

December saw broad negative performance across asset classes with the exception of commodities. Markets pulled back from their November rally as a result of uncertainties around the new incoming administration, rising treasury yields, and potentially some impacts from seasonal rebalancing for year-end tax-loss harvesting and portfolio repositioning.

“Much of what kept the economy afloat in 2024 can be attributed to large fiscal deficits. Spending exceeded revenue by \$1.83 trillion in 2024¹, and the fiscal deficit amounted to 6.4% of GDP, up from 6.2% in 2023.”

In December, the Personal Consumption Expenditures (PCE) report indicated continued stability in inflation metrics. Year-over-year, Headline PCE edged up from 2.31% to 2.44%, while Core PCE saw a modest increase from 2.79% to 2.82%. However, looking at the more stable three-month annualized inflation figure, we saw a slight decline to 2.54%.

Last year was another strong year for equity markets, driven by the continued growth and enthusiasm surrounding the AI boom, which propelled the market higher for the second consecutive year. Market leaders such as NVIDIA, Amazon, Google, Meta, and Apple led the charge as excitement around AI innovation intensified. This enthusiasm was reflected in the S&P 500's impressive 25.02% return, outpacing the 13.01% return of the S&P 500 Equal Weight Index. Growth, quality, and momentum factor segments remained dominant, with these companies significantly benefiting from the AI narrative, supported by robust revenue and earnings growth.

Furthermore, concerns about slowing growth and recession risks surprised to the upside, with economic growth exceeding expectations and recession fears easing. Coupled with falling inflation and the initiation of a rate-cutting cycle, these factors created a favorable environment for dominant equity market performance.

In contrast, bond markets had a relatively muted year, with the Bloomberg US Aggregate Index returning a modest 1.25%. This subdued performance reflected the market's pricing of improved growth prospects and a smaller-than-anticipated number of rate cuts throughout the year.

In relation to growth and inflation, it is important to address the role of irresponsible fiscal policy. Much of what kept the economy afloat in 2024 can be attributed to large fiscal deficits. Spending exceeded revenue by \$1.83 trillion in 2024¹, and the fiscal deficit amounted to 6.4% of GDP, up from 6.2% in 2023. This figure significantly exceeds the 50-year average of 3.8% of GDP and has been surpassed only six times since 1946 (from 2009 through 2012, as well as in 2020 and 2021).²

What makes this deficit particularly striking is that it occurred despite strong headline economic metrics, as average unemployment rate was 4% in 2024, and inflation metrics have stabilized in response to active efforts by the Federal Reserve. Historically, deficits of this magnitude are rare without a recession catalyst. This suggests that the deficit likely provided an artificial boost to growth, which is neither sustainable nor prudent in the long-term and should not be expected to persist in the future without serious economic consequence.

Looking ahead to 2025, the new administration has signaled a focus on fiscal responsibility, with spending cuts and deficit reduction as key goals. While achieving meaningful cuts in federal spending may prove challenging, it remains a possibility given the administration's stated priorities. A reduction in deficits as a percentage of GDP could remove the artificial boost to growth that large deficits provided in recent years, potentially tempering economic momentum in the short term.

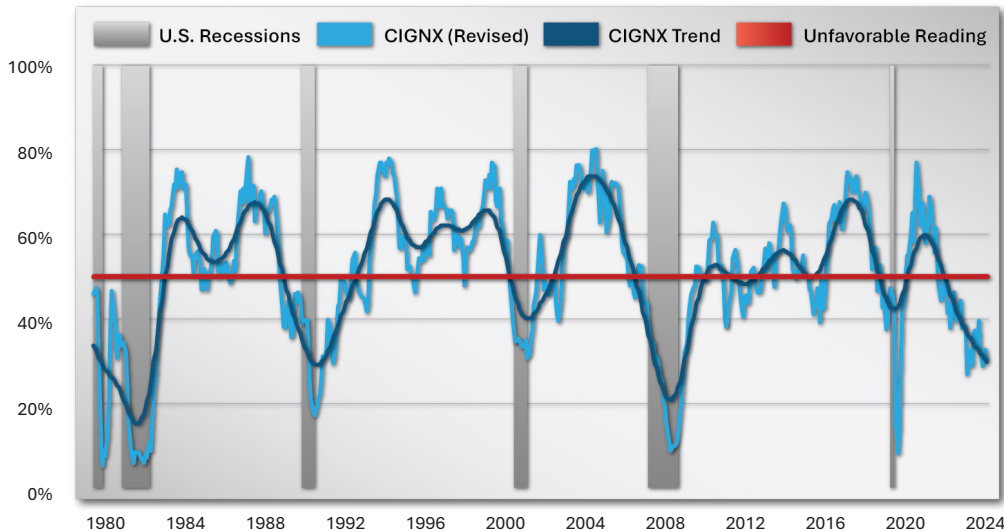
However, efforts to counteract this effect may stem from less restrictive regulatory policies. Reducing regulations could stimulate business activity and investment, partially offsetting the headwinds from tighter fiscal policy. Additionally, the Federal Reserve is in a favorable position to lower interest rates if necessary, providing further support to the economy. That said, the uncertainty surrounding incoming policy changes could increase market volatility, as investors tend to react negatively to uncertainty.

It's important to note that U.S. equity markets, especially the technology sector, appear to be trading at valuations well above historical averages. While less intrusive government policies can lay the groundwork for long-term economic growth – similar to the Reagan era – investors may need to recalibrate expectations for equity returns in light of stretched valuations, a shifting economic landscape, and the possibility of fiscal tightening. Looking to 2025, the laggards of the past two years, such as Value, could see a resurgence, with the market possibly rotating into other segments trading at more attractive valuations.

[1] <https://fiscaldata.treasury.gov/americas-finance-guide/national-deficit/>

[2] [https://www.cbo.gov/publication/60843#:~:text=In%202024%2C%20the%20deficit%20was,and%20in%202020%20and%202021\).](https://www.cbo.gov/publication/60843#:~:text=In%202024%2C%20the%20deficit%20was,and%20in%202020%20and%202021).)

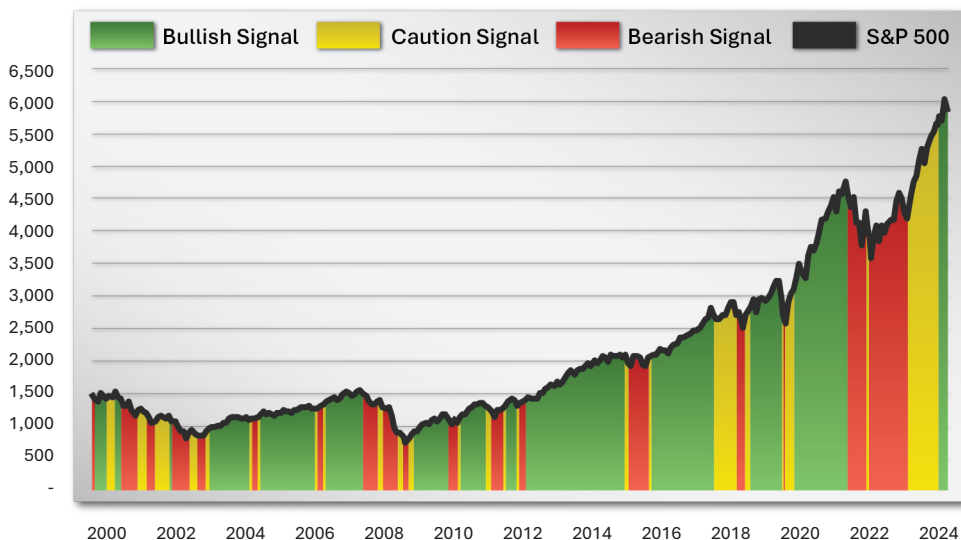
CIGNX = 29.5



Our **CIGNX** Economic Indicator has a reading of **29.5**, down from last month's revised reading of **30.6**. The reading is indicative of sluggish economic activity and a continued unfavorable trend in the economy. This remains well below our baseline threshold of **50.0**, indicative of unfavorable conditions, and below our secondary baseline reading of **40.0**, which we typically interpret as the economy experiencing recessionary conditions. **Our overall economic outlook remains negative.**

MONTH (2024)	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
CIGNX (Revised)	32.0	28.8	36.6	37.4	33.6	39.5	33.3	28.9	30.5	32.8	30.6	29.5
CIGNX Trendline	35.2	34.6	34.0	33.5	32.9	32.4	31.9	31.4	30.9	30.4	29.9	29.4

ALPHA = Positive (Buy) OMEGA = Positive (Buy)



Both our short-term (**Alpha**) signal and intermediate-term (**Omega**) signal remained **Positive** during the month of December, indicating the near-term and longer-term market trajectory is favorable. We remain in a "Bullish" positioning across each of our Dynamically managed Portfolios, with an increased exposure to equities. **Our overall market sentiment outlook is Bullish.**

MONTH (2024)	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
ALPHA	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY
OMEGA	SELL	SELL	SELL	SELL	SELL	SELL	SELL	SELL	BUY	BUY	BUY	BUY

U.S. Large Cap Stocks

S&P 500 Index

Monthly: -2.38%

Year to Date: 25.02%

The S&P 500 Index declined by 2.38% in December, however ended the year with a strong annual gain of 25.02%. December's retreat marked a reversal from the robust performance in November for the index, giving back some of its recent gains. Despite the monthly decline, the S&P 500's impressive yearly return underscores the resilience of large-cap equities in navigating a year marked by fluctuating economic and geopolitical. Investor sentiment in December appeared cautious, likely influenced by year-end portfolio adjustments and concerns about potential headwinds heading into 2025.

U.S. Mid Cap Stocks

S&P 400 Index

Monthly: -7.12%

Year to Date: 13.93%

The mid-cap segment faced a sharp pullback in December, with the index declining by 7.12%. Despite the challenging month, mid-caps closed the year with a respectable gain of 13.93%. December's losses erased some of the momentum built earlier in the year, as mid-cap equities contended with heightened volatility and a more cautious market environment. The annual performance highlights the segment's ability to deliver solid returns in a year characterized by shifting investor sentiment and evolving macroeconomic conditions.

U.S. Small Cap Stocks

S&P 600 Index

Monthly: -7.95%

Year to Date: 8.70%

Small-cap equities faced significant headwinds in December, with the index falling 7.95% for the month. This decline capped a challenging year for small caps, which posted a modest annual gain of 8.70%. December's losses highlighted the segment's sensitivity to market volatility, as investors shifted away from higher-risk assets amid an increasingly uncertain economic backdrop. While small caps managed to finish the year in positive territory, their performance lagged behind their mid- and large-cap counterparts, reflecting a more cautious risk appetite among investors.

U.S. Bonds

U.S. Agg Bond Index

Monthly: -1.64%

Year to Date: 1.25%

The Bloomberg U.S. Aggregate Bond Index declined by 1.64% in December, as fixed-income markets grappled with rising yields and ongoing concerns about the Federal Reserve's interest rate trajectory. Despite the challenging final month of the year, the index managed a lackluster annual gain of 1.25%. The year-end performance underscores the resilience of bonds in the face of persistent inflationary pressures and tightening monetary policy, though December's losses reflected the continued volatility within the fixed-income landscape.

Alternative Assets

S&P GSCI Index

Monthly: 3.28%

Year to Date: 9.25%

Alternative assets, as represented by the GSCI Commodity Index, stood out as the only major asset class to deliver positive returns in December, gaining 3.28% for the month and 9.25% for the year. Notably, the GSCI All Crude Index surged over 5%, reflecting strength in energy markets. However, this was not echoed across all commodities, as precious metals such as silver and gold both posted declines of over 1% for the month. The divergence within the commodity space highlights varying dynamics across sectors as markets reacted to shifting macroeconomic conditions and supply-demand fundamentals.

U.S. Real Estate

S&P 1500 Real Estate

Monthly: -8.25%

Year to Date: 5.42%

Real estate, as measured by the S&P 1500 Real Estate Index, experienced significant weakness in December, declining by 8.25% for the month. Despite this sharp monthly drop, the asset class managed to post a modest gain of 5.42% for the year. The sector faced headwinds as rising interest rates and broader economic uncertainties weighed on sentiment. However, its positive annual performance reflects resilience in select segments of the real estate market earlier in the year.

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