Q4 24 WEALTH MANAGEMENT QUARTERLY INVESTMENT LETTER

The Year in Ten Charts

Quick Look

- Yet again, the best performing asset class for the year was U.S. Large Stocks.
- This year's 25% gain marks only the third time of the post-war era that the S&P 500 Index has closed with consecutive 20%+ equity returns.
- In 2024, the Mag-7 grew earnings by 33%, while the other 493 stocks combined for just 4% earnings growth.
- The Cyclically Adjusted PE Ratio (known as CAPE) values the S&P 500 at nearly 40x; only the dot-com bubble was more expensive.
- The rest of the world trades at a 40% discount to the S&P 500 Index, the widest disparity on record.
- U.S. Stocks have outperformed bonds by more than 10% annualized over the last five years, which is well above the historical average spread of 4% between the two asset classes.
- Both investment grade and high yield corporates are essentially at their tightest yields in the past 20 years.
- The year ended with a sense of post-Election animal spirits for a handful of speculative assets.

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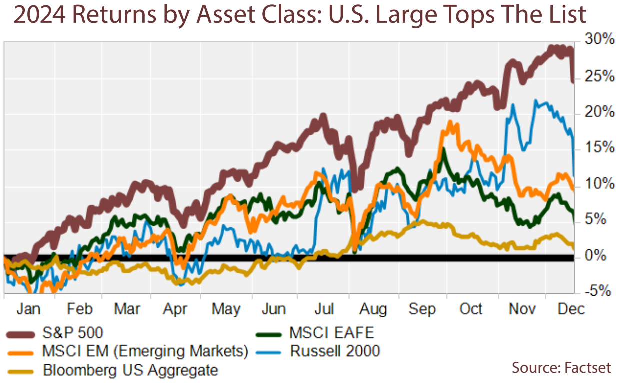
We are independent and transparent in all aspects of investment management decision making and financial planning. We selectively partner with like-minded individuals and families, endowments, foundations, and 401(k) plans in over 30 states.

Quarterly Investment Letter, Q4 2024

Happy New Year! Year 2024 was a profitable one for investors, as U.S. stocks reached nearly 60 all-time highs during the year. Here are ten charts that we think best encapsulate the year that was, as well as set the stage for our entry into Year 2025.

1 Let's start with **Asset Class Returns**. Yet again, the best performing asset class for the year was U.S. Large stocks (thick maroon line, up 25%). The dominance of the asset class has a similar feel to Tom Brady's Patriot dynasty, as U.S. Large stocks have finished as one of the top three asset classes in 10 of the last 12 years. U.S. Small stocks (blue line) gained 12%, which are solid returns on a standalone basis, though the asset class has now trailed U.S. Large stocks in six of the last seven years. Developed International stocks (green line) and Emerging Markets (orange line) returned 5% and 9%, respectively, as both saw local returns eroded when converted back into dollar returns. Investment-Grade bonds (gold line) returned 1%, as their coupons were partially offest by an increase in yields for longer-dated bonds. In summary, balanced portfolios finished the year with above-average annualized returns, especially those with higher allocations to stocks.

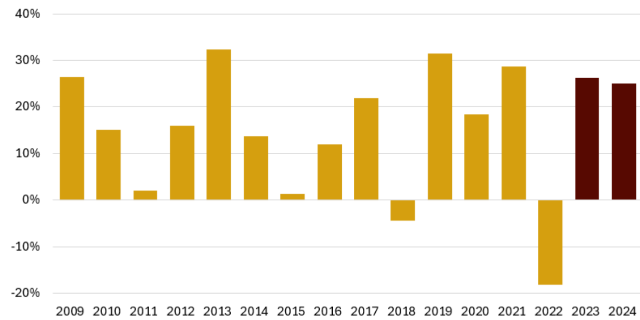
2024 Returns by Asset Class: U.S. Large Tops The List



Source: Factset

2 This year's 27% gain marks only the third time of the post-war era that the S&P 500 has closed with **consecutive 20%+ equity returns.** Since the October 2022 market bottom, the S&P 500 has gained 70%, leaving recession worries further in the rear-view mirror. Year 2024 marked the 15-year anniversary of the nadir of the Great Recession's drawdown, in which the S&P 500 Index bottomed out at 666 points. In November, the Index crossed above the 6,000 level. That means a $5,000 purchase of the Index at the 2009 market bottom has now grown to more than $50,000. A 10x bagger in just over 15 years! Annualized returns over this time have been more than 16%, well above the Index's historical returns of 10%. It has been a remarkable ride, and one that did not require picking the next great stock. Investors simply needed market participation and patience.

S&P 500 Annual Returns: Consecutive 20%+ Gains



Source: Portfolio Visualizer

3 Not mentioning the **Magnificent-7's** role in this recent stock market would be like failing to mention Tom Brady's contribution to the Patriots dynasty. The Mag-7 are the seven largest stocks in the U.S. by market capitalization, and they now comprise a 33% share of the overall index. Over the past two years, the Mag-7 have accounted for nearly 60% of S&P 500 Index returns. If you removed these seven stocks from the Index last year, returns would have been reduced from 29% to just 10%, and this explains why just 20% of stocks outperformed the overall Index. While concentration of returns is one of several parallels to the dot-com era, the Mega-Cap Tech stocks of this era are backed by robust profit margins, operating leverage, and strong earnings growth. This year, the Mag-7 grew earnings by 33%, while the other 493 stocks combined for just 4% earnings growth. This disparity in earnings growth is forecasted to narrow in 2025; if that occurs, you would expect returns to be more broad based.

U.S. EQUITY RETURNS (%)

As of 12/31/2024	Q4 2024	1-Year	3-Year	5-Year	10-Year
S&P 500	2.4	25.0	8.9	14.5	13.1
Russell 1000 (Large Cap) Growth	7.1	33.4	10.5	19.0	16.8
Russell 1000 (Large Cap) Value	-2.0	14.4	5.6	8.7	8.5
Russell 2000	0.3	11.5	1.2	7.4	7.8
Russell 2000 (Small Cap) Growth	1.7	15.2	0.2	6.9	8.1
Russell 2000 (Small Cap) Value	-1.1	8.1	1.9	7.3	7.1

Source: Morningstar

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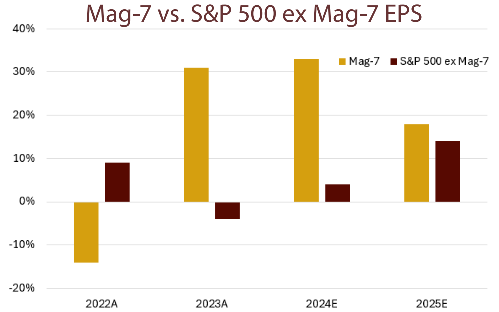
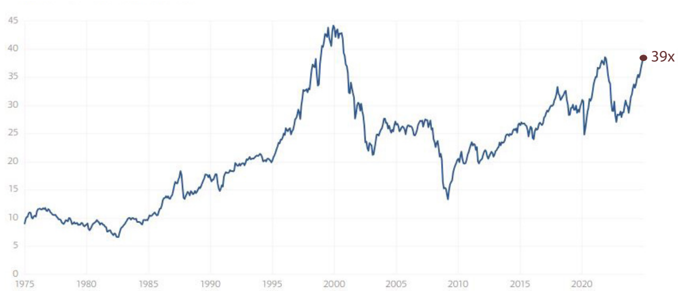
Mag-7 vs. S&P 500 ex Mag-7 EPS



Source: JPMorgan

4 What can trip up U.S. Large stock dominance? One major headwind is that **U.S. stock valuations** are rich by almost any metric. The Cyclically Adjusted PE Ratio (known as CAPE) values the S&P 500 at nearly 40x; only the Dot-com bubble was more expensive. Historically, when countries have exceeded a 40x CAPE ratio, future 5- and 10-year real returns have been negative. The challenge with valuations is that they show no predictive evidence for one-year returns. Expensive stocks and markets can always get more expensive. The takeaway here is that the origins of long periods of above-average returns, such as the last 15 years, almost always start with suppressed valuations like the 13x CAPE in 2009. History strongly favors the notion that, over the next decade, valuations will gravitationally pull returns back down towards historical averages.

U.S. Cyclically Adjusted Price-to-Earnings Ratios



Source: Robert Shiller

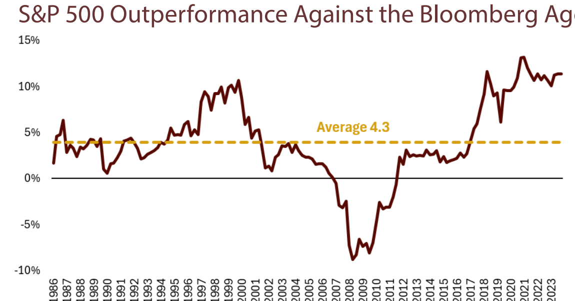
5 Though it is hard to remember, 15 years ago the U.S. stock market traded at a discount to the rest of the World. Fast forward to today, and the rest of the World trades at a 40% discount to the S&P 500 Index, the widest disparity on record. Yes, earnings growth has been stronger in U.S. stocks (specifically Mag-7), but while U.S. market valuations have soared, the rest of the World has seen no discernible multiple expansion over the last 15 years. Furthermore, dollar strength has also worked against **International equity** for U.S. investors. The collective post-Election presumption is that the dollar will further strengthen with Trump as President, but the U.S. Dollar Index actually declined -10% during the entirety of Trump's first tenure.

International and US 12mo Forward PE

Source: WSJ

6 No asset class has dragged on balanced portfolio returns over the past 15 years more than **Investment-Grade Bonds**. The primary culprit for the paucity of returns from the asset class stems from the Fed's zero-percent interest rate policy during much of this time period. Stocks have outperformed bonds by more than 10% annualized over the last five years, which is well above the average historical spread of 4% between the two asset classes. Higher interest rates should remedy this disparity going forward, as history shows that when the 10-year Treasury is above 4% (it closed the year at 4.6%), annualized returns for a 60/40 balanced portfolios trail the S&P 500 Index by less than 1%, despite 33% less volatility.

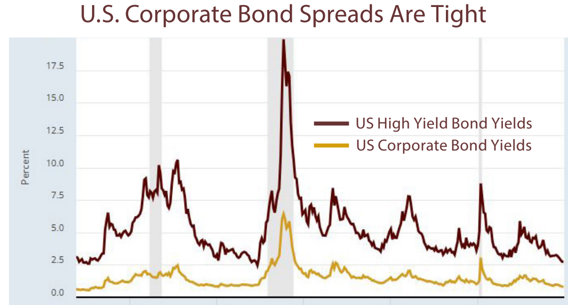
S&P 500 Outperformance Against the Bloomberg Agg



Source: MorningStar

7 While bonds are viewed primarily as safe investments, the degree of risk within bond asset classes can vary widely. Investors are compensated for riskier bonds with higher yields, and this difference between riskier corporate bonds as compared to Treasurys is known as the credit spread. Right now, **credit spreads** are tight! Both investment-grade and high-yield corporates are essentially at their tightest yields in the past 20 years, priced without any concern for unexpected macro shocks or market turmoil. Playing it safe with a hearty allocation to U.S. Treasurys looks like a sensible bet within fixed income allocations, given current spread levels.

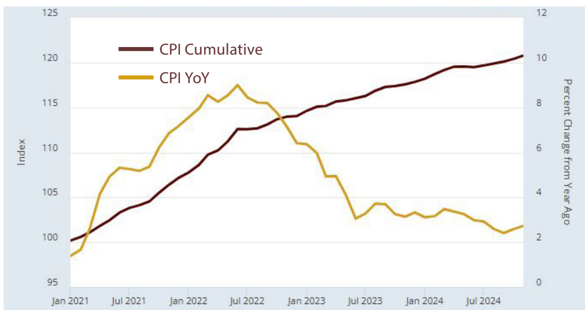
U.S. Corporate Bond Spreads Are Tight



Source: FRED

8 If the 2024 Election results had to be explained with one chart, we would point to this one. While Wall Street views **inflation** through the lens of price changes from a year ago (the gold line), Main Street measured inflation by the 20% cumulative surge in prices during the tenure of the Biden administration (maroon line). During the campaign, The Harris Team could accurately tout all-time highs in the stock market, real wage gains, and above-trend economic growth, but it could not overcome the cumulative impact of unexpected inflation. This was, of course, not just a U.S. swing issue, as every governing party facing election in a developed country lost vote share in 2024, the first time that has happened in the post-war era.

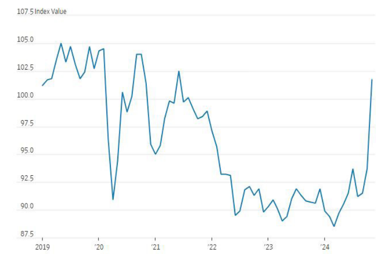
Inflation: Wall Street vs Main Street



Source: FRED

9 While economic policy details will have to wait until after the Inauguration, consumer confidence readings spiked following the election, citing expectations for lower inflation and higher stock prices. **Small Business Optimism** also surged to its highest level since November 2016, the last time Trump was elected, banking on lower taxes and less regulation, perhaps with the help of the newly appointed DOGE advisory commission. Despite the all-Republican Congress, the GOP's narrow majority in the House may make implementation of campaign promises on taxes and deregulation more challenging than currently projected. The debt ceiling will need to be one of the first items addressed, and will likely require participation from members of the House Freedom Caucus who have consistently voted against debt ceiling increases.

Small Business Optimism Index



Source: NFIB

10 Finally, we would be remiss if we did not touch on the post-Election **animal spirits** for a handful of speculative assets. Tesla is up 70% since the Election as investors bet that Musk's newfound political influence translates into company profits. Crypto-related stocks MicroStrategy and Coinbase both saw 70% gains within weeks after the election. Dogecoin, which was launched years ago as a joke, jumped 130%. These returns, however, pale in comparison to the 1,500% surge in Fartcoin. Yes, this is a real coin, with a year-end valuation of over $1 billion dollars. These price moves are not fundamentally driven, and our best advice for those entering this casino is to not be the one left holding the bag when the air goes out.

Fartcoin Price Rips

Source: CoinMarketCap

As a closing thought, two years ago we entered the New Year mired in deep pessimism due to a 40-year high in inflation, deeply restrictive monetary policy, and a near-certain recession. As those problems have abated, investors who stayed the course in risk assets have been rewarded with above-average returns. Now entering 2025, optimism abounds that not only will the recent good returns continue, but even get better. The fears of two years ago have transcended into fears of missing out, particularly within a concentrated subset of extremely speculative, but memeworthy, assets. We appreciate your partnership with our firm and wish you the best in the Year 2025.

INTERNATIONAL RETURNS (%)

As of 12/31/2024	Q4 2024	1-Year	3-Year	5-Year	10-Year
Int'l Developed ex US	-8.1	3.8	1.7	4.7	5.2
Emerging Markets	-8.0	7.5	-1.9	1.7	3.6

Source: Morningstar

FIXED INCOME RETURNS (%)

As of 12/31/2024	Q4 2024	1-Year	3-Year	5-Year	10-Year
Aggregate Bond	-3.1	1.3	-2.4	-0.3	1.4
Muni	-1.0	1.9	-0.4	1.0	1.8
Int'l Bonds	-4.3	-0.8	-2.7	-1.2	0.1
High-Yield	0.3	7.6	2.8	3.7	4.3
Short-Term	-0.1	5.1	1.8	1.9	2.0
90-Day T-Bill	1.1	5.3	4.3	2.6	1.9

Source: Morningstar

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