VAUGHAN NELSON

Investment Perspective

Fourth Quarter 2024

The U.S. Federal Reserve continued to cut interest rates despite rising near-term inflation expectations resulting in a steepening yield curve, higher longer-term interest rates, and reduced expectations of further interest rate cuts in 2025. During the fourth quarter, rising interest rates and a stronger U.S. dollar led to muted returns in equity markets with the S&P 500 increasing 2.41%, the Russell 2000 Value declining 1.06%, and the MSCI EAFE declining 8.11% for the quarter. Even with the muted fourth quarter returns, equity markets marched higher in 2024 with full year returns of 25.02%, 8.05%, and 3.82% for the S&P 500, Russell 2000 Value, and MSCI EAFE, respectively.

As we enter 2025, we anticipate U.S. economic growth will remain resilient despite a weak global industrial cycle and weak economic growth outside of the United States. Inflationary pressures will continue to build in the first quarter of 2025, but the longer-term outlook for inflation and economic growth will be highly dependent on any material shifts in fiscal and monetary policy by the new administration. Equity markets may prove vulnerable to corrections in the first half of 2025 as investors adjust to the heightened uncertainty of shifting monetary/fiscal policy, geopolitical countermeasures, and declining liquidity conditions.

The Bloomberg Aggregate Index declined 3.06% for the quarter and finished the year up 1.25%. The ICE BofA 1-10 AAA-A Municipal Index declined 0.81% during the quarter and finished the year up 1.43%. During the quarter, the Federal Reserve cut interest rates 25 basis points in November and December, reducing the target rate to 4.50% at year-end. With inflation declining towards the Fed's 2% target and with the labor market softening, the Fed indicated that more cuts are likely, but it will be a meeting-by-meeting decision based upon the data. Looking into 2025, the market is pricing in 1 to 2 additional 25 basis point cuts which would lower the target rate to 4.00-4.25%.

During the year, the front end of the yield curve declined approximately 100 basis points, matching the Fed's target rate cuts from 5.5% to 4.5%. Conversely, the intermediate and long end of the curve backed up approximately 70 basis points. These shifts in interest rates resulted in a normalized yield curve after being inverted since 2022.

Investment grade credit spreads tightened 7 basis points during the quarter, ending the year at +77 basis points over Treasury yields. Credit spreads declined throughout the year due to healthy financial conditions and strong investor demand for credit. With spreads now trading inside historical averages and with low volatility levels, we anticipate better opportunities to add to Corporate bonds in 2025 should credit spreads widen.

During the year, we increased duration across our fixed income strategies to lock in higher yields for longer. We plan to maintain duration in-line with the respective benchmarks in 2025 but will be nimble should interest rate policies or financial conditions change.

600 Travis St., Suite 3800 ▪ Houston, Texas 77002-3071 ▪ 713.224.2545 ▪ 888.888.8676 ▪ Fax: 713.247.9534