



2025 Market & Economic Outlook

Cerity Partners Investment Office

January 23, 2025

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Revisiting Our Key Themes for 2024

Short Term Themes

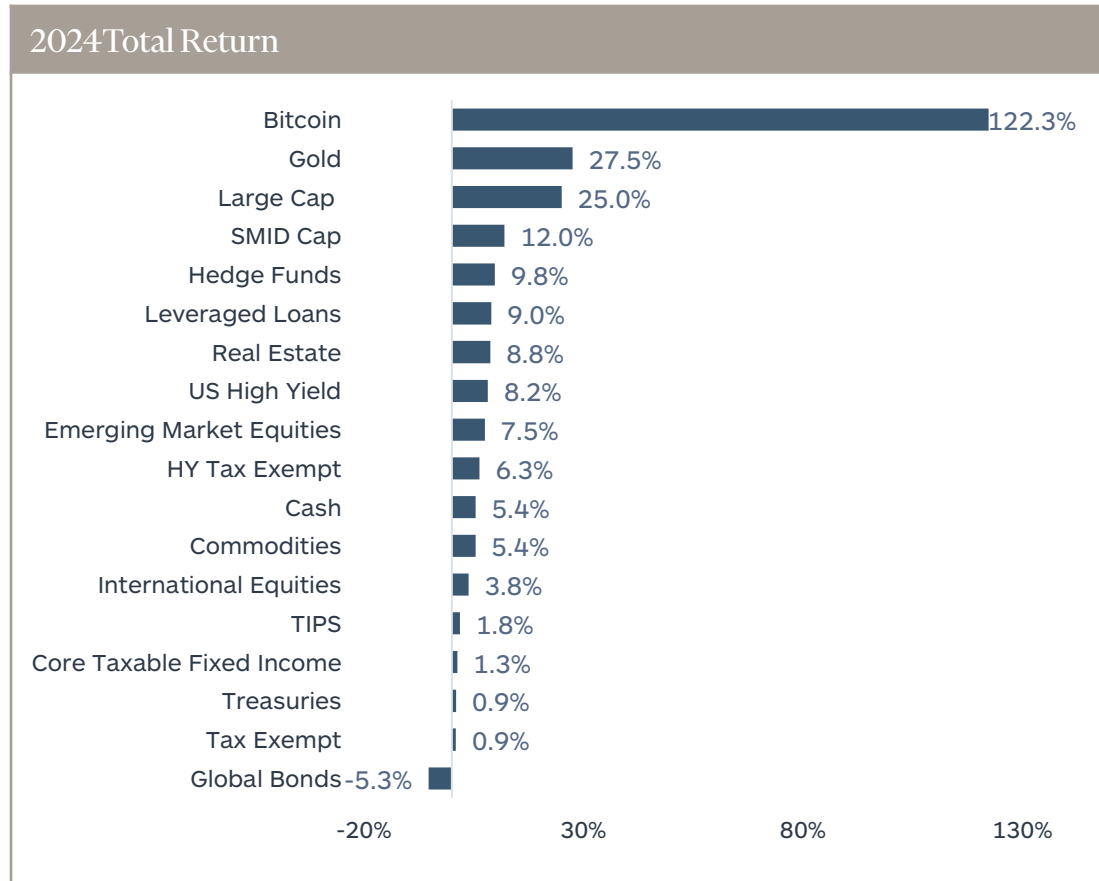
- ✓ 1. Slowing growth, but still no recession
- ✓ 2. Labor markets – cooling but not crashing
- ✓ 3. Inflation inches closer towards the Fed's target
- ✓ 4. Rate cuts in good times are rare, but we should get a few to normalize real rates
- ✓ 5. The yield curve moves towards normality through lower short rates and steady/higher long rates
- ✗ 6. Anticipating a recovery in manufacturing and housing
- ✓ 7. Earnings return to strong growth after a brief decline
- ✗ 8. Equity performance should broaden out – expecting a good year for small caps
- ✓ 9. Little appetite for austerity in an election year, despite the ballooning fiscal deficit

Long Term Themes

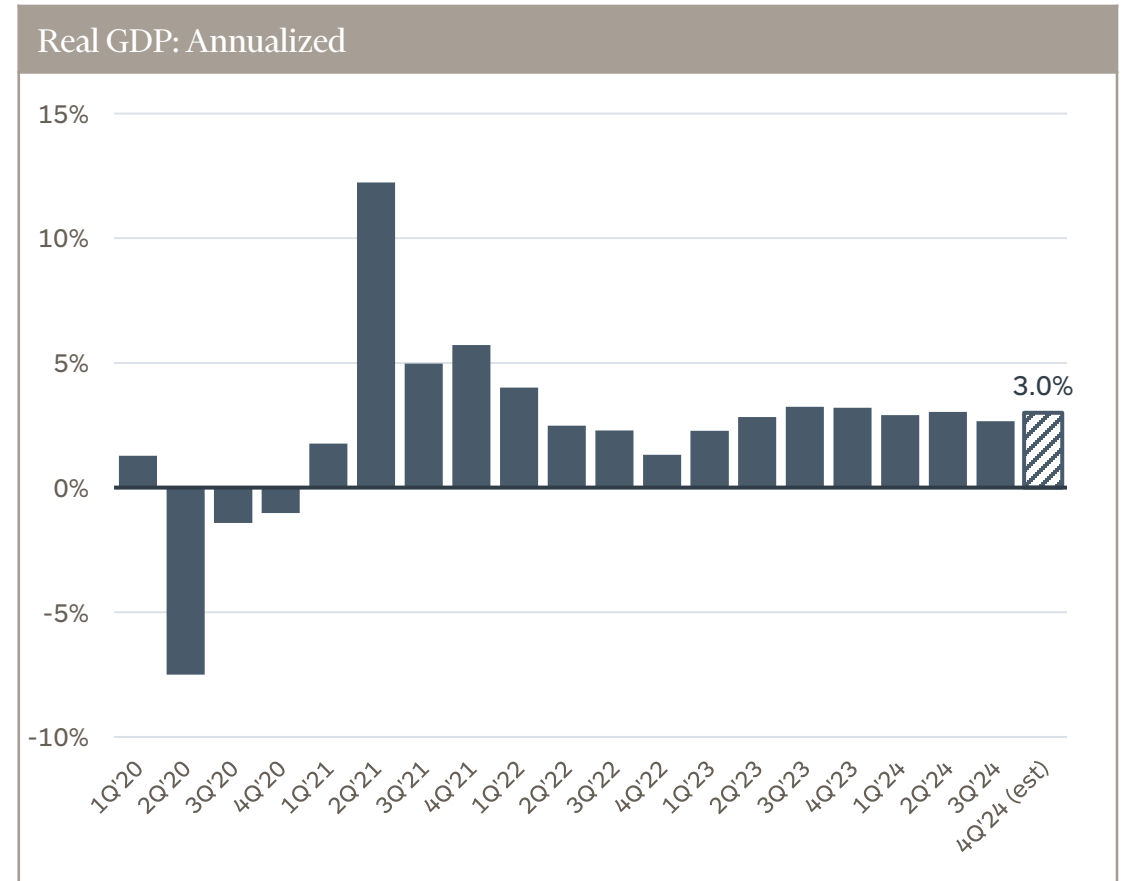
1. Baby Boomers are leaving the labor force, but they are also healthy, wealthy, and keen to consume
2. Reshoring continues to drive growth and diversify our economic model
3. AI & automation drive productivity gains and mitigate higher costs for goods and labor
4. The energy transition creates economic risks ... and opportunities

2024 in Review

Markets and economic growth kept chugging along, while recession calls largely disappeared



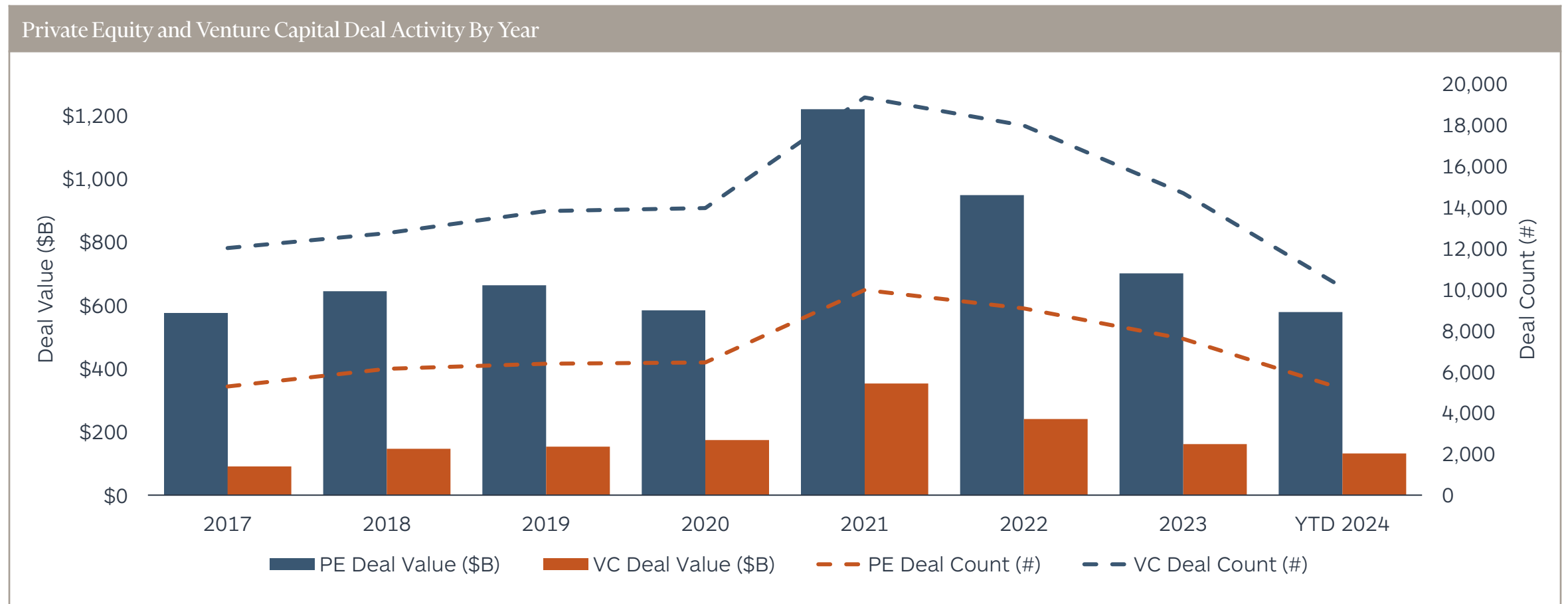
Source: Cerity Partners, Morningstar Direct, 12/31/2024



Source: Cerity Partners, FRED, Bloomberg, Federal Reserve Bank of Atlanta (GDPNow as of 1/17/2025)

Private Markets May Benefit From a Recovery in M&A and IPOs

Current environment marked by lower valuations and fewer deals

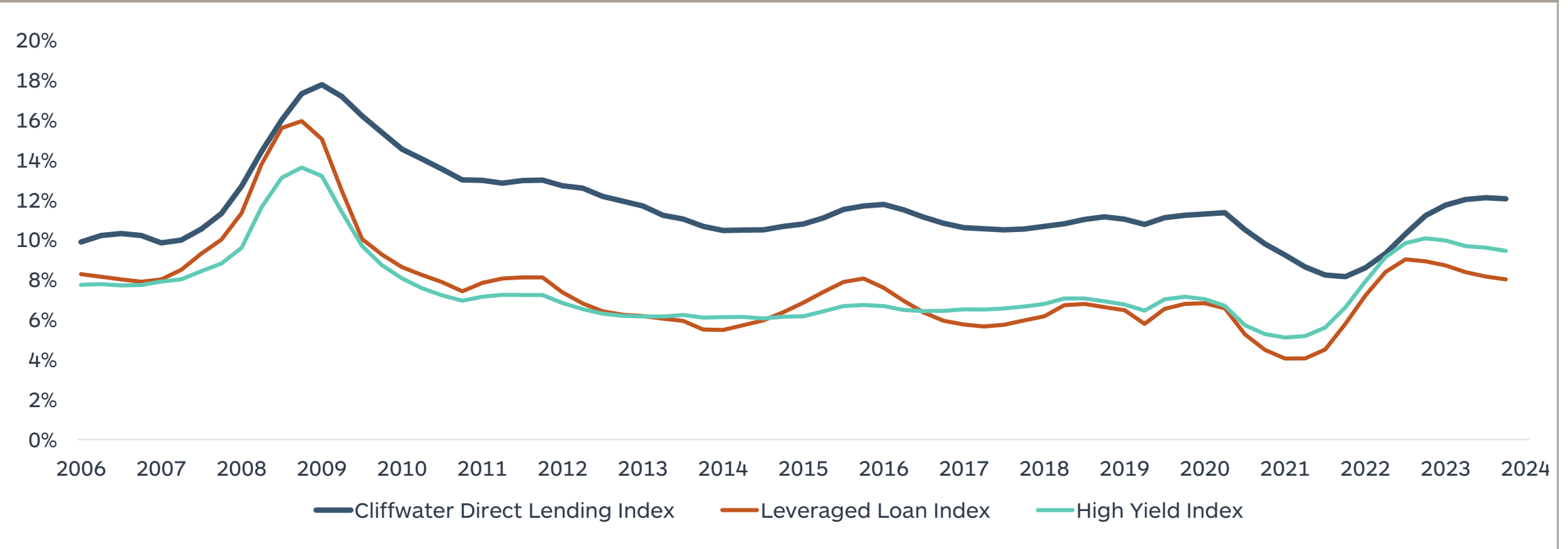


Source: Cerity Partners, Pitchbook.com as of 9-30-24.

Private Credit Yields Show a Premium to High Yield and Leveraged Loans

Private credit has matured as an asset class, but the value proposition remains

Comparative Yields: Direct Lending, High Yield, and Leveraged Loans (Rolling 12-Month Avg. Yield)

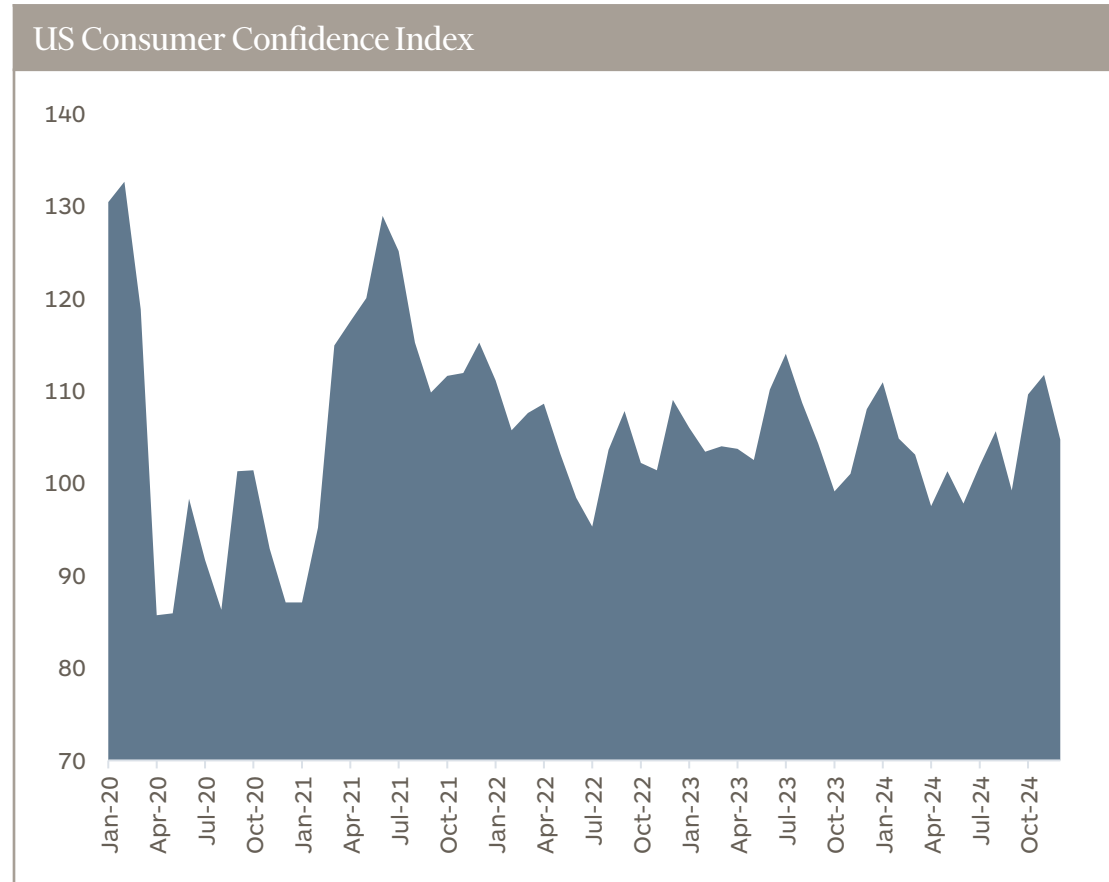


Source: Cliffwater Direct Lending Index (3 Year Takeout Yield), Bloomberg US Corporate High Yield, and Credit Suisse Leveraged Loan Index, 9/30/2024

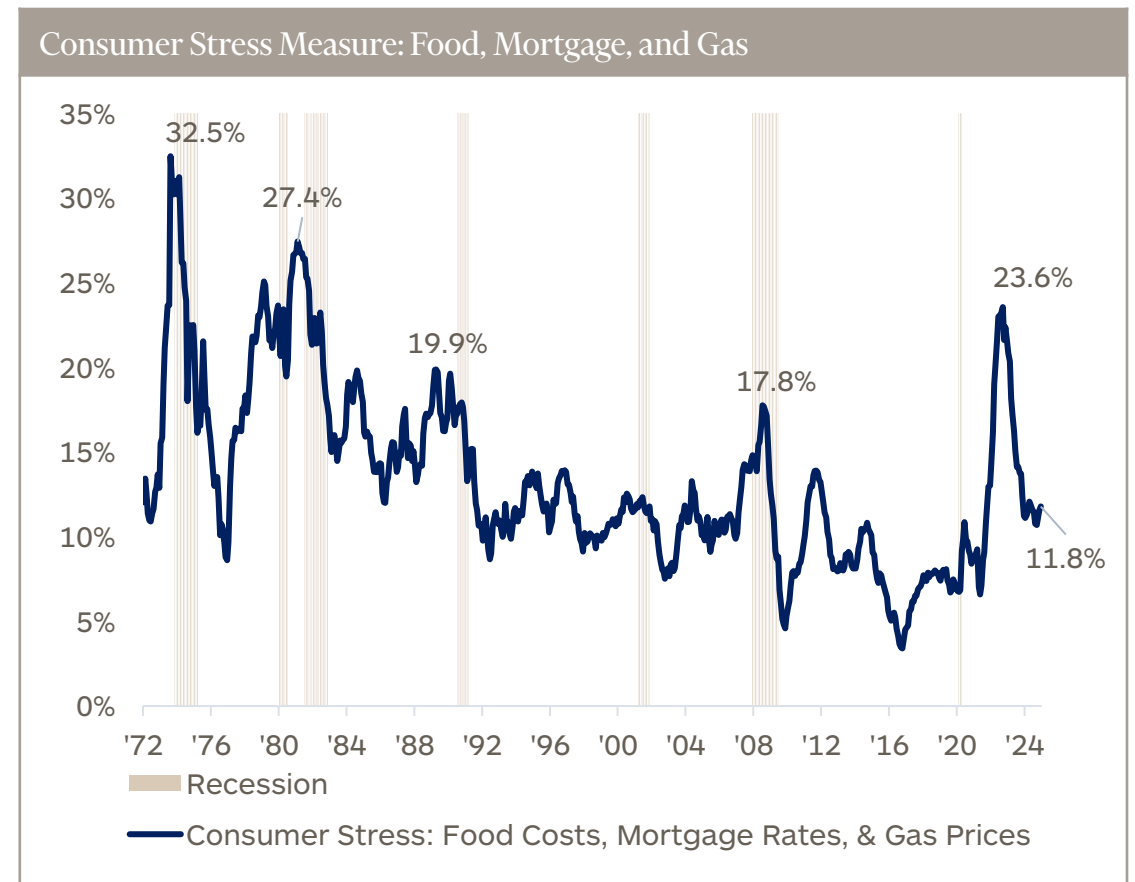
The State of the Economy

The US Consumer Shows Little Sign of Stress

Consumption remains the most important piece of the economic puzzle



Source: Cerity Partners, Bloomberg, 12/31/2024

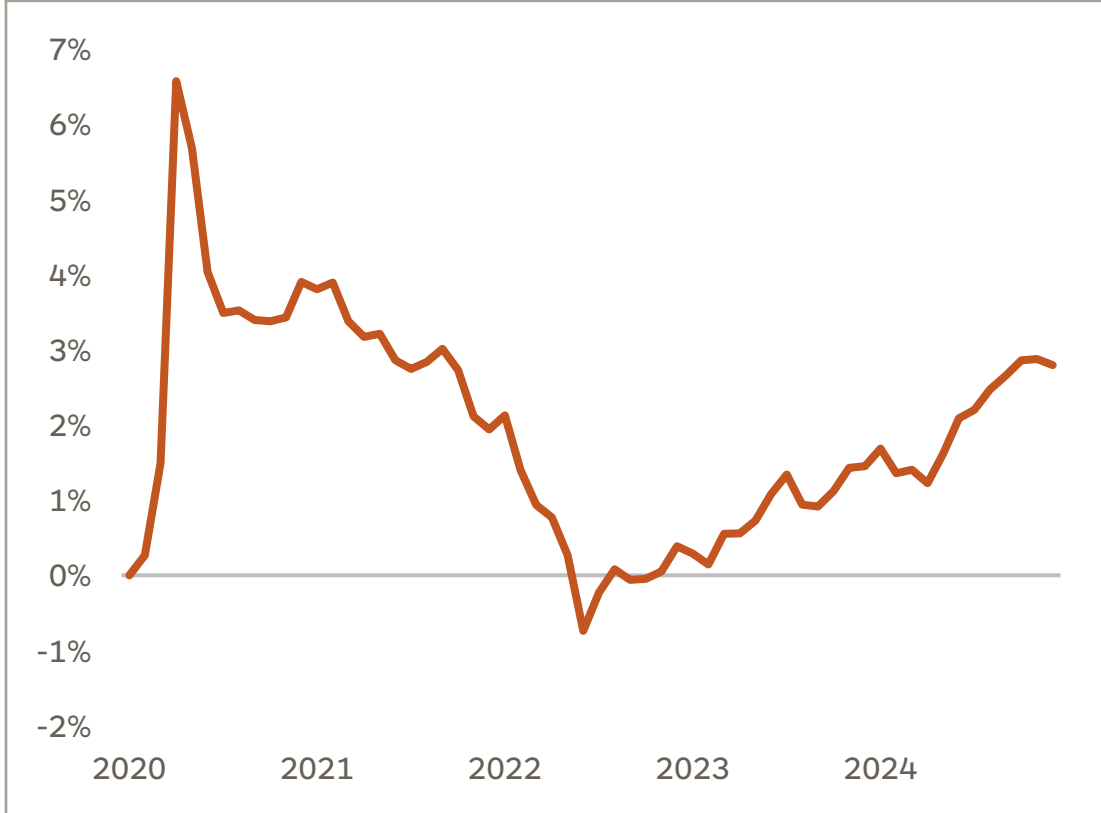


Source: Cerity Partners, Bloomberg, Strategas, 12/31/2024

Despite Elevated Inflation, (Most) People are Better Off

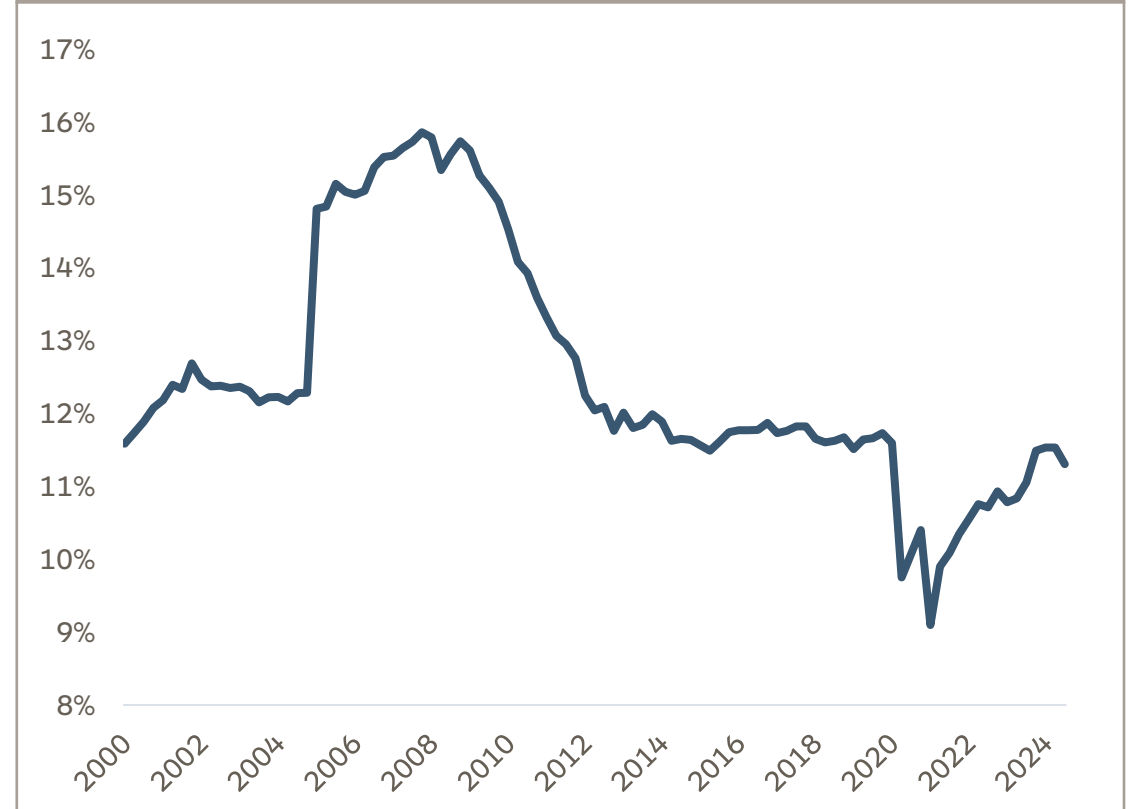
Thank stimulus, stocks, and salaries

Wages and Disposable Income, indexed to January 2020



Source: Cerity Partners, FRED. Average Hourly Earnings of All Employees, Total Private less CPI, 12/31/2024

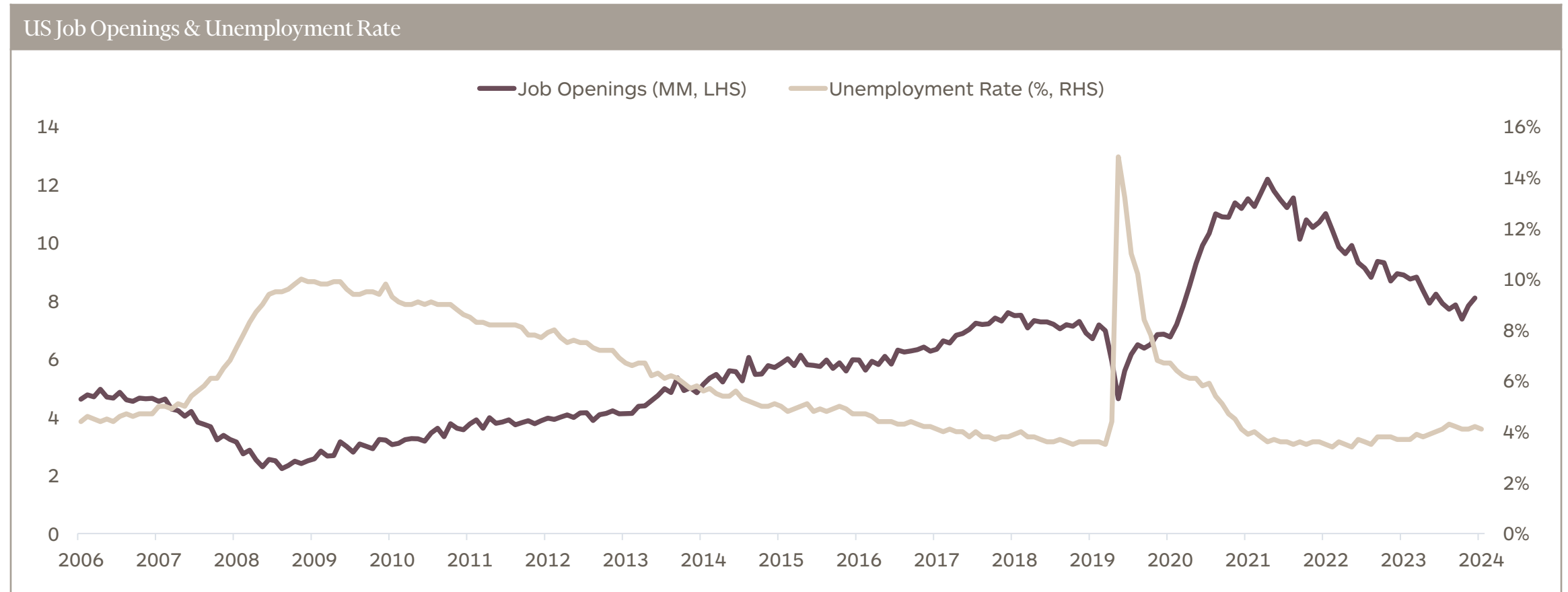
Household Debt Service Payments as a Percent of Disposable Income



Source: Cerity Partners, FRED, 12/31/2024

Labor Markets: Weakening, But Not Weak

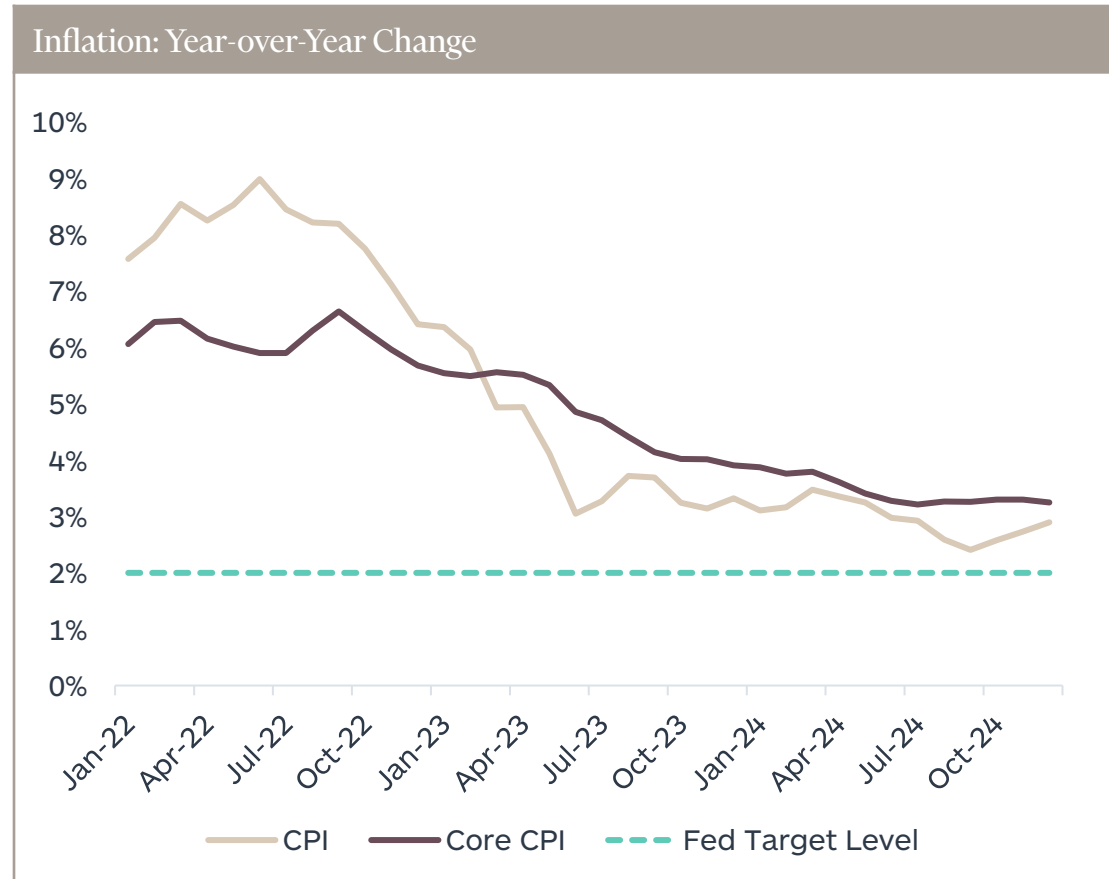
Supply and demand have moved back near equilibrium



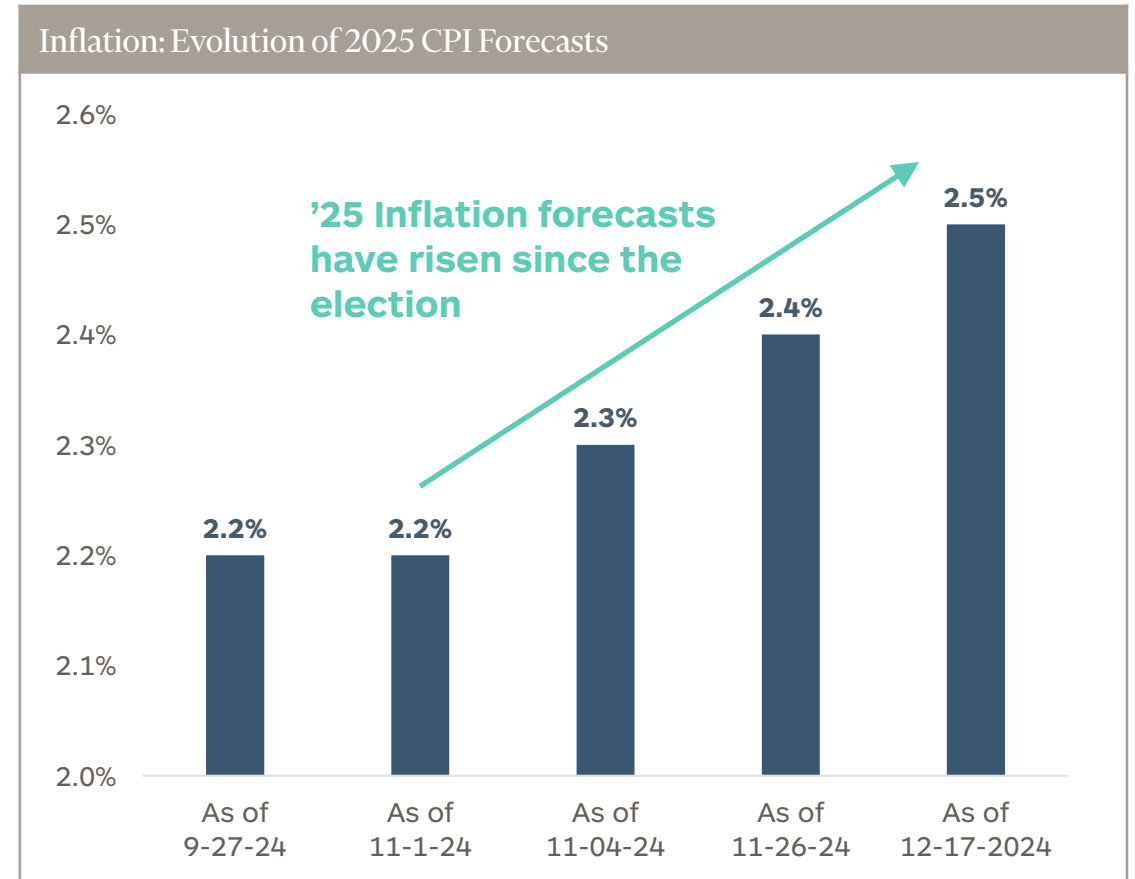
Source: Cerity Partners, Bloomberg, 12/31/2024

The Fed's 2% Inflation Target May Prove Elusive

Core inflation feels somewhat sticky, while the election results introduce added uncertainty



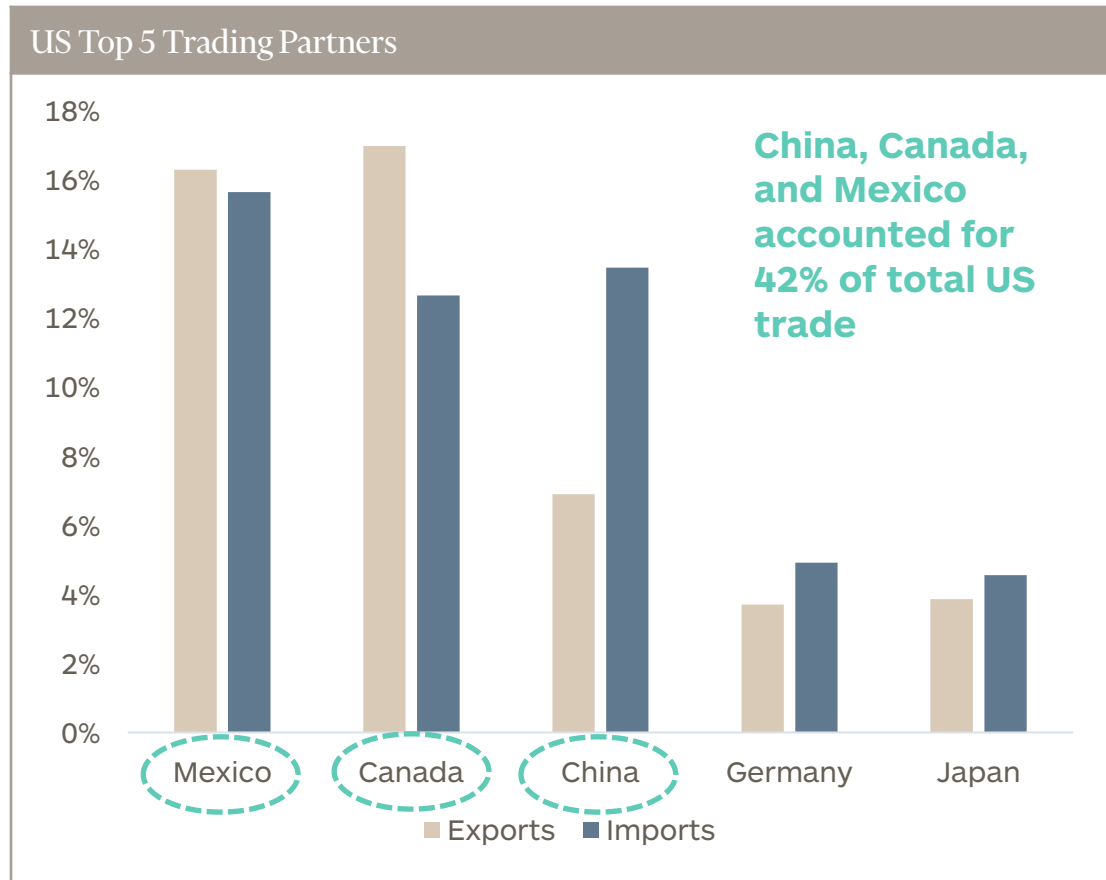
Source: Cerity Partners, FRED, 1/15/2024



Source: Cerity Partners, Bloomberg

Tariffs Could Have a Significant Economic Impact on the US and Beyond

Tariff policy remains a key unknown for growth and inflation in 2025



Source: Census.gov (YTD through November)

Trump tariffs could weigh on European growth and inflation, ECB's Cipollone says



See which products Trump's tariffs could make more expensive

The Washington Post

Trump tariffs would harm all involved, US trade partners say



Why Trump's plans for tariffs could be bad for Europe's economy

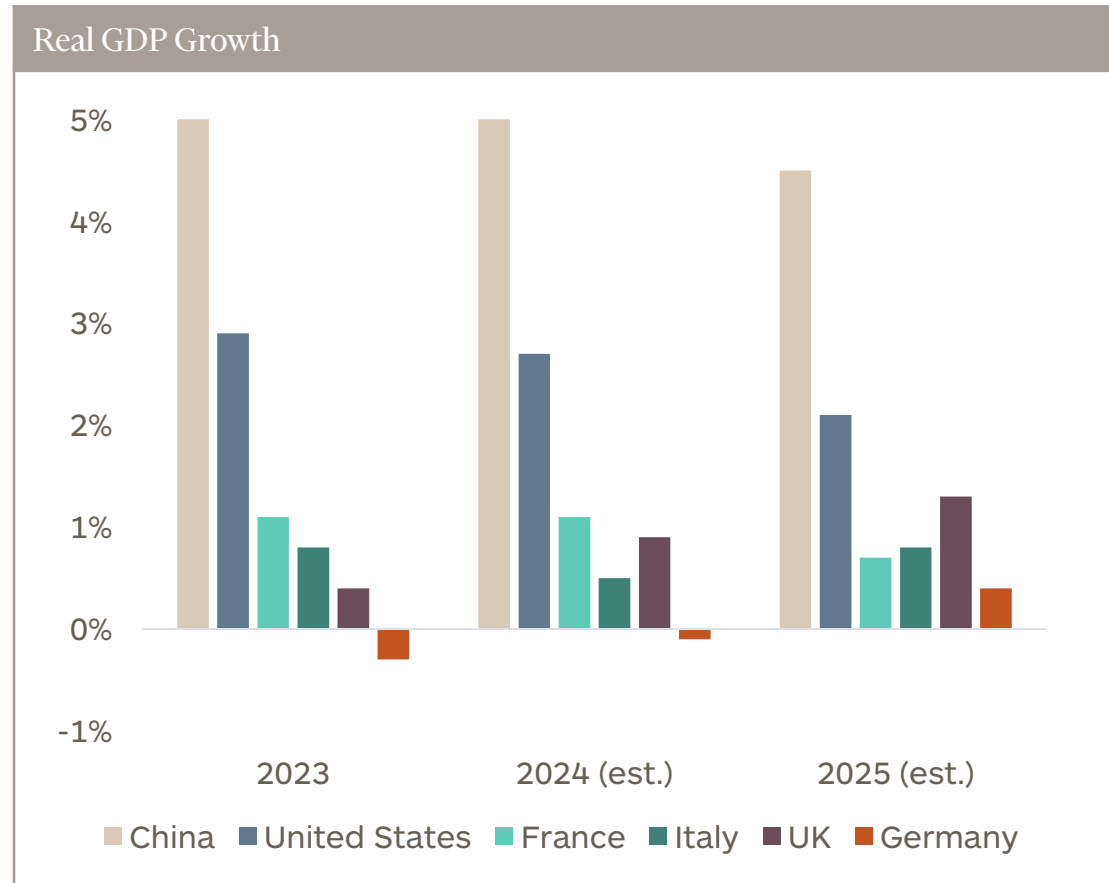
euronews.

How Trump's tariffs could spark a trade war and 'Europe's worst economic nightmare'

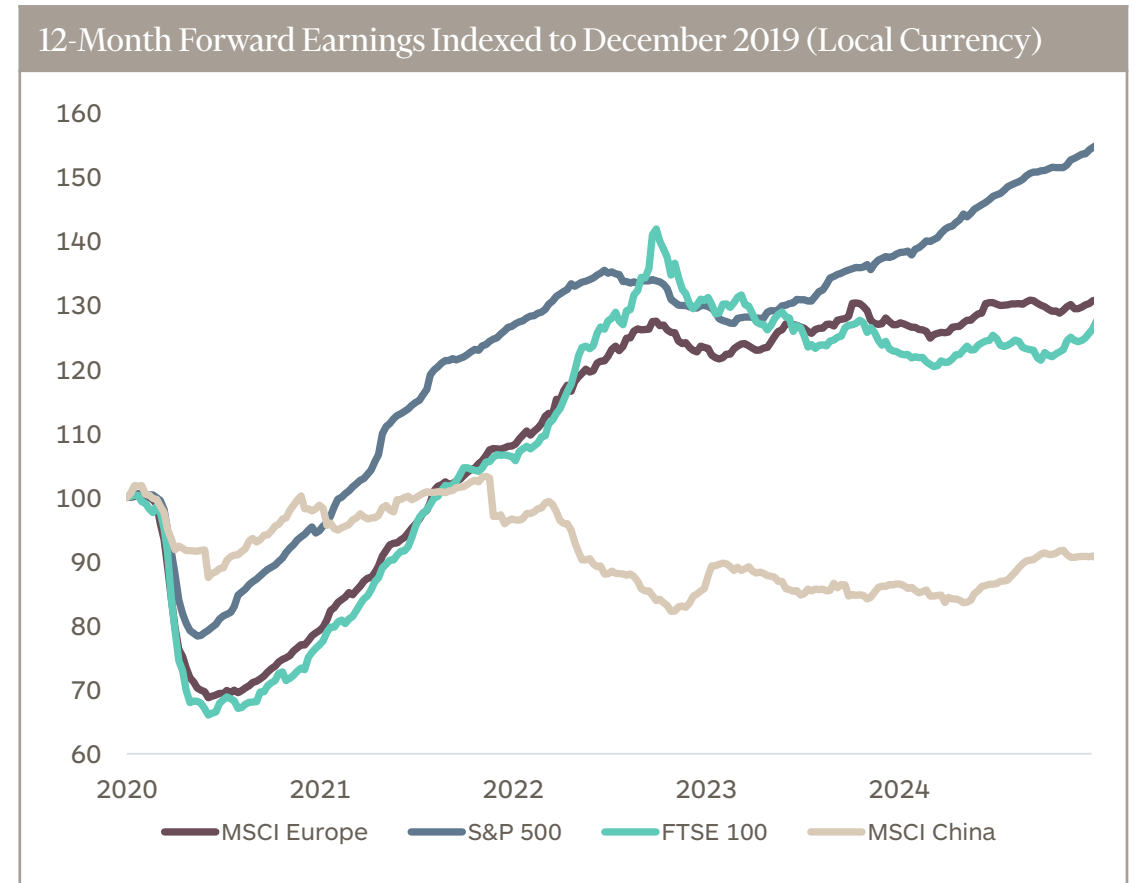
The Washington Post

Elsewhere in the World: Searching for a Growth Engine

A modest rebound is expected for many ex-US countries. Would that be enough to change the earnings outlook?



Source: Cerity Partners, FactSet, 1/22/2025



Source: Cerity Partners, Bloomberg, 1/10/2025

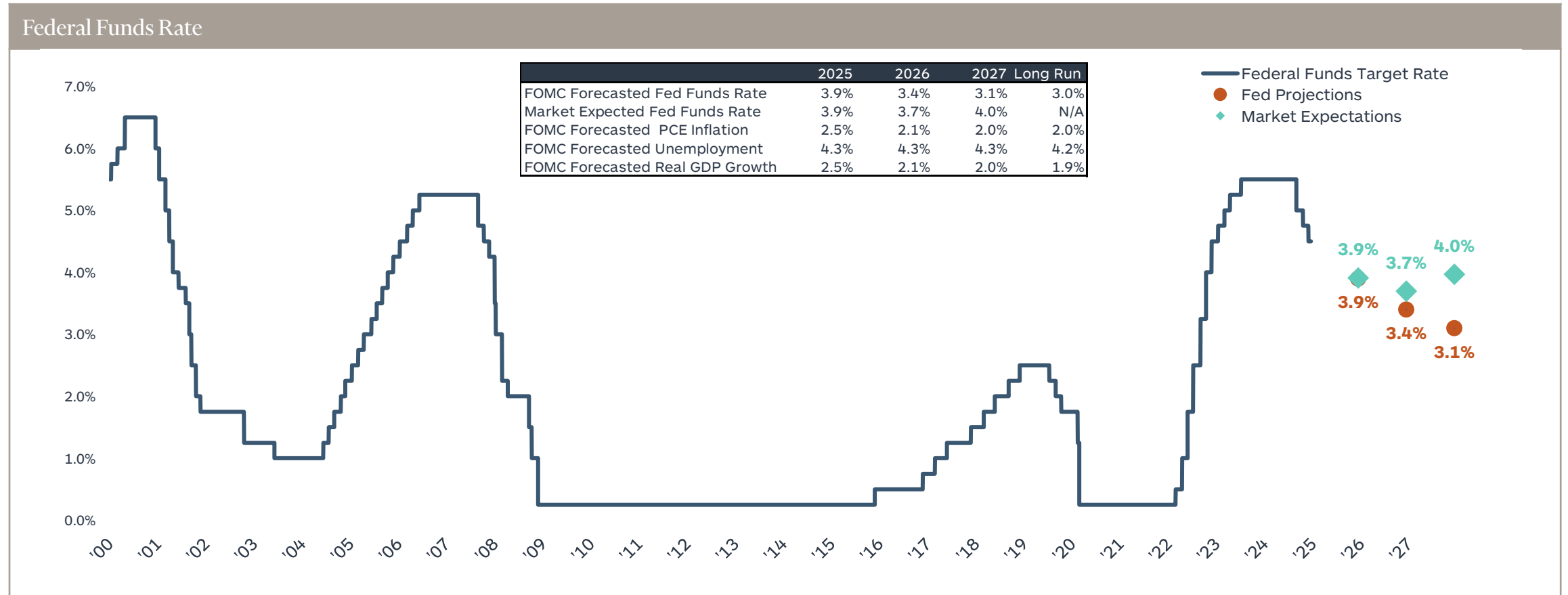
Key Themes for the Economy in 2025

- Inflation trends higher as a strong economy combines with a pro-growth administration and tariffs
- Market volatility returns as investors grapple with the potential for higher inflation and higher rates
- Expectations for future rate cuts diminish, but rates finish close to where they started
- Despite some growth concerns, the US economy remains the envy of the developed world at year-end

The State of Fixed Income Markets

Markets Learned Their Lesson on Rate Cuts

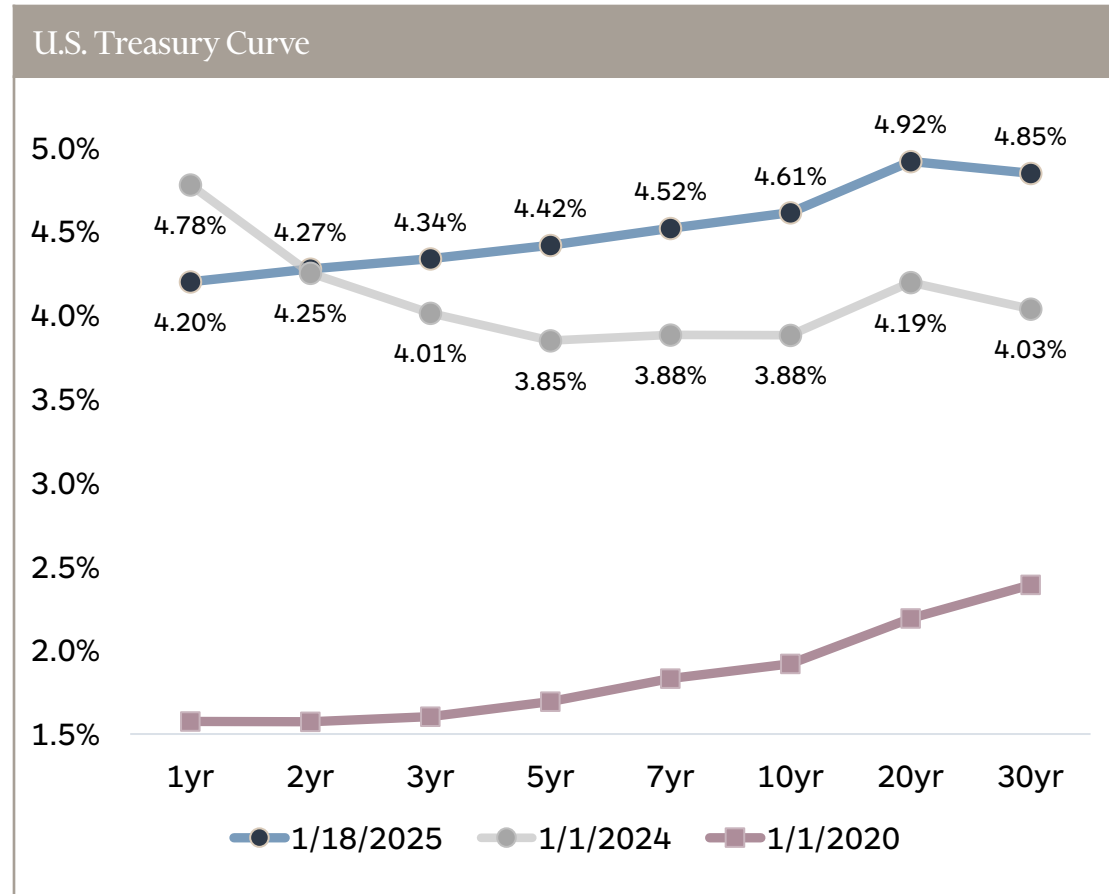
Going into 2024, markets were expecting more cuts than the Fed's projections. Going into 2025, they now expect fewer



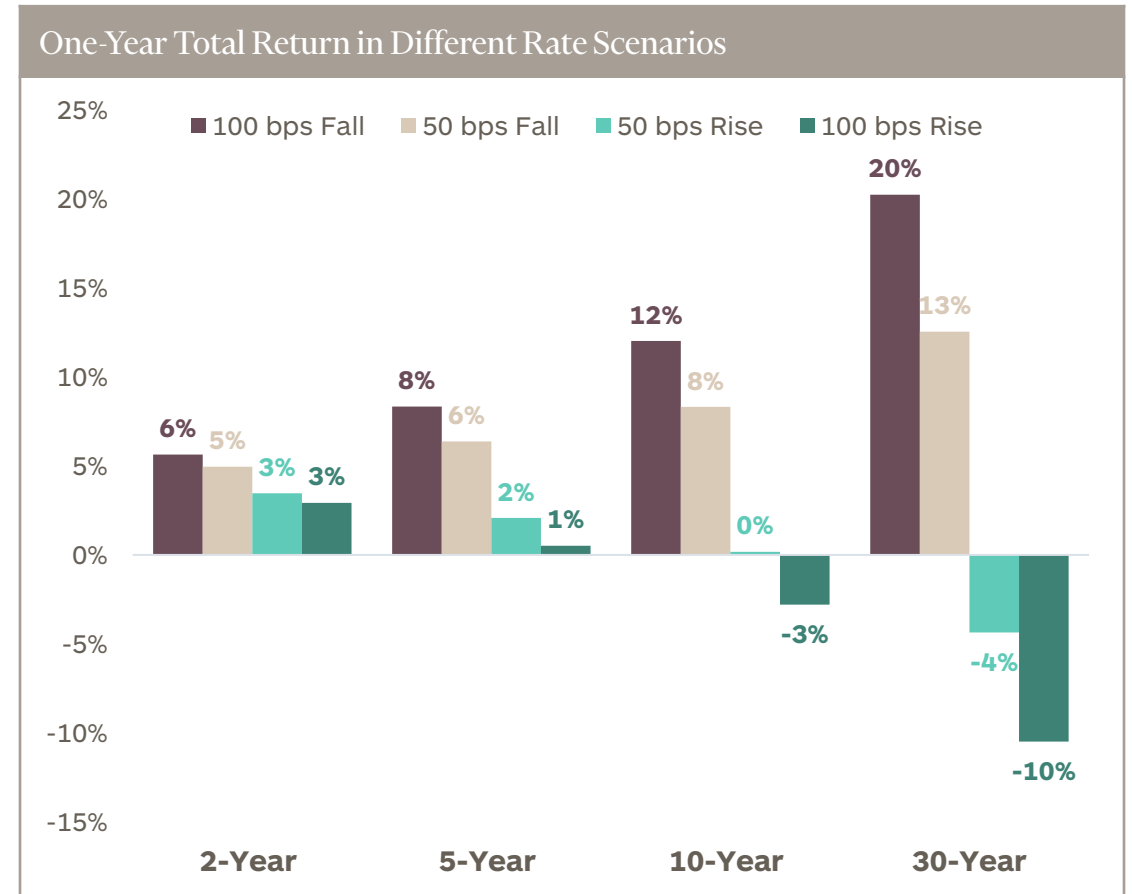
Source: Cerity Partners, Factset, FOMC, 12/31/2024. Market expectations derived from Fed Funds Futures

The Treasury Curve is Normalizing...Slowly

We expect curves to resemble the pre-GFC period



Source: Cerity Partners, Factset, 1/18//2025

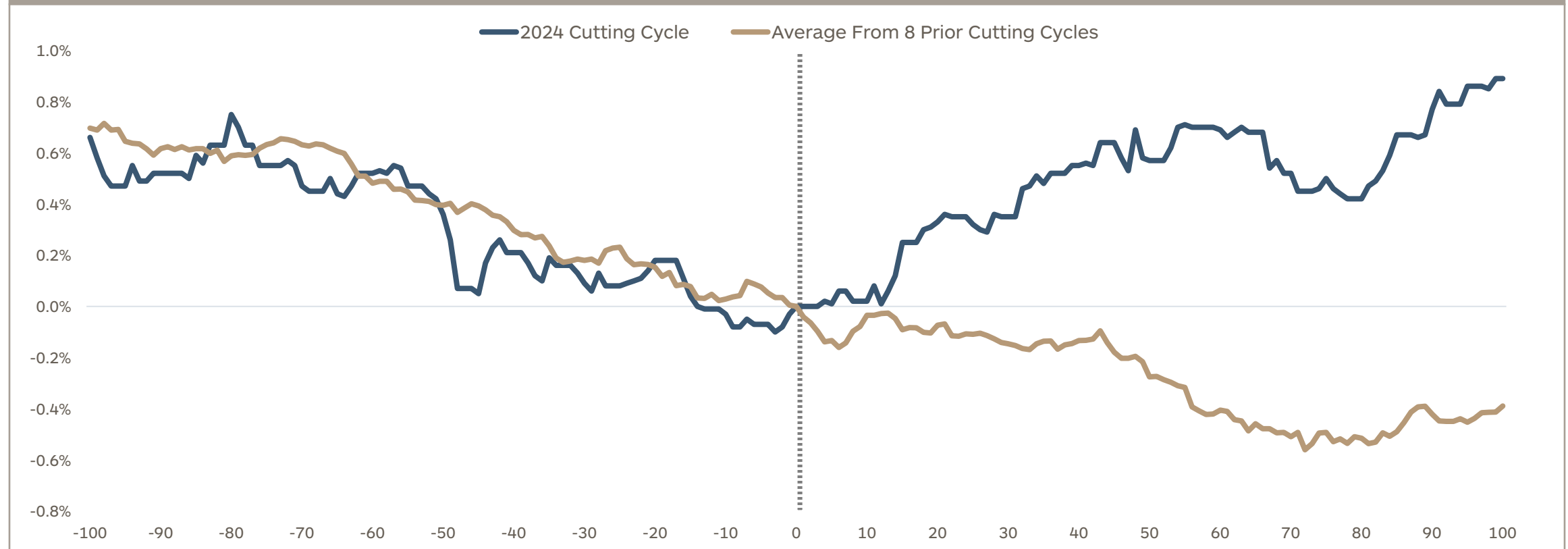


Source: Factset, 12/31/2024

Unusual Reaction in Treasury Market to Fed Cuts

It is rare for longer-term interest rates to rise during a cutting cycle

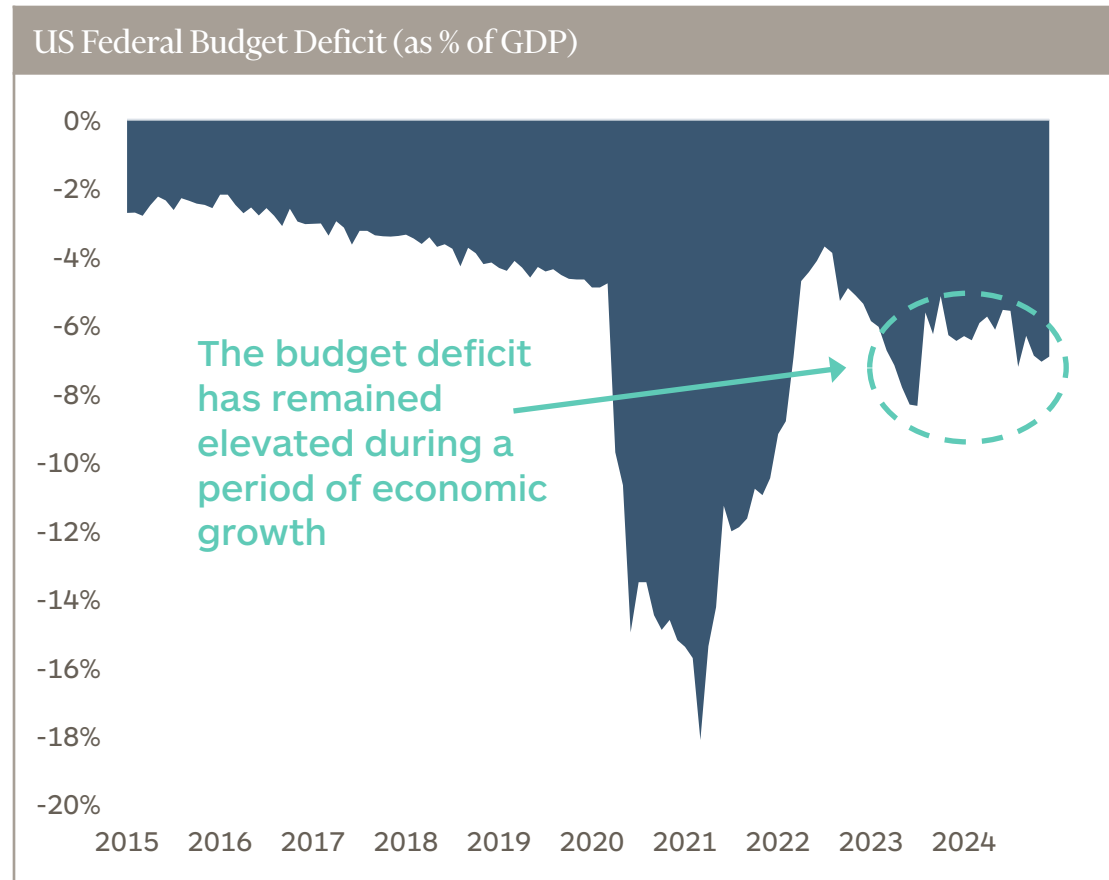
Change in 10-Year Treasury Yields in the 100 Days Prior and 100 Days After the Start of a Rate Cutting Cycle



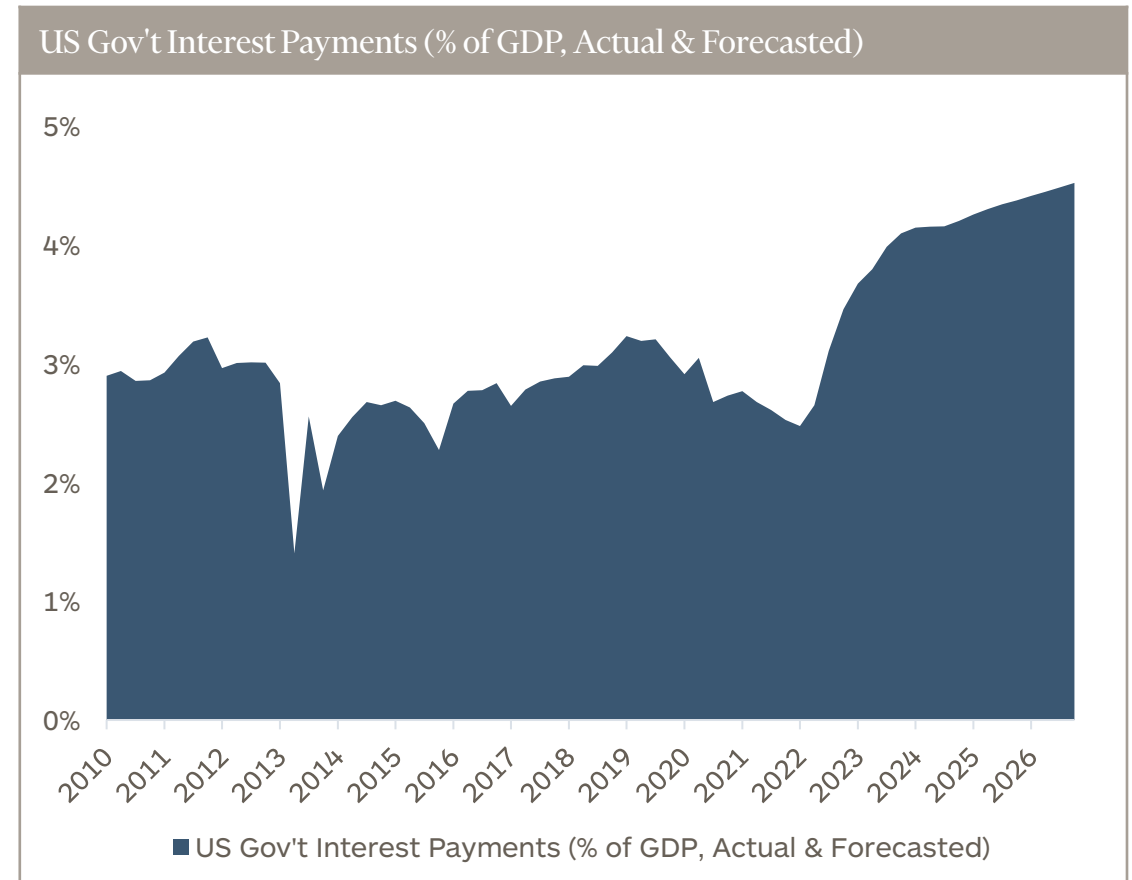
Source: Cerity Partners, FactSet, 1/22/2025

Deficits and Interest Expense Present a Challenge for the New Administration

Same old story about too much debt, but could higher interest payments finally cause the market to take action?



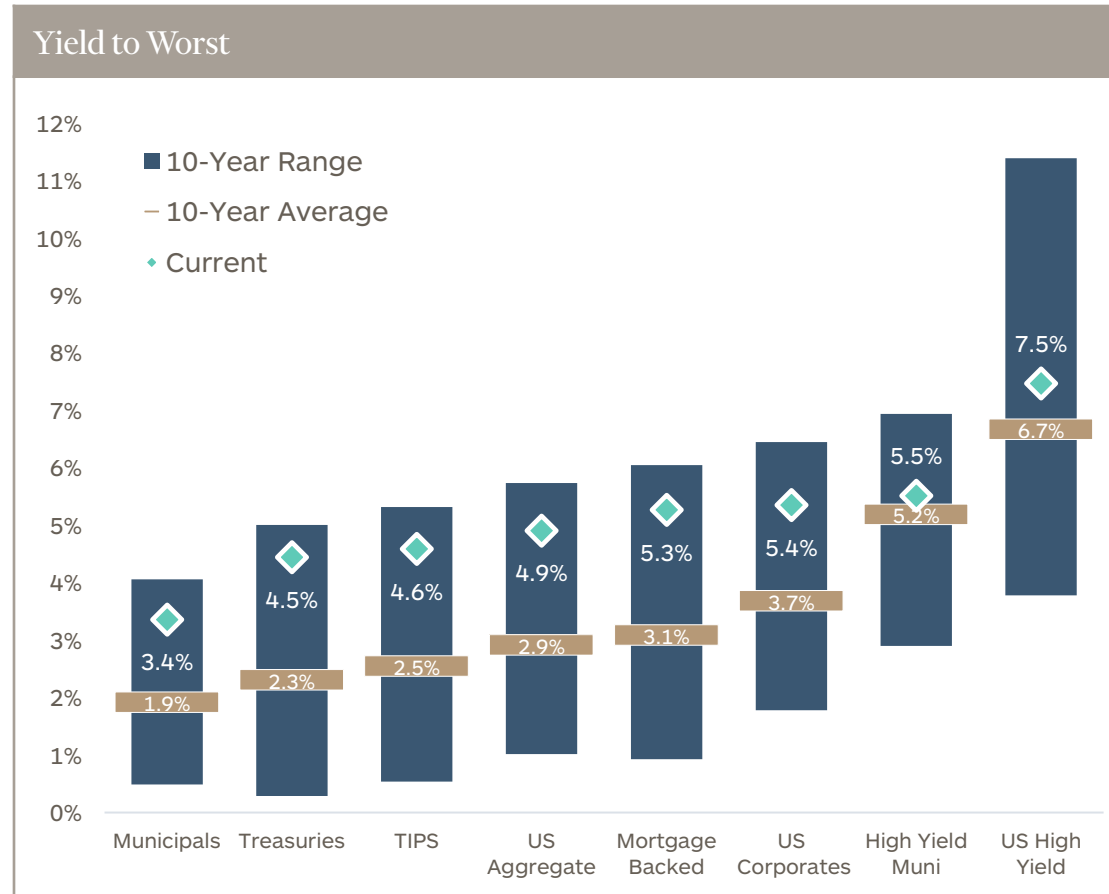
Source: Cerity Partners, Bloomberg, 12/31/2024



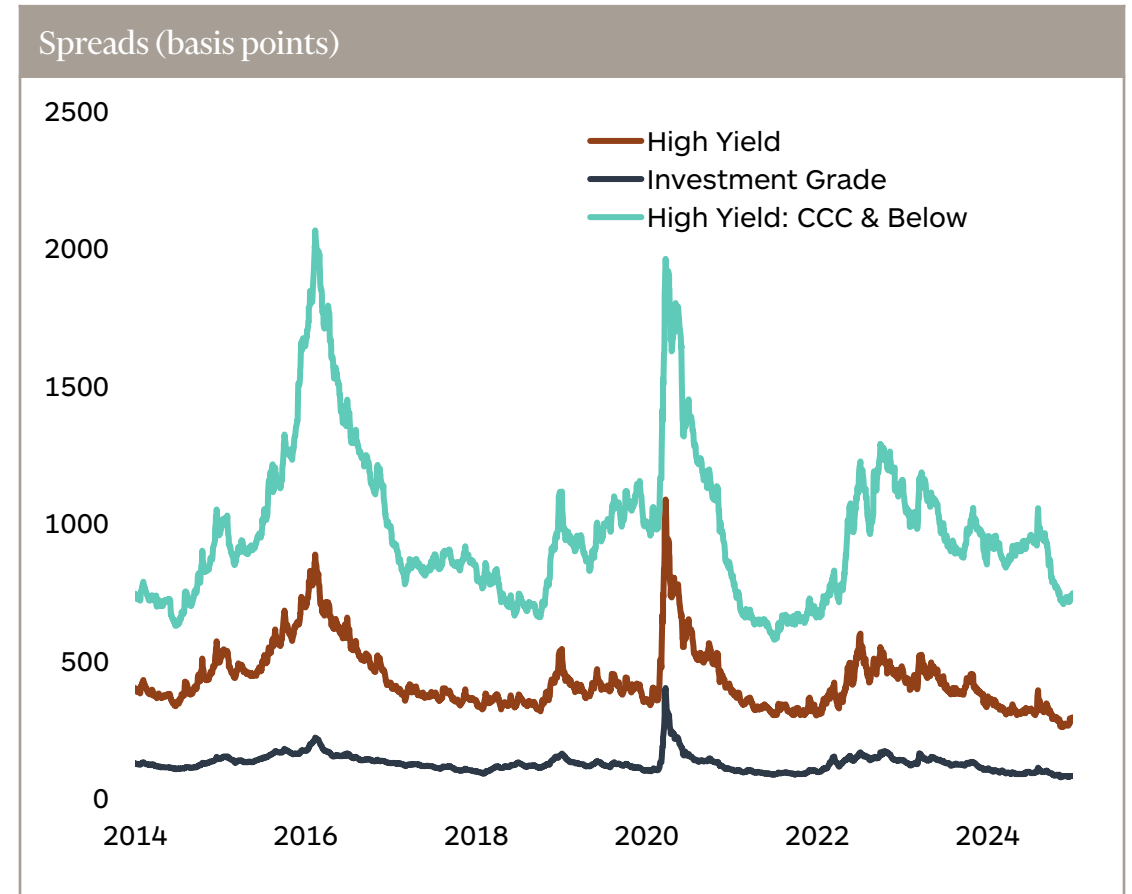
Source: Cerity Partners, Bloomberg, 12/31/2024

Yields and Spreads

Tight spreads reflect healthy fundamentals, while all-in yields remain attractive.



Source: Cerity Partners, Factset, 12/31/2024

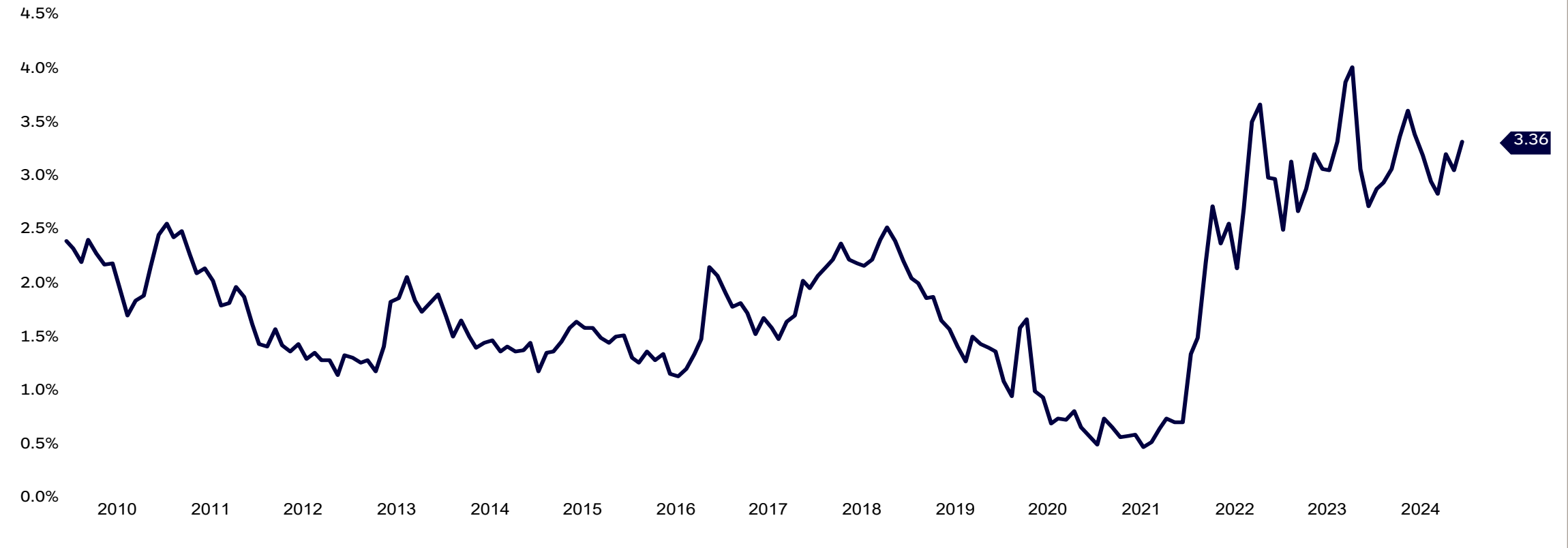


Source: ICE BofA US High Yield, ICE BofA US Corporate, ICE BofA US High Yield (CCC & Lower) Cerity Partners, Factset, 12/31/2024

Municipal Bond Yields are at Attractive Levels

Munis are offering yields not seen for almost two decades

Municipal Bonds: Yield to Worst



Source: Bloomberg Municipal Bond Blend 1-10 Year (1-12Y), FactSet, 12/31/2024

Key Themes for Fixed Income Markets in 2025

- We expect the Fed to cut 1-2 times this year but the terminal rate may be higher than initially thought last year
- Policy initiatives could be inflationary suggesting an overweight to duration remains prudent.
- The setup for fixed income remains solid: attractive yields, the potential for rate cuts, and ballast should equities falter.
- While economic growth is strong for now, tight credit spreads may not adequately compensate investors for the risk of a slowdown and a potential increase in defaults. Stick with high quality credits in both corporates and municipals.

The State of Equity Markets

A Simple Bull and Bear Case to Set the Tone for Today's Discussion

What could go right? What could go wrong?

A Bullish Case for Equities...

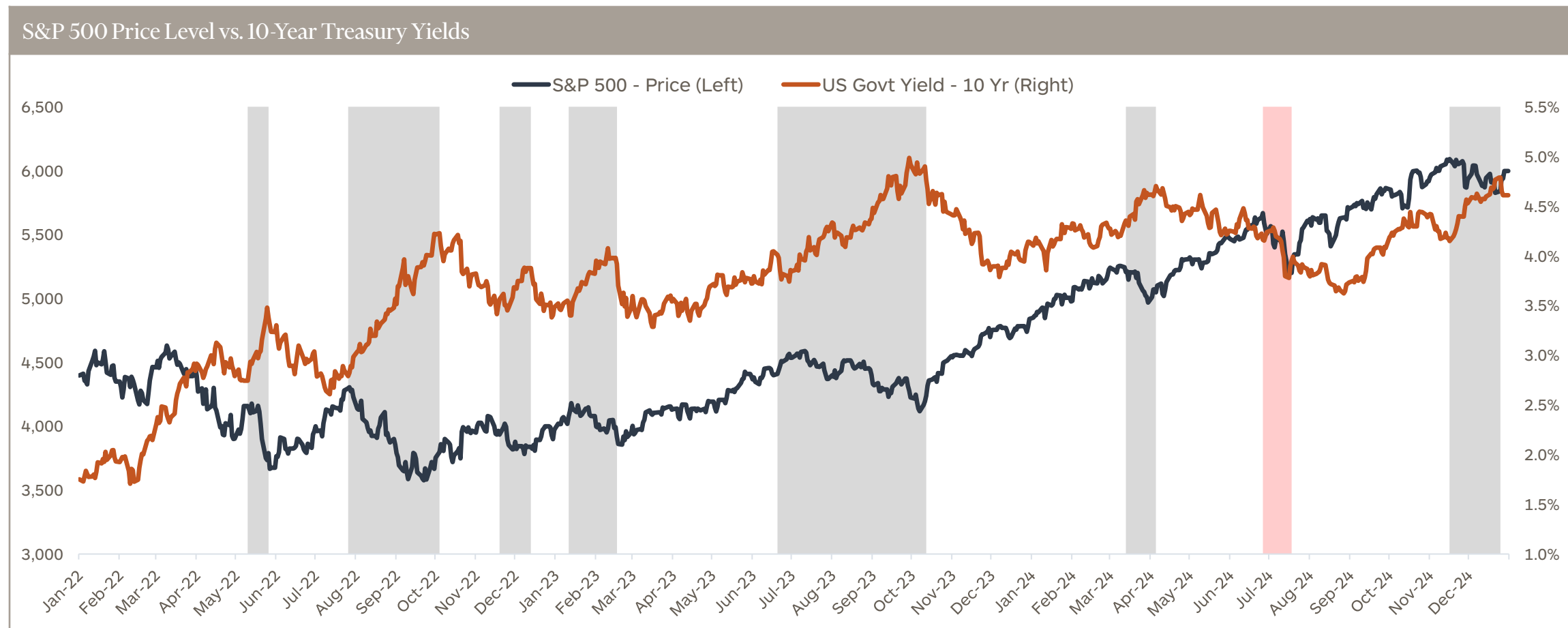
- Pres. Trump's "pro-business" policies prove effective, boosting growth outlooks
- Inflation moderates, enabling rate cuts
- US economic growth continues, while the UK/Europe/China muddle along
- AI growth continues, and the rest of the market "catches up" on strong earnings
- Negotiations calm geopolitical tensions

A Bearish Case for Equities...

- "Pro-business" policies prove disruptive and inflationary, harming confidence
- Consumers and CEOs cut spending, and recession fears grow in the US and abroad
- The Fed struggles to balance rising unemployment and rising inflation
- Lofty expectations for AI begin to sour
- Geopolitical risks grow

Equity Markets Don't Like Uncertainty in Rates

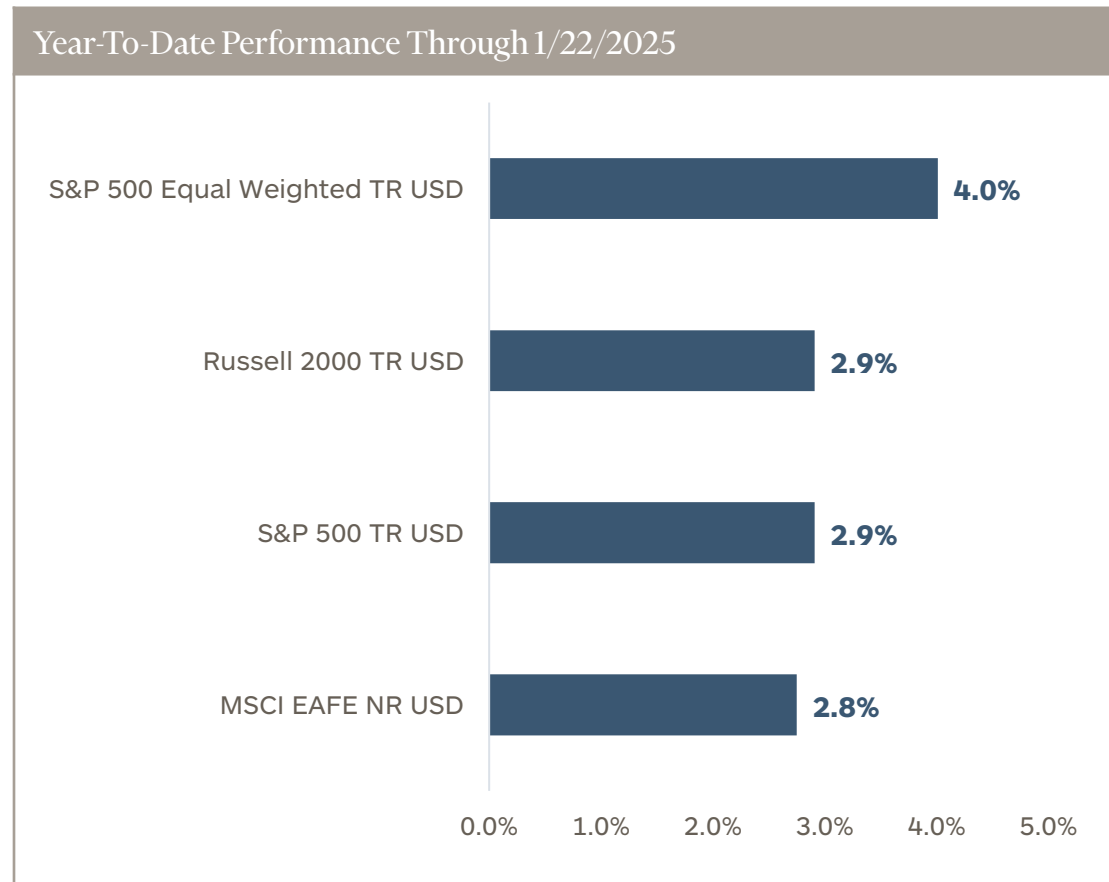
A temporary reset is often needed whenever rates make a move higher



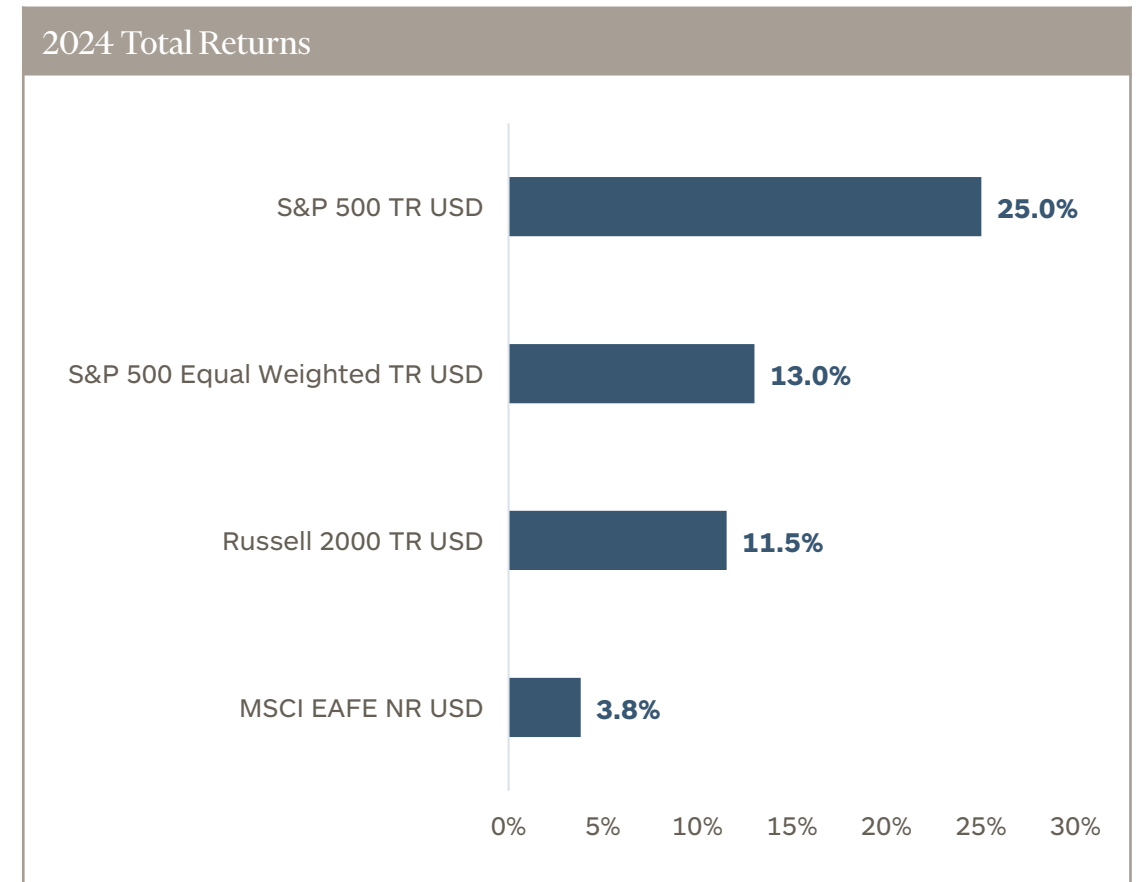
Source: Cerity Partners, FactSet, 1/18/2025

Market Breadth Is off to a Good Start in the Early Innings of 2025

We think broader earnings will help this trend continue



Source: Cerity Partners, Morningstar Direct, 1/22/2025



Source: Cerity Partners, Morningstar Direct, 12/31/2024

Unusual to See Estimates Increasing This Early in the Season

The first batch of earnings are setting an optimistic tone for the season.

- 43 companies are reporting this week.
- Of the 43 companies that have reported so far (9% of the S&P 500):
- Overall, 79% are beating estimates, and those that “beat” are beating by a median of 6%.
- Of the 21% missing, those are missing by a median of -3%.
- On the top line, overall results are beating estimates by a median of 2% and missing by a median of -1%, and 67% of those reporting are beating estimates.

S&P 500 Earnings Analysis

4Q24 Street Consensus EPS	
As of 12/31/24	\$61.54
Current	\$61.94
% change	0.7%

3Q24 Street Consensus EPS	
As of 9/30/24	\$60.46
Current	\$59.76
% change	-1.2%

2Q24 Street Consensus EPS	
As of 6/30/24	\$58.65
Current	\$58.81
% change	0.3%

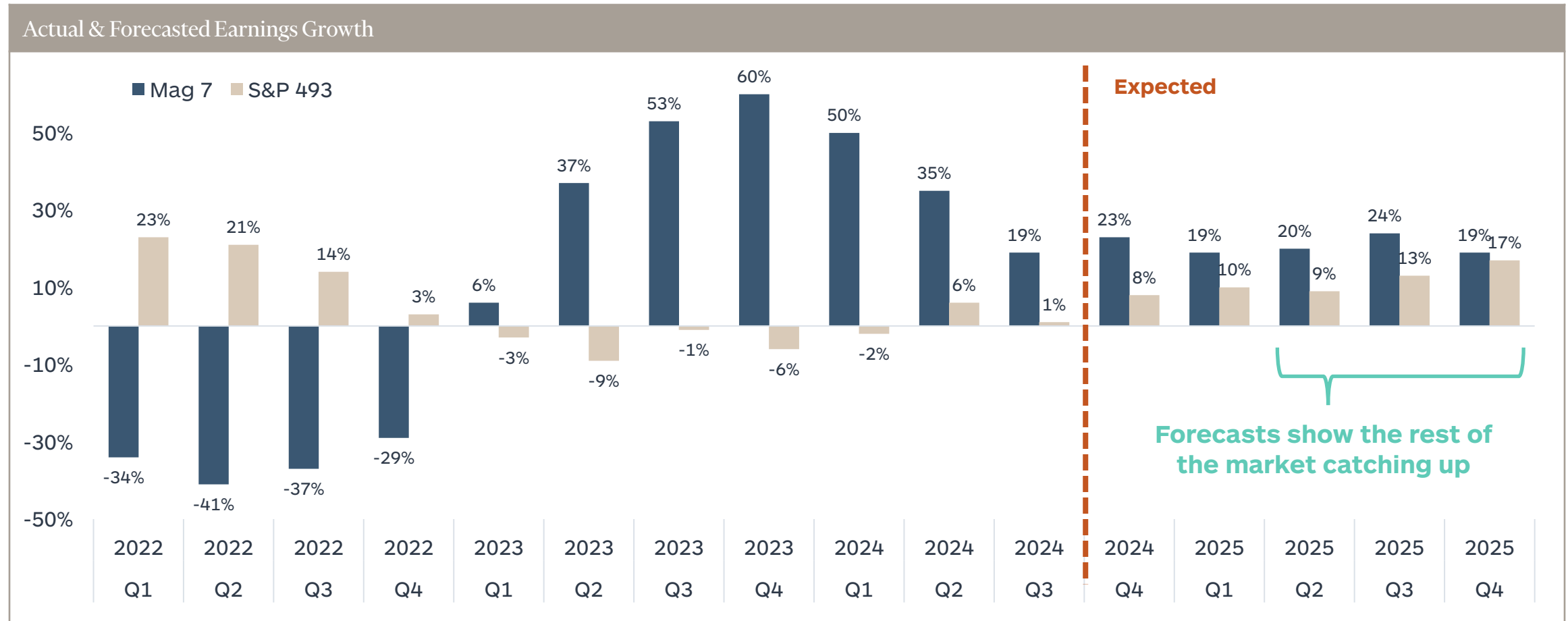
1Q24 Street Consensus EPS	
As of 3/31/24	\$54.63
Current	\$53.25
% change	-2.5%

4Q23 Street Consensus EPS	
As of 12/31/23	\$53.66
Current	\$51.97
% change	-3.1%

Source: Cerity Partners, Fundstrat

Lofty Growth Expectations Driven by Hopes of Greater Earnings Breadth

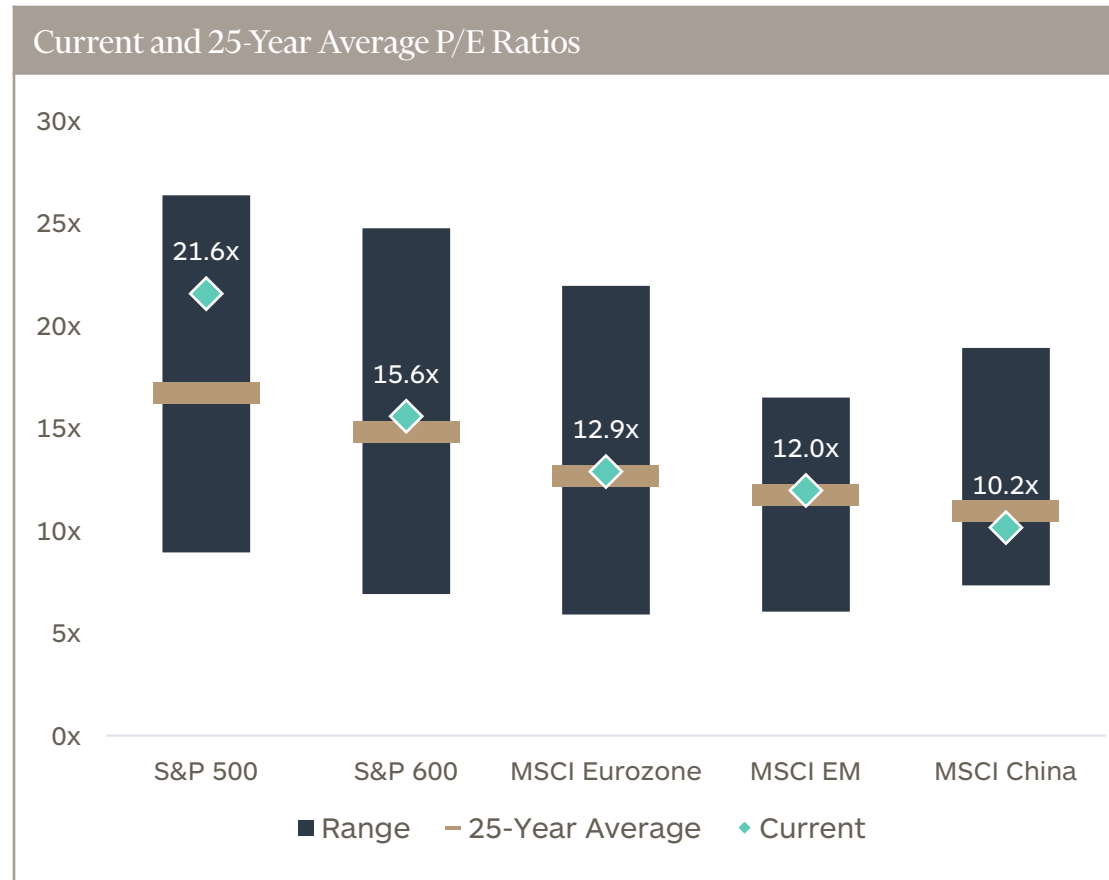
Two risks: Does AI growth meet expectations, and does the rest of the market “catch up”?



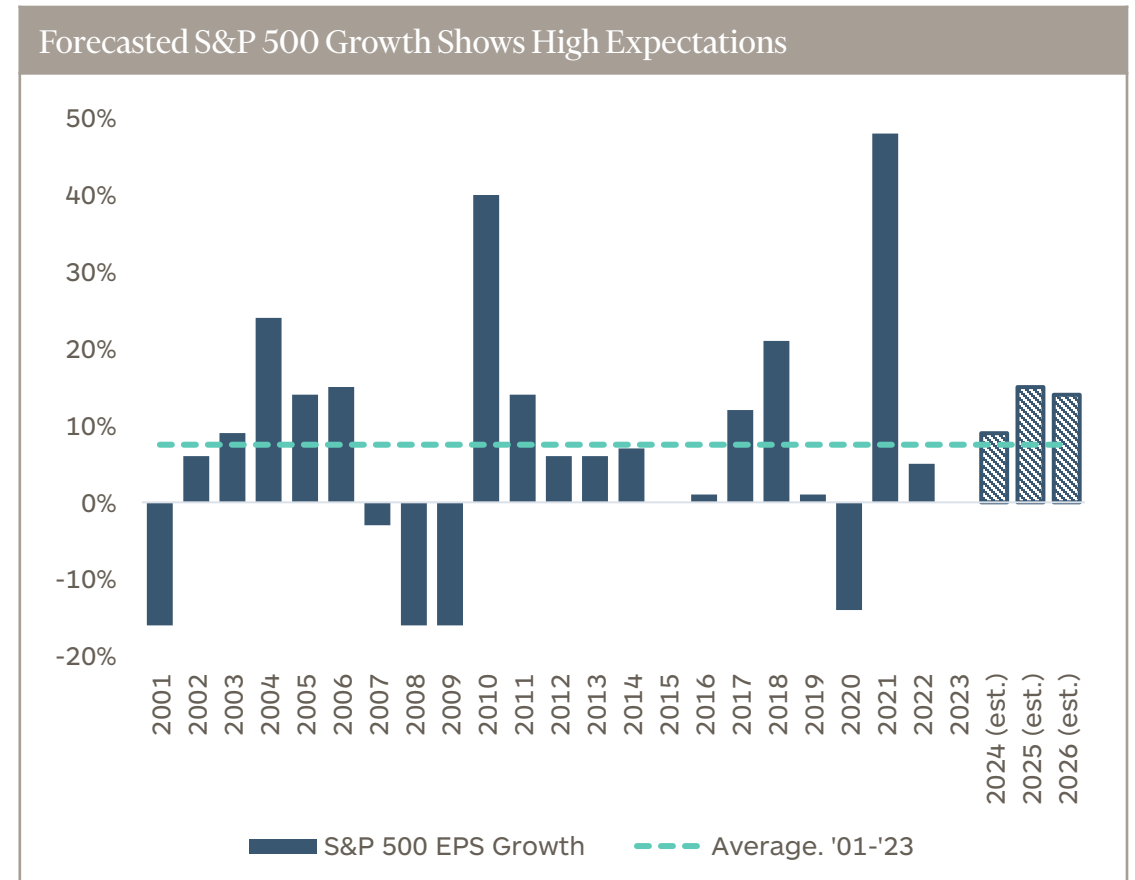
Source: JP Morgan, Cerity Partners

The US Appears Expensive, But for Good Reason

High valuations for the U.S. reflect strong earnings growth that is expected to continue



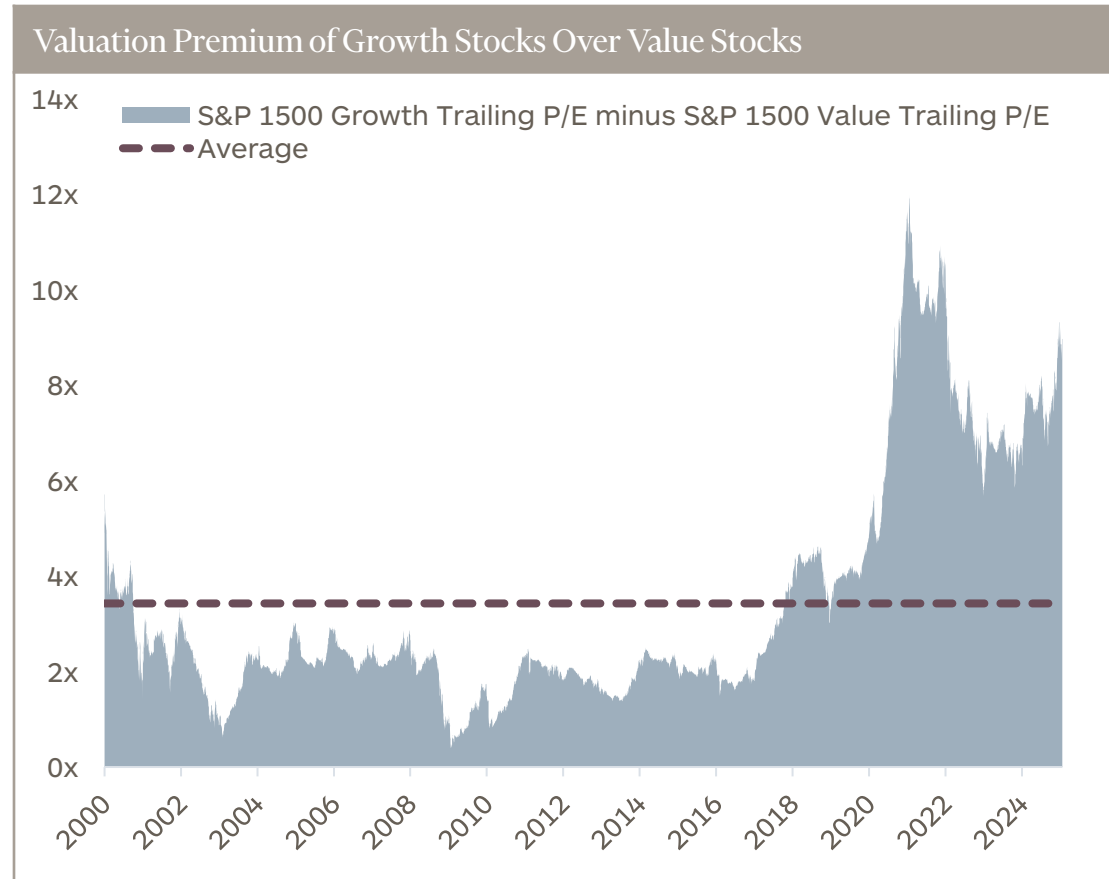
Source: Cerity Partners, FactSet, 12/31/2024



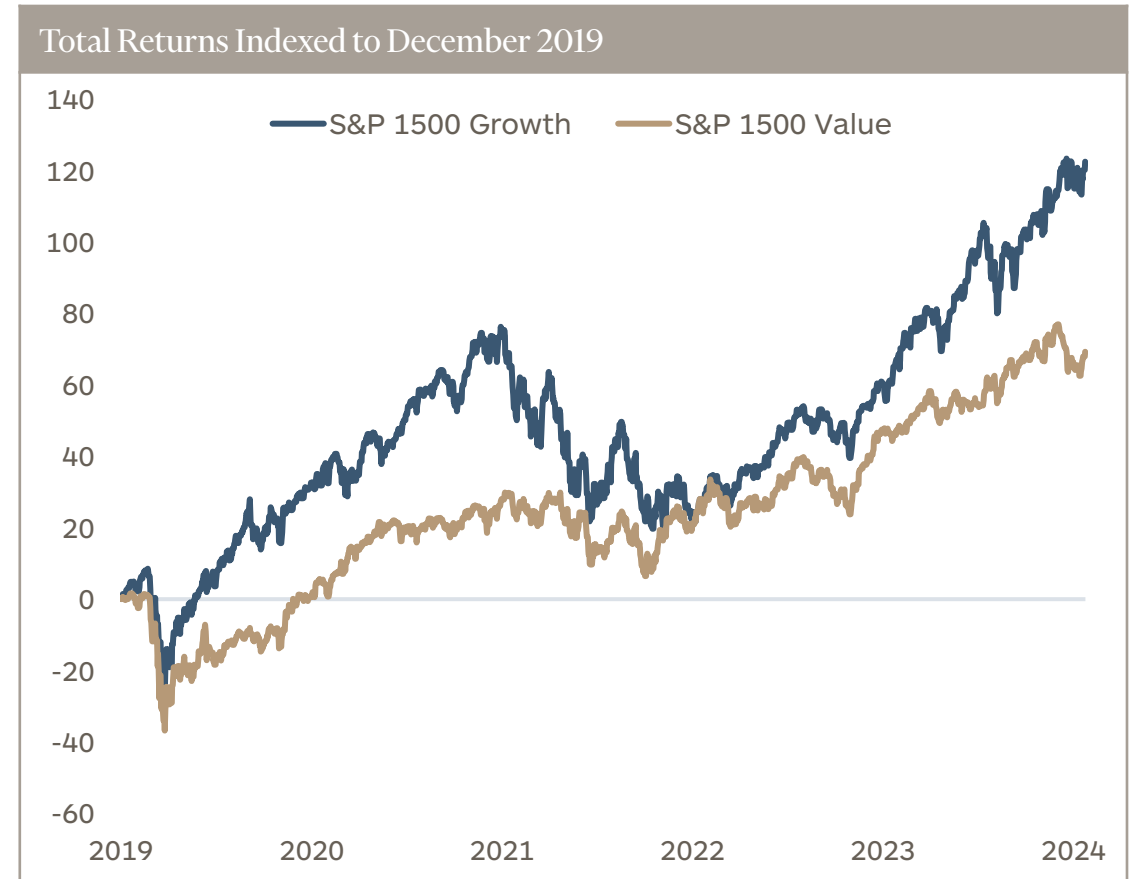
Source: Cerity Partners, FactSet, JP Morgan Guide to the Markets, 1/21/2025

Are Value Stocks Poised for a Turnaround?

As growth continues to outperform, the valuation premium grows



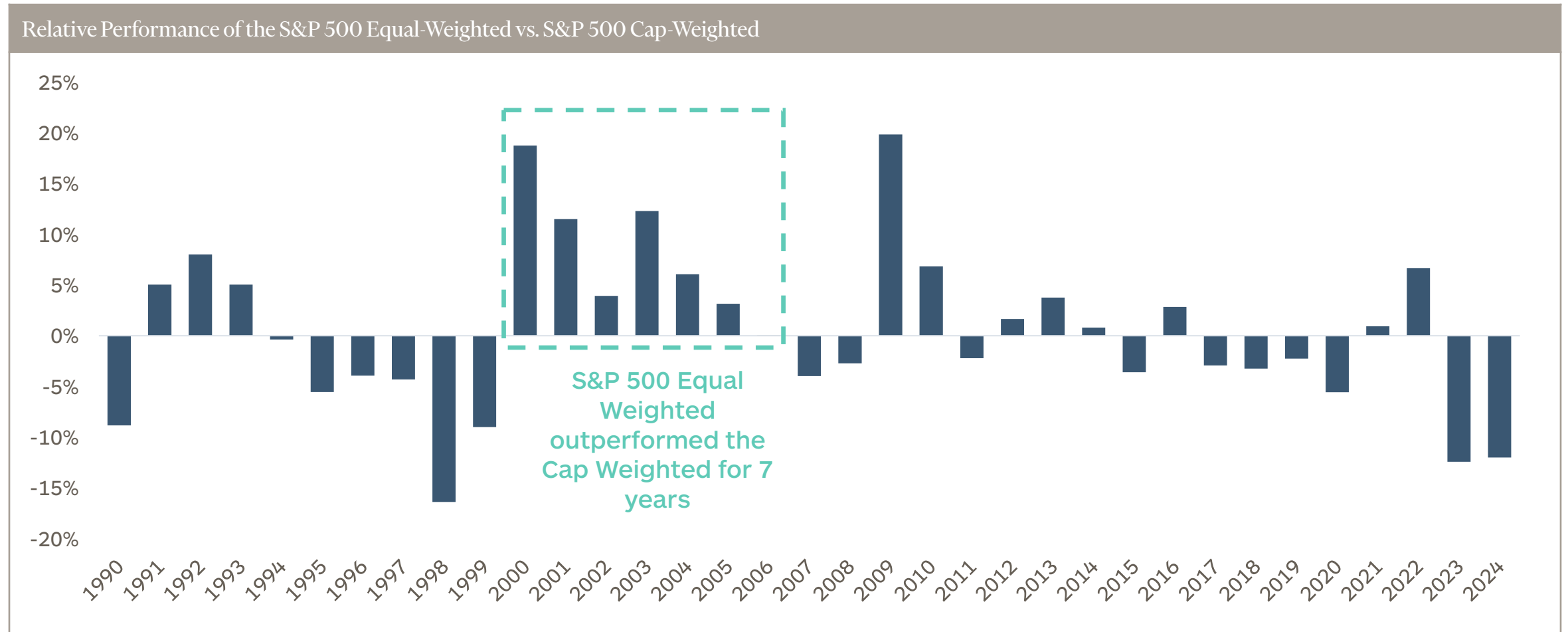
Source: Cerity Partners, FactSet, 1/21/2025



Source: Cerity Partners, FactSet, 1/21/2025

Could the “Average” Stock be Poised for Outperformance?

The S&P 500 equal-weighted index outperformed the cap-weighted index for 7 straight years from 2000-2006



Source: Cerity Partners, Bloomberg, 12/31/2024

Key Themes for Equity Markets in 2025

- Elevated concentration in the S&P 500, and lofty expectations for AI, favor a tilt to the S&P Equal-Weighted Index.
- After a long period of underperformance, small- and mid-cap equities regain investor interest as earning growth surprises.
- Emerging market indices are volatile as China seeks to stimulate its economy, but the long-term story for China remains a concern.
- UK and European equities remain broadly out of favor as the economies struggle, but certain companies are net beneficiaries of tariff policies.

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