Did You Know?

It’s Been a Whale of a Year

After a 26% total return from the S&P 500® Index in 2023, few predicted 2024 would deliver another big year of gains for U.S. stocks. But it did.

Not only did the S&P 500 post a 25% return for the year, but the index reached 61 new *all-time* highs. Together, 2023 and 2024 form the best two-year period for U.S. stocks since the late 1990s.

That’s great news for investors, but it just scratches the surface of their experience throughout 2024. **Figure 1** on the next page provides additional perspective, complete with the full-year cumulative return of the S&P 500 and various market, economic and pop culture headlines.

This illustration reminds us of how economic uncertainties, the November election, geopolitical tensions and other factors challenged investors. Even those all-time market highs likely contributed to anxiety, as some investors fear they indicate a possible correction ahead. Ultimately, we believe the year provided a lesson in maintaining discipline and a long-term focus.

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Figure 1 | S&P 500 Index Return and Headlines in 2024

Data from 1/1/2024 - 12/31/2024. Source: FactSet, Avantis Investors. **Past performance is no guarantee of future results.**
Gross Domestic Product (GDP) is a measure of the total economic output in goods and services for an economy.

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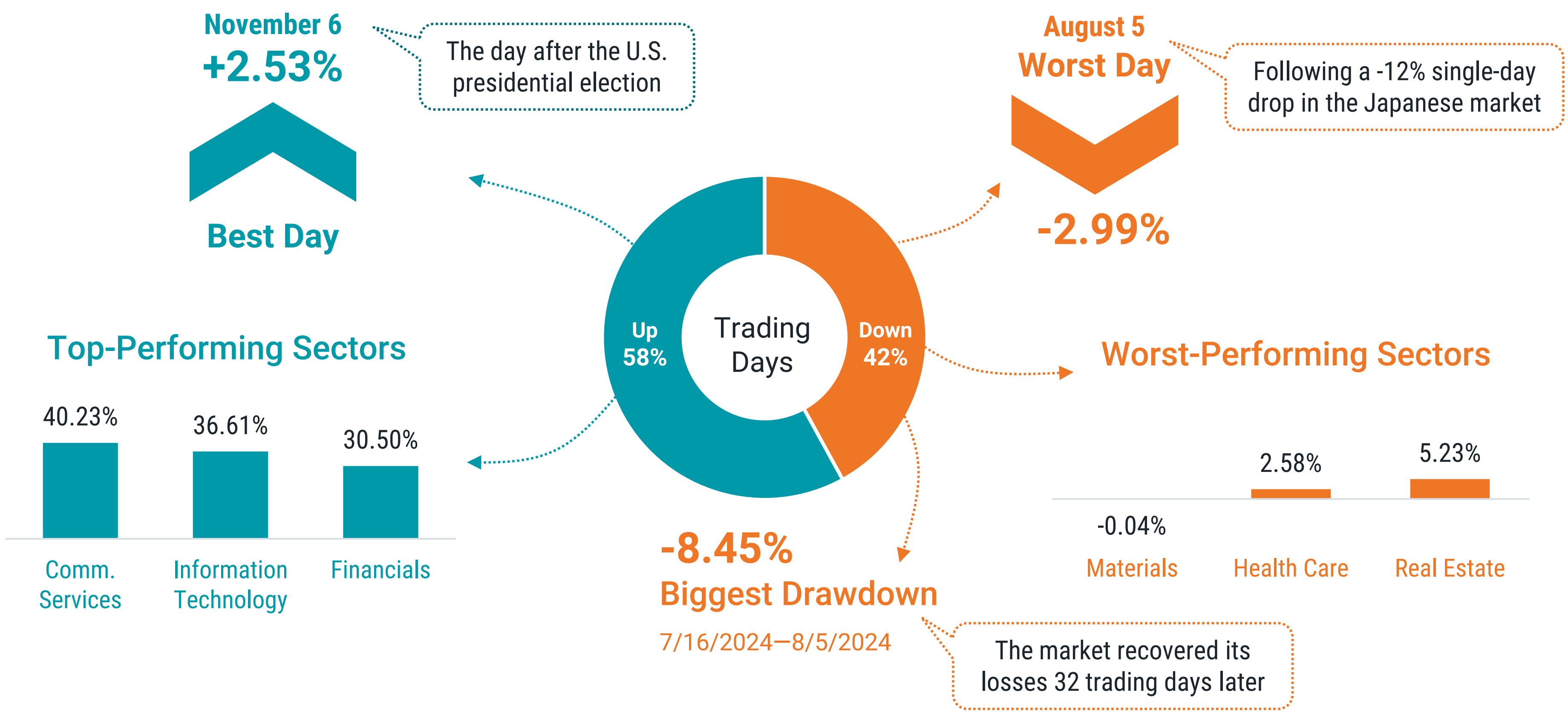
Figure 2 provides a deeper look into the numbers behind the market in 2024. As you might expect, U.S. stocks had more up days than down days, and some days were better than others, while some days weren't great at all.

Not all companies or sectors in the S&P contributed equally to the strong results. While returns were positive for all but one sector on the year, there was wide dispersion among them. Communication Services was the top-performing sector, besting materials stocks, the lowest performer, by more than 40%.

Figure 2 ~S&P 500 Index by the Numbers in 2024



Data from 1/1/2024 - 12/31/2024. Source: Bloomberg, Avantis Investors. **Past performance is no guarantee of future results.**

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The U.S. economic and interest rate picture also remained in focus for investors in 2024. We came into the year with indications that the Federal Reserve (Fed) would likely begin cutting rates before the end of the year. This finally became a reality with a 0.50% cut to the federal funds rate in September. Quarter-point cuts followed in November and December, bringing the target rate to a range of 4.25% to 4.50% at the close of the year, down from 5.25% to 5.50% at the start.

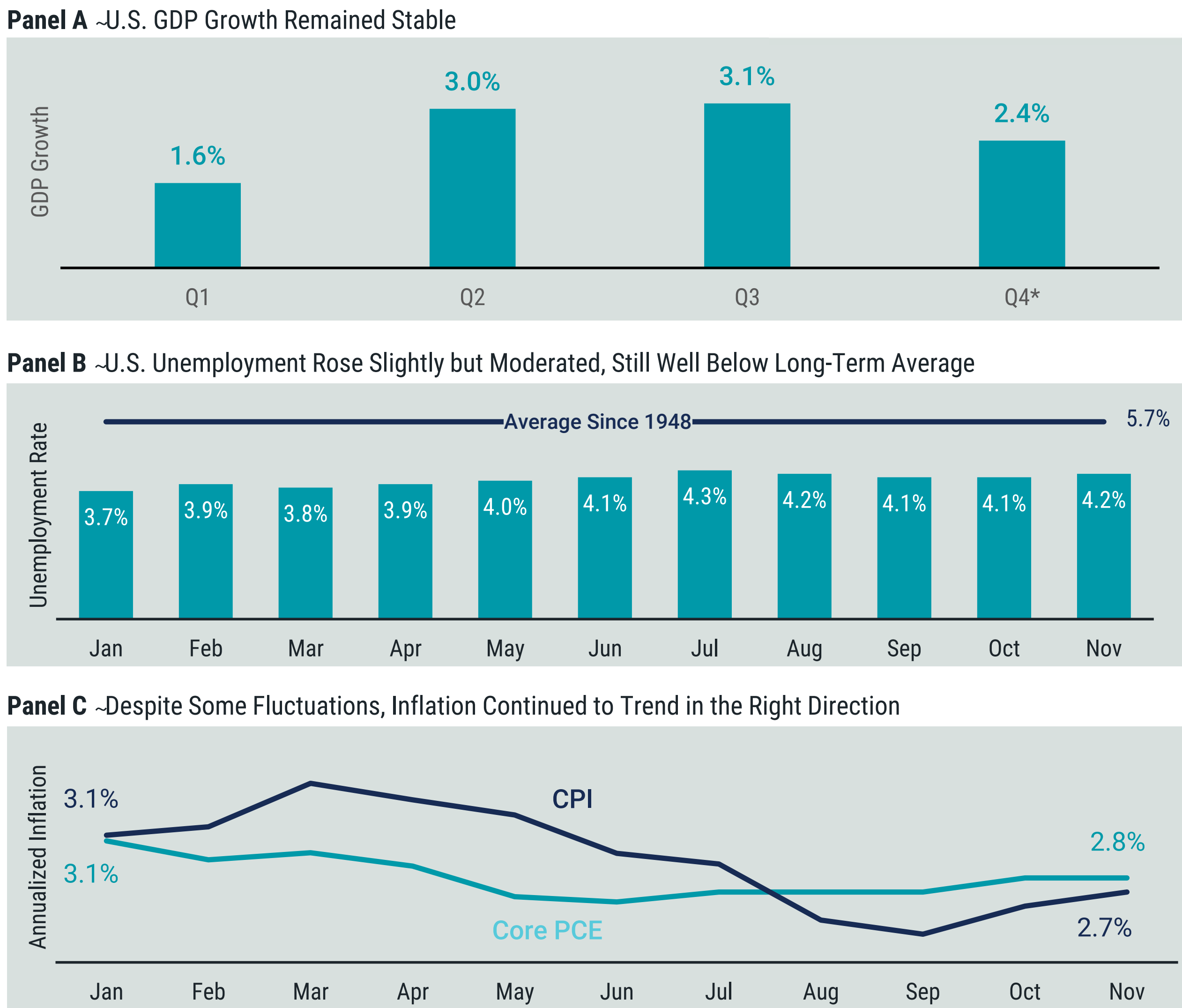
Figure 3 summarizes some of the most watched economic metrics in 2024. The key takeaway is that while much discourse surrounded month-to-month changes in unemployment and inflation, the U.S. economy closed 2024 on solid ground. Inflation still sits closer to the Fed's 2% target than a year ago.

Federal Reserve (Fed) is the U.S. central bank, responsible for monetary policies affecting the U.S. financial system and the economy.

Federal funds rate is an overnight interest rate banks charge each other for loans. More specifically, it's the interest rate charged by banks with excess reserves at a Federal Reserve district bank to banks needing overnight loans to meet reserve requirements.

Gross domestic product (GDP) is a measure of the total economic output in goods and services for an economy.

Figure 3 | The U.S. Economy Was Resilient, Yet Again, in 2024



Panel A Source: U.S. Bureau of Economic Analysis. *Estimate from Atlanta Fed GDPNow as of 1/3/2025.
Panel B Source: FRED. Data from 1/1/1948 – 11/30/2024.
Panel C Source: U.S. Bureau of Labor Statistics. Data from 1/1/2024 – 11/30/2024.

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And how did the bond market react to all this news in 2024? In terms of performance, returns of the Bloomberg U.S. Aggregate Bond Index, a common proxy for the total U.S. bond market, were positive but modest in magnitude compared to stocks, at about 1.25% on the year. The real story was the dramatic change in U.S. yield curves and its implications for investors going forward.

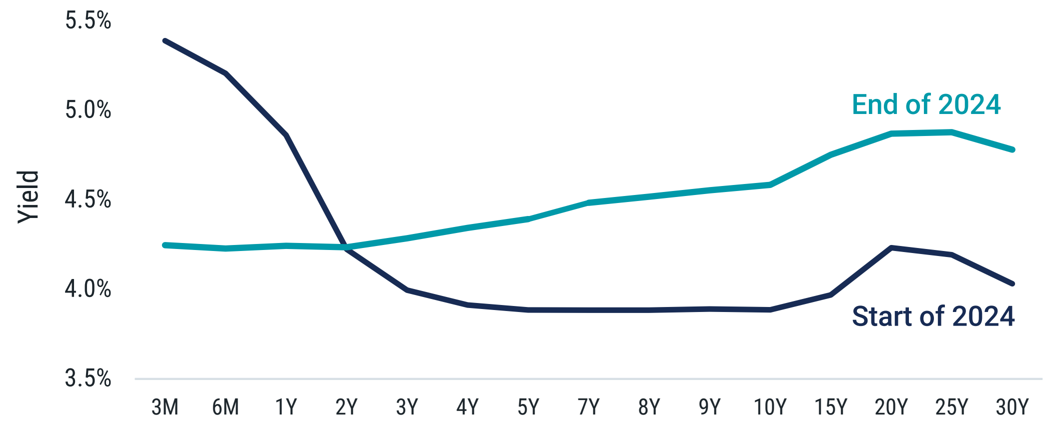
Coming into 2024, the U.S. Treasury curve had been inverted since April 2022 when the yield on 10-year maturity Treasury bonds first became lower than the yield on shorter-maturity, two-year Treasuries. This contrasts with a “normal” yield curve when yields increase with longer bond maturities. In other words, you earn a higher yield for investing in bonds that will take longer for your principal investment to be returned.

As short-term rates rose behind Fed rate hikes throughout 2022 and early 2023, investors could earn higher yields on very short-maturity bonds. Government money market funds became a popular choice for their relatively high yields with low risk. This environment held until around the time of the Fed's first rate cut in September. At that point, the more-than-two-year inversion period for the U.S. Treasury yield curve ended, and the shift toward normalization took hold.

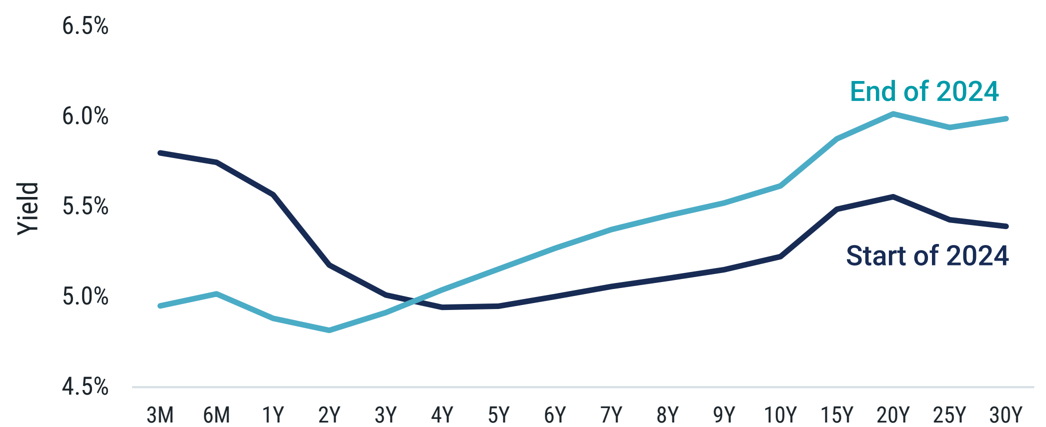
Figure 4 presents a snapshot of the U.S. Treasury curve at the start and end of 2024 (**Panel A**) and BBB-rated corporate bonds at the same dates (**Panel B**). The year-over-year change from inverted to normal is easy to see.

Figure 4 | Getting Back to Normal in 2024

Panel A | Short-Term Treasury Yields Dropped While Longer-Dated Bond Yields Rose



Panel B | Corporate Bond Curves Ended 2024 Normal and Steeper Than the Treasury Curve



Source: Bloomberg. Data as of 12/31/2023 and 12/31/2024.

For investors today, this means that the interest that can be earned on short-term Treasuries and money market funds has declined. Higher yields can now be earned for extending duration (or buying out the curve to longer maturities). But that's not all. With a normally shaped curve, extending duration also provides opportunities to take advantage of expected price appreciation (i.e., if bond yields go down as bonds mature, their prices will go up).

Some bonds across different sectors will have higher expected price appreciation and returns than others. Indexed bond funds simply buy the market without considering expected returns or diversification across issuers and issues, so there are opportunities for potential outperformance by taking these key considerations into account.

Wrapping Up and Looking Ahead

In many respects, 2024 was a tremendous year for investors. Does that mean we enter 2025 without uncertainties or potential anxieties? Hardly so. The truth is that investors always face uncertainty. It comes with the territory, but that doesn't necessitate a bad investment experience if you stay disciplined.

Think back to the start of 2024. There were plenty of reasons then to doubt stocks' performance in the year ahead, but those who stayed invested throughout the year were rewarded with a handsome return.

Of course, not every year will be so kind. Go back to 2022, a year when the S&P 500 ended down nearly 20%. Investors endured some pain that year, but those who continued to stick with the market earned that back and more in the years that followed. Staying the course paid off, as is often the case over time.

So, who knows where 2025 will take us, but if we're betting on anything, it's hanging on to sound, old-fashioned investment principles like broad diversification and a long-term outlook. Their benefits are as certain as you can get when investing for a better future.

Yield: The rate of return for bonds and other fixed-income securities. Price and yield are inversely related: As the price of a bond goes up, its yield goes down, and vice versa.

Yield curve: A line graph showing the yields of fixed income securities from a single sector (such as Treasuries or municipals) along a range of maturities (typically three months to 30 years) at a single point in time (often at month-, quarter- or year-end). Maturities are plotted on the x-axis of the graph, and yields are plotted on the y-axis. The resulting line is a key bond market benchmark and a leading economic indicator.