

L P L R E S E A R C H P R E S E N T S

OUTLOOK

2025

Pragmatic Optimism





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From the CIO

Looking back on 2024, it clearly echoed many of the themes from 2023. There were some brief economic growth scares along the way, but by and large the broader economy continued to defy expectations and surprised once again to the upside. Stocks continued their strong performance, and the S&P 500 is on track to record its second consecutive year of 20% plus returns as powerful trends in artificial intelligence (AI) and technology have proceeded unabated and largely overshadowed other factors like election uncertainty, continued geopolitical tension, and some rich stock valuations. After the election, the anticipation of potentially market-friendly policies from the incoming administration also helped bolster stocks. The bond market, in contrast, experienced another lackluster year. While the Fed initiated a long-awaited easing cycle, policy ambiguity and uneasiness over rising debt levels led to increased volatility in bonds, but no clear directional trend.

As we look ahead to 2025, we remain cautiously optimistic. Cautious because we know that no market environment is ever permanent, and that change is always potentially around the corner. Optimistic because we recognize constructive long-term technology trends are in place. Plus, potential tax policy and deregulation efforts in 2025 could provide some semblance of a tailwind – particularly from an economic perspective. While growth asset returns are not expected to be as robust as 2024, 2025's investment environment should prove to be favorable for investors.

To better ensure optimal outcomes for investors, our Strategic & Tactical Asset Allocation Committee (STAAC) employs a rigorous and systematic approach to investing. Leveraging proprietary quantitative modeling, our team seeks to identify potential risks and opportunities across capital markets. For 2025, new fiscal and regulatory policies will need to be digested, and relatively rich valuations may get tested. This means equity markets probably won't be as one-way as they have been. For the time being, this backdrop favors a constructive, but also a conservative and balanced approach to tactical stock and bond allocations.

LPL Research is committed to supporting our advisors, our institutions, and their clients throughout every market cycle. We truly value our partnerships and will always strive to deliver the highest level of guidance and support. We remain incredibly grateful for the confidence bestowed upon us and wish you a very prosperous 2025!

Sincerely,

Marc Zabicki, CFA
Chief Investment Officer, LPL Financial



ECONOMY

Steady Progress but Complexities Remain

As we enter 2025, the economic landscape remains complex, marked by both opportunities and potential risks. In the year ahead, investors should be thinking about the following:

- **The economic fog is lifting but hasn't fully dissipated:** The economy has experienced significant shifts over the last few years, including aggressive rate hikes followed by a pivot to rate cuts. While inflation has moderated, it remains historically elevated, putting pressure on certain segments of the population while arguably benefiting others. The bifurcated nature of the economy will continue to pose challenges for monetary policymakers in 2025.
- **Look for the economy to slow but not tip into recession:** The economy will likely downshift throughout 2025 as consumer spending, which makes up roughly two-thirds of economic growth metrics, begins to moderate from recent breakneck speeds. Pent-up demand for business capital expenditures, favorable tax policy, and likely deregulation are expected to be positive catalysts that should help offset some consumer softening.
- **Be prepared for inflation hiccups and changing narratives around rates:** Some inflationary pressures may re-emerge in 2025 as new policies are digested and wealthier consumers remain fairly insulated; overall inflation is expected to remain subdued. Nevertheless, upticks in inflation could lead to changing narratives and a slower pace of Federal Reserve (Fed) rate cuts than expected that force markets to adjust to yields staying higher for longer.
- **Remember that so goes employment, so will go the economy:** The labor market continues to show signs that it is slowly shifting. Workers are becoming less inclined to switch jobs and the average workweek for private payrolls has declined, which is indicative of a weakening demand for labor. We expect the unemployment rate will continue to move up in the coming quarters, but only at a moderate pace. Anything more than gradual would be a clear sign that our base case is wrong, and the economy is entering a more pronounced slowdown.



STOCK MARKET

Positive, but Less of a One-Way Street

It was another strong and impressive year for stocks. The market was driven higher by unwavering trends in technology, an enduring economy with moderating inflation, the delivery of Fed rate cuts, and the prospect of investor-friendly policies from the incoming administration. As we look towards 2025, investors should consider:

- **Varied upside potential:** If they persist, a combination of moderating inflation, stable interest rates, and strong earnings growth supports a higher S&P 500 valuation. Our fair value target range for 2025 is 6,275 to 6,375. Potential upside could come from lower rates, productivity gains, and confirmation of market-friendly policies from the new administration.
- **Avoiding recession is key:** The stock market has historically delivered single digit returns in the 12 months following an initial rate cut from the Fed, but when recession has been avoided, the median gain has been closer to 11%.
- **Potential risks:** While not the base case, a much slower-than-expected economy, coupled with a volatile interest rate policy, would be a serious headwind. Additionally, resurgent inflationary pressures in response to new policy or another increase in geopolitical tensions could also further undermine the current positive narrative for stocks.
- **Don't expect a one-way street higher:** Even in non-recessionary periods, it is still commonplace for equity bull markets to undergo 10% corrections along the way. Be prepared for bouts of volatility in 2025 and favor buying equities on market pullbacks. We expect equity returns to indeed be favorable in 2025, but the upside will not be as robust as 2024.



BOND MARKET

Higher for Longer Continues?

The bond market clearly remains in flux after another volatile year. But as things calm, there should be plenty of opportunities in fixed income. Looking ahead:

- **Expect a range-bound yield environment:** Ten-year Treasury yields are expected to remain in a range of 3.75% to 4.25% in 2025. The risks next year for yields are roughly equal, with potential upside pressures from fiscal deficits and Treasury supply, and downside risks from a more aggressive than anticipated Fed rate-cutting cycle.
- **Stay focused on income:** Given the expected higher for longer and range-bound interest rate environment, a focus on income generation is advised for bond investors. The next year will provide more of an opportunity for investors to take advantage of attractive yields in the bond market.
- **Balance yield and risk:** Considering the uncertainty surrounding future interest rate movements, now is not the right time to have above benchmark exposure to bonds with longer maturities and a higher degree of sensitivity to interest rates. Intermediate-term maturities of five years or less are favored in the current environment and look the most attractive in terms of generating optimal yield and managing risk.



THE BOTTOM LINE

- **On the economy:** The economy is expected to cool in 2025 due to moderating consumer spending, a softer labor market, and nagging inflationary pressures. Pent-up demand for capital expenditures and potentially business-friendly tax policy could help offset any weakness, while an unexpectedly sharp rise in unemployment would signal a more significant economic slowdown is underway.
- **On Fed policy:** The complexities of a bifurcated economy and the unknown impacts of new government policies will make things challenging for the Fed to deliver on its dual mandate. Inflation levels above target, and prone to an uptick, suggest to us that the Fed will not likely cut as much as investors originally hoped. However, the Fed's strong desire to engineer a soft landing keeps the door open to lower rates in 2025.
- **On bonds:** With risks roughly balanced for bonds over the next year, stay focused on income generation and look to take advantage of the favorable interest rate environment to secure historically attractive yields in portfolios. Avoid large exposure to longer-term maturities that are more interest rate sensitive and instead concentrate on intermediate-term maturities, which better balance risks but still offer attractive income potential.
- **On stocks:** If it can persist, the current backdrop of moderating inflation, stable interest rates, and robust earnings growth, sets the stage for a higher S&P 500 in 2025. However, the market has come a long way in a short amount of time. Exercise patience and selectivity with equity allocations and look to capitalize on market corrections.
- **On cash:** With cash rates coming down, long-term investors are likely better served by extending the maturity of cash holdings into short- to intermediate-term maturity bonds and taking advantage of still high bond yields.
- **Overall:** Remain informed and mindful of changing market trends. Be ready to make tactical adjustments to portfolios if, and when, market conditions change.

Consumer Slowing, but Policy Tailwinds Are Expected



KEY EXPECTATIONS

- Look for the economy to cool down in 2025, but avoid a significant slowdown
- Anticipate some easing in consumer spending and a continued drift higher in unemployment
- Inflation should remain contained, but will see occasional upticks as new policies are digested

● By Jeffrey Roach, PhD, Chief Economist

As we set out to understand the landscape for 2025, it's helpful to take a quick look back at some of the noteworthy moments in the recent past. Investors, both at home and abroad, have experienced the most aggressive rate-tightening cycles in modern history, and so far, nothing serious has broken. In fact, central bankers have moved into a new regime – that of cutting rates – and investors have happily responded with increased risk appetite – pushing some areas of the market to new highs. After a very well-telegraphed and much-anticipated decision, the Fed cut rates by a total of 75 basis points as of the end of November and continues to say the risks to inflation and employment are roughly in balance. However, the economic outlook still remains uncertain for the Fed.

Although the rate of consumer price increases has slowed, price levels continue to rise, putting acute pressure on some parts of the economy. As Charles Dickens complained about the obvious inequalities of his times, feelings in 2025 will be simultaneously the best of times and the worst of times. It all depends on who you are. Are you a renter or a homeowner? Are you still benefiting from flexible work arrangements? Where do you sit on the income spectrum?

In our *2024 Midyear Outlook: Still Waiting for the Turn*, we highlighted the economy was a lot less rate sensitive and household financial conditions improved for millions who refinanced in 2021, when rates were historically low. We now have key income and savings data revised, putting a twist in the forecasts.

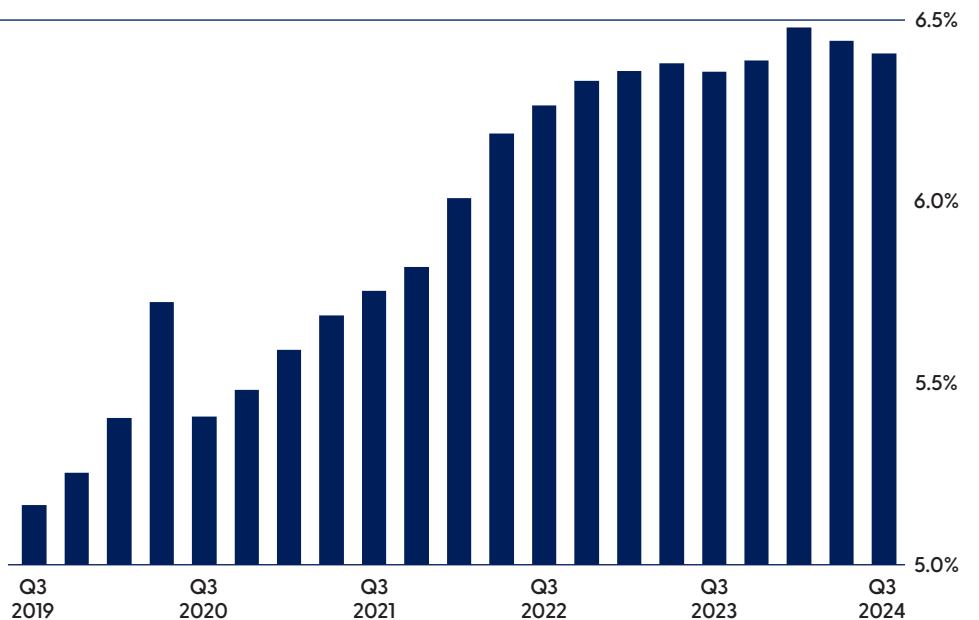


Pent-Up Demand for CAPEX Could Support Growth

Expect R&D to make up more of the economy

■ Intellectual property products as % of GDP

Source: LPL Research, U.S. Bureau of Economic Analysis, 11/02/24. Past performance is no guarantee of future results.



Data revisions and data dependency

Revisions occur as government agencies get more information and further revisions can highlight the inherent risk of being data dependent. For example, inflation-adjusted disposable income, which is after taxes, grew much faster over the past 24 months than originally thought. Because of high labor demand and plenty of job-switching, workers saw their wages and salaries grow faster than inflation in the past two years. This explains a lot of why we've noticed consumers spending despite high price levels. Earlier this year, one of the growing concerns among investors was the unknown impact of depleted savings. But after recent income and spending revisions, consumers are saving a lot more than originally estimated.

If disposable incomes grew faster than originally thought and real spending also grew, but at a slower pace, then by definition, consumers now have a larger portion of their money in savings. Just take this past July, for example. The initial estimate for July's personal savings rate was 2.9%, but after a more complete analysis, consumers' personal savings rate was revised up to roughly 5%. This is getting close to the pre-pandemic average of 6.5%. A higher savings rate means consumers have a bit more of a buffer to manage any potential shocks.

Business spending could support growth

Before we discuss consumer spending – which makes up roughly two-thirds of the economy – investors need to understand some of the potential opportunities we should expect from capital expenditures (CAPEX).

Many businesses admitted they delayed business fixed investments preceding the presidential election and planned to wait until after results were finalized, allegedly after an extended period of drawn-out vote counting. However, that scenario did not play out.

The historical contribution of private sector capital expenditures to overall growth is normally twice as high as it was in the third quarter of 2024, supporting the notion that businesses might have pent-up demand now that we are past the elections. **[Fig.01]** Construction spending for healthcare, power, communication, and other structures is poised to increase, and shipments of capital goods are below current run rates, corroborating business owners' comments about delaying, but not canceling, capital expenditures.

In addition to the pent-up demand for CAPEX, a pro-business tax and regulatory plan could also increase business spending while providing a modest tailwind to the economy. On balance, this should be enough of a boost to growth to offset some ease in consumer spending and set us up for stable, but unspectacular, gross domestic product (GDP) growth in 2025.

Well-heeled millennials could keep consumer spending going

For some, entering 2025 is truly the best of times – especially since average annual spending for those in their “mid-life” is significantly above other age cohorts. **[Fig.02]** Wage growth has more than

Consumer Spending Driven By 35 – 54 Year Olds

Millennials are reaching peak spending years



■ Average annual expenditure in 2023 by age range

Source: LPL Research, U.S. Bureau of Economic Analysis, 11/09/24

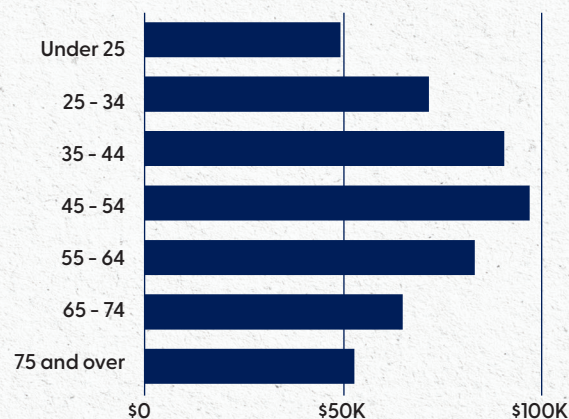
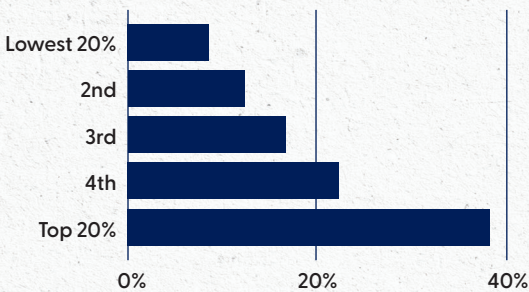


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03

Upper Income Households Provide the Biggest Support

Top two quintiles account for vast majority of spending

Source: LPL Research, BLS Consumer Expenditure Survey, 11/08/24



offset inflation, and a large swath of the population is just about to enter their peak earnings and spending years.

But we don't need to restrict ourselves to just wages. Something we don't often talk about in our annual outlooks but is something extremely important for those in the financial planning space, is the upcoming "Great Wealth Transfer." Over the next two decades, millennials and younger generations are expected to receive over \$84 trillion from the Boomers and Silent Generation. For perspective, annual GDP in 2023 was a mere \$27.7 trillion.

As they move into their peak earnings and spending years, millennials – especially those with upper incomes – will likely drive spending in the near future. Recipients from that upcoming intergenerational wealth transfer may have even more capacity to drive consumer spending. Companies whose main target audience is the well-heeled millennial should continue to benefit. **[Fig.03]** This new year will be one where businesses will flourish if they can attract and retain a loyal base of these clients. Investors could reward such businesses throughout 2025.

Inflation remains stubborn

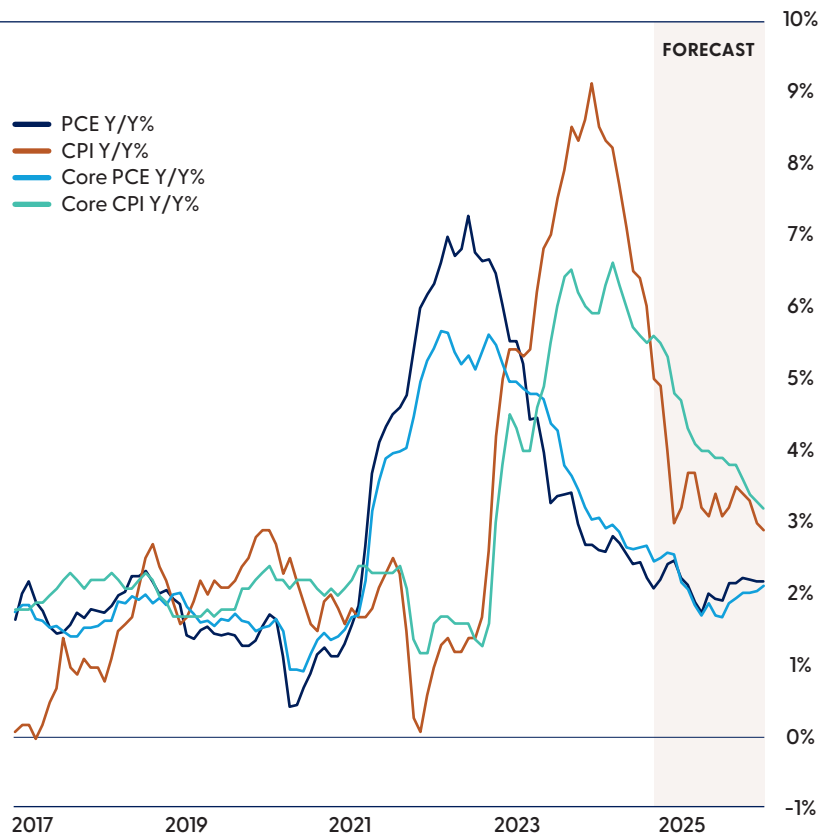
We could see some upticks in the Fed's preferred inflation metric, the Personal Consumption Expenditure (PCE) price deflator, but overall inflation should remain contained. **[Fig.04]** This is noteworthy because nagging inflation could change the Fed's

fig.
04

Inflation Closing In on Fed's Target

Rate cuts will likely continue throughout the year

Source: LPL Research, Bureau of Labor Statistics, Bureau of Economic Analysis, 11/07/24



rate-cutting cadence, and markets will have to adjust to yields staying higher for longer. Perhaps the Fed will institute a cut-and-pause cadence to mirror the process during the previous cycle.

So, what does this mean for markets, especially after a lively presidential election? Markets love clarity, and they were granted exactly that in a convincing way following this election cycle. These events will take time to digest; however, the idea that the markets can now work without the burden of complete uncertainty should be welcomed by investors.

Wealthier consumers and business CAPEX are key to forecasts

The economy will likely downshift throughout 2025, as consumer spending slows from recent breakneck speeds. The labor market has also shown signs of a shift. The quits rate fell as workers are less inclined to switch jobs and the average workweek for private payrolls has declined, suggesting weaker labor demand. The unemployment rate will stay historically low, but should inch up in the coming quarters. The strength of wealthier consumers keeps inflation stubbornly above the Fed's target, indicating the Fed will not likely cut as much as investors originally hoped. Slower payroll growth and fewer hours worked imply the economy will slow at a measured

pace, barring any exogenous shock. Positive signs from businesses about to release pent-up demand for capital expenditures could offset softness in other areas of the economy. Inequality will likely widen in 2025, as those who have the means to spend will likely do so, crowding out others. Demographics will also be an important factor as millennials are just entering their peak earnings and spending years.

THE BOTTOM LINE

The economy is anticipated to moderately decelerate throughout 2025, as consumer spending starts to slow from its recent rapid pace. The labor market is also showing signs of cooling, with the unemployment rate likely to remain relatively low but rise moderately in the coming quarters. **[Fig.5]** An unexpected sharp increase in unemployment would warn of a more significant economic slowdown. The strength of wealthier consumers may keep inflation somewhat sticky, suggesting the Fed will be less aggressive with rate cuts than the markets anticipate. Slower payroll growth and reduced hours worked point to a gradual economic slowdown, barring any external shocks. Positive signals from businesses planning to release pent-up demand for capital expenditures, along with generally supportive fiscal and monetary policy, should help offset softness in some parts of the economy.



2025 Quarterly and Annual Forecasts

Key U.S. variables

	Q1-24	Q2-24	Q3-24	Q4-24*	Q1-25*	Q2-25*	2022	2023	2024*	2025*
Real GDP (Q/Q annualized)	1.6%	3.0%	2.8%	1.7%	1.5%	1.9%	2.5%	2.9%	2.5%	1.9%
Unemployment Rate[^]	3.8%	4.0%	4.2%	4.4%	4.5%	4.7%	3.6%	3.6%	4.2%	4.8%
CPI (YoY)	3.2%	3.2%	2.6%	2.7%	2.5%	2.4%	8.0%	4.1%	2.8%	2.6%
PCE (YoY)	2.7%	2.6%	2.3%	2.4%	2.3%	2.1%	6.6%	3.8%	2.4%	2.3%
Core PCE (YoY)	3.0%	2.7%	2.7%	2.7%	2.3%	2.0%	5.4%	4.1%	2.7%	2.2%
Fed Funds (Upper Bound)[^]	5.5%	5.5%	5.0%	4.75%	4.5%	4.25%	4.5%	5.5%	4.75%	3.75%
Prime Rate[^]	8.5%	8.5%	8.0%	7.75%	7.5%	7.25%	7.5%	8.5%	7.75%	6.75%

Source: LPL Research. The economic forecasts in this material may not develop as predicted. Annual GDP figures are Y/Y.

* Forecast as of November 25, 2024

[^] End of period

A More Measured Approach to 2025



KEY EXPECTATIONS

- Stocks are expected to deliver modest gains in 2025
- A steady economy, solid corporate profits, and stable Fed policy should help support the market
- Be prepared for occasional bouts of volatility

● By Jeffrey Buchbinder, CFA, Chief Equity Strategist

As the stock market wraps up a strong 2024, and we look ahead to 2025, the economic foundation remains, for the most part, solid. Corporate profits are rising, and the Fed is cutting rates, which is likely to keep the current bull market on track. In 2025, investors will have to grapple with a market pricing in a lot of good news. Positive surprises that drove stocks higher in the last year may be more difficult to come by over the year ahead. Continued steady growth in the economy and corporate profits will be keys to a positive year, balanced against lingering inflation risks, elevated interest rates, and significant geopolitical threats that won't go away. Potential cuts to corporate taxes in 2026 could also offer upside.

The road ahead gets tougher as bull market ages

The bull market has entered its third year, having celebrated its second anniversary on October 12, 2024. The S&P 500 is up roughly 65% since the move began, with a booming year two (+32% as of November 10, 2024) following a below average but respectable year one (+21%). A surprisingly resilient economy, unwavering trends in technology, moderating inflation, the start of the Fed's rate-cutting cycle, and a strong earnings recovery (after the earnings recession ended in 2023) have driven much of the gains. **[Fig.06]**

fig.
06

Year Three Tends to Be Good for Bull Markets

Year by year bull market performance

S&P 500 Index bull markets (1950 - current)

Source: LPL Research, FactSet 11/07/24. All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results. The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.

S&P 500 Index Returns

Bear Market Bottom	Bull Market Peak	Year 1	Year 2	Year 3
6/13/49	8/2/56	40.0%	11.9%	12.9%
10/22/57	12/12/61	31.5%	9.7%	-4.8%
6/26/62	2/9/66	32.7%	17.4%	2.3%
10/7/66	11/29/68	33.2%	6.6%	X
5/26/70	1/11/73	44.5%	10.2%	X
10/3/74	11/28/80	34.6%	21.2%	-7.1%
8/12/82	8/25/87	57.7%	2.0%	13.8%
12/4/87	7/16/90	21.4%	29.0%	X
10/11/90	3/24/00	28.8%	5.6%	14.3%
10/9/02	10/9/07	33.7%	8.2%	6.6%
3/9/09	2/19/20	68.6%	15.9%	3.5%
3/23/20	1/3/22	74.8%	14.0%	X
10/12/22	?	21.4%	32.2%	?
Average:		40.2%	14.1%	5.2%

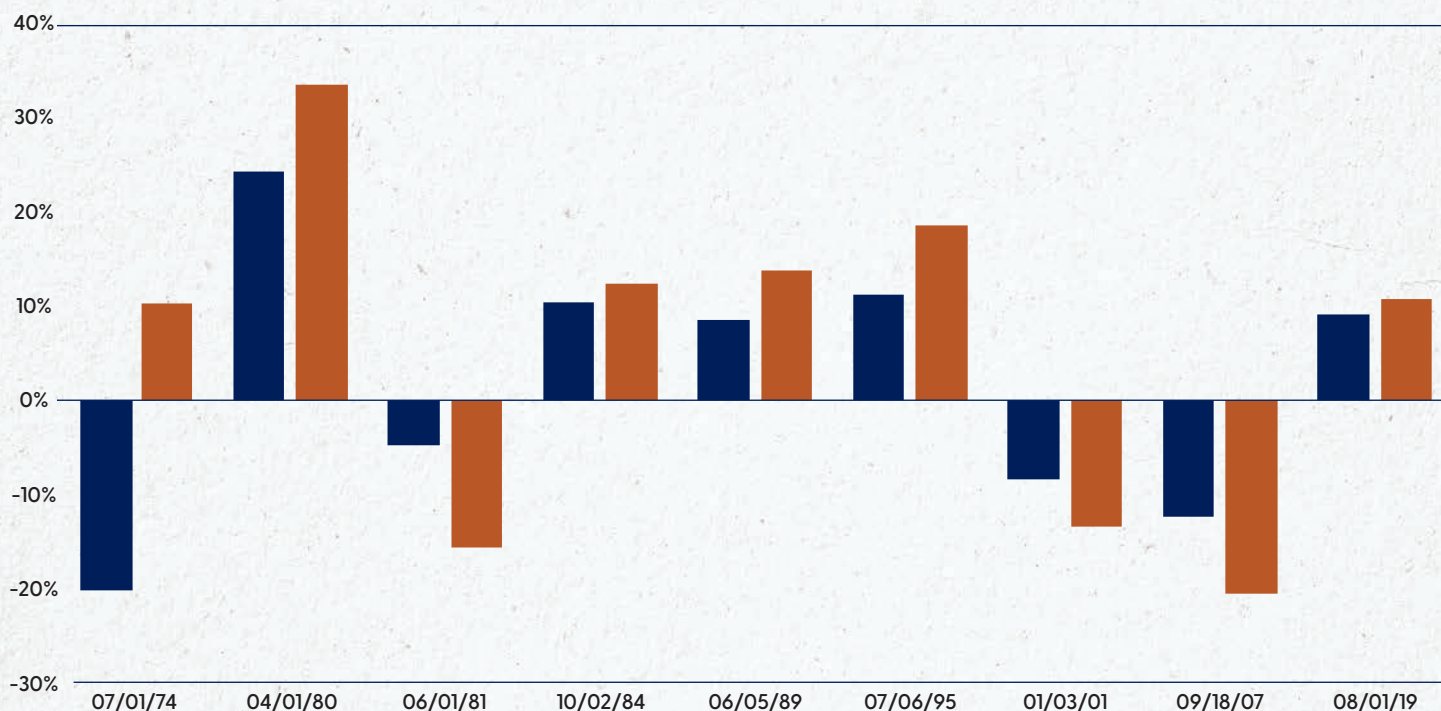


Stocks Usually Go Higher After Fed Rate Cuts Begin

When they don't, as in '81, '01, and '07, recessions are usually to blame

S&P 500 Performance After Start of Fed Rate Cutting Cycles

■ 6 months later ■ 12 months later



Source: LPL Research, Bloomberg 11/12/24. Disclosures: Past performance is no guarantee of future results. All indexes are unmanaged and can't be invested in directly.

History suggests that this bull market has a good chance to celebrate its third anniversary. The accompanying table illustrates that in the absence of recession, the odds that a two-year-old bull market gets to three are solid. The good news is that for bull markets that get through year three, the average gain for the S&P 500 is 5.2%, with gains in six out of eight years. The bulls that didn't make it through year three were ended by recessions, an overly aggressive Fed, or, in the case of 1987, excessive speculation. We believe the chances of another positive year in 2025, without the start of a bear market decline, are quite good, supported by the same drivers as 2024, but bull market history tells us to be on the lookout for modest gains.

While our expectation is for modest positive returns in 2025, the longer-term history of bull markets offers cause for optimism. Since 1950, excluding the current period, S&P 500 bull markets have averaged 61 months, and have produced average cumulative gains of 167%. In other words, while volatility along the way is to be expected, this bull market could still have legs.

Good combination: Fed rate cuts plus economic growth

After one of its longest pauses in history, the Fed cut interest rates in September and November. Now, the question is how much support additional cuts may provide for stocks in the year ahead.

Based on the last nine major rate-cutting cycles since the 1970s, the S&P 500 has generated relatively modest average returns of 5.5% during the 12 months following the initial cut of a cycle. Taking out the recession-plagued outliers of 2001, 2007, and 2020, the median gain has been 10.8%. **[Fig.07]**

As with middle-aged bull markets, prospects for solid returns in 2025 are favorable if the economy avoids recession. That does not, however, mean we should not expect volatility. In fact, even in non-recession periods of 1984, 1989, and 1995, the S&P 500 experienced pullbacks of between five and 10% along the way to double-digit 12-month returns after the initial Fed cut.



Corporate America continues to do its part

The earnings growth picture has improved from a year ago. In the past year, stocks went from an earnings recession and widespread recession fears to a now widely-held consensus view that the U.S. economy would continue to grow steadily – though perhaps at a slower pace than recent trends – and that corporate profits would grow by double digits.

In response to improved corporate profit trends [Fig.08], LPL Research is maintaining its S&P 500 earnings per share (EPS) forecasts for 2025 at \$260, in line with the long-term average earnings growth rate near 10%. For 2026, LPL Research is initiating a forecast of \$275, 6% above 2025. Broadly, corporate America will get some help from AI investment and related productivity gains.

Banks and energy companies should benefit from deregulation in Washington, D.C. However, some slowing of economic growth, and a likely firmer tariff policy, are among reasons to expect modest earnings gains in 2026. Possible cuts to corporate taxes also offer potential upside.

Valuations raise the bar for corporate America

An improved earnings outlook and high valuations have raised the bar for corporate America, so gains from improved profit growth may already be reflected in prices. Upside surprises may be tougher to come by. In addition, still-high interest rates compress what equity investors are willing to pay for stocks, based on the equity risk premium calculation. Equity investors are not being compensated for the additional risk they are taking on relative to Treasury yields. The equity risk premium, at -0.7% compared to the long-term average of +1.2%, is calculated by taking the earnings yield (earnings divided by price) minus the 10-year Treasury yield. While this statistic helps us pinpoint valuations, the market can trade outside of its valuation equilibrium for an extended period. This occurred in 2024 and may continue in 2025.

fig.
08

Magnificent Seven's Earnings Edge Starting to Diminish

Narrowing earnings gap could set the stage for shift toward value at some point in 2025

S&P 500 Year-Over-Year Earnings Growth

■ S&P 500 Index ■ Magnificent Seven

Source: LPL Research, Bloomberg 11/08/24. All indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

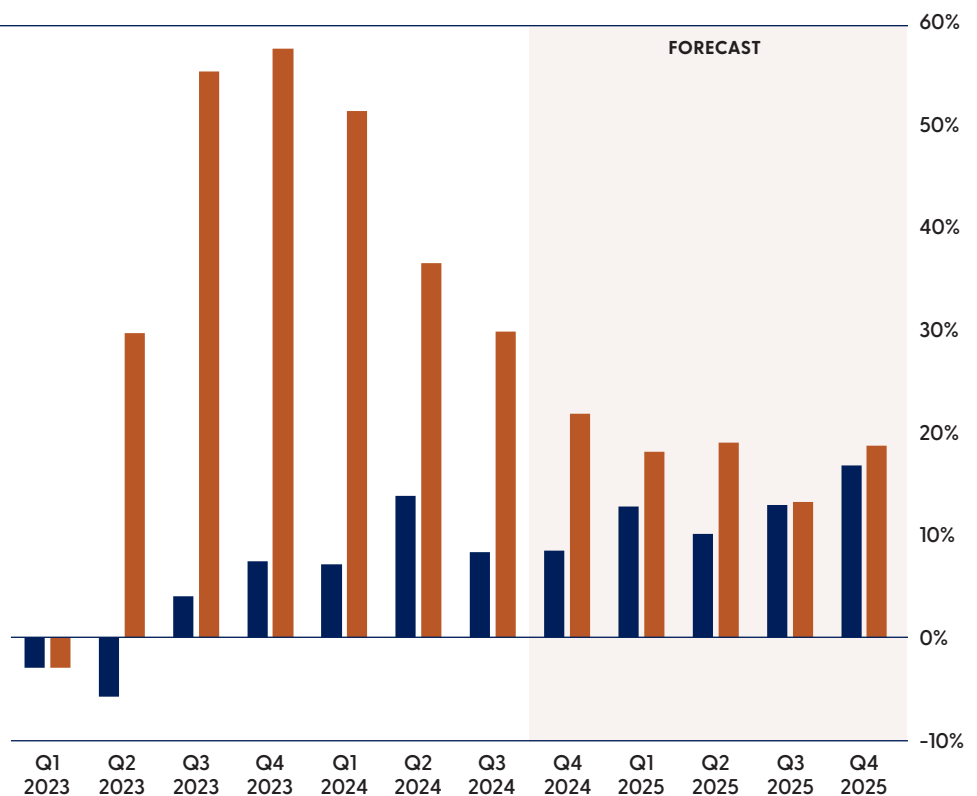
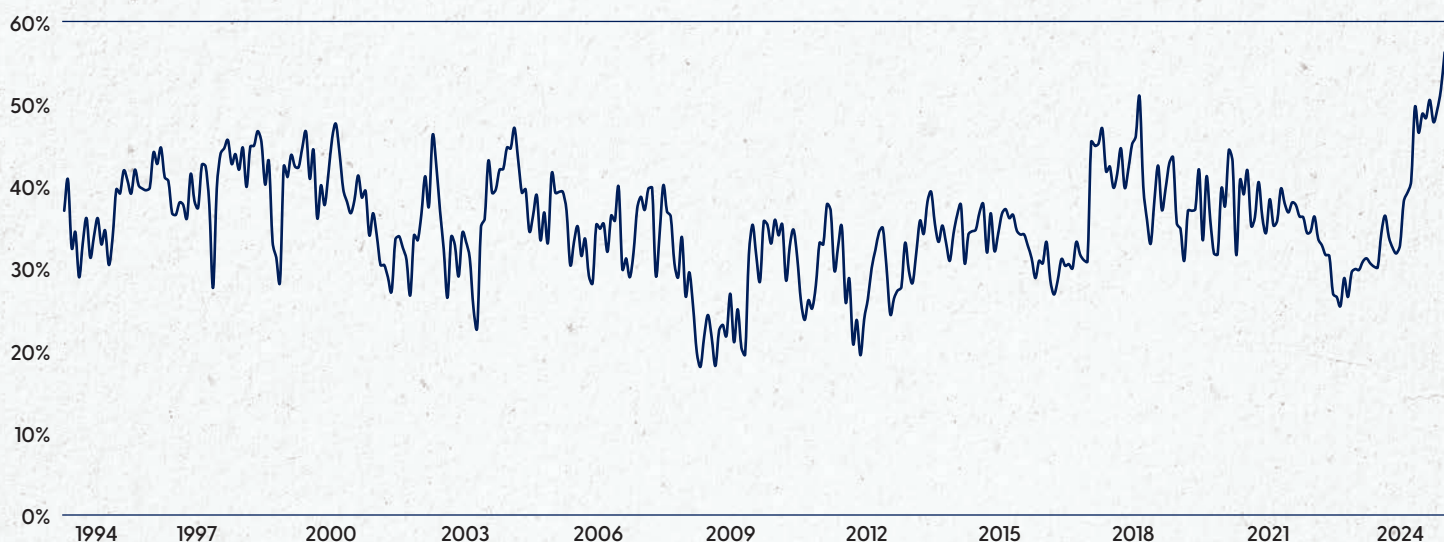


fig.
09

Signs of Exuberance Call for Discipline

On the year ahead for stocks, U.S. households have never been as confident as they are now

— Percent of consumers expecting stocks to increase over the next 12 months



Source: LPL Research, Conference Board, Bloomberg 12/02/24

The path to the Fed's target inflation level could be bumpy and put occasional pressure on rates, potentially weighing on equity valuations. However, a soft-landing scenario with slower growth may help the market declare victory on inflation. If rates move lower, this offers potential valuation upside, as would any cuts in corporate taxes, although these are far from assured.

Sentiment getting stretched

With positive sentiment at record extremes by some measures, risks may be growing for a near-term correction. In fact, U.S. households are as confident as they have ever been that stocks will move higher in the year ahead [Fig.09]. Though some sentiment readings, such as those taken from the options market, are more subdued, any signs of exuberance call for discipline.

Fair value S&P 500 target range

In our view, moderating inflation, stable interest rates, and potential double-digit earnings growth in 2025 support above-average valuations. Based on a price-to-earnings (P/E) ratio of 23 times the LPL Research forecast for 2026 S&P 500 EPS, our estimated fair-value range for the S&P 500 at year end 2025 is between 6,275 and 6,375. The

upside could come from lower interest rates, unexpected productivity gains, or prospects for lower taxes in 2026. Although it's not our base-case, a blue-sky scenario could lift S&P 500 EPS above our \$275 forecast and justify slight P/E expansion, potentially putting the index at or above 6,700.

Key risks include rising interest rates, an uptick in inflation, tariffs, and bullish sentiment. Investors should consider adding to their equity position during periods of market weakness.

THE BOTTOM LINE

Expect modest stock market gains in 2025, supported by a stable economy, solid corporate profits, and a Fed that is no longer hawkish, as well as some potential deregulation tailwinds. With stocks pricing in a lot of good news, positive surprises may be tougher to come by, so a repeat of the strong market performance in 2024 is unlikely. With the bull market another year older, interest-rate risk rising, valuations elevated, and still significant geopolitical threats, expect volatility to be more prevalent in 2025.

Assuming a forward P/E multiple of 23 times 2026 EPS of \$275, LPL Research estimates a fair value target range of 6,275–6,375 for the S&P 500 at the end of 2025. Upside could come from lower interest rates, productivity gains, or prospects for further tax cuts.

Sector Recommendations

Favor communication services and industrials

The STAAC recommends more economically sensitive, or cyclical, sectors for 2025. Cyclical value stocks, particularly financials and industrials, may garner support in 2025 from deregulation and a potential soft-landing scenario for the U.S. economy. Increased scrutiny on AI investments and rich valuations could lead to a bumpy ride for the technology sector. Interest-rate risk has increased for dividend-rich consumer staples, real estate, and utilities post-election. Our favored sectors as 2025 begins include:

- **Communication services:** Mega-cap technology stocks and traditional media have enjoyed strong performance, and the sector boasts attractive earnings at a reasonable price.
- **Industrials:** Beneficiary of the AI data center buildout, defense spending, onshoring, and energy infrastructure.

Watch for tactical opportunities in the consumer discretionary and financials sectors, supported by resilient consumer spending and deregulation.

OVERWEIGHT +

- Communication services
- Industrials

NEUTRAL =

- Healthcare
- Utilities
- Consumer staples
- Technology
- Financials
- Materials
- Consumer discretionary

UNDERWEIGHT -

- Energy
- Real estate



A Golden Age for Income Investors

KEY EXPECTATIONS

- Expect a range-bound yield environment in 2025
- Remain focused on income generation and look to secure historically attractive yields in portfolios
- Intermediate-term maturities are favored in the current environment as they best balance risk and income potential

● By Lawrence Gillum, CFA, Chief Fixed Income Strategist

To say the U.S. economy has been difficult to read is an understatement. From generationally high inflation and interest rates to concerns about the labor market, it's no wonder consumers are unsure about the overall health of the economy. In fact, last June, 59% of Americans believed that the U.S. was currently in a recession (it wasn't), according to a survey of 2,000 adults by Affirm. Conversely, prominent economists have downgraded the probability of a recession over the next 12 months to around 15%, which is the average probability of recession in any given year. But the Fed's very own recession forecasting model still says there is a 60% chance of recession over the next 12 months... huh? But after what looks like a temporary growth scare last summer, economic growth data has been coming in generally better than expected of late, which has helped push Treasury yields higher, while at the same time pricing out much of the need for an aggressive rate-cutting campaign by the Fed. So, the question for 2025 for fixed income markets is how low will the Fed take the fed funds rate, absent a more material economic contraction?

Current market pricing suggests the Fed will take the fed funds rate back to around 3.75–4.0% in 2025. If markets are right, and the U.S. Treasury yield curve eventually reflects its historical upward-sloping shape, that likely means the 10-year yield should remain around current levels. The spread between the fed funds rate and the 10-year Treasury yield has averaged around +1.1% in non-recession periods, meaning the 10-year yield, on average, has been higher than the fed funds rate by around 1.1%, albeit with a large range when not in a recession. **[Fig.10]** So, unless or until economic data starts to show signs of a sustained slowdown, the 10-year

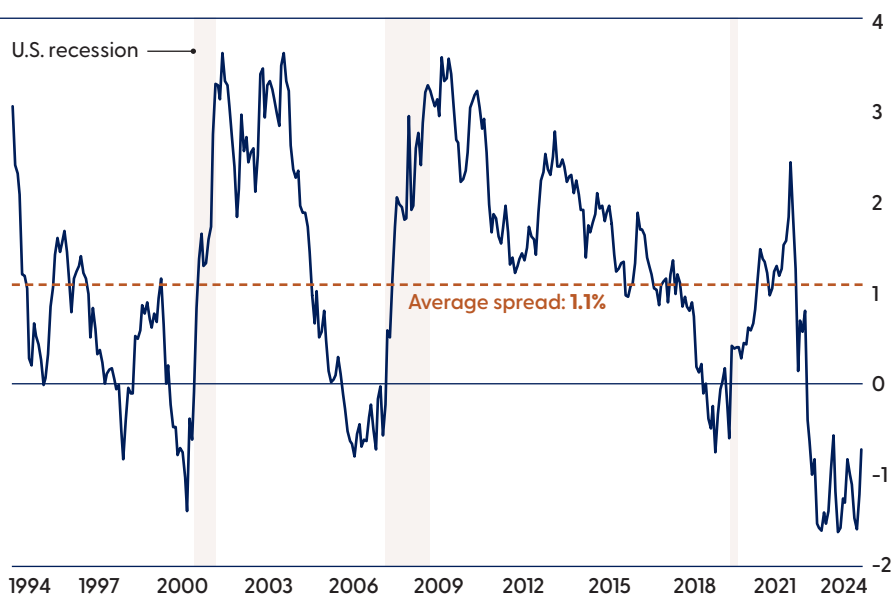
fig.
10

Yield Curve Could Steepen as the Fed Cuts Rates

Spread between fed funds rate and 10-year Treasury yield still negative

— Spread between 10-Year and Fed funds rate

Source: LPL Research, Bloomberg, 11/08/24. All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.



could fluctuate between 4.0–4.5% to start 2025. But if the economy does start to show signs of slowing, the Fed could cut rates more than what is priced in, which would mean the 10-year Treasury yield could get back into the 3.75–4.25% range to end the year, which is our expectation.

That said, the risk for the bond market is a Fed that cuts too aggressively into a still-growing economy, which could then potentially rekindle inflation concerns. Moreover, as it relates to the Donald Trump presidency, there is a concern that deficit spending (which would have likely happened under a Harris presidency as well) and tariffs could help growth but also keep inflationary pressures elevated. Better economic growth and perhaps a too dovish Fed, along with more policy details from the Trump administration, could push Treasury yields higher. It will likely take negative economic surprises for yields to fall meaningfully from current levels, so investors should continue to prioritize income opportunities, which remain plentiful.

Return of the Treasury term premium

Stay with us here; this is where things get wonky, but important. According to economic theory, each security on the Treasury yield curve represents the expected fed funds rate over the security’s maturity, plus or minus a term premium. The Treasury term premium is the additional compensation required by investors who buy longer-term Treasury securities. The term premium, which is unobservable and hence must be approximated, considers a variety of factors, including Treasury supply/demand dynamics, foreign central bank expectations, and the possibility of future inflationary pressures. And after years of a negative term premium, investors are just now getting compensated for owning longer-maturity Treasury securities. But that additional compensation is still below longer-term averages. **[Fig.11]**

So, how does this affect fixed income investors? A positive term premium could keep longer-term interest rates elevated, perhaps even reducing the diversification benefits of core bonds. Although monetary policy will



Investors May Demand Higher Yields

Treasury term premium remains below historical averages

— ACM 10-year Treasury term premium



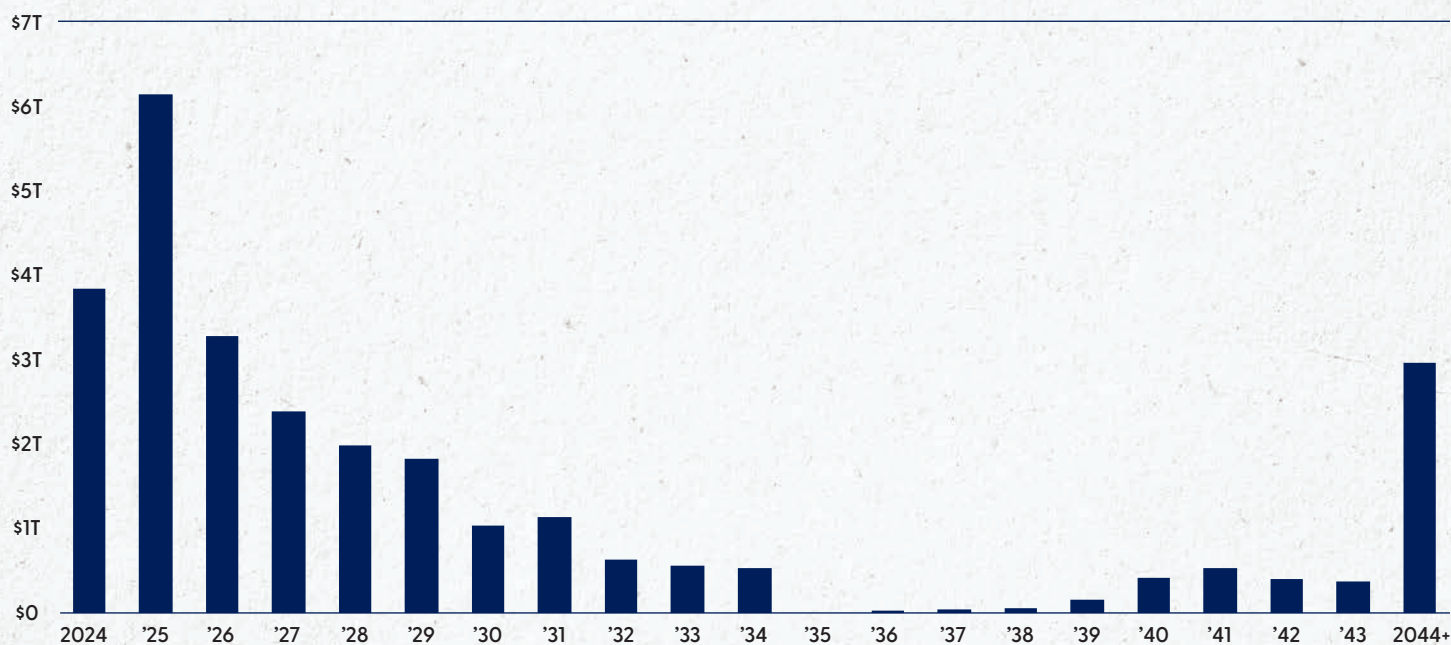
Source: LPL Research, Bloomberg, 11/08/24. Past performance is no guarantee of future results.

fig.
12

Debt Deluge

Over \$6 trillion in Treasury securities mature in 2025

■ Treasury maturity schedule (\$ Trillions)



Source: LPL Research, Bloomberg, 11/08/24

continue to broadly shape interest rate movements, the positive term premium may begin to dampen the effectiveness of Fed rate cuts in lowering longer-term yields. Moreover, while Treasuries will remain an important safe-haven asset during more pronounced equity market selloffs, they may not offer great protection against more ordinary corrections.

And, if we assume things get back to normal and the Fed sticks the soft landing, we could see that term premium increase back to long-term averages. As a result, we don't think right now is a good time to overweight duration (interest rate sensitivity) in fixed income portfolios. A neutral duration relative to benchmarks is, in our view, still appropriate. Moreover, for those investors that want to own bonds for income, the belly of the curve (out to five years) remains attractive.

Are bond vigilantes headed to the U.S.?

Ed Yardeni, the veteran strategist, coined the term “bond vigilantes” in the early 1980s to describe investors who sought to exert power over government policies by selling their bonds, or merely threatening to do so. And after a brief hiatus, it seems like the bond vigilantes may be back – at least in the British and French government bond

markets – as we've seen markets pushback on recent budget proposals. But the risk is rising that perhaps the bond vigilantes could be headed to the U.S.

While economic growth will remain the driver of interest rates, a secondary risk to rates remains the amount of Treasury debt needed to fill federal budget deficits that are expected to stay elevated. Per the Congressional Budget Office (CBO), the U.S. government is expected to run sizable deficits over the next decade – to the tune of 5–7% of GDP each year. The deficit is projected to increase significantly in relation to GDP over the next 30 years, reaching 8.5% of GDP in 2054. That growth results from rising interest costs and large and sustained primary deficits. CBO deficit projections assume no new spending initiatives nor an extension of the Tax Cuts and Jobs Act, which is set to sunset at the end of 2025, so the CBO forecast likely underestimates budget deficits going forward. To fill those deficits, the Treasury Department will need to issue trillions more in Treasury securities. But complicating the math for the Treasury Department, it will also need to roll over more than \$6 trillion in Treasury securities set to mature in 2025. Thus, the Treasury will need to find investors for some \$8 trillion of Treasury debt over the next 12 months. **[Fig.12]**



Despite the mountain of debt and growing interest payments, the U.S. government is not at risk of financial collapse, nor are there concerns as such. As long as Treasuries are considered risk-free securities, there will always be buyers of Treasuries. Full stop. But with a Republican sweep of Congress and the White House, the deficit will likely remain broadly unchanged at elevated levels in the coming years or perhaps even grow, given what we know so far about Trump's policy proposals. And with the amount of Treasury supply, interest rates may need to stay higher than otherwise expected given economic data alone. And until/unless U.S. debt markets experience market volatility like what took place in the U.K. in 2022 or France in 2024, politicians are unlikely to take deficit spending seriously. We hope we're wrong.

So where does that leave us? While a lot of attention is (rightly) focused on budget deficits and the amount of Treasury supply coming to market over the next few years, the primary driver of Treasury yields is still Fed policy. Our base case is that the Fed will take the fed funds rate to 3.75% in 2025. And after a few months of overly aggressive expectations, markets have generally repriced to be more in line with our expectations. Unless inflationary pressures re-accelerate, Treasury yields are unlikely to surpass the highs reached in 2023.

Moreover, the current increase in supply will occur amid a backdrop of slowing inflation and Fed rate cuts.

Investors might require some concessions to digest the larger issues (higher term premium), but the improved outlook for rate volatility in 2025 should attract some additional demand from the sidelines. With the economic data (so far) continuing to reflect a more resilient economy than originally expected, we think Treasury yields are likely going to stay in a trading range at least in the near term. Despite the ongoing supply discussion, we think the 10-year Treasury yield could end the year between 3.75–4.25% and into 2025, with risks to both the upside and downside roughly balanced. In this new, higher-for-longer interest rate environment, income-oriented investors have a plethora of opportunities to build portfolios that can generate income levels in excess of 5%.

THE BOTTOM LINE

Bond yields are expected to remain elevated, with the 10-year Treasury yield likely to remain in a range between 3.75–4.25% in 2025. Over the next 12 months, we see roughly equal upside and downside risks to yields as the markets grapple with the true impacts of budget deficits, increasing Treasury supply and the scope of the Fed's current easing cycle. For fixed income investors, a focus on income generation and duration management is advised, and we believe the most attractive opportunities lie in the five-year maturity range.

Seizing Opportunities in a Changing Market

KEY EXPECTATIONS

- Investors should prepare for a more dynamic market in 2025 and consider alternative strategies for diversification and portfolio enhancement

● By Jina Yoon, CFA, Chief Alternative Investment Strategist

While the second half of 2024 was largely about policy shifts and a pick-up in volatility, 2025 is likely to be more about the impacts of lower rates and the changes in the political landscape. As the Fed has joined the rest of the world in cutting rates, the focus will now move to the size and length of the rate-cutting cycle. Discrepancy between the market expectation and the Fed's decisions, along with continued policy divergence with other central banks, should result in plenty of investment opportunities for alternative managers and strategies. Lower rates can also have a direct impact on various strategies and sectors. While future shifts in policy are far from guaranteed, certain changes like lower corporate taxes, deregulation of various sectors (e.g., energy, finance and technology), and tariffs have the potential to move the needle in terms of who will win and lose from a country and sector perspective.

Fertile environment for low net stock pickers

In terms of hedge fund strategies, we remain positive on equity market-neutral strategies as the uncertainty surrounding the new Trump administration's policies may lead to increased volatility, divergences of individual stocks and sectors, and how they trade versus the broader market indexes. As the market digests these changes and begins to distinguish between stocks that are positively and negatively impacted, strong fundamental long/short and market-neutral stock strategies should benefit. The CBOE Implied Correlation Index chart highlights how closely the components of the S&P 500 are tracking against one another. The historically low level of the index reveals that many stocks are trading independent of broader market factors. **[Fig.13]** This type of market environment is typically beneficial for equity market-neutral strategies.

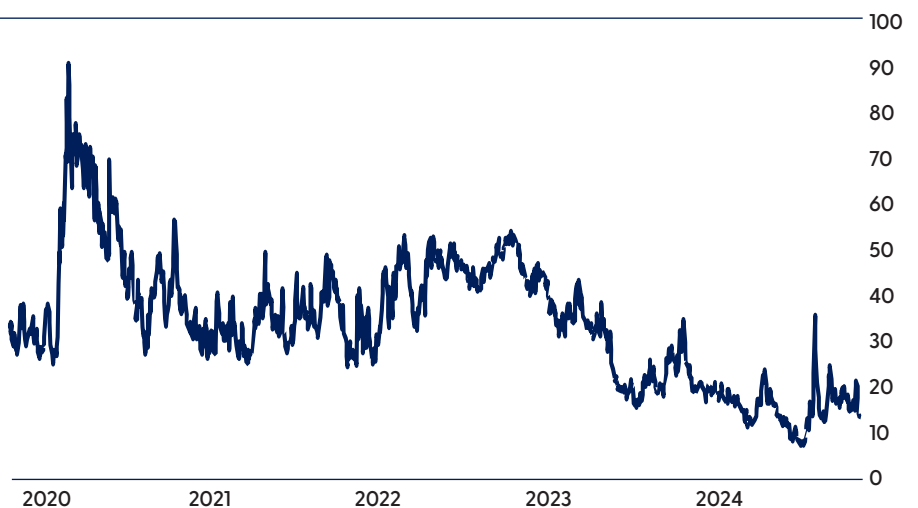
fig.
13

Stock Dispersion Expected to Continue

Policy shifts will drive clear winners and losers

— CBOE 3-month Implied Correlation Index

Source: Bloomberg, LRL Research 11/01/24. Indexes are unmanaged and cannot be invested into directly. Past performance is not a guarantee of future results.





Look for sub-strategy and manager differentiation in global macro and managed futures

We remain positive on global macro and managed futures, which tend to perform well in higher volatility environments and can often deliver uncorrelated returns in times of uncertainty. However, we are tempering our return expectations slightly as they should see a reduced yield on their unencumbered cash. Investors are also likely to experience greater differences in performance between various sub-strategies and the geographic regions invested in. We favor more nimble and discretionary global macro managers with broader geographic coverage. For instance, selective emerging market equity and fixed income valuations look attractive, but these would be best traded by local market experts who understand the political nuances, data shortcomings, and limitations of liquidity in these markets.

Within managed futures, we have been cautiously monitoring how trend following strategies are positioning themselves. At the time of this writing, their main positioning is in the stock and bond markets and fairly in line with 60/40 portfolios, diminishing some of the diversification benefits investors seek from them. Therefore, we encourage investors to consider a combination of managed futures that have broader market exposures and time horizons.

Multi-strategy, more than the sum of its parts

Lastly, we are also positive on multi-strategy “pod shops,” that allocate capital across independent portfolio management teams as they continue to deliver results that prove they are more than the sum of its parts. **[Fig.14]**

Remaining positive on private credit and infrastructure with moderation

In the private markets, we favor private credit and infrastructure, but with a slightly tempered view. Private credit has grown significantly over the years and is now a major capital source for businesses and individuals, and we expect it to continue delivering strong yields that are higher than its public counterparts. That said, the impact of lower rates and increasing competition for high-quality deals makes us slightly moderate our positive view. We also recommend investors look beyond direct lending and participate in complementary opportunities, such as asset-based lending, distressed, or special situation strategies.

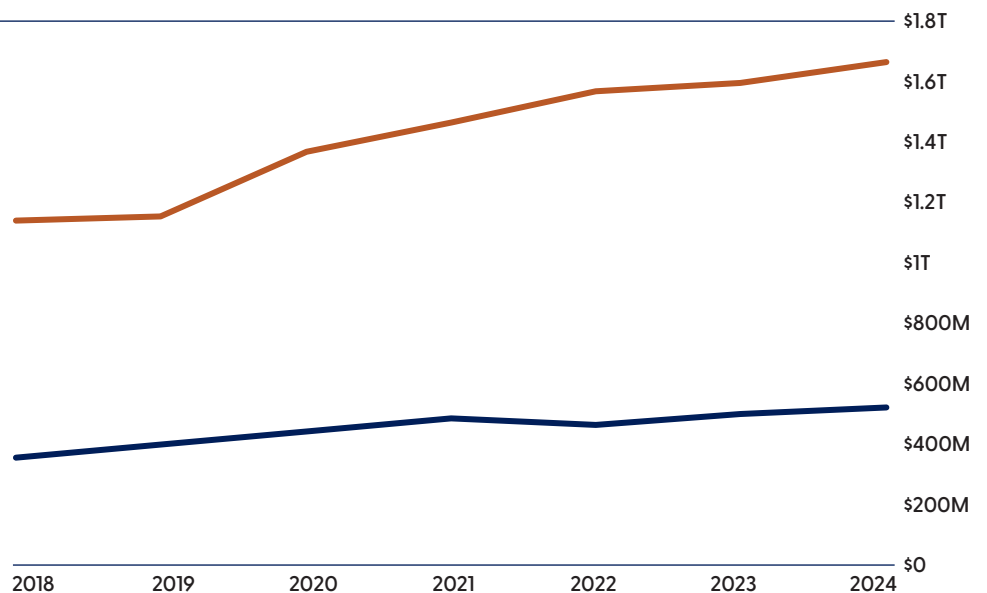
fig. 14

Multi-Strategy Continues to Deliver

Faster growth of multi-strategy funds driven by strong inflows and performance

Average AUM per funds

— Total industry — Multi-strategy



The new administration's potential impact on infrastructure is one of the more complex areas to fully grasp. Trump's preference for traditional energy sources could begin to shift how capital is allocated, and renewable energy projects may be sidelined in favor of oil and gas pipelines and refineries. The potentially new inflationary pressure and secular tailwind of digitalization should continue to support the infrastructure space, but sector and regional factors could produce meaningfully different outcomes.

Signs of positive signals in private equity, especially in secondary markets

Lastly, while we continue to observe subdued deal volumes and slow exits, we are noticing positive signals for private equity. Valuations have now begun to stabilize at attractive levels for new buyers, and lower financing costs could help provide a boost to the space. Private equity will still need to find new buyers for the investments that were

made at lofty valuations or come up with alternative ways to return capital to investors. This challenge may have turned into a new set of opportunities in the secondary market for private equity managers, and we expect this trend to continue.

THE BOTTOM LINE

Lower interest rates and potential policy shifts will impact markets differently, creating both opportunities and risks. Equity market-neutral, global macro, and managed futures strategies are well-positioned to capitalize on increased volatility and market dispersion. In the private market space, private credit and infrastructure remain attractive, albeit with some moderation in expectations. While challenges persist in private equity, opportunities should exist in the secondary market. Investors should be prepared for a more dynamic market environment in 2025 and consider the use of alternative strategies to further diversification and portfolio enhancement.

Strategies	Our Views	Positive	Neutral	Negative
Long/Short Equity	Expect a more favorable environment for corporates under the new administration, which should benefit both long-biased and long/short equity strategies as well as market-neutral stock pickers. An increase in volatility and stock market dispersion brought about by market uncertainty and a change in direction in policies will be beneficial for low-net stock pickers.	✓		
Event Driven	Monitor the improving market backdrop associated with lower financing costs and corporate-friendly policies.		✓	
Global Macro	We continue to see a fertile trading environment for global macro. Broader economic and policy divergences, as well as discrepancies between market expectations vs. reality in terms of rate cuts, should be beneficial. We favor nimble and discretionary managers with broad geographic coverage.	✓		
Managed Futures	While we remain positive on this "long volatility" strategy, note the decreased yield from cash and the potential reduced diversification benefit trend followers could provide due to their current positioning. We favor a combination of managed futures with broader market coverage and different time horizons.	✓		
Multi-PM Single Funds	Multi-strategy funds continue to benefit from the ability to dynamically invest across alternative investment strategies.	✓		
Specialty Strategies	Suitable for clients who are able to tolerate the limited liquidity these strategies may exhibit		✓	

The International Chessboard



KEY EXPECTATIONS

- Geopolitical uncertainties will persist in 2025
- Markets could become more reactive to geopolitical risks

● By Kristian Kerr, Head of Macro Strategy

As we embark on 2025, geopolitical uncertainty remains elevated. The conflict in Ukraine is approaching its three-year anniversary and continues to gradually escalate. Tensions in the Middle East remain high but have so far avoided a full-scale regional escalation. The recent political shift in the U.S. also introduces a new dynamic to the global stage, with important potential implications for trade relations and geopolitical alliances.

From deterrence to escalation in the Ukraine

In 2024, the U.S. and its NATO allies authorized the use of advanced weaponry and provided it to Ukraine. While this was intended to deter further Russian aggression, it has also heightened tensions, as Russia perceives these actions as a direct threat and an escalation of the conflict into a broader confrontation.

Russia has responded to increased Western military aid by deploying more advanced weaponry in the battlefield, surprising the West with its capabilities. Additionally, Russia has looked to deepen its alliances, securing support from North Korea, Iran, and China. North Korea has provided military equipment and personnel, while Iran has supplied drones and missiles. China has offered various forms of military and economic assistance.

This escalation has further complicated the conflict and makes the prospects for a negotiated settlement more difficult as Putin faces increasing pressure internally from Russian hardliners. While the incoming U.S. administration should offer up alternative diplomatic pathways, the ongoing tensions and increasing military involvement will likely cast a large shadow over any potential peace talks.

The fragile balance in the Middle East crisis

The steady escalation of tensions in the Middle East has raised concerns about the potential for a wider regional conflict. The conflict, originally initiated by Iranian proxies targeting Israel, has evolved into a direct military exchange between Iran and Israel, marked by targeted and well-telegraphed strikes that seek to minimize civilian casualties and infrastructure damage by both sides.

Iran's actions appear to be aimed at disrupting regional stability and undermining U.S. influence. A potential U.S.-Saudi military pact could further escalate tensions. However, a coalition of nations, including the U.S. and European powers, is working towards a diplomatic solution to de-escalate the situation and at least an interim détente looks likely. The incoming U.S. administration may also offer a fresh perspective and opportunities for diplomatic engagement.

Iran's nuclear capability remains a major concern for Israel and the U.S., but so far, those facilities have been explicitly avoided during retaliatory strikes by Israel, which has prevented a wider confrontation. However, given the clear

fig.
15

The S&P 500 Continues Its Ascent

The S&P 500 powers through tense geopolitical events

— S&P 500 performance



Source: LPL Research, Bloomberg 11/04/24. All indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

threat a nuclear Iran poses, there is risk that the situation becomes more critical in the year ahead and more aggressive steps are pursued by the U.S. and Israel, which could abruptly intensify the conflict.

The tariff showdown

The use of international trade as a geopolitical tool will likely increase over the next year as the incoming Trump administration made tariff policy a key focal point of its election campaign. What the new administration actually plans to do remains to be seen. During the campaign, statements were made about implementing tariffs in a variety of different ways, but another school of thought is that the threat of tariffs could just be a negotiation tactic used to achieve better trade terms and diplomacy goals. Whatever the case may be, the mercantilist and adversarial nature of tariffs will challenge the current order in one form or another. Countries affected by new U.S. tariffs on their exports to the U.S. would likely retaliate by increasing tariffs on imports from the U.S. or by taking action on other matters. The clear risk in this type of environment is the potential for

an escalating cycle of retaliation, and investors should be prepared for much more headline volatility surrounding international trade in 2025.

Geopolitical risk and market resilience

Markets have remained resilient despite geopolitical tensions. While markets are adept at assessing risk, they sometimes can get overly complacent. As geopolitical risks evolve, investors need to remain vigilant and prepared to adapt to changing market conditions. **[Fig.15]**

THE BOTTOM LINE

As we enter 2025, geopolitical uncertainty remains high. The ongoing conflict in Ukraine continues to escalate; while tensions in the Middle East have avoided full-scale regional conflict the situation remains fragile. A shift in U.S. politics introduces another set of dynamics, particularly with potential trade protectionism and new diplomatic strategies. Given the dynamic geopolitical landscape, investors should adopt a flexible approach and be prepared to adapt their strategies as needed.

Are Commodities Due for an Uptick or a Supercycle?

KEY EXPECTATIONS

- The global buildout of data centers is driving demand for various commodities, notably copper and other critical materials
- Commodity exposure should be a small portion of well diversified portfolios

● By Kristian Kerr, Head of Macro Strategy

Last year brought a blend of strong and weak performances from commodities. While gold rallied due to geopolitical tensions and central bank buying, many other commodities faced challenges from weaker-than-expected demand from China and oversupply issues. Looking ahead, the wide range of potential policy shifts in the U.S. and around the world, coupled with ongoing geopolitical uncertainty, suggest commodities will continue to be an important area of focus for markets and policy makers in 2025.

The evolving commodities market

When many different commodities see their prices rise sharply in tandem over a number of years, this is often referred to as a commodities supercycle.

After China emerged from its COVID-19 lockdowns, there was hope for a new commodities supercycle, particularly fueled by the production of electric vehicles (EVs) and other high-value goods. This was seen as part of China's broader shift away from being a producer of low-margin goods, aiming to drive long-term economic growth independent of U.S. consumer demand.

While certain key commodities used in the production of high-value items did have price increases, the broad supercycle that many anticipated did not materialize. **[Fig.16]** This was largely due to China's much slower-than-expected economic recovery over the past four years.

fig.
16

Commodity Prices Soften

Chinese growth fueled commodities' supercycle, now prices stall as Chinese growth slows

Source: LPL Research, Bloomberg 11/05/24. Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results. Normalized to 100 on 11/04/24. The Bloomberg Commodity Index (BCOM) is a diversified commodity price index comprised of 23 commodities across six sectors.



Additionally, economic growth outside of the U.S. has been sluggish, with commodity prices rising sporadically, and often only in response to China's policy actions or geopolitical developments.

Looking ahead to 2025, China will still have an important role in the commodities landscape, particularly as the scale of their potential fiscal stimulus becomes clearer. However, another important factor will be the growing interest in the global expansion of data centers, as this could create another lasting and important source of demand for essential commodities.

Whether this leads to a full-fledged supercycle or remains confined to just a specific set of commodities is yet to be determined, but the data center trend is gaining momentum. Perhaps more importantly for markets, it represents a potential driver that isn't reliant on Chinese economic policy or geopolitical instability.

Rising copper demand and the challenges of securing supply for data centers

Data centers are being developed not only in the U.S. but also across the Middle East and Asia, including China.

Copper is a key commodity in data center construction, with projections indicating a 3% annual increase in copper demand in North America alone through 2035.

However, securing an adequate copper supply may become challenging. Mine output is expected to peak by 2026, and from that point on, new copper projects will be crucial to meet demand. The industry's challenge will be whether it can bring new mines online in time to keep pace with the anticipated demand growth.

Other critical materials for data center construction include: cobalt, gallium, silicon, lithium, manganese, chromium, graphite, nickel, and tungsten. Many of which, could face similar challenges as copper from a supply perspective.

A bright year for gold, but 2025 could be more challenging

Gold was one of the clear bright spots for commodity investors in 2024, with the metal on track to gain near 25% for the year. Steady buying by foreign central banks, uncertainty around the U.S. presidential election, and a heightened geopolitical climate all helped to support gold.

However, given our expectations of a "higher for longer" interest-rate environment and a firmer dollar, as well as the clear recent slowdown in central bank purchases, gold may face a tougher time in 2025. Geopolitical developments will also play a key role, as new diplomatic efforts by the incoming administration in Ukraine or the Middle East could weigh on the metal if successful but may drive prices higher if they fail or the efforts prove only short-lived.

Crude oil's balancing act between demand and policy

Crude oil languished in 2024, largely due to geopolitical tensions in the Middle East failing to cause significant disruptions in production, and China – the world's largest oil importer – continuing to struggle economically and falling short of demand expectations.

Looking ahead to 2025, global geopolitical dynamics and China's physical demand needs will remain key factors influencing the oil market, but the incoming administration's energy policies will also play a pivotal role. During his campaign, Trump expressed strong support for the oil and gas industry, and in his second term it is expected that he will focus on boosting U.S. energy supply through lesser regulation and tax policy.

While on the surface these measures should help cap oil prices, U.S. production is already near all-time highs, suggesting meaningful production increases may be difficult to achieve – at least in 2025. Furthermore, with gasoline and crude oil inventories near their lowest levels in five years, there is plenty of risk that oil could surprise the markets by moving higher in 2025, especially if efforts to replenish inventories begin to markedly accelerate.

THE BOTTOM LINE

Supercycle or not, demand for a broad assembly of commodities will be crucial for new infrastructure projects globally. The data center buildout is poised to require an abundance of commodities, even if not "officially" a supercycle. For investors, commodity exposure should remain as a small portion of a portfolio with diversification across the commodity complex being a necessary part of the strategy. As an adjunct, investors should consider infrastructure opportunities previously mentioned in the Alternative Investments segment of this report.

King Dollar Continues to Reign



KEY EXPECTATIONS

- The U.S. dollar is expected to remain firm in 2025, supported by a resilient U.S. economy, gradual Fed easing, and uncertainty over inflation
- The euro may face headwinds due to slower growth in Europe and a more dovish European Central Bank, while the yen could be pressured by wide interest-rate differentials despite potential Bank of Japan hikes

● By Adam Turnquist, CMT, Chief Technical Strategist

The dollar continues to shine against a backdrop of synchronized monetary policy easing. Relative strength and stability in the greenback have been underpinned by a resilient U.S. economy, an expected slow and steady approach to future Fed easing, and brewing uncertainty over the last mile lower for inflation.

Of course, with currencies, it's all relative, and when you compare domestic growth to other developed countries, it's no wonder the dollar remains the currency of choice. Germany's economy, Europe's largest and the third largest in the world, is expected to shrink 0.2% this year, marking its second straight year of contraction. Anemic growth in Germany has weighed on the broader Eurozone outlook, with forecasts calling for GDP growth of only 0.7% in 2024 and 1.2% in 2025. This compares to 2024 and 2025 U.S. growth estimates of 2.6% and 1.9%, respectively. While the weaker growth profile of Europe reduces inflation risk, it also supports a more dovish stance from the European Central Bank (ECB). The rising likelihood of the ECB outcutting the Fed next year has created headwinds for the euro (the largest weighting within the U.S. Dollar Index), a theme we expect to continue into 2025.

This economic backdrop has also reinforced interest-rate differentials in favor of the dollar and created notable headwinds for emerging market (EM) economies – a strong dollar generally creates capital outflow pressure within EM, increases the cost of carrying U.S.-denominated debt in local currency terms, and weighs on EM export activity. According to the International Monetary Fund (IMF), a 10% appreciation in the U.S. dollar decreases EM economic output by 1.9% after one year, compared to an output decrease of only 0.6% for advanced economies.

Although not an EM country, Japan's yen has been on the losing end of global rate differentials for the last couple of years. To spur sustainable inflation and support economic growth, the Bank of Japan (BOJ) kept interest rates extremely low over the last two years as other global central banks raised rates aggressively. The diverging policy paths made the yen a popular funding currency for the carry trade, where investors borrow in a low-rate currency to fund the purchase of a higher-yielding currency. Some of these trades were unwound over the summer as the BOJ raised its target rate to 0.25% in July. However, even after factoring in the prospect of additional BOJ hikes in 2025 and potential rate cuts from the Fed, interest-rate differentials will likely remain wide and put downward pressure on the yen.

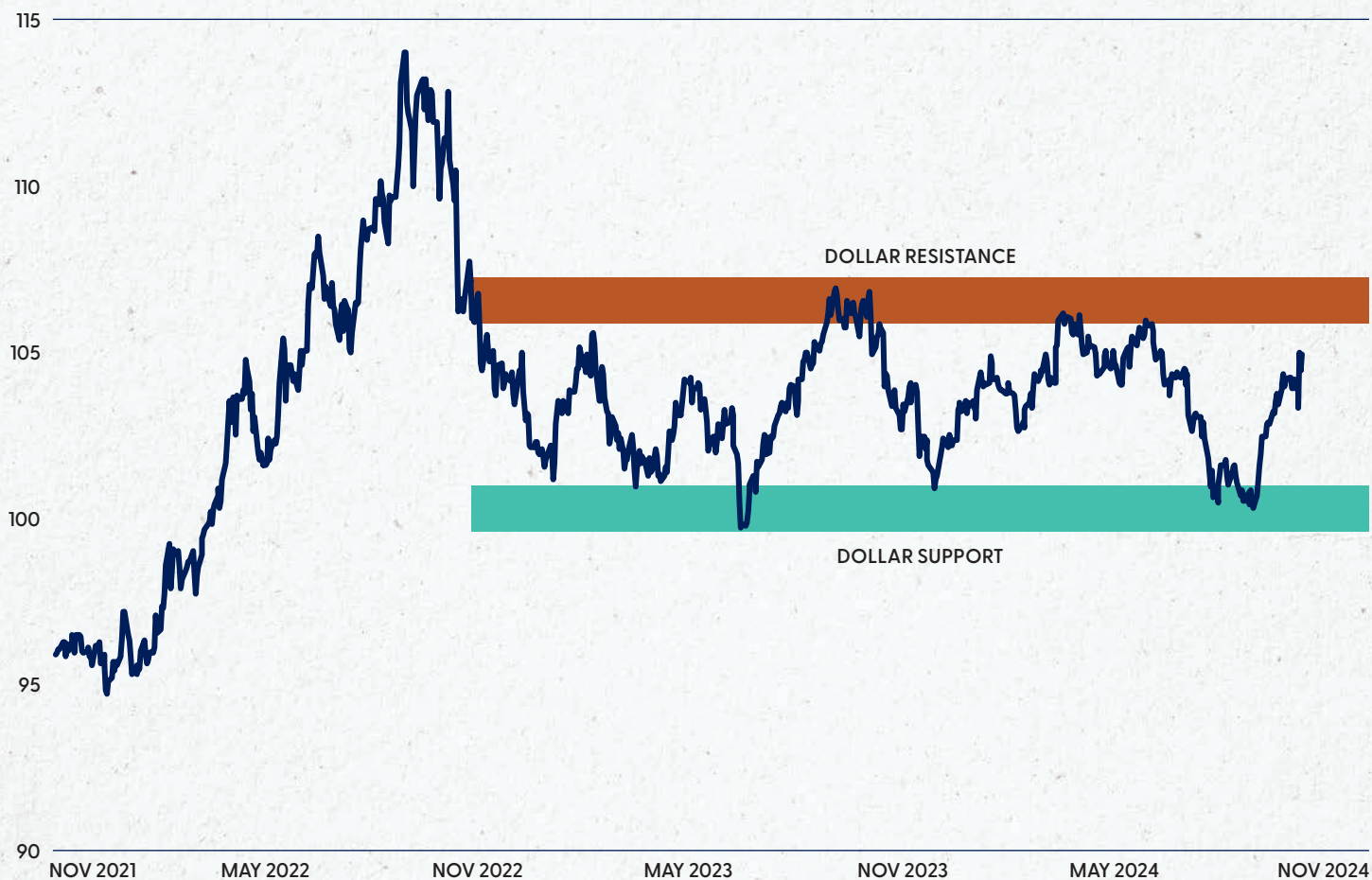
Politics could be a major factor in currency market volatility next year. President-elect Trump has proposed a 10% blanket tariff and additional tariffs on China, Mexico, and Canada. They also raise the risk of triggering a full-blown trade war as countries retaliate with tariffs on U.S. imports, potentially driving up inflation and putting upward pressure on Treasury yields and the dollar. Other countries, especially the more export-reliant, may also have to

fig.
17

Dollar Tailwinds Build Into 2025

The greenback remains range-bound and relatively stable

— U.S. Dollar Index



Source: LPL Research, Bloomberg 11/11/24. Past performance is no guarantee of future results. All indexes are unmanaged and can't be invested in directly.

devalue their currencies to offset the higher tariffs. Given this backdrop and the wide latitude Trump will have on implementing tariffs, we expect currency volatility to remain elevated in 2025.

From a technical perspective, we believe significant upside risk to the dollar could be limited in 2025. The U.S. Dollar Index has been contained within a range over the last two years, marked by support near 100 and resistance around 107. **[Fig.17]** And while recent upward momentum could push the dollar into the upper end of the range, a breakout appears unlikely.

THE BOTTOM LINE

The dollar continues to reign across global currency markets. Solid economic growth, especially compared to other developed countries, has been a major driver of strength and stability in the greenback. Developing uncertainty over the trajectory of inflation, expectations for gradual easing from the Fed, and positive interest-rate differentials have further supported the dollar. President-elect Trump's proposed tariffs could elevate currency market volatility and stoke inflation fears, putting additional upward pressure on the dollar. Based on this backdrop, we believe the dollar will be well-supported in 2025. We expect limited downside risk, while meaningful upside could be capped by the gravitational pull of a less hawkish Fed.

Putting It All Together

A Summary of the STAAC's 2025 Tactical Views

■ Strong Overweight
 ■ Overweight
 ■ Neutral
 ■ Underweight
 ■ Strong Underweight

ASSET CLASS		
	Stocks	■ Expect modest gains and more volatility in 2025. A solid economic and corporate profit backdrop along with Fed rate cuts are balanced against lingering inflation, a risk of higher interest rates, tariffs, and geopolitical threats. Continue to favor a patient approach geared toward buying dips.
	Bonds	■ Fixed income provides attractive income opportunities with starting yields still elevated (relative to history). With few signs of a slowing economy, investors should prioritize coupon clipping as opposed to expected price appreciation. However, while current yields for bonds and cash are similar, bonds offer portfolio preservation and potential price appreciation if an unexpected event occurs that would negatively impact the economy.
	Cash	■ With the Fed cutting short term interest rates, cash rates will continue to fall. And while cash rates are likely going to stay above levels experienced pre-COVID-19, long-term investors are likely better served by extending the maturity of cash holdings (not too far out on the Treasury curve) and taking advantage of still high bond yields.
	Alternative Investments	■ Lower rates and political shifts will impact each alternative strategy differently in the year ahead. Sub-strategy and manager differentiation is essential in achieving the benefit of diversification and outperformance potential. In the current environment we favor Equity Market Neutral, Global Macro, and Multi-Strategy in portfolios.

EQUITIES	Geography	
	U.S.	■ LPL Research expects the U.S. economy to handily outgrow and outearn Europe and Japan in 2025, a position likely strengthened by Trump's trade policy and a potentially strong U.S. dollar. Additionally, the AI boom justifies an innovation premium, supporting elevated U.S. valuations.
	Developed International	■ European economies have seemingly stabilized, and attractive valuations and corporate reforms in Japan are supportive of international equities longer term. However, Trump's trade policies and related dollar strength will likely be drags.
	Emerging Markets	■ Emerging markets face heightened trade risk as tariffs increase and accelerate the pace of de-globalization. Earnings weakness and continued geopolitical risk in Asia and the Middle East remain overhangs on the asset class despite attractive valuations, Fed rate cuts, and prospects for more China stimulus.
	Style and Market Capitalization	
	Large Growth	■ The AI-fueled earnings on the growth side help justify rich valuations, and large cap companies enjoy superior earnings power and may outperform if the economy cools some in 2025.
	Large Value	■ A resilient economy and Trump's likely agenda are positives for cyclical value stocks, but the resilient economy has weighed on defensive sector performance. Value stocks are more attractively valued than normal, and the earnings gap is poised to narrow in coming quarters. Staying near neutral but watch for value opportunities.
	Small and Mid-Cap Growth	■ Low valuations, healthy credit markets, and the possibility of lower taxes are supportive. Enthusiasm surrounding benefits of Fed rate cuts for small caps may be overdone. Potential slowdown in the economy in 2025 is a key risk. They are also less likely to be exposed to new tariffs than large caps.
	Small and Mid-Cap Value	■ As with large value, small/midcap value stocks may benefit from a resilient U.S. economy, while valuations are attractive versus history. Regional banks could benefit from deregulation. However, an economic slowdown may limit potential upside.

■ Strong Overweight
 ■ Overweight
 ■ Neutral
 ■ Underweight
 ■ Strong Underweight

FIXED INCOME

Core Sectors

U.S. Treasuries	■	The U.S. Treasury yield curve remains relatively flat, so the risk of a meaningful fall in longer-maturity yields is limited, in our view. Absent a sharp unexpected fall in economic growth, we think the 10-year yield is likely to remain range-bound and will end the year between 3.75–4.25%. A large amount of Treasury issuance and still unclear economic priorities under the Trump administration remain risks.
Mortgage-Backed Securities (MBS)	■	With yields and spreads at multi-year highs, we think MBS remain an attractive investment opportunity, particularly relative to lower-rated corporates. Due to still-high mortgage rates and a lack of prepayments, favorable supply/demand dynamics may help support the market. Additionally, as the Fed continues to cut rates and interest rate volatility falls, MBS should outperform other high-quality fixed income sectors.
Investment Grade Corporates	■	We recommend a strong underweight position to benchmarks, but we think there is currently an opportunity to invest in shorter to intermediate maturity corporate securities without taking on elevated levels of interest rate or credit risk. Fundamentals remain solid, and a slowing (not collapsing) economy should remain supportive for credit.
Treasury Inflation-Protected Securities	■	While inflationary pressures have fallen from peak levels, we think inflation volatility could remain higher than pre-COVID-19 levels. And all-in yields for Treasury Inflation-Protected Securities (TIPS) are attractive and could provide a good hedge against unexpected inflation surprises.

Plus Sectors

Preferred Securities	■	We remain overweight Preferreds but acknowledge the next 12 months are unlikely to be as robust as the last 12 months. Preferreds offer higher credit quality among the riskier fixed income options, while bank fundamentals are generally sound overall. Yields remain elevated relative to history, so the asset class still provides attractive income levels.
High-Yield Corporates	■	Yields for high-yield bonds are above historical averages but spreads remain near secular tights. A still strong economy should support spreads; however, in our view, further price appreciation is limited. The asset class may be better suited for longer-term minded investors with tolerance for higher volatility and risk.
Bank Loans	■	Given the variable-rate debt, higher interest rates may make repayment more challenging for some issuers and the default rate for loans has increased recently. Fewer investor protections and the illiquidity of individual loans remain concerns as well. Yields for the asset class remain above historical averages, but given the risks of the two leveraged credit asset classes, we have a slight preference for high-yield bonds over loans.
Foreign Developed Market Bonds	■	Non-U.S. developed bonds provide potential diversification benefits to a U.S. economy that may have stickier inflation than their European counterparts. We're neutral on foreign bonds, but given the potential for additional ECB rate cuts, foreign bonds ex-Japanese government bonds may outperform. Currency volatility remains a concern though, so investors may be better served by using a currency-hedged option.
EM Debt	■	EM central banks are slightly more accommodative than the Fed, but with over 70 emerging markets, it's hard to find commonality in the asset class. Valuations are relatively attractive, but idiosyncratic risks remain. A strong dollar could provide a headwind to prices. Liquidity is also an added risk during periods of market stress.

Our Investment Committee is Your Investment Committee

The Strategic and Tactical Asset Allocation Committee (STAAC) is the investment committee broadly charged with overseeing the investment decisions for LPL's discretionary asset allocation platform. The 11-member committee is comprised of the senior members within LPL's Research department and is responsible for the firm's capital market views that ultimately form the firm's asset allocation decisions.

The STAAC determines the firm's investment outlook and asset allocation that helps define LPL Research's investment models and overall strategic and tactical investment guidance. That guidance is delivered via recommended allocation weightings and a suite of strategy reports, articles, chart analysis, videos, and podcasts.

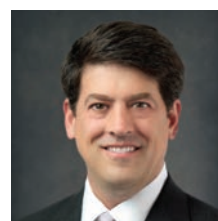
The committee is chaired by the chief investment officer and includes investment specialists from multiple investment disciplines and areas of focus. The STAAC meets weekly to foster the close monitoring of all global economic and capital market conditions, and to ensure the latest information is analyzed and incorporated into our investment thought.



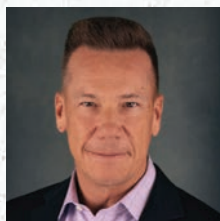
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Jeffrey Buchbinder, CFA
Chief Equity Strategist



Garrett Fish, CFA
Head of Model Portfolio Management



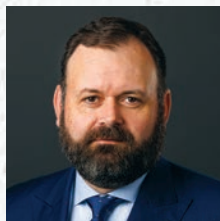
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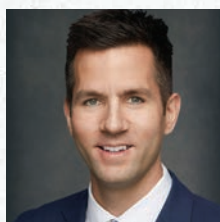
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Portfolio Strategist



Adam Turnquist, CMT
Chief Technical Strategist



Jina Yoon, CFA
Chief Alternative Investment Strategist

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Any forward-looking statements including the economic forecasts herein may not develop as predicted and are subject to change based on future market and other conditions. All performance referenced is historical and is no guarantee of future results.

References to markets, asset classes, and sectors are generally regarding the corresponding market index. Indexes are unmanaged statistical composites and cannot be invested into directly. Index performance is not indicative of the performance of any investment and does not reflect fees, expenses, or sales charges. All performance referenced is historical and is no guarantee of future results.

Precious metal investing involves greater fluctuation and potential for losses.

Any company names noted herein are for educational purposes only and not an indication of trading intent or a solicitation of their products or services. LPL Financial doesn't provide research on individual equities.

All index data from FactSet or Bloomberg.

All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy

GENERAL RISK DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. Investing in foreign and emerging markets debt or securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

GENERAL DEFINITIONS

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

A company's market capitalization is the market value of its outstanding shares. Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share. Classifications such as large-cap, mid-cap and small-cap are only approximations and may change over time.

EQUITY RISK

Investing in stock includes numerous specific risks including the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies. Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time. The prices of small and mid-cap stocks are generally more volatile than large cap stocks.

EQUITY DEFINITIONS

Cyclical stocks typically relate to equity securities of companies whose price is affected by ups and downs in the overall economy and that sell discretionary items that consumers may buy more of during an economic expansion but cut back on during a recession. Counter-cyclical stocks tend to move in the opposite direction from the overall economy and with consumer staples which people continue to demand even during a downturn.

Growth stocks are shares in a company that is anticipated to grow at a rate significantly above the average for the market due to capital appreciation. A value stock is anticipated to grow above the average for the market due to trading at a lower price relative to its fundamentals, such as dividends, earnings, or sales.

Value stocks are anticipated to grow above the average for the market due to trading at a lower price relative to its fundamentals, such as dividends, earnings, or sales.

Large cap stocks are issued by corporations with a market capitalization of \$10 billion or more, and small cap stocks are issued by corporations with a market capitalization between \$250 million and \$2 billion.

FIXED INCOME RISKS

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield. Government bonds and Treasury bills are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk, as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features. Mortgage-backed securities are subject to credit, default, prepayment, extension, market and interest rate risk.

FIXED INCOME DEFINITIONS

Credit Quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. As the term implies, credit quality informs investors of a bond or bond portfolio's credit worthiness, or risk of default. Credit ratings are published rankings based on detailed financial analyses by a credit bureau specifically as it relates to the bond issue's ability to meet debt obligations. The highest rating is AAA, and the lowest is D. Securities with credit ratings of BBB and above are considered investment grade.

The credit spread is the yield the corporate bonds less the yield on comparable maturity Treasury debt. This is a market-based estimate of the amount of fear in the bond market.

Base-rated bonds are the lowest quality bonds that are considered investment-grade, rather than high-yield. They best reflect the stresses across the quality spectrum.

Bloomberg U.S. Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

FIXED INCOME ASSET CLASSES

Mortgage-backed Securities (MBS) A mortgage-backed security (MBS) is security that is secured by a collection of mortgages, referred to as a pool. The mortgages are "securitized", or packaged, together and can be sold to investors. In this structure interest and principal payments from the borrower pass through to the MBS securities holder. Mortgage-backed securities are subject to credit, default, prepayment, extension, market and interest rate risk.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Preferred stock dividends are paid at the discretion of the issuing company. Preferred stocks are subject to interest rate and credit risk. As interest rates rise, the price of the preferred falls (and vice versa). They may be subject to a call feature with changing interest rates or credit ratings.

Municipal bonds are subject to availability and change in price. They are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply. If sold prior to maturity, capital gains tax could apply.

Commodities include increased risks, such as political, economic, and currency instability, and may not be suitable for all investors. The fast price swings in commodities will result in significant volatility in an investor's holdings.

ALTERNATIVE INVESTMENT RISKS AND ASSET CLASSES

Alternative investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

Hedge funds are private investment partnerships that pool funds. Hedge funds use varied and complex proprietary strategies and invest or trade in complex products, including listed and unlisted derivatives. Managed futures are speculative, use significant leverage, may carry substantial charges, and should only be considered suitable for the risk capital portion of an investor's portfolio. Private credit is non-publicly traded debt instruments created by non-bank entities, such as private credit funds or business development companies (BDCs), to fund private businesses.

Event driven strategies, such as merger arbitrage, consist of buying shares of the target company in a proposed merger and fully or partially hedging the exposure to the acquirer by shorting the stock of the acquiring company or other means. This strategy involves significant risk as events may not occur as planned and disruptions to a planned merger may result in significant loss to a hedged position.



LPL Research

Outlook 2025

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Any Other Government Agency

Not Bank/Credit Union Guaranteed

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or Obligations

May Lose Value