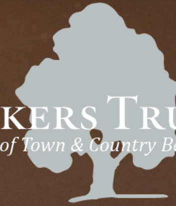
A LOOK BACK ON 2024: HISTORY ONLY RHYMES



First Bankers Trust Company
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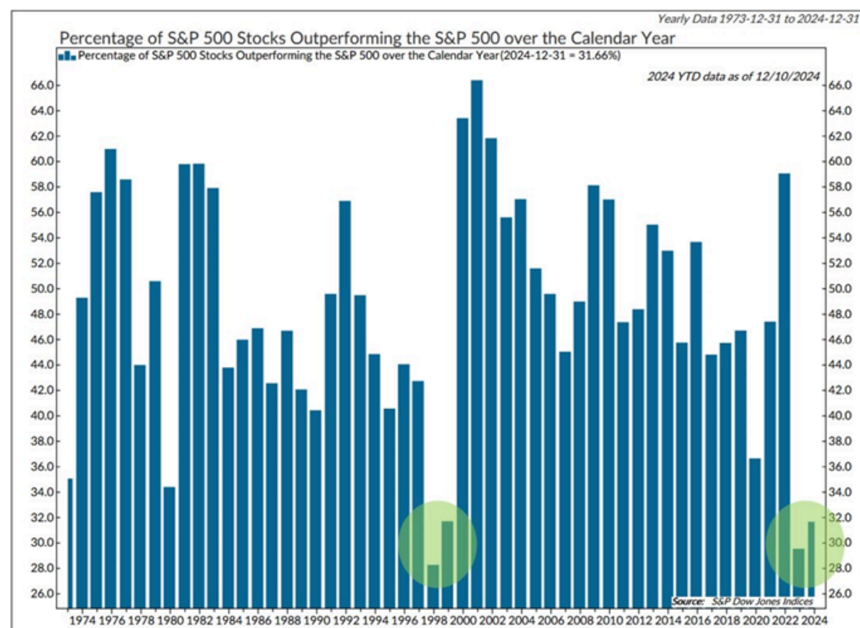
Financial markets are fascinating creatures to those passionate about them. To the untrained eye, they may seem chaotic. To those that fell in love, they are like poetry in motion. Well, sometimes it still feels like chaos. But even the chaos creates fond memories – after recoveries of course.

What sonnet did the beautiful beast write in 2024? The ink flowed with ease and had investors singing in the streets. The strength of the stock market was something to behold considering corporate profits for the S&P 500 only grew around 7% (final numbers are still trickling in). Valuations coming into the year were not exactly attractive so the extent of the market outperformance versus earnings should at least be of concern.

The story of 2024 in our opinion is that of history rhyming. It will never repeat perfectly, but as students of market history we can't help but hear some familiar verses. Incredibly, almost alarmingly, certain areas are echoing some of the irrational exuberances of 2021, a mere 3 years later. Markets typically have longer memories than that! Other bears or skeptics, of the few that remain, point to the excitement around artificial intelligence and technological advances in other fields and say we are mirroring the Tech Bubble of the late 1990s. Still others suggest the flocking to certain reliable names and willingness to pay any price, even those outside of innovative industries, is more akin to the Nifty Fifty of the 1960s, which preceded the brutal 1970s for the stock market.



While the stock market is rhyming in various ways with various periods in history, this is the stock market of 2025. History rhymes but it does not repeat.

A LOOK FORWARD: MAKING VOLATILITY GREAT AGAIN

It seems all too appropriate that financial markets exit 2024 rhyming with history considering the United States is experiencing a rhyme, electorally speaking. Donald Trump is set to take office once again this year and the market dusted off the 2016 playbook after the election results were final. However, some skepticism has already started to seep into the market, as evidenced by a weak December and choppy start in January.

We think the dose of skepticism is healthy. First of all, the economy is wildly different than it was in 2016. The beauty of the Permian basin fracking innovation had just provided a huge deflationary blanket and consumer tailwind to the economy in the prior years. Unemployment was around 5% and trending down. The 10-year treasury yield was comfortably below 3%. Government deficits were around 3% of the economy. Government debt held by the public was under 80% of the economy. Corporate tax rates were high.

There's plenty of debate in the oil market about supply and demand today, but the push to oversupplied is unlikely to come from domestic oil fields, in our opinion. The key to putting a low ceiling on oil prices sits in the hands of the Saudis; appetite for increasing domestic production is modest without the pain of higher prices at the pump first. Unemployment is closer to 4% and flat-to-trending up with anemic job creation last year. The 10-year treasury yield spends most of its time bouncing between 4% and 5%. Government deficits were almost 7% of the economy at the close of 2024. Government debt is now equal to GDP. Corporate tax rates are at modest levels. The biggest similarity between now and 2016 is the sluggish industrial sector waiting for a rebound.

We're not downplaying the impact a more business friendly administration can have on all of those variables. Trump can mend relations with the Saudis. Business optimism has already surged and could lead to greater job creation. Corporate tax rates still have room to go down. However, Trump is unpredictable and has some bad ideas too. Thus, we suspect the story of 2025 will be making volatility great again.

THE THREE KEY RISKS FOR 2025

And what about our federal government's fiscal problem? This leads us to our three key risks for the economy in 2025: government deficit reduction, housing, and inflation. Trump and his Department of Government Efficiency (DOGE) team have vowed to reduce the absurd levels of deficits the government is currently running. We're initially skeptical that much will be done on this front but we certainly remain open minded. While we think it would be beneficial long-term, even reducing the deficit by half and ripping $1 trillion out of a $30 trillion dollar economy (rough numbers) will be extremely painful in the short term.

We mentioned 2024 rhymed with 2021 for the stock market. We think 2025 has the risk of rhyming with 2022 for the housing market. A spike in interest rates caused a collapse in housing demand in 2022 and created a ton of fear around a housing-led recession similar to 2008. As we said in 2022 and 2023 after the mini-banking crisis, this looks nothing like 2008. Homeowners' equity is extremely high and banks are less leveraged as well. Nonetheless, a housing-led recession should at least be on investors' radars. This year will only rhyme with 2022 due to the fear. However, the cause could be quite different. Homeownership demand is still extraordinarily low with mortgage applications back to levels seen 30 years ago despite a larger population and economy. Demand is on the floor and unlikely to go lower as life still happens (job changes, upgrades, family formation, etc.). The risk for housing and the economy now comes from the supply side. While existing home inventory is still below pre-pandemic levels, it is increasing and getting close to normal. New home inventory is growing rapidly and arguably oversupplied. If demand doesn't accelerate this spring, homebuilders will have to make difficult decisions later this year.

Finally, everyone's beloved topic these days: inflation. Inflation remains above the Federal Reserve's "target" of 2% but the risk for the economy and the market is not inflation staying around 2.5%, in our opinion. The Fed is clearly comfortable with that level even if they won't admit it. Inflation presents a risk if it accelerates from here and the Fed has to increase interest rates again– it seems unlikely they could pull off multiple soft landings in such a short time frame. While we don't see this risk materializing in the first quarter or two, the inflation embers have not been extinguished in our opinion. Fiscal policy is way too loose relative to the conditions in the labor market, monetary policy is probably adequate but possibly moving in the wrong direction, private sector balance sheets are solid and corporate borrowing is easy, and now there is new policy risk such as tariffs. If inflation comes in waves, history would suggest wave two could start later this year (table to the right). Again, we don't see it in the data currently but will continue to monitor closely with this backdrop.

Inflation Peak Month	Inflation Peak Rate	Inflation Trough Month	Inflation Trough Rate	Peak to Trough Time (Months)
5/31/1942	13.2	**5/31/1944**	0.0	24.0
3/31/1947	19.7	**7/31/1949**	-2.9	28.0
2/28/1951	9.4	**1/31/1953**	0.4	23.0
12/31/1969	6.2	**6/30/1972**	2.7	30.0
12/31/1974	12.3	**11/30/1976**	4.9	23.0
3/31/1980	14.8	**6/30/1983**	2.6	40.0
10/31/1990	6.3	**1/31/1992**	2.6	15.0
6/30/2022	9.1	**9/30/2024**	2.4	*26*

**Average of all inflationary episodes over 6% from 1940 to present*

WHAT DOES THIS MEAN FOR PORTFOLIOS?

We started beating the valuation drums at this time last year in our 2023 recap / 2024 outlook. As we have repeated in client meetings, valuations are not timing tools. They imply an uphill battle over longer-term horizons but give little indication of what the coming year brings (first chart in appendix). However, as investors we have to consider a range of outcomes and time horizons. As valuations climb, the range of outcomes over the long-term narrows. Furthermore, unless one thinks the end game is a Great Depression level crash, the range of outcomes starts to narrow over the intermediate term as well. Thus, too much valuation-driven gains may create some additional selling opportunities this year.

We also reminded readers there were plenty of reasonably priced stocks beneath the surface with solid long-term prospects from both an earnings perspective and valuation perspective. This remains the case today. Last year did give a valuation boost to a wider array of stocks than 2023 did so the opportunity set has perhaps narrowed a bit. However, the market will inevitably provide more opportunities in select names or sectors throughout the year regardless of what the broad indices do.

Finally, the valuation problem the market faces is a reminder to remain disciplined for asset allocation and have robust bond portfolios for clients that need them. Short-term bonds have oscillated around fair value for the past couple of years, but long-term bonds have spent most of the past two years in expensive territory. At long last, we enter 2025 with a fairly priced bond market. Could both short- and long-term interest rates go up further? Sure, we wouldn't rule it out; we didn't say long-term bonds were cheap yet. But due to the pressure building once again in the housing market, increases in interest rates this year will be buying opportunities for bonds and we will take full advantage to round out client portfolios accordingly.

This should be another fun year as every year is in the poetic markets. We look forward to helping clients navigate interesting times and continuing to reach their goals!

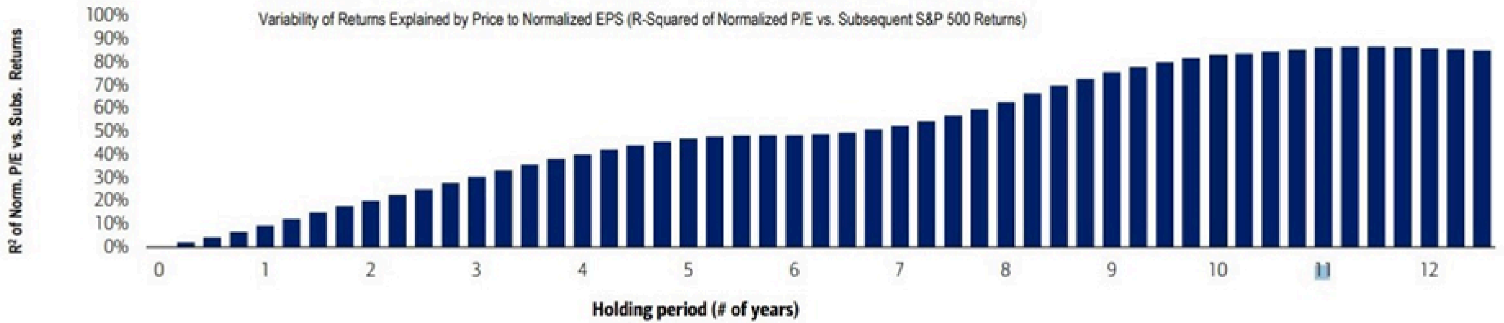
Sincerely,

Your First Bankers Trust Team

Investment products are not FDIC insured, not guaranteed by the bank, and may lose value

CHART APPENDIX

Sources: Bank of America, Bloomberg, First Bankers Trust Research, Google Trends, Todd Sohn & Strategas Securities, S&P Global, Bank of America Research



Unprecedented Fiscal Impulse

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12/1/1968, 12/1/1970, 12/1/1972, 12/1/1974, 12/1/1976, 12/1/1978, 12/1/1980, 12/1/1982, 12/1/1984, 12/1/1986, 12/1/1988, 12/1/1990, 12/1/1992, 12/1/1994, 12/1/1996, 12/1/1998, 12/1/2000, 12/1/2002, 12/1/2004, 12/1/2006, 12/1/2008, 12/1/2010, 12/1/2012, 12/1/2014, 12/1/2016, 12/1/2018, 12/1/2020, 12/1/2022

Deficit as % of GDP (lhs) — Unemployment Rate (rhs - inverted)

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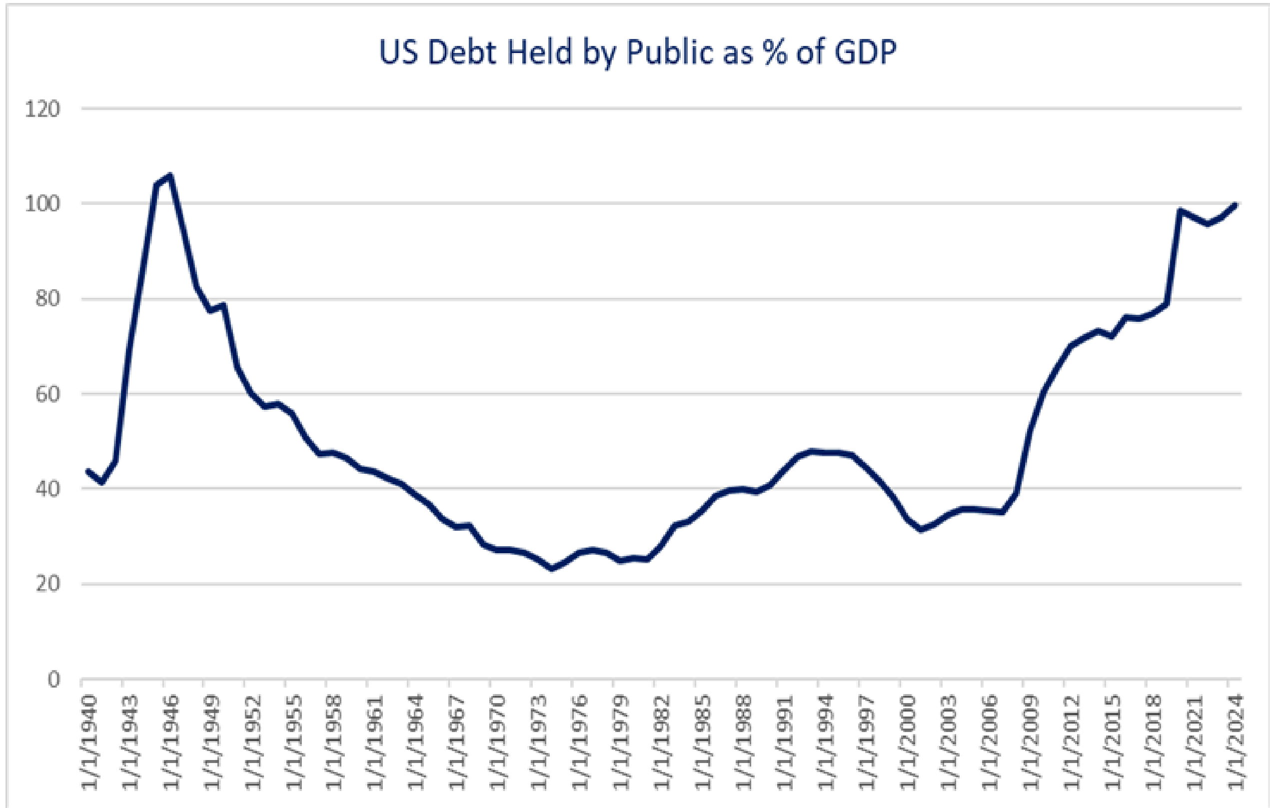

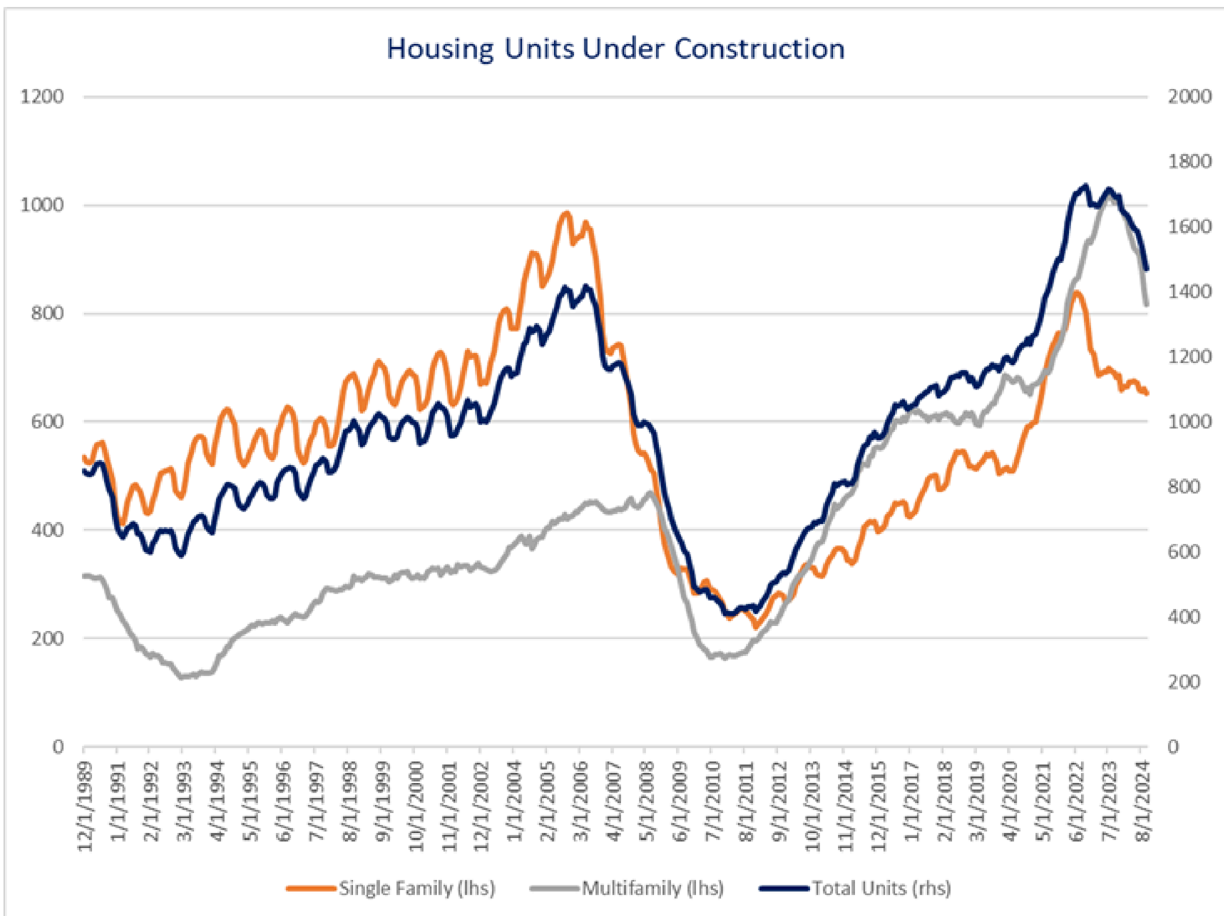

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