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Journey Wealth

Quarterly Market Commentary

Q1 January 2025

Explore the world your wealth makes possible.

Overview

- Investment Team
- Market Update
- Leading Topics
- Economic Outlook
- Inflation: Leading & Lagging Indicators
- Federal Reserve: Update & Outlook
- Fixed Income
- Domestic Equities: Valuation & Concentration
- Rate Cuts & The Housing Market
- International Equities: Cautious Optimism
- Behavioral Finance: Chasing Trends
- What It All Means

Journey Wealth Investment Team

Pete Franz, CFA, CFP –
Chief Investment Officer

As the CIO of Journey Wealth, Pete is responsible for establishing, managing, and articulating the firm's investment platform and approach. He collaborates with the firm's investment partners, monitors markets, and conducts portfolio analysis to construct allocations that align with client objectives.

As the Director of Investments, Jack divides his time between developing solutions for clients and assisting with the curation of the firm's investment portfolios. Jack supports Pete in all facets of developing and monitoring the Journey Wealth investment platform, including working with key asset managers, our advisory team, and conducting ongoing research.

Jack LaLiberte, CFA, CPA -
Director, Investments

Market Update

Market Recap

As the cloud of election uncertainty lifted, domestic equities capped off the year with continued strength. Equity performance has broadened, with small caps outperforming large caps in the second half of 2024. Fixed income has remained volatile as inflationary risks have re-emerged, and long-term yields have disconnected from their short-term counterparts. The global consumer has remained stable, although there have been some indications of cracks around the edges.

Looking Ahead

Rate cuts and fiscal concerns have prompted yield curve steepening in the US. Long-term yields are likely to remain elevated due to uncertainty over inflation and Treasury issuance. The equity outlook is mixed. Large cap US equity valuations remain lofty. Small caps could be outsized beneficiaries of lower rates and potential deregulation. International markets have been hampered by tariff concerns. However, the combination of more reasonable valuations and diversification is appealing. Although US growth is likely to continue to decelerate in 2025, a gradual slow-down appears more likely than a recession.

Asset Allocation

At Journey Wealth, we let our clients' financial plans and unique needs drive the allocation of their capital. While volatility has been minimal in 2024, there's no guarantee that 2025 will be the same. Equities are priced for perfection in many segments, and volatility could materialize as markets adjust to shifting fiscal and monetary policy, geopolitical uncertainty and potential slower growth. While volatility can be disconcerting, we encourage proactive risk management by working to ensure that your investment allocation lines up with your risk tolerance and financial plan. Please don't hesitate to reach out to your advisor to schedule time to discuss your financial plan, including your goals and planning assumptions. Letting planning drive the investment approach helps ensure that your portfolio remains aligned with your vision for the future.

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Leading Topics

Macroeconomic Outlook

In 2024, we saw some economic softening but nothing to indicate that a recession is imminent. Unemployment has ticked up but remains below long-term historical averages. The US consumer has weakened over the past few years from a very strong position fueled by stimulus. A weaker consumer with lower levels of savings points to more gradual growth. The fight against inflation has become more complex. The lagged measurement of shelter cost deceleration is likely to continue to place some downward pressure on inflation. However, the disinflationary trend in goods prices could reverse if anticipated tariffs materialize.

Equity Markets

One of the most substantial risks facing equity investors as we turn the page into 2025 is concentration. The top ten stocks in the S&P 500 represent a near-record 36% of the Index. Nine out of ten are in the closely related Communications and Technology sectors. There are meaningful valuation discounts on offer in US small-cap as well as international equities, relative to their large-cap US counterparts. While we don't see a significant recession risk in 2025, slower growth is a real possibility. Historically, valuations have been good predictors of longer-term equity returns. The trailing 12-month S&P 500 PE ratio now exceeds 25x earnings, well above the long-term average. Trying to time equity markets by jumping in and out is a futile exercise. However, it's important to be aware of concentration risk. While indices like the S&P 500 may provide an illusion of diversification, a narrow subset of holdings have driven an outsized proportion of returns.

Federal Reserve/Fixed Income

We began 2024 with a wide gap between the Fed and the market's expectations for interest rate cuts, setting the table for volatility. Markets and the Fed appear to have become more aligned, with the Fed's dot plot and futures markets indicating approximately two to three rate cuts in 2025. The potential for a reinvigoration of inflation due to Federal spending, potential tax cuts and tariffs has shifted the outlook for the neutral rate upward. A notable development, particularly in the final quarter of the year, has been the divergence in short and long-term yields. The longer end of the curve is less subject to the Fed's manipulation and is more heavily influenced by Treasury supply. Given the uncertainty over inflation and Treasury issuance, we believe that there is a strong case to be made for active management in the fixed income space. We consider reinvestment risk to be a larger concern than interest rate risk, given the yield parity between short-term and intermediate fixed income instruments and the likelihood of a more gradual, yet still downward trajectory in short-term rates.

Election Implications

Elections have little correlation with long-term market performance. However, there are a few policies that could impact markets in the next year and beyond. Increased tariffs and tighter immigration restrictions are likely to hamper domestic growth, but these could be at least partially offset by the extension of tax cuts and deregulation. Emerging market equities are likely to remain volatile as the extent of the tariffs becomes clearer. Some of the downside risk in international equities is likely overblown. The US now accounts for about 15% of Chinese exports, as they've actively diversified their trade partners since COVID. While no election outcome was likely to prompt a pivot to fiscal responsibility, unified government raises concerns that there will be no check on deficit-expanding policies. Ultimately, none of these implications are likely to materially alter the trajectory of the economy, monetary policy or market outcomes over the long term.

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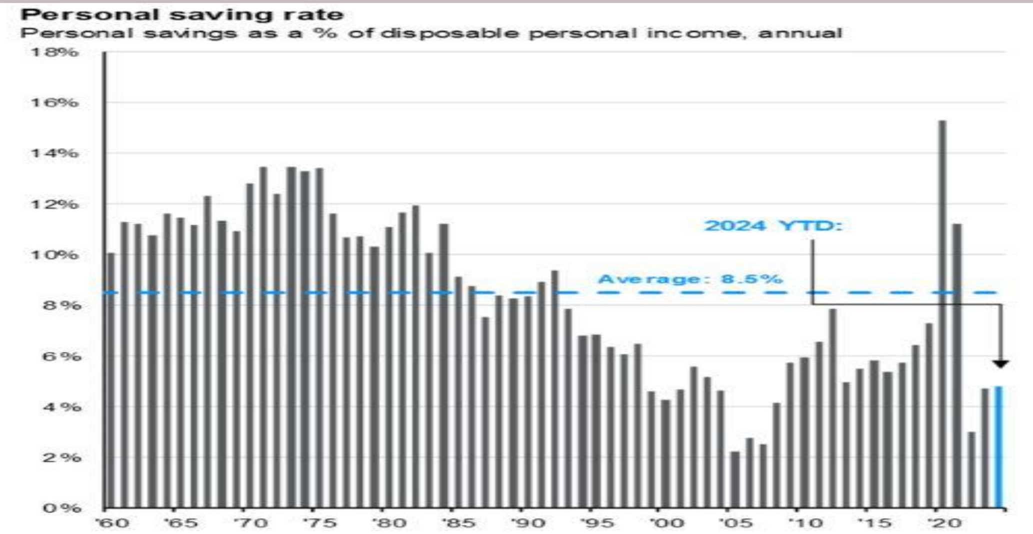
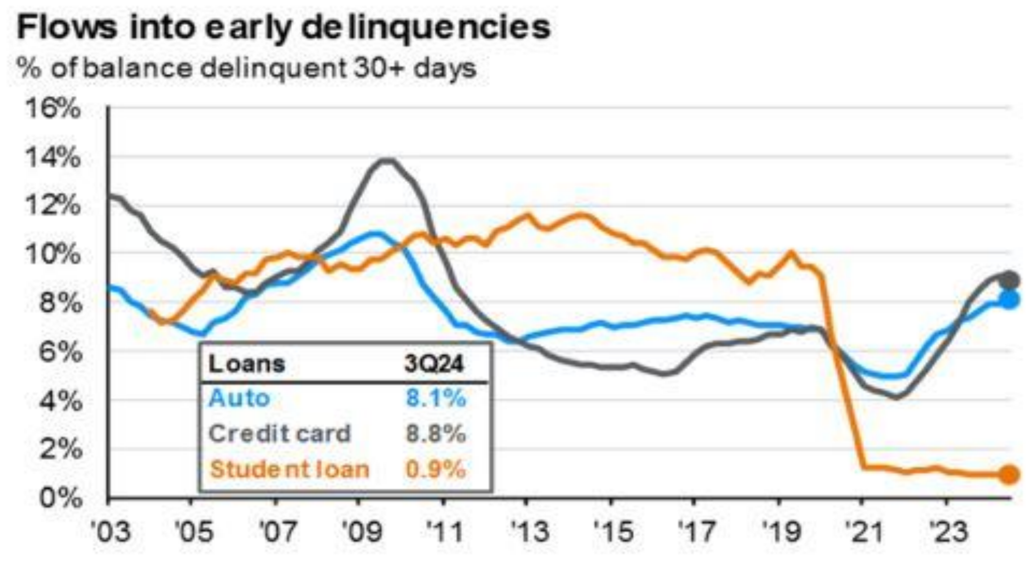
Economic Outlook: Slower & Bumpier

Since 2021, the US consumer has gradually weakened. In the immediate aftermath of COVID, the consumer was flush with stimulus while job openings outnumbered job-seekers and wages were growing at a robust clip. Over the past few years, we've seen a return to normalcy. Wage growth has reverted to near the pre-COVID average and consumer balance sheets have weakened considerably. The labor market has loosened but unemployment remains near pre-COVID figures. Equity markets and housing values remain near all time highs, driving the wealth effect. The factors weighing on the health of the consumer today are a lack of excess savings and larger debt service obligations. The personal savings rate is now well below pre-COVID levels and debt service ratios have steadily increased. Auto and credit card delinquencies have risen to levels not seen since the wake of the financial crisis. Higher interest rates took some time to slow down consumer spending but appear to be having the desired impact.

Consumer spending represents nearly 70% of US GDP. Rising debt service costs, sharply increasing delinquencies and a consumer savings rate well below the long-term average indicates that the US consumer is strained. While the risk of an imminent recession remains low, barring some unforeseen economic shock, a weaker domestic consumer points to a strong possibility of slowing growth.



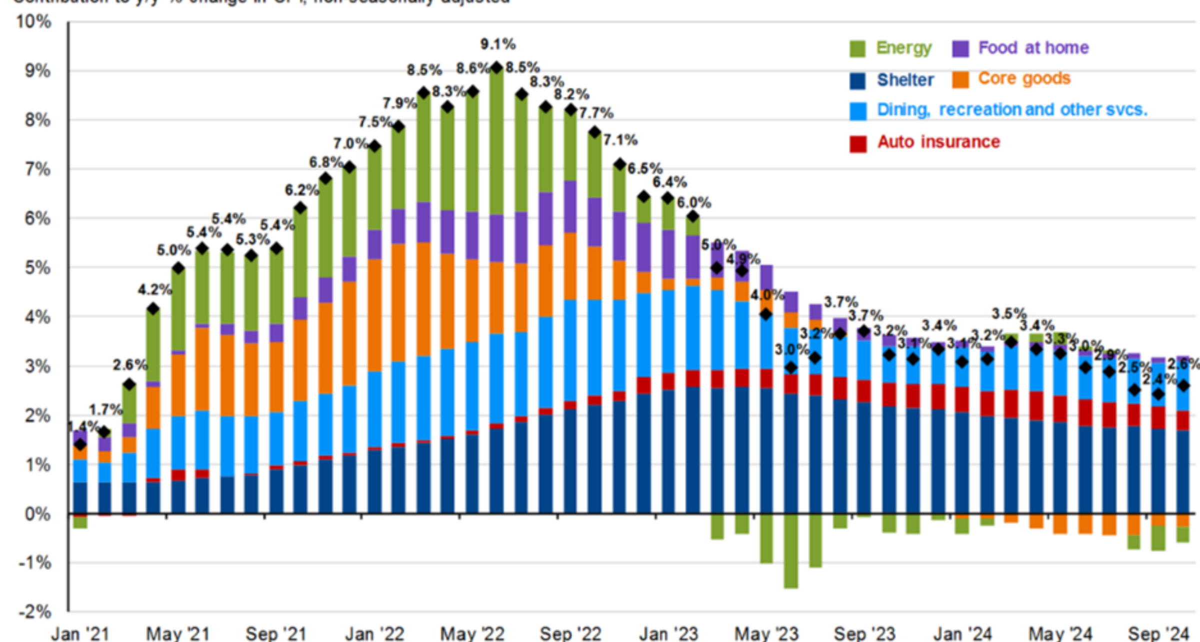


Source: JP Morgan

Inflation: Lagging & Leading Indicators

Progress on inflation stalled in the second half of the year. While goods and energy prices have declined, services and shelter costs have remained stubborn. The decline in inflation has been accomplished without a significant increase to unemployment or a dramatic slowdown in economic growth. Declining payroll gains indicate that employers are being more cautious on the hiring front. However, job openings have settled to pre-COVID levels, pointing to some form of equilibrium for the time being.

The shelter component of CPI represents nearly two thirds of the current inflation figure. It's important to note that the shelter element of CPI is measured based on leases signed over the past 12 months. The Zillow Rent Index is a more current measurement that uses new leases signed. The Zillow Rent Index has increased 3.38% YoY as of November while the CPI shelter component currently sits at 4.78% YoY. As the shelter portion of CPI catches up to current conditions, headline inflation is likely to naturally trend lower. The primary risks to this outlook include the threat of additional tariffs and a continuation of loose fiscal policy, likely in the form of an extension of the 2017 tax cuts. A tariff shock would likely cause a short-lived jump in price levels and not place ongoing pressure on CPI.



Federal Reserve Update & Outlook

Last month, the Fed executed another widely telegraphed rate cut, reducing the Fed Funds rate by 25 bps and bringing total cuts for 2024 to 100 bps. Policymakers anticipate another 50 bps of cuts in 2025, although that estimate is predicated on inflation continuing to decline. According to the Fed's projections, policymakers anticipate a long-term neutral rate of around 3%. While the Fed's projections haven't been very accurate historically, they provide insight into the FOMC's mindset. The Fed seems reasonable in shifting their focus to the upside risk in inflation as opposed to the downside risk in the economy. The combination of a healthy consumer, unsustainable Federal spending and the possibility of continued de-globalization of trade sets the table for potential stubbornness in inflation.

Since the Fed began the cutting cycle, short and long-term interest rates have diverged. The Fed Funds rate has fallen by 100 bps while long-term rates (as represented by the 10-year Treasury) have risen by about 85 bps. While the rise in long-term rates was likely not the Fed's intended outcome, it aids in their fight against inflation. A potential unintended consequence of higher short-term rates was that consumers may have felt an increased ability to spend, as they were earning more on deposits. A steepening yield curve impacts the consumer in two ways. The Fed's cuts at the short end of the curve have an almost immediate impact as consumers see decreased rates on cash deposits. The rise in long-term rates is most apparent in the mortgage market. Since the Fed began easing, 30-year mortgage rates have increased from about 6.1% to nearly 7%. The trend in long-term rates indicates that markets are concerned over the path of inflation and the trajectory of Treasury issuance.

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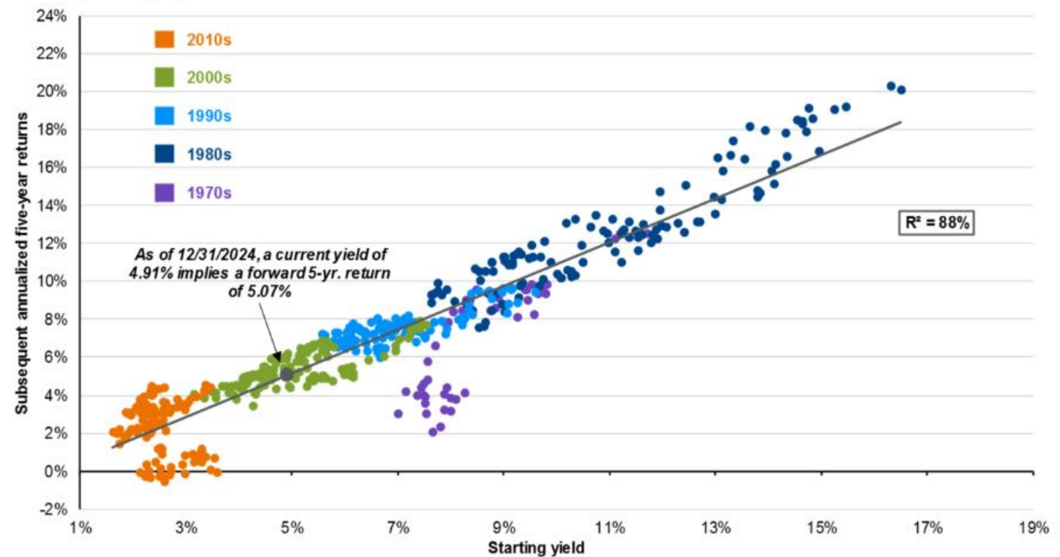
Fixed Income

2024 has been a tumultuous year for fixed income investors. Returns in many fixed income segments have lagged that of cash and near-cash instruments as post-election volatility wiped out the summer bond rally. One of the critical aspects of fixed income portfolio management is the balancing of reinvestment and interest rate risk. While fixed income yields are likely to remain volatile, they're now above those of short-term instruments. The two components of fixed income returns are coupon payments and the potential for capital gains. On the coupon front, yields are at attractive levels, while those in cash are likely to continue to decline, although at a slower pace than initially anticipated. The potential for capital losses exists as you extend duration. However, larger coupons reduce that risk meaningfully. Part of the reason that fixed income performed so poorly when the Fed hiked rates in 2022 was the lack of yield. Over the past six Fed easing cycles, fixed income has healthily outperformed cash, with the Bloomberg US Aggregate Bond Index averaging a 15% return in the 12 months following the first cut. Given the possibility of additional volatility, we'd caution against over-extending duration but feel that core fixed income offers a better risk adjusted opportunity set than cash equivalents.

While we believe that fixed income is positioned to benefit from declining short-term rates, it's important to be discerning about how you obtain your fixed income exposure. Whereas weighting equity indices by market cap is logical, weighting fixed income exposures based on who is issuing the most debt doesn't make a lot of sense. For example, the US Aggregate Bond Index consists of about 70% US Government-issued debt. While that reduces credit risk, it may not optimize total return potential. Continued volatility in rates is likely to provide additional opportunities for skilled active managers to outperform. While credit spreads are near the tightest levels since 2007, fundamentals remain strong and absolute yields justify some measured exposure to credit. A bright spot in 2024 has been international fixed income, which has outperformed its domestic counterpart substantially. As central bank policies diverge, the diversification benefits of holding a global bond allocation increase. Ultimately, the best predictor of fixed income returns in the long-run is yield-to-worst. The yields currently available in most fixed income sectors remain well above their 10-year averages.



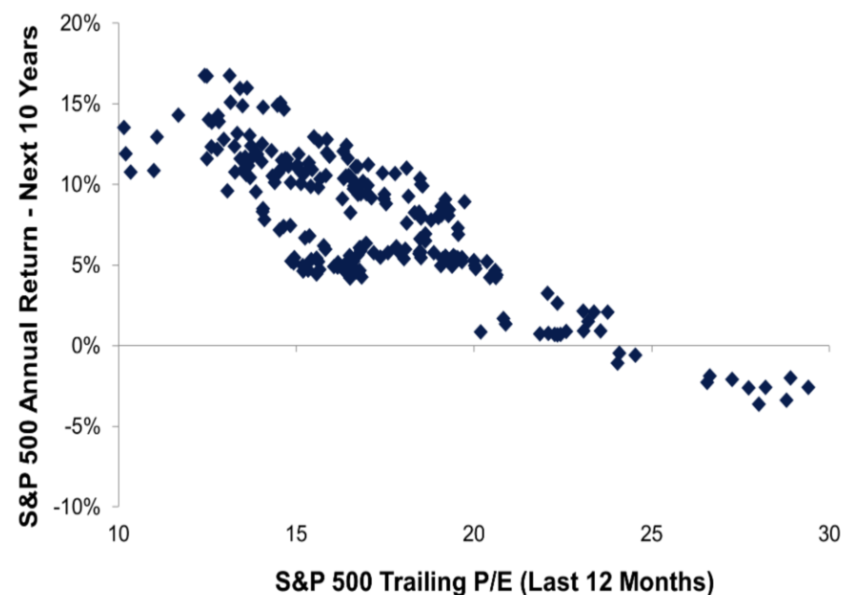
Source: JP Morgan

Domestic Equities: Valuation & Concentration

It's been a banner year for domestic equities, as the S&P 500 posted consecutive years with returns over 20% for the first time since the mid-'90s. While it's tempting to get absorbed into the hottest asset classes, it's important to keep fundamentals in mind. In the short term, there are few effective predictors of equity performance. Over longer horizons, PE ratios do a reasonable job of providing context for forward returns. Currently, the PE ratio of the S&P 500 based on trailing 12-month earnings is just under 30x, well above the historical average. The chart to the right illustrates the correlation between valuations and subsequent 10-year returns. At its root, equity investing involves determining a fair price for a stream of future cash flows. Various metrics indicate that cash flows for US large cap growth equities are expensive relative to the rest of the global equity universe. While technological innovations may spur faster cash flow growth, higher rates also mean that that future cash flow growth is worth less in present terms.

Additionally, concentration in US equity markets remains at elevated levels. Ten stocks currently represent over one third of the weight of the S&P 500 and these are concentrated in just a few sectors. We're not making the case to avoid large cap domestic equities entirely, but we do feel that some caution is warranted. The AI revolution may continue to drive performance by a narrow range of market leaders. However, we believe that diversification in the equity sleeve is beneficial. There are several areas, including small cap US equities and international equities, where valuations are nearer to their historical averages.

P/E Ratios Have Historically Been Excellent Predictors of Ten-Year Performance

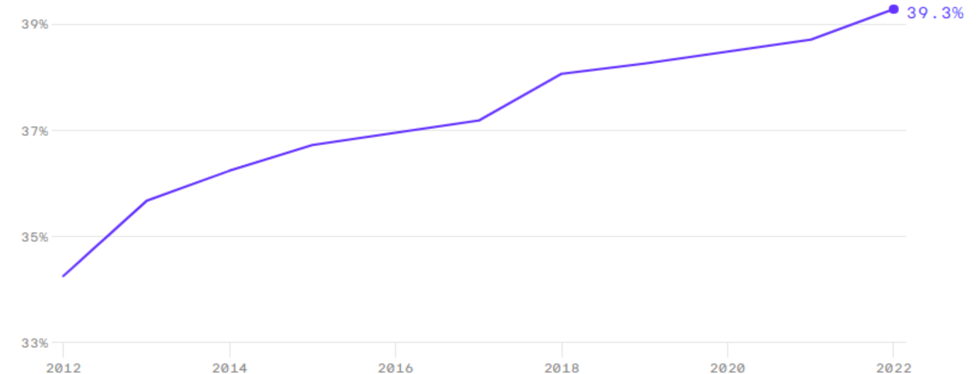


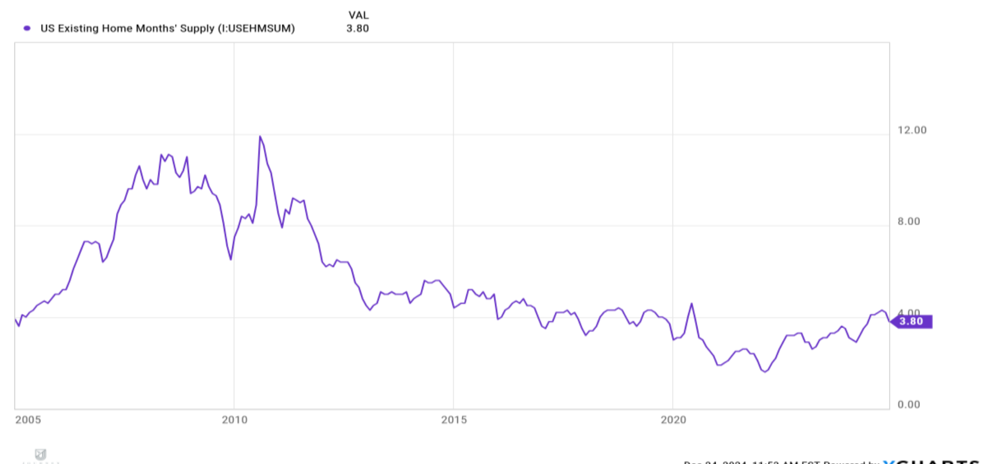
Source: LPL Financial

Rate Cuts & The Housing Market

Alas, the much-anticipated Fed rate cuts have yet to put downward pressure on mortgage rates. While the Fed has cut rates by 100 bps, 30-year mortgage rates have risen by over 50 bps. Bureaucrat-engineered cuts to short-term rates are not a cure-all for housing affordability and supply issues. Adjusting for seasonality, housing starts have steadily declined since their 2022 peak. 2024 has seen the three slowest months for housing starts since April 2020. As far as existing supply goes, approximately 40% of US homeowners own their homes outright. Of those with mortgages, the average rate is about 4%.

Mortgage rates have declined somewhat over the past year, after peaking near 8% in the Fall of 2023. 30-year rates now sit just under 7%. The rate trade-off for sellers remains a considerable hurdle. On a $400,000 home, a 3% rate increase (from the average existing rate of 4% to current levels) represents approximately a $600 difference in monthly mortgage costs. Ultimately, the long end of the yield curve has disconnected from the Fed's rate cuts and unless the market's concerns over fiscal sustainability and inflation are assuaged, mortgage rates may not decline meaningfully for some time. Nationally, home affordability remains near record lows. Inventories are well below pre-COVID levels nationally but have rebounded meaningfully in select markets. Notably, Florida and Texas have seen inventory levels rebound to pre-COVID levels. The lack of housing supply in the US isn't aided by the path of interest rates over the past few years. However, interest rates aren't the causal factor in the housing shortage. Even in the heady ultra-low rate environment of 2020, housing starts didn't come close to pre-financial crisis levels, while the number of US households has increased by nearly 15% since 2007.





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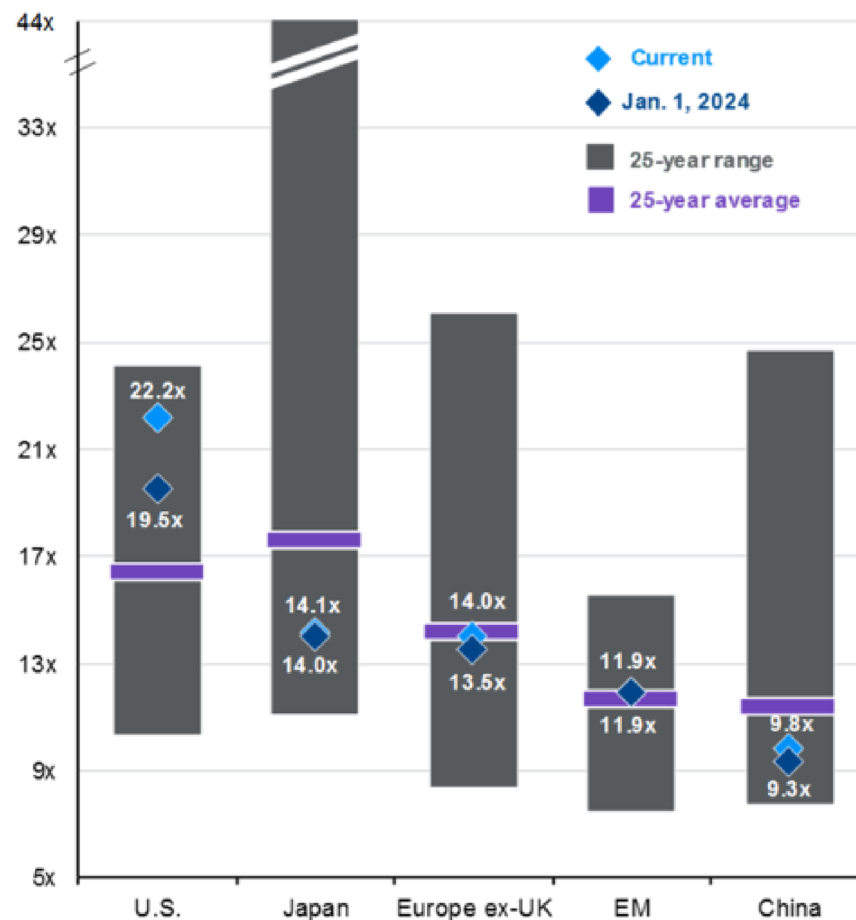
International Equities: Measured Optimism

US investors have shown some hesitation to invest overseas, partially due to recent underperformance by international equities and the belief that international equities are riskier than domestic stocks. There are a myriad of risks facing both domestic and international investors. Domestic investors are exposed to concentration risk as well as elevated risk of stagflation and the potential for a debt crisis as fiscal irresponsibility continues unabated. International investors are right to be concerned over currency and geopolitical risk. At the end of the day, total risk is difficult to quantify. We believe that exposure to a mix of different risks provides the best opportunity to compound long-term risk-adjusted returns.

In an environment where the S&P 500 is arguably more concentrated than ever before, international equities offer valuable diversification. The potential of a trade war with China raises some concerns. However, Chinese equities represent only about 8% of the non-US equity market. Several other countries stand to benefit from the shift in manufacturing away from China, primarily India. Japan also offers some unique structural opportunities, as the country emerges from a lengthy battle against deflation. A healthy level of inflation in Japan could help stimulate consumers. Since the election, the Dollar has surged in line with expectations of higher US rates and tariffs, presenting a potential risk for international equities. We aren't recommending a drastic international overweight. However, we believe that a meaningful international equity allocation offers diversification benefits in addition to exposure to attractive valuations and demographic trends.



Source: JPMorgan Asset Management

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Behavioral Finance: Chasing Trends

Recency bias is a cognitive predisposition in which humans tend to over-emphasize recent events. This is remarkably applicable to investing. Investors tend to chase recent outperformers even though that has proven to be a poor strategy over the long term. One of the best recent examples is the rise and fall and resurrection of Bitcoin and other cryptocurrencies. The classification of the asset class is difficult: is it a commodity or a currency? The best answer is that it lacks the defining attributes of either. One of the characteristics of commodities is that they provide utility in their consumption, which Bitcoin does not. While Bitcoin and other cryptocurrencies possess some of the elements that define currencies such as having a limited supply and being accepted for transactions, they're lacking in the "store of value" qualification. While Bitcoin is scarce, scarcity doesn't necessarily imply value. Cryptocurrencies do possess some inflation-hedging characteristics. However, they're poor hedges for market volatility. While Bitcoin's volatility has declined, it remains about 4.5x as volatile as the S&P 500 and 4x as volatile as gold.

Although it can be tempting to chase the latest trend, whether that be Bitcoin or AI stocks, we believe that diversification is critical. That's one of the reasons that we believe so strongly in designing investment allocations that align with client goals, removing the temptation to tweak and adjust based solely on valuations, feelings or headlines. We recommend systematic rebalancing to improve risk-adjusted returns as well as to "buy low" and "sell high" in an organized way. While it's enticing to chase yesterday's winners, there's a great deal of variability from year to year in which asset classes provide the best returns. As such, we recommend a more systematic approach of matching your target allocation with your financial plan and regularly rebalancing towards that target.

2010–2024																
Ann.	Vol.	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Large Cap 13.9%	Small Cap 20.6%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	REITs 41.3%	Comdty. 16.1%	Large Cap 26.3%	Large Cap 25.0%
Small Cap 10.3%	EM Equity 17.9%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	Large Cap 28.7%	Cash 1.5%	DM Equity 18.9%	Small Cap 11.5%
REITs 9.4%	REITs 16.8%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Comdty. 27.1%	High Yield -12.7%	Small Cap 16.9%	Asset Alloc. 10.0%
Asset Alloc. 7.2%	DM Equity 16.5%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 14.8%	Fixed Income -13.0%	Asset Alloc. 14.1%	High Yield 9.2%
High Yield 5.9%	Comdty. 16.1%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	Asset Alloc. 13.5%	Asset Alloc. -13.9%	High Yield 14.0%	EM Equity 8.1%
DM Equity 5.7%	Large Cap 15.1%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	DM Equity 11.8%	DM Equity -14.0%	REITs 11.4%	Comdty. 5.4%
EM Equity 3.4%	Asset Alloc. 10.4%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.0%	Large Cap -18.1%	EM Equity 10.3%	Cash 5.3%
Fixed Income 2.4%	High Yield 9.4%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%	EM Equity -19.7%	Fixed Income 5.5%	REITs 4.9%
Cash 1.2%	Fixed Income 4.7%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	Fixed Income -1.5%	Small Cap -20.4%	Cash 5.1%	DM Equity 4.3%
Comdty. -1.0%	Cash 0.9%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	EM Equity -2.2%	REITs -24.9%	Comdty. -7.9%	Fixed Income 1.3%

Source: JPMorgan Asset Management

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What's It All Mean

Economic Outlook

US consumer health has eroded steadily as the post-COVID stimulus has worn off, evidenced by declining savings rates and rising consumer debt delinquencies. The labor market appears stable and healthy while the risk of a recession in the near term seems minimal, barring an economic shock.

Housing: Rates & Supply

The Fed Funds rate and longer-term rates such as mortgages have become disconnected. Mortgage rates are more likely to be influenced by the outlook for fiscal policy than the Fed's actions. While lower mortgage rates would likely be beneficial in unlocking the housing market, the root issue is more likely the lack of supply.

Inflation & The Fed

Housing makes up about 2/3 of the total CPI figure. Shelter costs are likely to continue to decline as the CPI's measurement methodology catches up to present market conditions. Tariffs and expansionary fiscal policy pose an upside risk to inflation. The Fed is likely to be much more measured in their approach to loosening monetary policy going forward.

Fixed Income

While the Fed has cut rates by 100 bps in 2024, longer-term rates have proven volatile, which has been reflected in fixed income performance. Although volatility isn't likely to diminish meaningfully, starting yields are the best indicator of future returns and current yields represent an attractive opportunity. Fixed income typically outperforms cash during Fed easing cycles.

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What's It All Mean

Equities: Concentration & Opportunities

US growth equities have driven markets over the past decade, but we believe there are opportunities outside of this narrow neighborhood. Valuations and concentration levels are well above historical averages, particularly in the largest US equity segments. In addition to more favorable valuations and growth trends, international equities offer greater diversification than their more concentrated US counterparts.

Behavioral Finance

Historically, attempting to time markets and chase the latest winners has proven to be a poor investment strategy. While some investors can be captivated by recent return trends, it's critical to understand how your investments are working together to achieve your financial goals. Constructing an investment allocation that fits with your unique financial plan reduces the temptation to chase shiny objects. Regular rebalancing helps maintain target risk levels and allows investors to "buy low, sell high" in a systematic manner. We believe that your planning needs should dictate your investment allocation choices rather than short-term trends.

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Relevant Disclosures

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