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PRIVATE WEALTH

Straus Group 2025 Economic Outlook and Market Commentary

The stock market has just completed two of the most impressive consecutive years of performance in history—a rarity that hasn't been seen in over 25 years. One of the key drivers of this success last year was the remarkable strength of the U.S. economy, which consistently outperformed expectations, often by a wide margin.

Inflation, as measured by the CPI, surged to a peak of 9.3% annually in June 2022 but has since retreated to more sustainable levels. For context, inflation in the U.S. has averaged around 3.3% annually over the past 50 years. The Federal Reserve's well-publicized goal of reducing inflation to 2.0% remains ambitious, and we have some doubts about its feasibility. However, we believe that strong economic growth doesn't depend on achieving this historically low target objective. In our opinion, even if inflation stabilizes between 2.5% and 3.25% over the next five years, the U.S. economy could still enjoy a period of solid expansion. Goldman Sachs has echoed this sentiment, suggesting that growth prospects remain favorable even with slightly higher inflation levels. Inevitably, a recession will occur at some point, but it's important to remember that the U.S. has experienced 14 recessions in the past 75 years, with 10 of them lasting a year or less. This suggests that the next recession doesn't have to be particularly deep or prolonged.

It may surprise some, but looking back over the past 60 years, the average yield on the 10-year U.S. Treasury Bond has been approximately 6.0%. Currently, the 10-year Treasury rate is around 4.5%. Market expectations suggest that the Federal Reserve may reduce the discount rate once in 2025, lowering it by 0.25%. If this occurs, the year-end 2025 discount rate could fall into a range of 4.0%-4.25%. In this scenario, Goldman Sachs projects that the 10-year Treasury yield will decline to 4.0%-4.25%, fostering favorable conditions for continued economic growth.

S&P 500 earnings per share are breaking free from the static range of the past three years (2021–2023) and appear poised to reach a higher plateau—a development that bodes well for the stock market. In 2021, earnings rose sharply to around $220 per share, but they remained flat in 2022 and 2023 at $221 and $222 per share, respectively. For 2024, consensus expectations place earnings at approximately $243 per share, with 2025 projections in the range of $270–$275 per share. If these estimates prove accurate, a recession is unlikely through 2025. Goldman Sachs shares this sentiment, forecasting no recession until at least 2027, an outlook echoed by J.P. Morgan.

Should 2025 earnings align with projections, estimates for 2026 earnings could rise to $300–$305 per share. Based on these forecasts, the S&P 500 would trade at a 20x price-to-earnings (P/E) multiple, with an 18x P/E multiple for the index excluding the earnings of the "Magnificent 7" companies. Such valuations are not excessive by historical standards. It's important to recognize that stock market momentum is often shaped by investor psychology, and a clear path to higher corporate earnings can play a powerful role. This insight forms the foundation of our view that the stock market is likely to trend upward in 2025, barring any unforeseen developments.

The transformative potential of Generative Artificial Intelligence (AI), according to McKinsey, could dramatically boost productivity and add trillions of dollars in value to the global economy. By automating repetitive tasks and enhancing individual worker capabilities, AI has the potential to reshape industries and drive labor productivity across the board. Recent advancements, such as DeepSeek and other cost-efficient AI models, have further reduced the costs of adoption, increasing confidence in the widespread use of these tools.

The American consumer remains a powerful force in the U.S. economy, with Personal Disposable Income playing a decisive role in shaping economic and market trends. For middle-income households, the single largest asset value is typically the price of their home. With 130 million households in the U.S., two thirds of whom own their home, home ownership is widespread, and homeowners have benefited significantly from rising property values. Inflation, while challenging for many, has been advantageous for those owning tradable assets such as real estate. According to the Federal Housing Administration (FHA), the average home price has reached new record highs in recent years, even amidst higher borrowing costs due to elevated mortgage rates.

Consumer spending patterns are heavily influenced by the "Wealth Effect," or the perceived financial health of households. When families feel wealthier—bolstered by rising home values or job security—they are more likely to spend and less inclined to save. Historically, the U.S. savings rate has ranged between 6-8% of Personal Disposable Income. Today, that rate has fallen to 4-5%, reflecting a sense of financial confidence for the majority of working Americans, even as inflation continues to weigh on the cost of goods and services, excluding gasoline.

The U.S. economy remains remarkably strong, supported by a historically low unemployment rate. Over the past 75 years, the lowest annual unemployment rate recorded was 3.5%, a level briefly revisited just nine months ago. Today's unemployment rate of 4.0% is nearly as good as it gets, signaling a healthy labor market. This is a point of pride for the nation and a positive indicator for stock market investors. In the United States, virtually everyone who wants a job has access to one, which reflects the strength of our full employment economy.

Meanwhile, the growing U.S. Federal debt, currently at $37[1] trillion and increasing by $2-3 trillion annually, is a critical concern. This mounting debt represents one of the most significant challenges facing the U.S. economy. When interest rates were near zero, the debt was financed at a low annual cost of just over 2%. As rates climb toward 4.5%, the annual interest expense could swell to $1.5 trillion, a heavy burden compared to the government's annual revenue of $9.5 trillion. This raises the possibility of a "buyer's strike," where global investors shy away from U.S. Treasury debt. However, the dollar remains the dominant global currency, as no alternative has emerged. Still, we would not be surprised if the U.S. debt credit rating faces further downgrades in the near future.

In this commentary, we have emphasized the robust state of the U.S. economy, the low likelihood of a near-term recession, manageable interest rates (albeit higher than ideal), the financial health of the American consumer, and the benefits of a strong labor market. That said, geopolitical concerns remain a source of uncertainty. While global challenges persist, there are reasons for cautious optimism in certain areas. In the Middle East, military tensions appear to be easing, though the humanitarian toll remains severe. Iran, widely regarded as a major source of global terrorism, is facing renewed opposition from Israel and the U.S., both of whom are committed to preventing the development of Iranian nuclear weapons. The U.S. has indicated its readiness to act militarily, if necessary, without deploying troops on the ground. Additionally, there are signs of progress toward a ceasefire in the Russia-Ukraine war. If the U.S. and its Western European allies reduce financial support for the conflict, a resolution may follow. In such a scenario, Russia might retain control of approximately 20% of Ukraine's territory—an area with minimal economic significance. Meanwhile, in the Red Sea, Houthi forces have ceased attacks on commercial and petroleum shipping, likely due to concerns over potential U.S. military retaliation.

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[1] **So-called off-balance government debt is an additional $80 trillion, but much of it does not have the same government guarantee as to repayment of interest and principal.**

We are watching the incoming administration's efforts to expand manufacturing in the US, reduce "wasteful" federal government spending and mitigate excessive regulations impacting the private sector. Our discussions with business leaders, suggest a willingness to increase domestic investments (capital and employment) as regulations ease. If government can be streamlined and services provided at lower cost; the tax burden may be reduced - we are cautiously optimistic. One cannot quantify the impact of proposed tariff actions without knowing specifics regarding magnitude and duration. The new administration's recently proposed policies have so far been short of specifics.

We also want to take a moment to remind you of the extensive Wealth Management capabilities offered by our firm. Courtney Perez, CFP®, a member of our Straus Group, is available to provide customized wealth planning services tailored to your needs. These complimentary services include a detailed net worth statement, asset allocation overview, cash flow analysis, and estate planning recommendations. These tools can help you prepare for your future as it relates to long-term care needs, philanthropic goals, and estate considerations. Neuberger Berman's Trust Company also offers fiduciary and investment services, including gift and estate tax planning, trustee roles, and executor services. With trust offices in New York and Delaware, clients can benefit from Delaware's advantageous trust laws. Please let us know if you'd like to explore these services.

To conclude, while the road ahead presents both opportunities and challenges, we remain cautiously optimistic about the equity markets and the economy in 2025. We are committed to closely monitoring these critical developments, as time will reveal which political and economic factors will significantly impact the markets and potentially necessitate adjustments to the portfolio.

Thank you for your continued trust and confidence in us. We look forward to speaking with you soon.

Sincerely,

The Straus Group