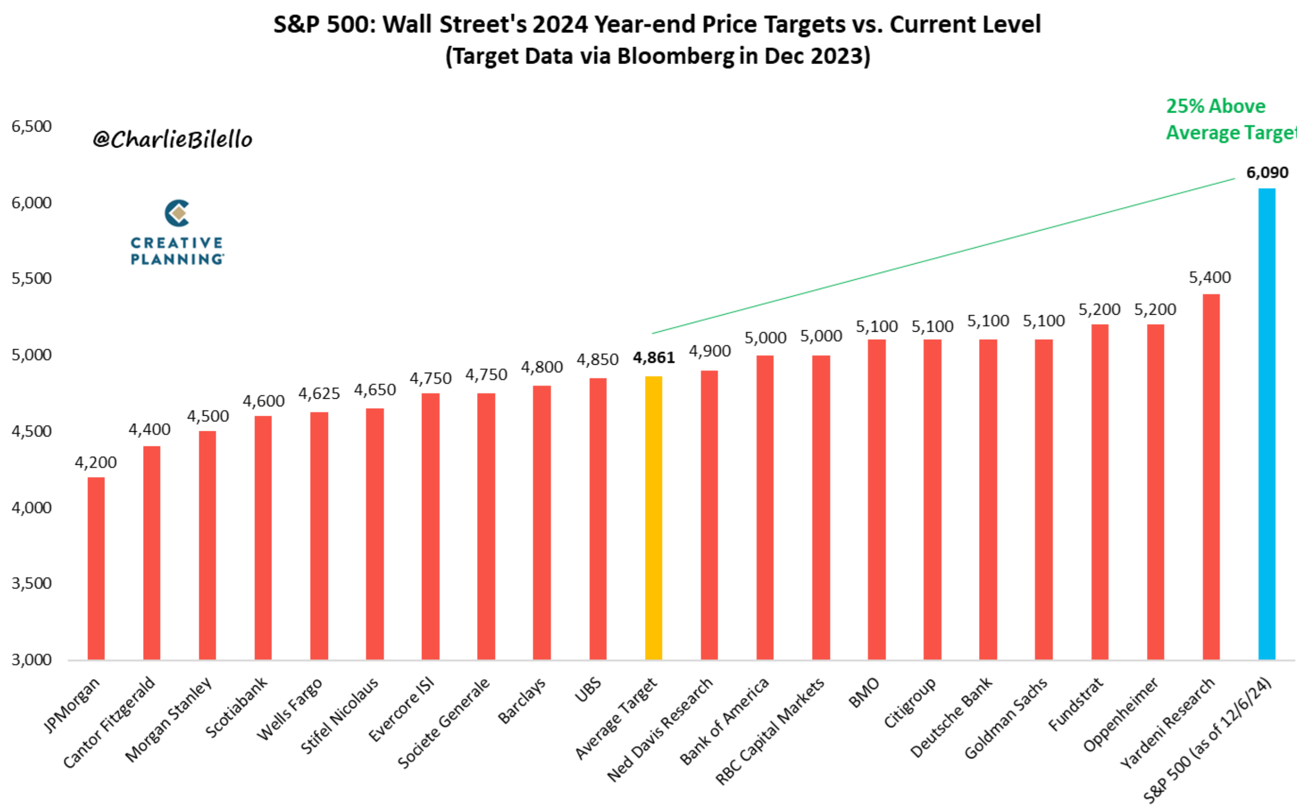
New Year Economic Commentary
January 1, 2025

As a new member of the Sather Financial Group team, I wanted to extend my sincere gratitude to our valued clients. Your trust in our firm allows us to pursue what I love: serving as a wealth manager and continuously learning as a student of the markets. I am also fortunate that Dave encourages me to write, a passion of mine for over two decades.

To begin, I'd like to share my favorite chart (below) of 2024. As you may notice, the S&P 500 reached an impressive 5,881 by year-end. Meanwhile, consider the forecasts made by many so-called "experts" at the start of the year. The average year-end target for the S&P 500 was 4,861, a full 20% below the actual close. Even J.P. Morgan, the world's largest bank, projected just 4,200. Their estimate was off by nearly 40%.

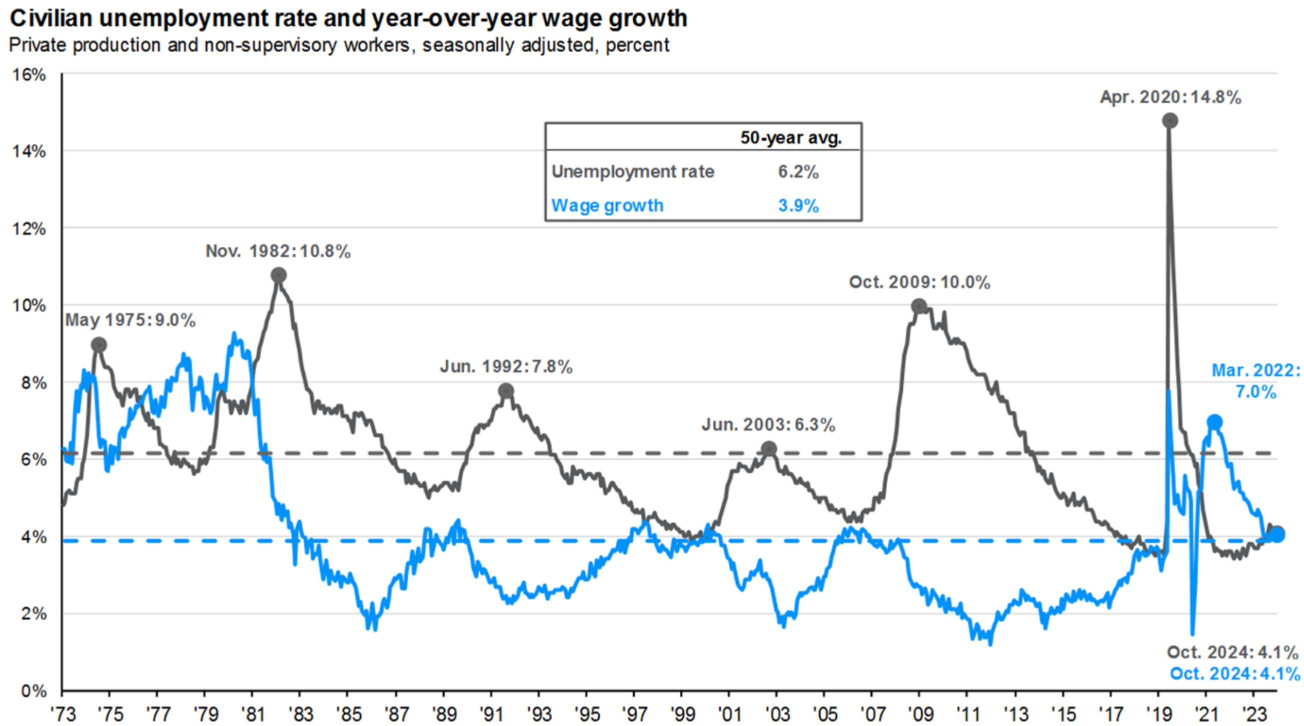
Why point this out? Because forecasters are among the most educated and respected minds in finance, yet they, and their colleagues, were still so far off the mark. Warren Buffett put it best when he said, "Forecasts may tell you a great deal about the forecaster; they tell you nothing about the future."

In other words, stay focused on owning quality businesses and ignore the noise. That is precisely what we are doing and it's what you have entrusted us to continue doing on your behalf.

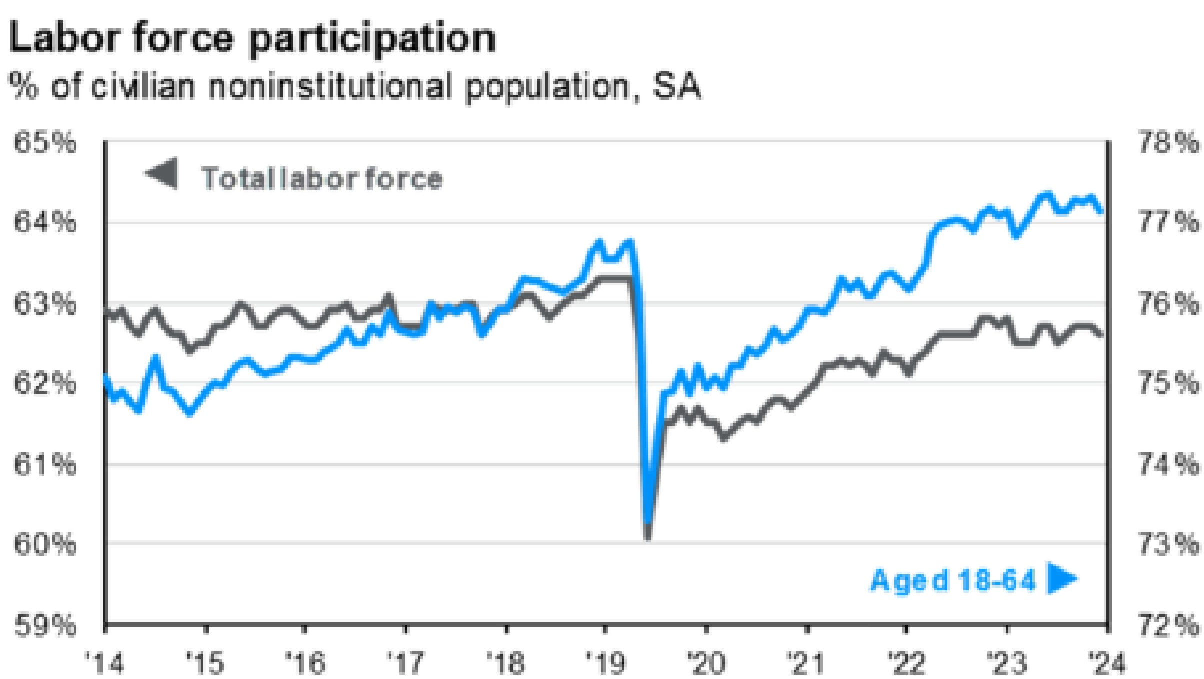


Employment and Labor Markets

Unemployment rose slightly from 4.1% in October to 4.2% in November, a year-over-year increase of 0.5%. Much of this rise comes from more people entering the labor force, not from layoffs. With an expanding supply of workers, wage growth is moderating, easing upwards pressure (better for inflation) seen in earlier quarters.



Wage growth of 4.1% is more than the rate of inflation meaning the average family is getting an increase in real purchasing power. Meanwhile, the labor force participation rate (workers aged 18-64 who are in the workforce) continues to climb, rebounding from the pandemic's lows. People are working and their pay is increasing.

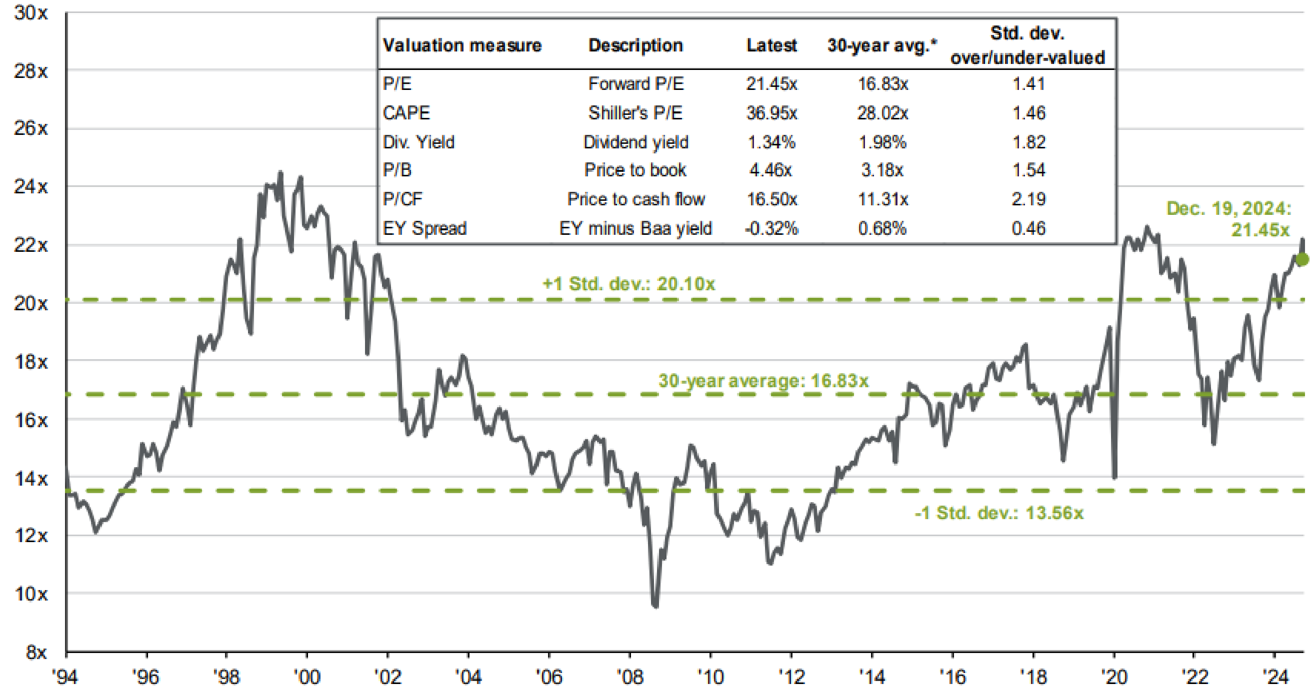


Market Valuations / Profitability

The forward price-to-earnings (P/E) ratio is above its 30-year average. This is not necessarily a signal of an imminent sell-off. Rather, it serves as a useful benchmark, reminding us that today's market optimism comes at a higher price.

Additionally, remember that the market is an anticipatory mechanism. Currently, as employment is full, inflation is tame and profit margins continue to record levels, the market is expected higher profitability in the future. As such, higher market valuations are not an unusual expectation.

S&P 500 Index: Forward P/E ratio



Valuation measure	Description	Latest	30-year avg.*	Std. dev. over/under-valued
P/E	Forward P/E	21.45x	16.83x	1.41
CAPE	Shiller's P/E	36.95x	28.02x	1.46
Div. Yield	Dividend yield	1.34%	1.98%	1.82
P/B	Price to book	4.46x	3.18x	1.54
P/CF	Price to cash flow	16.50x	11.31x	2.19
EY Spread	EY minus Baa yield	-0.32%	0.68%	0.46

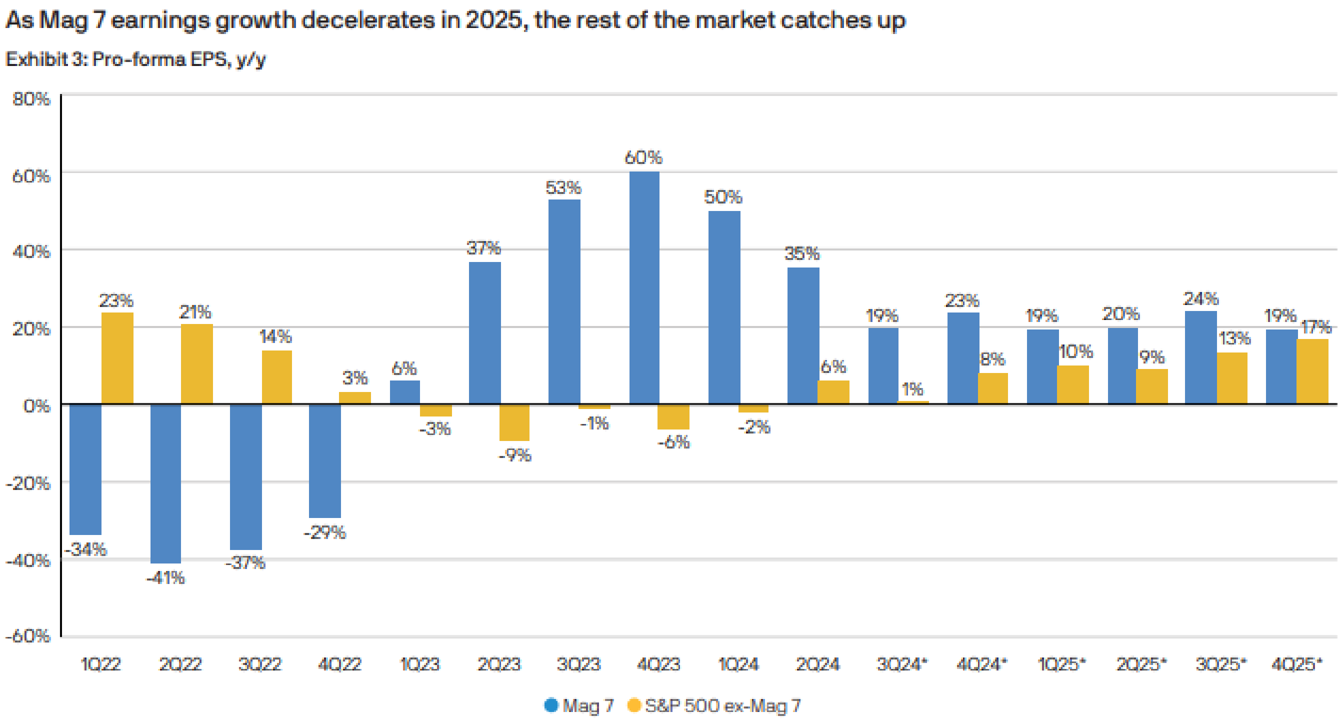
Companies have generally maintained healthy profit margins, even after the dip in 2022.

Part of this resilience stems from robust consumer demand, cost efficiencies, and continued productivity gains, regardless of what happens in Washington.

S&P 500 profit margins

Quarterly earnings/sales

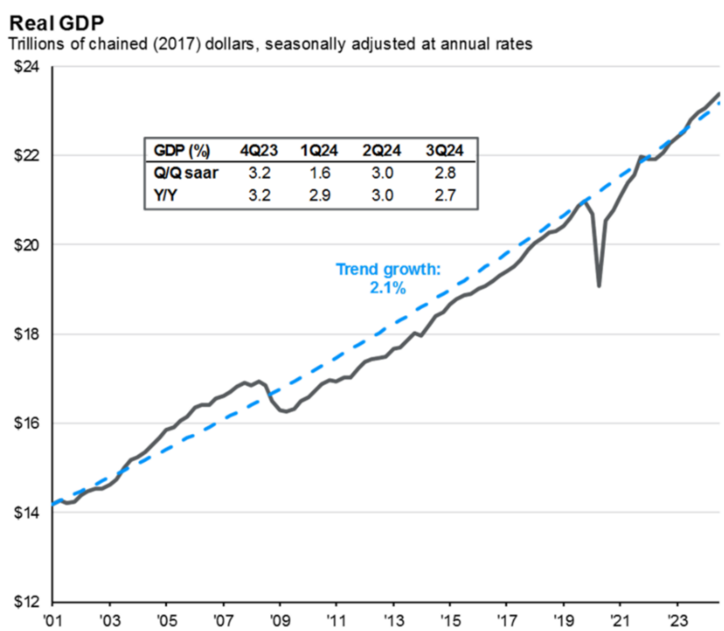
Moreover, although the "Mag 7" (Microsoft, Amazon, Meta, Apple, Google, Nvidia, & Tesla) dominated market performance for much of the year, earnings growth outside these mega-caps has picked up. This broader-based profitability is a positive sign for market health over the long run.

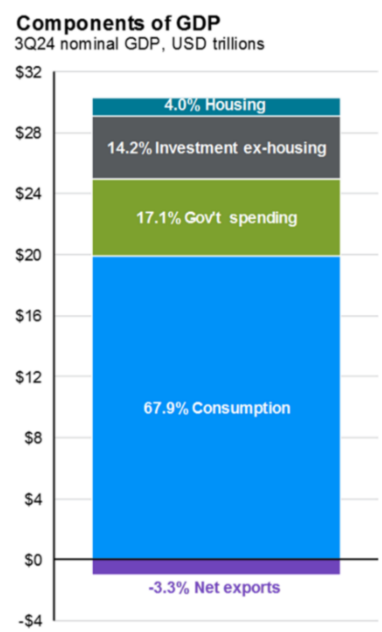


GDP

Contrary to some media headlines or social media posts, Inflation-Adjusted Gross Domestic Product (Total Value of US products and services) continues on an upward trajectory and remains strong.

As for its components, consumer spending accounts for 67.9% of GDP, followed by government spending at 17.1%.



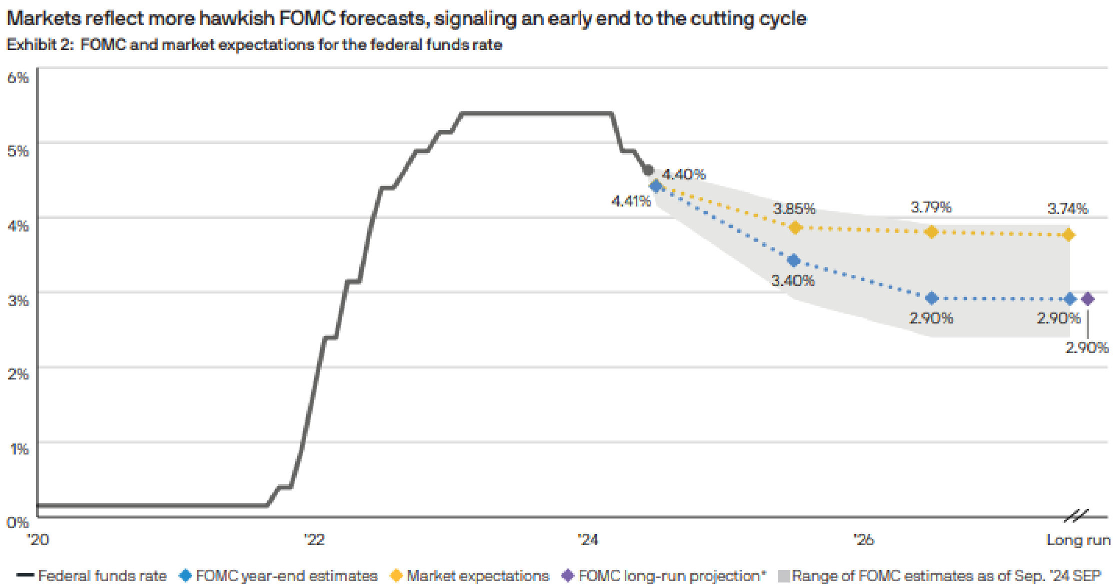


Interest Rates

Markets expect the Fed to keep short-term rates elevated with an approximately 0.75% of additional cuts throughout next year before pausing.

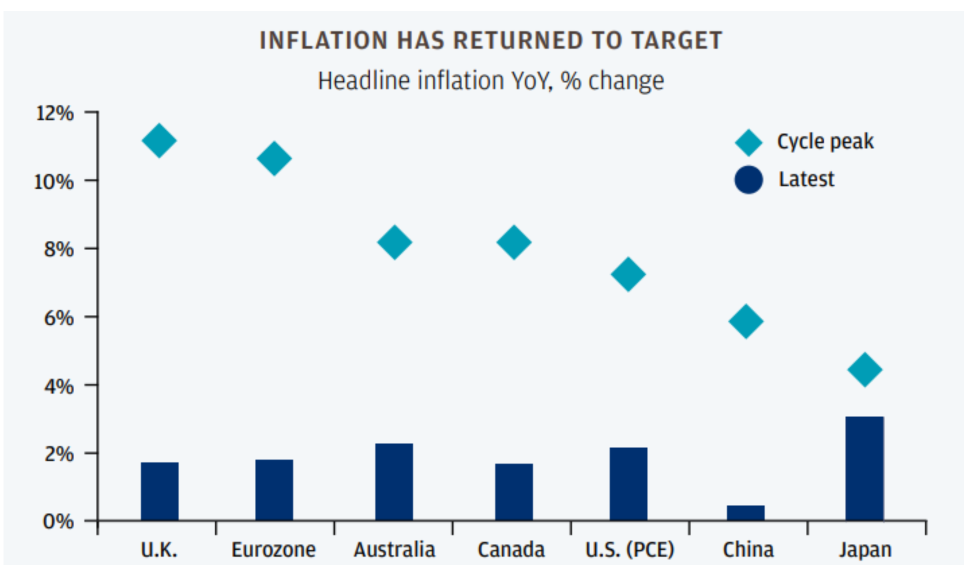
With Republicans in control of Congress and the White House, the potential for tariffs may have an inflationary pressure thus causing the Fed to slow rate cuts. **(higher rates are used to decrease inflation**).

Additionally, this stance allows the Fed to react to any major Trump administration policy changes including taxes and spending. The chart below shows expectations for the Fed Funds rate, along with year-end estimates and long-term projections, and market expectations.



U.S. vs Rest of World

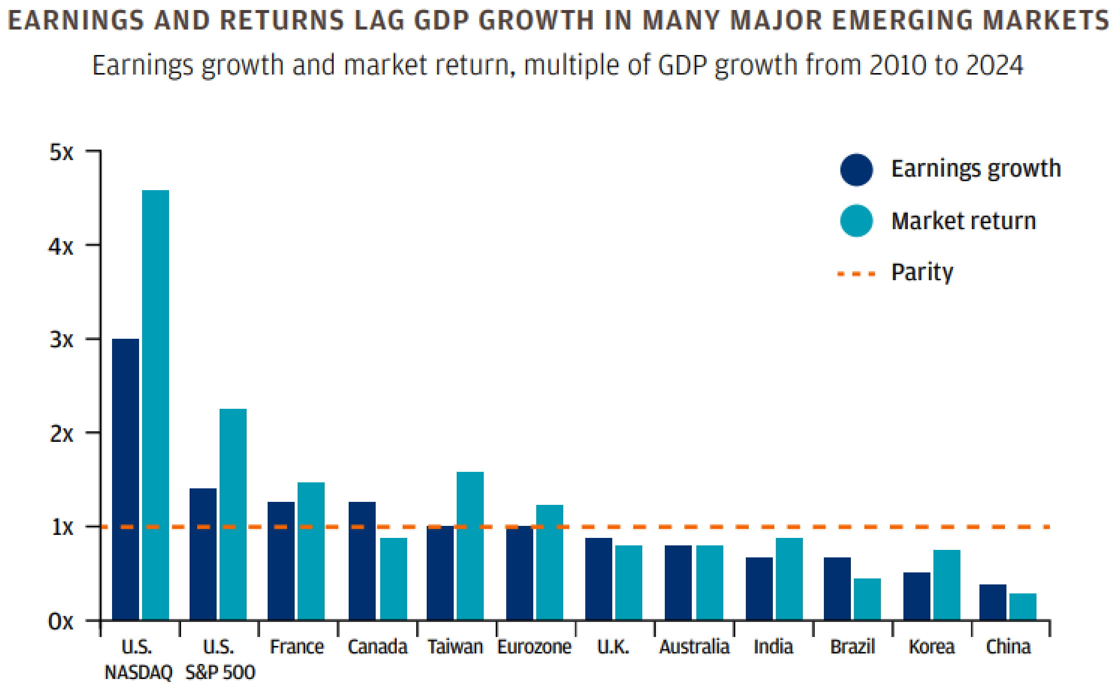
European markets, where inflation reached double digits only a year ago, have seen prices cool considerably, though they remain above preferred levels. Meanwhile, in November, the U.S. recorded inflation at 2.4%, which is still above the Fed's 2% target. Further, across numerous developed countries, including emerging markets like China, inflation is reverting to more manageable levels as seen with the chart below.



The chart below underscores the relative strength of U.S. markets on the global stage. When comparing earnings growth and market returns to GDP expansion across various regions, emerging markets like Brazil and China have seen their stock performance fall short of actual economic growth.

In contrast, U.S. markets have performed better than respective earnings growth, which is a continued sign of confidence in the U.S. markets.

One explanation is that global investors continue to view the U.S. as their preferred investment destination.



Lastly, 2025 will surely bring surprises and challenges. Despite this, capitalism will remain the tide that lifts the most boats. Politics will surely dominate the news cycle. Social media will drive tremendous confusion.

In the new year, focus on quantifying things with data and facts. Realize that many scary things may happen….but few actually will happen. And even when we encounter bad things, realize the economy, profits and capitalism will continue to grind higher.

As we think about the challenges in front of us, we continue to remain laser focused on finding extremely high-quality companies that make money in all markets. If we succeed in doing so, we will be in a better place over ten-year cycles.

As we move forward, remember that the more we hear from you, the better we can help you. Don’t be a stranger! Best wishes for health and prosperity in 2025.

Sincerely,

Joe Olive

Joe Olive
Financial Advisor