
# Precarious

2024 was a positive year across most asset classes, but the path to gains was not easy and the dispersion in returns was wide. This was particularly the case in the final quarter of the year. U.S. stocks and gold climbed throughout the year, briefly surging after the Presidential election, reflecting positive sentiment from the markets due to the end of uncertainty surrounding the election outcome, anticipation of the profit potential from deregulation, extension of tax cuts and likely easier monetary policy under the new administration. However, a surprise hawkish announcement by the Federal Reserve sparked an unprecedented decline in late December, as the S&P 500 lost 2.6% in the last week of the month, the greatest year-end fall in decades.

The downturn was sparked by the Fed's 50 basis point interest rate cut in September, where equities cheered the decision and long bonds jeered. From the time of the Fed's first rate cut in September until the end of December, long rates rose from 3.90% to 4.83%. By the December Fed meeting, concerns about too-sticky inflation and a robust economy and labor market caused the Fed to reduce the number of rate cuts originally planned for 2025. This was not priced into stocks and the rally faltered.

## 2024 Full Year Returns


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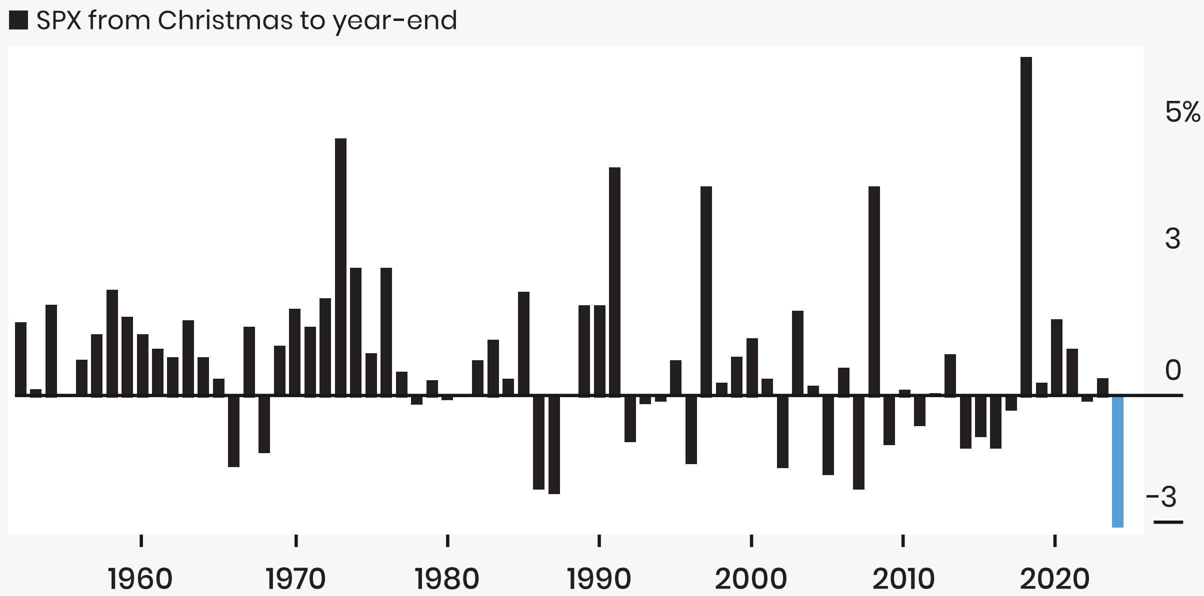
**S&P 500 Saw Worst Year-End Fall Since 1952**

Index declined over 1% only 12 times during this period




Source: Bespoke Investment Group

Bloomberg

# Boomerang

In what turned out to be a dismal ending to a strong year, Avalon portfolios weathered the fourth quarter decline better than most. Our equity positions in large-cap U.S. technology, bitcoin, and gold bullion offset losses in other areas as shown in the table, where many asset classes lost more than 5%. Currently, our analysis shows U.S. equities in the very late stage of its uptrend that began in 2009. We have concerns about overvaluation, political uncertainty and rising volatility. Still, in the near term, we believe the uptrend in equities has room to run due to the sharp losses at the end of the year, a resilient economy, and recent inflation reports showing improvement. As the year progresses, the staying power of this trend will be determined by the strength of earnings reports now underway and the fulfillment of still robust earnings growth estimates for 2025 and 2026. The prop of lower interest rates is unlikely to be a tailwind in 2025. With valuations already at historically high levels, prospects for more than a modest return in stocks in 2025 are low. Still, we are finding opportunities in natural resources and some fixed income as a counter to what could be a volatile year.

We began the year concerned about stock market concentration, noting in our previous strategy piece in early 2024 (*link*) "Historically, a lack of breadth indicates a less than healthy market. As breadth narrows, market concentration peaks. And, historically, market concentration has tended to foreshadow equity drawdowns." For a brief window in the third quarter, participation broadened, with strong performance from REITS, bonds, gold, value stocks and shares of small and mid-cap companies. Yet, by the end of the year markets were right back where they started. Concerns about narrow breadth that defined the early months of 2024 dominated the final quarter. The largest mega-cap stocks rallied and the balance of asset classes lagged.

## Asset Class Returns for a Dismal Q4 2024


# U.S. Stocks

In the fourth quarter and the balance of the year, the U.S. stock market was dominated by a concentration of companies primarily focused on AI and related technologies. This has been a trend within the stock market rally that started in late 2022. With the "Magnificent Seven" stocks rallying 48% in 2024, the largest 10 stocks in the S&P 500 now account for a record 39% of the index. This has masked what has been an incredibly difficult period for the average stock, where the rest of the 493 companies in the S&P 500 returned just a third of the top 7 companies. These outsized gains have so far been supported by much stronger earnings from these stocks, but here too, the growth rate may not justify the high prices.

# Hard Assets

Gold climbed 27% in 2024, while silver gained 22%, fueled by central bank purchases and investor hedging against heightened geopolitical uncertainty and market volatility. Avalon portfolios benefitted from our allocations to precious metals and precious metals stocks. Our analysis continues to identify this asset class as attractive over the long-term. We believe these commodities, and the industries focused on mining and exploration, should continue to see support from inflationary pressures, governmental fiscal undiscipline and geopolitical uncertainty.

**Exhibit 15: But valuation premium reflects the faster expected sales and EPS growth**

| | | Mkt cap | Return | | Sales growth | | Earnings growth | | Valuation | |
|---|---|---|---|---|---|---|---|---|---|---|
| Ticker | Name | ($ tn.) | 2024 | 1-month | 2025E | 2026E | 2025E | 2026E | EV/Sales | P/E |
| NVDA | NVIDIA | $3.4 | 171 % | 1 % | 49 % | 22 % | 47 % | 26 % | 17.8 x | 32 x |
| META | Meta | 1.3 | 66 | 1 | 14 | 12 | 11 | 14 | 8.5 | 24 |
| TSLA | Tesla | 1.3 | 63 | 1 | 16 | 17 | 33 | 24 | 11.5 | 118 |
| AMZN | Amazon | 2.3 | 44 | (2) | 11 | 11 | 21 | 22 | 3.4 | 35 |
| GOOGL | Alphabet | 2.2 | 36 | 11 | 11 | 11 | 10 | 14 | 6.1 | 22 |
| AAPL | Apple | 3.7 | 31 | (2) | 10 | 7 | 12 | 5 | 9.0 | 32 |
| MSFT | Microsoft | 3.1 | 13 | (5) | 13 | 15 | 10 | 19 | 10.6 | 30 |
| **Magnificent 7** | | **$17.4** | **48 %** | **(0) %** | **14 %** | **12 %** | **18 %** | **16 %** | **7.5 x** | **31 x** |
| **S&P 493** | | **35.0** | **16** | **(3)** | **3** | **6** | **11** | **13** | **3.1** | **19** |
| **S&P 500** | | **52.5** | **25** | **(2)** | **5** | **6** | **12** | **14** | **3.1** | **22** |

Source: Goldman Sachs Global Investment Research

## Cryptocurrency

2024 saw progress in the institutional adoption of cryptocurrencies as the SEC approved of Bitcoin exchange-traded funds for the first time last year. Bitcoin's price skyrocketed after the election, ending the year with gains of 122%, in anticipation of an administration seen as supportive of the digital currency. Our analysis points to the emergence of cryptocurrency as a more credible asset class, as what was once considered a niche financial product has become a legitimate digital store of value and is a key holding of many prospective Cabinet members.

## Fixed Income

In the past year, fixed income underperformed significantly, reflecting the ongoing decline in this asset class as U.S. 30-year Treasury bond yields rose to their highest point since 2023. The uptick in yields adds further pressure to the U.S. fiscal situation and to the stock market. There may be opportunities in long duration U.S. Treasury bonds this year, particularly as anxiety about inflation wanes. Bonds would also become more attractive in the short term if the Fed has overtightened and we are headed toward a recession. So far that is not our forecast, but it could be a relative hiding place if stocks disappoint. From the peak in 2021, the long bond has now lost 50% of its value. It is likely close to fair value after being grossly overvalued a few years ago.

## Looking Forward

In 2025, expectations are high for U.S. stocks and the dollar, due to Trump's policies and the Fed. The dollar performed well last year, reflecting perceived U.S. economic strength and threats of protectionist tariffs. Financial and industrial stocks were supported by the administration's emphasis on deregulation and tariffs. Tech stocks remain a dominant theme for future growth and will continue to deliver double-digit earnings. The extent to which all of this is already discounted is unknown. Another large unknown is the impact of mass deportation on industries like farming, construction, homebuilding and restaurants at a time of near full employment. This issue alone could cause wages and inflation to rise. For the markets, our analysis says more of the same emphasis in early 2025, but the outlook grows cloudy after that, creating a precarious situation which will require vigilance.

We haven't quite seen the "soft landing" that many predicted. It was more of a "no landing". U.S. economic growth has been resilient, and inflation has stabilized, but at a higher level and at a slower pace than previously expected. The risk of recession hasn't disappeared completely, and Avalon is more defensively positioned than a year ago as the case for a corrective cycle later in the year is gaining traction. We believe an intentional allocation is critical to maximize opportunities in other asset classes outside of large-cap technology stocks where valuations are better, and earnings growth is improving.

## Closing Comments

We have one housekeeping note; the first version of 1099s is available. Feel free to download them or let us know if you want us to send them to your accountant. There are likely to be corrections in February, so this is just the first version. Please let us know if you have any questions or need help.

We also want to express our deepest sympathy for those of you who have been impacted by the Los Angeles area wildfires. Wildfires have become a recurring problem in the West, but these have been particularly devastating, with economic losses estimated to exceed $250 billion. Our thoughts are with those who have been affected.

Finally, in these volatile and challenging times, we would like to recommend Neil Howe's book *The Fourth Turning is Here*. It outlines history in 100-year cycles broken into the four seasons. It is riveting and illuminating. If we have entered Winter, it will surely be followed by Spring. We will do our best to keep you sheltered should a blizzard appear.

Best wishes for the New Year!

Clara Basile      Ross Revenaugh

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