A Look Ahead to 2025

It was another resilient year for the U.S. economy. Despite predictions of a slowdown, robust consumer and business spending powered growth in 2024. Although the labor market cooled, it continued to be reasonably strong, and inflation moderated. Ultimately, this led the Federal Reserve (Fed) to begin cutting interest rates in September, signaling progress toward a "soft landing," an ideal scenario in which the U.S. economy slows enough to reduce inflation but doesn't enter a recession. Investors prefer this stability, setting a positive tone as we enter the new year.

What to Expect in 2025

This year comes with the usual uncertainties of a new administration taking over in Washington, DC. Although headlines about trade policy could cause concerns, we believe the outlook for U.S. business spending should continue to provide a solid fundamental backdrop in 2025. Corporations are expected to earn more than they did in 2024, with growth likely to spread across industries as business spending broadens.

Key Economic Drivers

There are two critical components when analyzing the economy—consumer spending and business investment. Together, they create a solid foundation.

- **Consumers –** Consumer spending makes up two-thirds of the U.S. economy. If people have jobs, they have money to spend, driving economic activity.
- **Businesses –** Companies invest to support consumer spending, reinforcing economic growth.

This combination provides the backdrop for a continued soft landing, enabling the Fed to further reduce interest rates in a measured way throughout 2025.

Keep in mind

The most important investment you can make right now is staying curious, adaptable, and focused on the long term, not just the immediate future.

Interest Rates and Earnings

Interest rates tend to affect stock market valuations. In 2022, for example, rising rates contributed to declining stock valuations. Since then, rates have been quite volatile, but 2025 could be a year when corporate earnings—the profits businesses generate—take the spotlight. Lower rates, if achieved, may also provide relief and support equity markets.

- **Broader earnings growth –** The excitement around artificial intelligence and the large amounts of money spent to capitalize on the opportunities it presents have fueled earnings growth over the past several years. That earnings growth, however, has been concentrated in a handful of companies commonly referred to as the Magnificent Seven. A positive economic backdrop in 2025 should allow more companies to generate earnings growth, creating more opportunities across industries.
- **The bond market –** Although equity markets capture headlines, the bond market is particularly intriguing right now. U.S. Treasury yields look attractive, offering strong long-term value. Adding bonds to a portfolio can help balance risk, especially if equity markets encounter a period of volatility.

LifeTime Asset Management

LifeTime Asset Management, LLC
801 Corporate Center Drive | Suite 110 | Raleigh, NC 27607
919.845.5315 | 919.845.5346 fax | www.lifetimeasset.com

Political Shifts: Risks and Opportunities

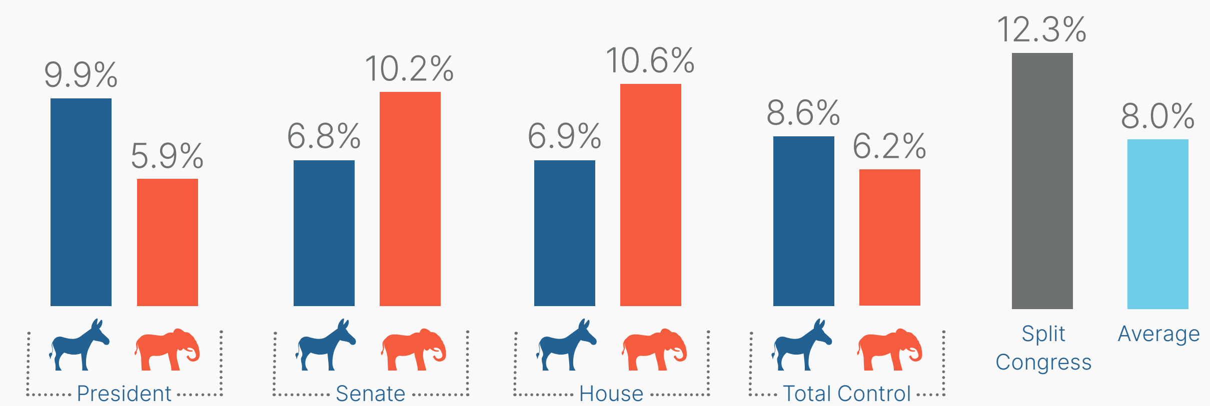
Although the current economic backdrop appears favorable, there are risks. The uncertainty of a new administration always causes concern for investors—and this year is no different. Critical areas to watch include:

- **Pro-growth policies –** Potential tax cuts and deregulation could support economic expansion.
- **Trade and immigration –** Changes in these areas might pose risks by slowing growth or causing inflation to climb again. This combination could complicate the Fed's soft-landing goal.
- **Global tensions –** Ongoing geopolitical challenges, such as in Eastern Europe and the Middle East, add to the need for careful risk management.

Uncertainties like these accompany all presidential transitions. When you step back and focus on the long term, however, markets have shown remarkable resilience regardless of who's in the White House. More than six decades of data show stocks have risen over time, no matter which party has controlled the government.

Staying Cautiously Optimistic

Every year has unique risks, and 2025 is certainly no different. Still, there's real reason for optimism. Yes, the environment is dynamic, but the key is to stay adaptable, tune out short-term noise, and keep your long-term goals in focus.



S&P 500 Average 2–Year Post-Election Return (Annualized) 1940–2022

Source: Mercer, Bloomberg. As of 12/31/2023. **Data is based on past performance which is no guarantee of future results.**

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Authored by Chris Fasciano, chief market strategist, Commonwealth Financial Network®.

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