BERNSTEIN

Our Top Questions for 2025

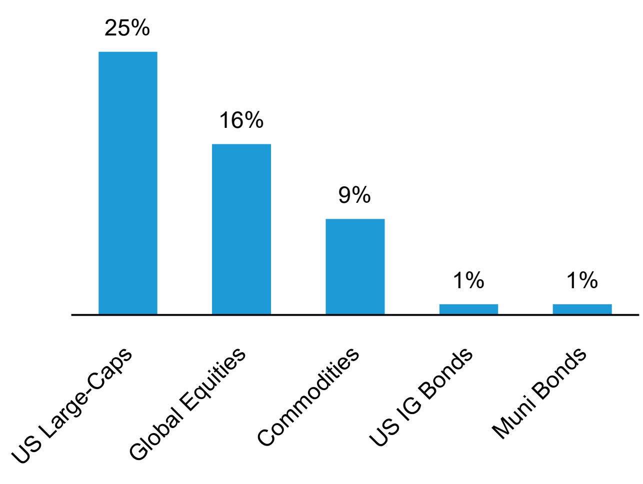
As we prepare to tackle the pressing questions for 2025, it's important to reflect on the year that has just passed. So before we turn our attention to the year ahead, it's worth one last look at the year that was. Overall, markets were surprisingly formidable in 2024. Stocks rose steadily through the year, with only two major hiccups—one in the spring when the US economy's strength seemed to dash hopes of lower interest rates and one in the summer as rising Japanese interest rates rattled markets.

US large-caps led once again among major asset classes for the year, returning another 25% after surging 26% in 2023. That marks five out of the past six years that they've rallied over 15%, despite a sharp 18% tumble in 2022. In fact, 2023's advance merely offset the decline from the year before.

While US large-caps led, global stocks also had a fine year, returning 16%. A diversified basket of commodities gained 9%, with gold contributing significantly. The precious metal rose 25% over the course of the year due to buying by the Chinese central bank and resulting market enthusiasm.

YEAR-TO-DATE RETURNS OF MAJOR ASSET CLASSES

Percent



As of December 31, 2024.
Past performance does not guarantee future results.
Source: Bloomberg and Bernstein analysis

Bond markets faced tougher sledding, mainly due to the timing of changes in interest rates. Ten-year Treasury bonds finished 2023 with a rapid rally, as yields fell from 5% to 3.8% in the fourth quarter. Yet in 2024, the bond market faced headwinds as interest rates reversed part of that move. Still, both taxable bonds and municipal bonds delivered positive returns for the year, earning 1%. Plus, with rates starting higher in 2025, bonds should be in decent shape going forward, even without further relief from rate reductions.

As we step into 2025, we've been fielding a variety of client questions, which tend to fall into a few key categories. Since I can't meet with each of you personally, I wanted to take this opportunity to share these common questions along with our responses. If there's something we haven't covered, please reach out to your Bernstein Advisor. We'll be happy to address your concerns, and may even include them in our next update.

Is inflation truly in the past or do we have to worry about a reacceleration?

It's reasonable to be concerned about inflation after the post-pandemic episode, especially as potential inflationary threats remain on the horizon. In fact, we've raised our inflation forecasts for next year, as has the Federal Reserve. Yet we still believe that policymakers can keep it mainly in check.

The higher inflation we anticipate in 2025 is largely driven by the possibility of new tariff policies being introduced early in the year. Past studies have shown that a 10% rise in the effective tariff rate can lead to an additional 1 percentage point of inflation. While the exact nature of the tariff policy remains unclear, we're evaluating a range of potential outcomes. Additionally, part of the inflationary pressure is due to underlying economic strength, which can naturally drive prices higher. Indeed, it's this economic strength which has already set the baseline inflation higher than the Fed's 2% target, in our view. That said, the potential inflationary impact beyond that baseline doesn't overly worry us or the Fed. On their own, tariffs typically have a one-time effect—and we wouldn't expect an ongoing wave of inflation unless a prolonged trade war broke out.

With the economy strong, how much of a risk are the debt and deficit?

When we wrote our long-form research piece on the national debt and deficit last year, it was met with considerable interest but not a lot of concern. Now, the concern is real. The discussion came to a head in December with the launch of the Department of Government Efficiency as well as the debt ceiling fight. While the solutions aren't easy, at least we're having the conversation.

Our take remains unchanged: warning lights are flashing but alarm bells aren't ringing yet. We still have time to address this issue before the markets potentially react, and we have a reasonable amount of policy space to work with. However, the longer we wait and the less policy flexibility we have, the more challenging it will be to tackle the underlying problems. What's more, if the debt ceiling is removed as a policy constraint, it could spell further trouble.

That said, we consider this a tractable problem that can be addressed with some combination of higher productivity and GDP growth along with fiscal policy changes around taxes and spending. Echoing the previous question, inflation is a little bit of a risk here, too. But inflating our way out is a much less realistic solution than would seem at first blush. The hardest part of solving the debt issue will be forging compromise in Washington, DC, where political polarization remains extreme. We genuinely hope both sides can come together to address the challenge for the good of the nation and our economy.

Has the market gone up too far, too fast?

We understand where this question comes from, given that:

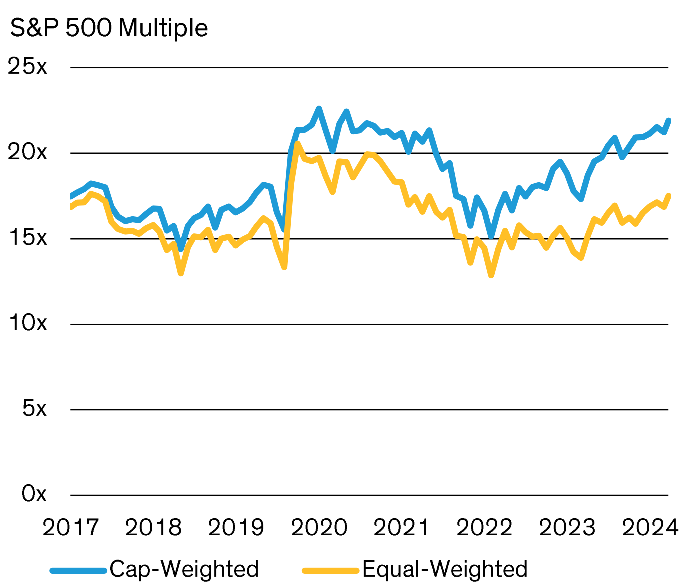
1. The market hit new all-time highs more than once per week in 2024,
2. Today's valuation multiples seem somewhat stretched by historical standards (*Display*), and
3. Sentiment remains quite positive.

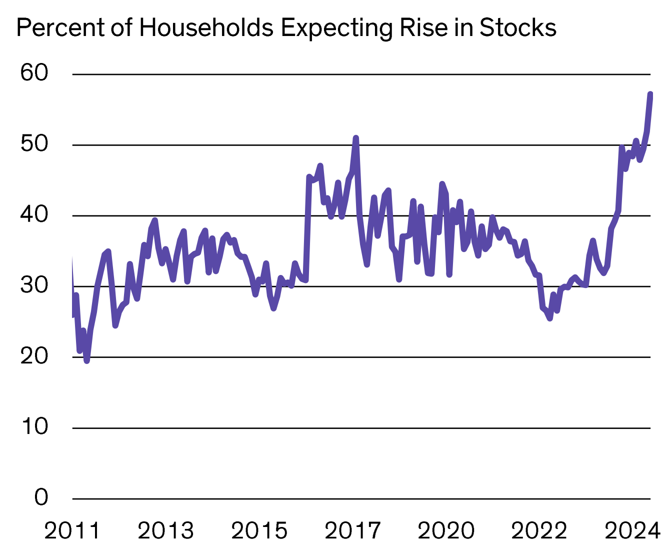
The S&P 500 has risen 81% over the past five years, despite a pandemic, an inflationary breakout, and an interest rate shock. Meanwhile, earnings have risen around 50% in that time.

Valuations for the index overall, as well as for an equal-weighted version of it, both sit in the top decile of their historical ranges. And because they're easy to measure, valuations are one of the most salient metrics investors have. But they're still just part of the picture and tend to have little correlation with returns in the subsequent year. Over longer periods, though, they do exert more of a gravitational pull.

Sentiment has been extremely positive lately as well. Wall Street strategists don't have quite the same degree of narrative consensus as they did coming into 2023. But their market forecasts are uniformly positive. Professional investors are operating with close to as little cash as ever. And one household survey suggests that people feel more bullish about stocks than at any point in the past few decades.

VALUATIONS AND SENTIMENT ARE BOTH ELEVATED





Sources: S&P, The Conference Board, FactSet, Bloomberg, and Bernstein analysis

Here at Bernstein, we work hard to determine what may happen next. But just as important as considering our base case is considering the range and probabilities of realistic outcomes. While we want to perform well if our expectations materialize, we work just as hard to ensure that our clients are protected across all scenarios.

What's the right way to allocate my portfolio today?

Bernstein has several proprietary tools to help refine your asset allocation or confirm that it aligns with your current circumstances and long-term plans. Striking the right balance is the most important decision you can make for your investments. And even though we all navigate the same economic and market conditions, each client's situation is unique.

The key factor in this process isn't just comparing the relative value of stocks versus bonds but understanding your personal risk tolerance. That helps determine your initial stock and bond mix, though it's still not your final step. Our aim is to make sure that your mix of stocks and bonds is right for you—aggressive enough to meet your capital appreciation goals, yet defensive enough to weather shocks and let you sleep soundly.

Including both asset classes in a portfolio is essential, as their diversification benefits largely depend on bonds' ability to protect against growth shocks. However, as we observed in recent years, not every shock is a growth shock. For instance, the shock to real interest rates in 2022 negatively impacted the value of nearly every asset worldwide. As long as inflation is no longer the primary risk driving the market, a combination of stocks and bonds should offer fair diversification benefits.

With interest rates relatively high versus recent years and stock valuations also elevated, bonds do appear slightly more attractive relative to stocks than they have been. Yet even with rates where they are, bonds can't provide the degree of capital appreciation most investors require, which tempers the urge to shift more heavily toward them. In reality, both stocks and bonds offer decent long-term return potential from here. But as Paul Harvey used to say, that's only *half* the story. The rest of the story is in the next answer.

What's the optimal balance to strike between public investments and private investments?

While long-run stock and bond returns both appear reasonably attractive, public markets account for only a portion of the investable universe available today. We think the time has come for individual investors to stop treating alternative investments as "alternative." They're just as core to an investment portfolio as stocks and bonds.

What's more, because of ongoing imbalances and inefficiencies between the supply and demand for capital in private markets, we find that they offer more attractive risk-adjusted returns compared to public markets. We believe these investments can enhance both total returns and reduce the volatility investors experience. But volatility is only one measure of risk. Investors must recognize that private markets come with distinct liquidity needs, tail risks, and other considerations. Since these risks differ from those in public markets, combining them responsibly can also provide valuable diversification benefits.

Has the era of US market dominance run its course?

The perpetual debate over market returns in the US versus the rest of the world has intensified in recent weeks. That's partly driven by the magnitude and persistence of the US's dominance, the role that the Magnificent 7 companies have played, and the gap in valuations between the US and international markets.

Yet the real reason the US has been a star performer over the past 15 years hasn't been multiples or a handful of tech titans. As we detailed in our blog on US versus international stocks, earnings growth has been the true engine of US outperformance. Part of that stems from a tilt toward faster-growing sectors and part from superior performance even within sectors.

Put simply, the future outcome between the US and international stocks will come down to two primary factors: a tailwind for the US from a continued edge in earnings growth and a headwind from relative valuations. In addition, a strong dollar would assist US stocks' relative performance and a weak dollar would detract from it.

On balance, we think that over the medium to long term, the edge from earnings growth is likely to outweigh the valuation gap. Plus, the incoming administration's proposed policies are likely to boost the value of the dollar.

One factor most tend to ignore? The low signal-to-noise ratio in geographic calls. In other words, even though we expect the US to outperform, we can only have so much confidence in that call. That's why we remain overweight relative to a global benchmark but view "going all-in" on the US as overdoing it.

Another Year, Another Set of Surprises

Here at Bernstein, we're not aiming to predict what happens next. Instead, we try to prepare for a range of outcomes. Over the past few years—and the past few decades—that approach has served our clients well.

We don't know what surprises 2025 has in store for the markets, but our portfolios stand ready to weather them and our investment teams remain confident they'll navigate them astutely.

As always, thank you for trusting us with your capital. We endeavor every day to ensure we consistently deserve that well-placed trust.

Happy New Year!

Best regards,

Alex Chaloff
Chief Investment Officer

Alex Chaloff is the Chief Investment Officer and Head of Investment and Wealth Strategies at Bernstein. In this role, he leads a national team of strategists across investments and wealth planning—including asset allocation advice, investment platform oversight, model portfolio construction, new product development, manager research, tax planning and solutions, and estate planning research—while remaining continuously focused on moving our clients forward with strong after-tax risk-adjusted returns. Alex has spent his Bernstein career refining our investment platform, listening to clients, and conducting deep research into investment and wealth planning topics that are critical to achieving clients' goals.

BPWM-661575-2025-01-02

BERNSTEIN

INVEST WITH INTENTION®
BERNSTEIN.COM