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Can Stocks Pull Off a Third Consecutive Year of Big Gains?

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By Krystal Hur
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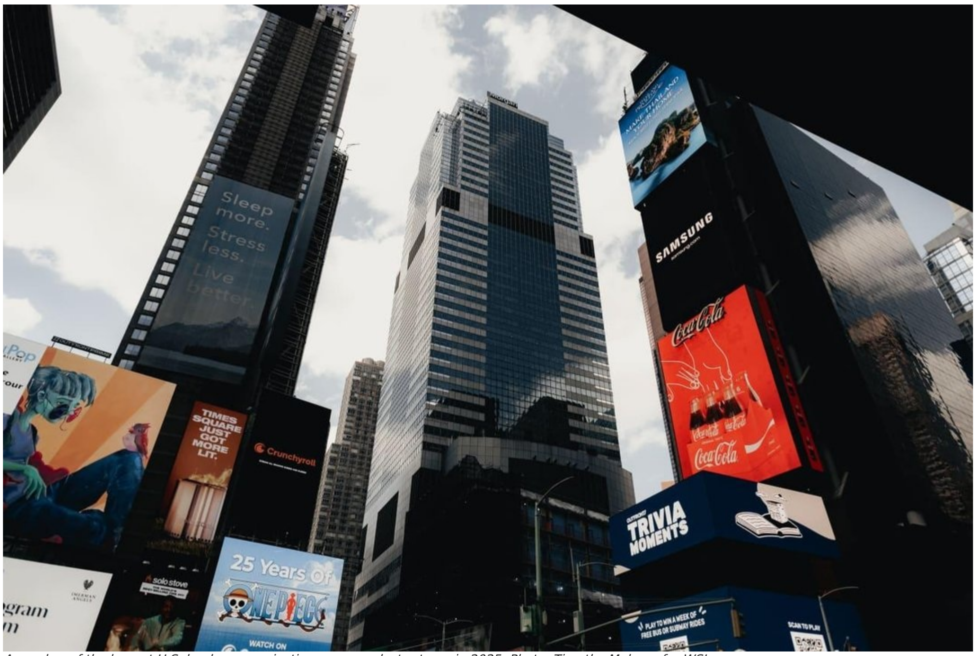
Wall Street is grappling with whether another year of robust gains is possible for a stock market that is looking precariously expensive.

The S&P 500 has surged 28% in 2024 and is on pace for back-to-back annual jumps of more than 20% for the first time since a four-year stretch that ended in 1998.

Strategists at some of the nation's biggest banks are projecting more modest returns in 2025. JPMorgan Chase, Morgan Stanley and Goldman Sachs project that the S&P 500 will reach 6500 by the end of next year, a 6.7% increase from Friday's close of roughly 6090.

Others are a little more bullish. Barclays recently raised its price target to 6600. Bank of America and Deutsche Bank expect the benchmark index to hit 6666 and 7000, respectively.



A number of the largest U.S. banks are projecting more modest returns in 2025. Photo: Timothy Mulcare for WSJ

Analysts generally agree that President-elect Donald Trump's pro-growth policies will be a boon for stocks, but some question how much farther they can run. A backdrop of high interest rates, geopolitical turmoil and potential trade wars could dent the market's gains, some warn. Yet many investors are hesitant to call an end to a rally that has repeatedly defied expectations.

"We're kind of in the honeymoon phase of the new administration," said Matt Miskin, co-chief investment strategist for John Hancock Investment Management. "But the Fed is going to be on the hook for reacceleration of the economy, when it's doing pretty well, frankly, and perhaps a bit firmer inflation."

In the coming days, investors will parse another round of inflation data to see whether price pressures are continuing to ease. That report will be one of the final readings on the state of the economy before the Federal Reserve's December meeting, where the central bank is expected to cut interest rates again. Friday's jobs report suggested the labor market remains healthy.

One reason for optimism heading into next year? More stocks are joining the rally. Traders are bidding up economically sensitive stocks that lagged behind the wider market during the first half of the year. The small-cap focused Russell 2000 index is within striking distance of its first record close in three years, and its November gains nearly doubled those of the S&P 500.

More than 220 stocks in the benchmark index have closed at a 52-week high since the end of October. It would now take erasing the gains of the top 171 stocks in the S&P 500, including Nvidia and Apple, to negate the index's total return this year, according to S&P Dow Jones Indices data as of Wednesday.

Traders typically take a more inclusive rally as a sign that it has legs because the market is less vulnerable to a downturn if a few sectors stumble.

"I don't think there's any surprise about the broadening," said Hal Reynolds, co-chief investment officer at Los Angeles Capital Management. "I'd say the only surprise is that it's taken so long to occur."

Much of the stock market's gains in the first half were driven by the Magnificent Seven group of big tech stocks—Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia and Tesla—that have been propelled higher by artificial intelligence fervor.

Those stocks, seen as safety picks for their massive balance sheets, hopped back into the driver's seat of the market last week, when investors contended with political chaos in France and South Korea. A batch of better-than-expected earnings from Salesforce, Okta and Marvell Technology further lifted tech shares.

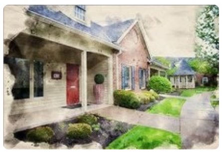
Longer-term, expectations for the stock rally look much bleaker than next year's forecasts. Goldman expects the S&P 500 to gain a meager 3% a year over the next decade, while Bank of America sees flat to 1% annual growth.

One concern darkening the 10-year outlook is uncertainty about whether the AI boom will continue. Some strategists warn AI is unlikely to be as transformative as the market's rally suggests, which could lead to bruising losses down the line.

A potentially stronger dollar during the Trump administration could also weigh on the earnings growth of larger companies that conduct business outside the U.S., some investors say. The U.S. dollar has surged in recent weeks, boosted by the prospect of higher tariffs.

That means that earnings growth beyond the Magnificent Seven could be especially crucial for stocks to continue their climb. Analysts polled by FactSet project S&P 500 earnings to jump roughly 17% next year.

Some investors are skeptical that those expectations, along with another year of blockbuster gains, will pan out.



LVW Advisors Team
Office : 585-267-4900
Fax : 585-504-4599
info@lvwadvisors.com
lvwadvisors.com

Contact Now

"With a consumer that's sort of petered out, drawing down a lot of their savings…it gets hard for me to see those higher price targets," said Logan Moulton, senior portfolio manager at Intelligent Wealth Solutions.

But investors say they are still hunting for pockets of value in a market inundated with expensive stocks. Jimmy Lee, chief executive of Wealth Consulting Group, added to his firm's position in small-caps and other sectors that are less expensive than megacap tech stocks.

The S&P 500 is trading at 22 times its expected earnings over the next 12 months, above its five-year average of 20. The index's information technology sector, which houses Nvidia and Apple, was recently trading at roughly 30 times. In contrast, the S&P SmallCap 600's multiple is about 17.

Traders also remain divided on how much and how quickly the Fed will cut rates in 2025 and beyond. Chair Jerome Powell last week indicated the central bank isn't in a rush to ease policy.

"People think there's going to be this kind of nirvana where the Fed is cutting interest rates and the economy, based on [Trump's] policies, is growing," said Lori Van Dusen, chief executive of LVW Advisors. "There are real risks out there."

Write to Krystal Hur at krystal.hur@wsj.com