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A LOOK AT THE YEAR AHEAD: Ten Investment Forecasts and Four Strategic Wealth Management Themes to Capitalize on Them

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As we acknowledge each December in presenting our outlook for the coming year, no one can know the unknowable or predict the unpredictable. However, as wealth managers that invest for our clients over the long-term, it is also our job to continually analyze the world around us and assess how the short-intermediate term economic landscape may impact our long-term investments. We have never believed in a "one size fits all" portfolio and have always provided custom tailored advice to our valued clients based on their personal goals and risk tolerances. With this in mind, we would like to share with you our perspective and predictions about some significant events that we believe are likely to unfold in the year ahead.

Beacon's Ten Investment Forecasts for 2025

1. U.S. stocks will undergo a period of digestion, generating positive returns that are roughly in line with historical averages.
2. Bonds, as measured by the Bloomberg Barclays Aggregate Index, will deliver low to mid-single digit positive returns over the full calendar year.
3. The Federal Reserve (Fed) will cut short-term interest rates 50bps or less in 2025.
4. Inflation will average more than the Fed's 2% desired target over the full 2025 calendar year.
5. The IPO markets will recover, driven by a new wave of artificial intelligence (AI) companies going public.
6. An agreement will be reached to end the Russia-Ukraine War.
7. The U.S. economy will continue to expand and avoid a recession.
8. Consumer sentiment will increase year-over-year, as consumers gradually become accustomed to higher prices and the new political landscape.
9. The price of oil will fall, on average, versus 2024 prices, due to changes in U.S. energy policy.
10. The federal budget will be cut less than 25% of the $2 trillion planned by the Department of Government Efficiency (DOGE).

Beacon's Four Strategic Wealth Management Themes for 2025

Beacon's Four Strategic Wealth Management Themes for 2025 echo our forecasts for the coming year and reflect our best thinking to protect capital and improve returns:

1. Prepare for a normalization of equity returns.
2. Plan for an economy where the inflation rate remains above the Federal Reserve's target of 2%.
3. Ride the second wave of the artificial intelligence (AI) revolution.
4. Invest in high-quality companies with above-average profitability, free cash flow, and strong balance sheets.

A Glance Back on the Year That Was

U.S. stocks had another very strong year with the S&P 500 rising roughly 25% in 2024, as of the time of this writing. However, this robust figure is somewhat deceptive since performance continued to be driven by a small number of very large companies. Perhaps the most glaring example of this dynamic is NVIDIA, which increased roughly 160% in 2024 and is now among the most valuable companies in the world at $3.2 trillion. Most other equity indexes had solid but less spectacular performance, with the Dow Jones Industrial Average (+15%), Russell 1000 Value (+14%), and Russell 2000 (+12%) all reporting double-digit gains for the calendar year thus far. Bonds had a modest year, with the Bloomberg Barclays Aggregate Bond Index increasing ~2.25% in 2024 so far.

Before we look ahead to 2025, it seems only fair to look back on our 10 forecasts for 2024. What did we get correct and where did we go wrong? In our view, seven of our ten forecasts from 2024 were correct, and three incorrect. Let's provide some color to these assessments and then move on to our 2025 forecasts.

Let's start with our mistakes, which we always try to learn from. We forecasted that small U.S. stocks would outperform larger ones. Although Russell 2000 Index of smaller capitalization stocks has rallied significantly over the past few months, it is highly unlikely to surpass its larger peers in the S&P 500 by year end. As noted above, investor enthusiasm for artificial intelligence stocks has propelled mega cap technology stocks, such as NVIDIA, Microsoft, Meta, and Apple to near all-time highs. We also thought the U.S. Dollar Index (DXY) would decline this year. In contrast, DXY increased roughly 6.5% year-to-date (YTD) since the Federal Reserve (Fed) cut interest rates less than many expected and the U.S. economy remained stronger than that of most other nations. Lastly, we thought the November elections in the U.S. would result in a mixed decision or political gridlock. Instead, the Republican Party won the Presidency and both chambers of Congress.

Let's move on to our clairvoyant calls from 2024. We thought stocks would have another solid year and return very low double digits. The S&P 500 exceeded our somewhat rosy forecast by increasing over 25% so far in 2024. We thought bonds would essentially clip coupons and provide a low to mid-single digit returns. The Bloomberg Barclays Aggregate Bond Index has increased about 2.25% YTD, roughly in line with our views. We predicted the Fed would cut rates at least three times in 2024. The Fed did cut interest rates 3 times and 1% over the full calendar year. We forecasted that inflation would continue to decline in 2024. The Consumer Price Index (CPI) increased at a rate 3.4% at the time of our forecast in December 2023. The most recent reading of the CPI in December 2024 showed an increase at the rate of 2.7%.

We believed 2024 would be a good year for earnings growth. S&P 500 earning are projected to increase at least 10% this year, moderately above its long-term average of 8%. We also thought that the U.S. unemployment rate would increase to more than 4% from its December 2023 level of 3.6%. The unemployment rate peaked at 4.3% in June of 2024 and remained at 4.2% as the year comes to a close. Consumer sentiment has been somewhat dour since inflation began to accelerate more than two years ago. We believed that consumer sentiment would slowly start to improve, and we believe this trend will continue into 2025. The University of Michigan Consumer Sentiment Survey showed an increase in sentiment of 6% over the 2024 calendar year. **Table 1** provides a summary scorecard for our 2024 forecasts.

Table 1: Review of Beacon's 2024 Financial Forecasts

Forecast	Assessment	Rationale for Assessment
Stocks to deliver positive returns in 2024	Correct	The S&P 500 increased ~25% in 2024 (so far)
Bonds to deliver positive returns in 2024	Correct	The Bloomberg Barclays Agg rose ~2.25% in 2024 (so far)
The Fed will cut rates at least 3x in 2024	Correct	The Fed decreased rates three times and 1% in 2024
Inflation will fall, but remain above 2%	Correct	The CPI inflation rate went from 3.4% to 2.7%
Small Cap will outperform Large Cap	Incorrect	The S&P 500 rose 25% and Russell 2000 12% (so far)
S&P 500 EPS Growth to Exceed 8%	Correct	2024 S&P 500 earnings are projected to increase > 10%
The unemployment rate will increase to 4%+	Correct	The U.S. unemployment rate increased to 4.2%
U.S. Dollar will weaken vs. its trading partners	Incorrect	DXY increased ~6.5% (so far)
Consumer sentiment will increase	Correct	U Mich Consumer Sentiment Index increased 6%
Nov. elections will result in political gridlock	Incorrect	The Republicans swept all 3 races (House, Senate, Pres.)

A Closer Look at Beacon's Ten Investment Forecasts for 2025

There is an element of risk in offering predictions since the future is uncertain. We can state with confidence that some forecasts we offer for 2025 are again likely to be correct, some incorrect, and some partially correct. We can also predict with great confidence that what will ultimately prove to be some of the major events of 2025 are neither on our list, nor likely on anyone else's. For example, few analysts predicted Bitcoin would surge roughly 130% to exceed $100,000 per coin in 2024. It is often the events that few investment strategists are talking about that result in the most extreme market movements.

As noted in our Executive Summary section, Beacon portfolios are custom-tailored to each client's unique risk tolerance and personal circumstances. Hence, our investment ideas may be appropriate for some clients, while not consistent with the goals and objectives of others. With these important caveats in mind, we humbly offer you some color around our top ten investment forecasts for 2025.

1. **U.S. stocks will undergo a period of digestion, generating positive returns that are roughly in line with historical averages.**

   The S&P 500 is poised to increase more than 20% for the second consecutive year. The record is mixed for the four other times since 1900 when the stock market has notched similar gains. In our view, growing earnings, a further decline in short-term interest rates, and the productivity boost from the proliferation of artificial intelligence are reasons to be optimistic. Tempering our enthusiasm are heightened valuations and the possibility of inflation lingering above 2%. Netting out the pluses and minuses, we expect the S&P 500 to provide total returns in the range of 8%-12% for 2025, roughly in line with its historical average.

2. **Bonds, as measured by the Bloomberg Barclays Aggregate Index, will deliver low to mid-single digit positive returns over the full calendar year.**

   We view bonds as a source of income and a portfolio diversifier, especially during times of distress for equities. We believe bonds will continue to serve this role and provide returns in 2025 similar to the current year, namely low to mid-single digits. Looking under the hood of the yield curve, we think short-term rates will modestly decline and that intermediate to long-term rates will stay flat to modestly increase. We elaborate on these views below.

3. **The Federal Reserve (Fed) will cut short-term interest rates 50bps or less in 2025.**

   Short-term interest rates currently stand at 4.25%-4.50%, while inflation is tracking at roughly 2.5% as the year comes to a close. In general, short-term interest rates usually modestly exceed the inflation rate. Hence, in our opinion, the Fed has room for small rate cuts in 2025 since we believe inflation will average meaningfully above 2% for the duration of the year, placing a boundary on how aggressive the Fed may be with its rate cut path.

4. **Inflation will average more than the Fed's 2% desired target over the full 2025 calendar year.**

Several factors lead us to believe that inflation rates will remain stubbornly high, although not come close to approaching the near double-digit levels that we saw in 2022. First, we think former and incoming President Trump's tariff policies are generally inflationary. We realize that the threat of high tariffs may be used as a negotiating tactic but believe that nonetheless some sizeable tariffs will be implemented. A well-known case from President Trump's first term was tariffs placed on washing machines and the resulting increase in prices for consumers. Furthermore, a large-scale deportation program may be inflationary since new workers will need to replace many former workers, often at higher wage rates that employers will try to pass on. In contrast, a significant reduction of regulations and cheaper energy costs may help inflation avoid spiraling out of control.

5. **The IPO markets will recover, driven by a new wave of artificial intelligence (AI) companies going public.**

The regulatory pendulum is likely to swing further in the direction of market forces and pro-business policies. Although certain proposed mergers, like that of Nippon Steel and U.S. Steel, will remain in political crosshairs, we believe more mergers will be approved in 2025+ versus what occurred during the Biden Administration. Furthermore, the IPO market has been somewhat dormant since the technology bear market of 2022. We believe this important capital market will be reawakened from its slumber, led by a wave of artificial intelligence firms going public.

6. **An agreement will be reached to end the Russia-Ukraine War.**

Former and incoming President Trump has made ending the war between Russia and Ukraine among his highest priorities. He has boldly claimed that he has a plan to end the war in one day. We are not willing to make such a striking claim, but believe he will get the relevant parties together and try to work out an agreement. Besides the highly important reduction in human casualties and tragedy, the main economic implication may be a reduction in global commodity prices as both nations' economies gradually return to normal. We are also fully aware that any settlement that involves the loss of Ukrainian territory to Russia opens a Pandora's box of potential future aggression and increases long-term geopolitical risk.

7. **The U.S. economy will continue to expand and avoid a recession.**

The U.S. economy is currently expanding at a decent clip, the unemployment rate is relatively low, interest rates are modestly falling, artificial intelligence will improve worker productivity, and business regulation seems to, on balance, favor pro-growth policies. For these and other reasons, we expect the U.S. economy to continue to grow in the 2%-3% range over the course of 2025.

8. **Consumer sentiment will increase year-over-year, as consumers gradually become accustomed to higher prices and the new political landscape.**

The U.S. consumer accounts for roughly 70% of U.S. GDP so its pulse bears watching. Consumer sentiment has been somewhat dour since the second half of 2021, which corresponds to a period of rising inflation and the fallout from the pandemic. In recent months, the U.S. economy has experienced disinflation (i.e., inflation, but at a lower rate) and a highly contentious election season. Thankfully, the pandemic is largely behind us. As wages rise, consumers will begrudgingly become accustomed to paying higher prices for most items and U.S. citizens will have to live with the election results, at least until the next set of midterm elections roughly 2 years from today. In our view, the conditions for an upward trajectory of consumer sentiment are in place, which partially explains our belief in a growing U.S. economy in 2025.

9. **The price of oil will fall, on average, versus 2024 prices, due to changes in U.S. energy policy.**

One element of incoming and former President Trump's economic platform is to control inflation by dramatically increasing energy output in the U.S. He frequently cites the phrase "Drill, Baby, Drill" as a pithy summary of his energy policy.

His economic platform also includes rolling back subsidies for clean energy projects, which tilts the calculus of U.S. energy companies to (re)invest in fossil fuel projects. Furthermore, if there is some resolution to the Russia-Ukraine War, undoubtedly Russia will seek to bolster its shaky finances by producing more oil and gas. Net-net, we do not see a collapse in energy prices due to economic growth and increased demand from artificial intelligence data centers, but rather a decline versus 2024 prices.

10. **The federal budget will be cut less than 25% of the $2 trillion planned by the Department of Government Efficiency (DOGE).**

    Elon Musk and Vivek Ramaswamy have been tapped to lead the new Department of Governmental Efficiency (DOGE). The pair claims they can reduce the federal budget by a hefty $2 trillion. The U.S. annual federal budget is roughly $7.5 trillion today. A $2 trillion cut works out to a 26 percent decline in the federal budget. According to the U.S. Constitution, Congress controls the purse strings of the federal budget, not the President or DOGE. A cut of $2 trillion to the 2024 U.S. GDP figure of roughly $28 trillion amounts to a decline of 7% in GDP and may push the economy into a recession. Although we expect GDP to grow in 2025, a 7% growth rate is highly unlikely. Hence, we believe DOGE will cut the federal budget at the margin, but the reduction will be 25% or less of the stated $2 trillion figure in 2025.

Beacon's Four Strategic Wealth Management Themes for 2025

Investment forecasts in and of themselves are interesting, but of little direct value. They must be actionable if they are to be valuable for our clients. Therefore, coupled with our Ten Investment Forecasts we offer Four Strategic Wealth Management Themes for 2025, which are often tied to the specific investments in your portfolio.

1. **Prepare for a normalization of equity returns.**

   The S&P 500 has increased at a compound annual rate of return of approximately 15% since the depths of the Great Recession. This figure is roughly 50% higher than its long-term average of 10% per annum. Furthermore, the S&P 500 is on pace to increase at more than 25% per year for the past 2 years, partially on investor enthusiasm for artificial intelligence stocks and a decline in short-term interest rates spurred by a change in Federal Reserve policy. Heightened stock market valuations act akin to the law of gravity, making it more challenging to continue to earn excess returns. In sum, we believe U.S. equity returns at or modestly below long-term averages are par for the course over the next several years.

2. **Plan for an economy where the inflation rate remains above the Federal Reserve's target of 2%.**

   The latest annual reading on the rate of inflation according to the Consumer Price Index is 2.6% and this figure has generally been trending downward for the past 30 months. In our view, the Federal Reserve will continue to find "last mile" of bringing down inflation to 2% troublesome. Although the actual details of former and incoming President Trump's tariff policies have yet to be specified, most economists view tariffs as inflationary. In addition, his proposed policy of the mass deportation of illegal immigrants may also be inflationary since new workers will have to be found to cover existing positions, usually at higher wages. Lastly, we expect middle-income to affluent consumers to spend somewhat freely due to the low unemployment rate and near-record stock market and real estate prices (i.e., the wealth effect).

3. **Ride the second wave of the artificial intelligence (AI) revolution.**

   Market participants have clearly placed their bets on the first wave of artificial intelligence winners. These firms include mega-cap technology stocks, such as NVIDIA, Broadcom, Apple, Microsoft, Meta, TSMC, and Amazon.com. Nearly all companies are analyzing the impact of AI on their businesses and examining how it may improve productivity or help them move into new markets. As noted in our forecasts for the year ahead, we believe a number of exciting companies will go public in 2025 creating some interesting investment opportunities. In addition, some companies will unexpectedly, but shrewdly, pivot to new opportunities afforded by AI. For example, Amazon.com today makes the bulk of its profits from its Amazon Web Services (AWS) unit, rather than its original online retail business. Similarly, we believe other firms will embrace AI to supercharge their business.

In our view, most of these companies will be headquartered in America, due in part to our technological infrastructure, Silicon Valley funding ecosystem, and access to low-cost power enabled by the shale oil revolution. Much of Europe and Asia lack these fundamental AI ingredients, putting U.S. stocks in the pole position to continue to lead the AI revolution.

4. **Invest in high-quality companies with above-average profitability, free cash flow, and strong balance sheets.**

   All of Beacon's internal equity strategies, most notably its Core Strategy, favor high-quality companies. In the financial landscape that we anticipate, high valuations, modestly declining short-term interest rates, and somewhat elevated inflation, we believe it is especially important to tilt equity strategies towards not only high-quality firms, but also companies that have above-average profitability, free cash flow, and strong balance sheets. In other words, a discriminating investor may favor the strongest companies in a "survival of the fittest" equity environment.

We at Beacon look forward to the opportunity to discuss our Ten Investment Forecasts with you, as well as the ways in which our Four Strategic Wealth Management Themes can be custom tailored to your personal situation. As always, we close by thanking you for your loyalty and support. We consider our relationship with our clients a true partnership, and our sole mission as a firm is to add value to our clients in any way we can. It is with the fulfillment of this mission in mind that each of us at Beacon is focused on individual and collective improvements each day. We also wish you a happy, and especially healthy, holiday season and a wonderful New Year.