Investment Perspective

The S&P 500 (SPX) delivered a robust 25% return in 2024, driven by the exceptional performance of the "Magnificent Seven" (Mag 7), which propelled the index to record highs. At year-end, the Mag 7 accounted for 31% of the index's market capitalization, highlighting a notable concentration in the largest companies. However, this dominance is expected to diminish as other companies within the index may experience greater return potential going forward. We anticipate an inflection point this year that will broaden investor sentiment, benefiting small- and mid-cap stocks.

Several catalysts, including deregulation, heightened M&A activity, improved business confidence, and a stronger emphasis on domestic winners fueled by favorable terms of trade and reshoring efforts

In 2025, a positive market environment will likely be supported by several catalysts, including deregulation, heightened M&A activity, improved business confidence, and a stronger emphasis on domestic winners fueled by favorable terms of trade and reshoring efforts. Smaller-cap stocks, which tend to have a more domestic focus, are well-positioned to capitalize on these trends, offering strong capital appreciation potential over the coming years, particularly when compared to large-cap counterparts. The current backdrop of double-digit earnings growth, moderating inflation, and monetary easing by the Federal Reserve underpins a bullish outlook for equities. A summary of index returns for the year ending December 31, 2024 is as follows:

Index	Return	Index	Return
Dow Jones Industrials	15.0%	Russell 2500	12.0%
MSCI EAFE	4.4%	Russell 2500 Growth	13.9%
NASDAQ Composite	29.6%	S&P 500	25.0%

GLOBAL ECONOMY

World economic growth will expand by 2.5% this year after better-than-expected results in 2024. America continues to dynamically grow amidst a global backdrop that is challenging for the other major economies. From a regional perspective, Europe and Japan are experiencing slow growth with the Eurozone at 0.8%, the U.K. at 0.7% and Japan at 1.2%. China is struggling to stimulate domestic demand and digest the problems associated with too much local government debt and an oversupply of real estate development. Also, the Chinese export sector is weaker due to tougher trade relations with the U.S. Furthermore, China is experiencing population decline for the third consecutive year, with the total population decreasing by approximately 1.39 million people. Overall, the global growth outlook is moderately constructive and supported by easing at all the major central banks, except for the Bank of Japan which is raising interest rates.

The global growth outlook is moderately constructive

Turning to the U.S., the economic outlook for 2025 is positive, with several key indicators suggesting steady progress. GDP growth is expected to be 2.5% after a solid year of 2.8% growth in 2024. This optimism centers around balanced contributions from all major economic sectors and no obvious weaknesses in the economy. Consumer spending is

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expected to remain robust this year at a 2.7% annual rate. Although there is lingering concern that the consumer segment may face exhaustion after a multi-year period of expansion, steady employment and recent wage growth above inflation are bolstering disposable incomes. Payrolls added 2.2 million workers in 2024 compared to the 3.3 million additional workers added in 2023, so some deceleration of growth is evident but not thesis changing. The residential sector is projected to experience moderate growth. The housing sector, while constrained by relatively high mortgage rates impacting existing home sales, is expected to see some uplift from new housing constructions as market demand shifts toward newly built homes.

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Business investment is expected to contribute strongly to GDP growth, especially for technology investments. The service sector is exhibiting robust growth with the Services PMI indicating continued expansion and hitting a high reading of 54.1 in December 2024. The services PMI has expanded in 22 of the last 24 months dating back to January 2023, and December's reading was the 3rd highest reading in 2024. Manufacturing activity levels are subdued but improving from a trough period. The manufacturing PMI registered 49.3 in December, up a little bit from the prior month. In summary, the U.S. economy is set for steady growth, driven by solid consumer spending, an improving housing market, enhanced capital investments, and resilient employment dynamics. These factors collectively underpin a positive economic trajectory for the U.S., which distinguishes it from the slower growth rates observed in other major global economies.

INTEREST RATES & INFLATION

In the three meetings between September and year-end 2024, the Federal Reserve reduced the federal funds rate by 100 basis points to 4.5%. The central bank acted to reduce the impact of restrictive monetary policy so that the economy does not slip into recession. At this juncture, Fed Chairman Powell has successfully engineered a "soft landing" despite the claims that it was going to be tricky. However, inflation will need to decrease to justify another 100 basis points of interest rate cuts. Currently, the market expects approximately 40 basis points of cuts over the next 12 months, slightly below the Fed's internal forecasts of 50 basis points. Most important, this easing process will be data dependent, and the monthly inflation report will continue to play a dominant role in investor psychology.

We expect a gentle downtrend trend in inflation over the next year, but it may be challenging to meet the Fed's 2% policy target

The consumer price index (CPI) in December increased 2.9% y/y and core inflation (CPI excluding food and energy) rose 3.2% y/y. The Fed's preferred measure of inflation, the core personal consumption expenditure (PCE) price index, which excludes the impact of food and energy prices, rose 2.8% y/y in December. We expect a gentle downtrend trend in inflation over the next year, but it may be challenging to meet the Fed's 2% policy target. To reflect the challenges of winning the battle against inflation, the yield on 10-year Treasury bonds increased from 3.60% to 4.61% since the September 18 interest rate cut. Bond investors are pricing in risk associated with a bigger budget deficit and demanding a higher term premium.

NEW YEAR, NEW LEADERSHIP, NEW PRIORITIES

President Trump hit the ground running with a flurry of executive actions that will create tailwinds for businesses and the investment environment. The full set of initiatives will center around deregulation, antitrust leniency, energy policies, tax reforms, domestic production incentives, reshoring efforts, immigration policies, and the broader America First strategy. First and foremost, the administration's commitment to deregulation remains a cornerstone of its economic strategy. By reducing the regulatory burden on businesses within sectors such as energy, healthcare, and technology, the government aims to foster a more conducive environment for expansion, thereby attracting investment from domestic and international partners. This initiative is projected to particularly benefit small and medium-sized companies by allowing them more flexibility and reducing compliance costs, which are often disproportionately burdensome for smaller players. In tandem with deregulatory efforts, the administration is also adopting a more lenient stance on antitrust scrutiny, which will facilitate more M&A. By removing barriers to consolidation, U.S. firms can better compete with international rivals, especially those in China that benefit from government-backed sponsorship.

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Additionally, incentives for domestic production are being aggressively promoted to strengthen the U.S. manufacturing sector and reduce dependency on foreign manufacturing, particularly from China. The goal is to make it economically viable for companies to return production to the U.S., thus creating jobs and enhancing the nation's industrial base. Regarding energy policy, the administration favors strategies aimed at lowering oil prices and increasing domestic energy production. By expanding drilling operations and rolling back restrictions on coal, energy costs should decline. In turn, lower energy prices should have a cascading effect on other sectors, such as manufacturing and transportation, thereby boosting economic activity and keeping inflation in check. Immigration policies are also changing in ways to focus on attracting skilled workers through merit-based immigration systems while tightening borders to curb illegal immigration. The supply of unskilled labor will shrink, and corresponding wages may increase. Lastly, tax policy also plays a pivotal role in the Trump agenda. The administration proposes further tax cuts for individuals and corporations, aimed at spurring spending and investing. Overall, these initiatives are designed to enhance the U.S. economy's competitiveness and improve the investment climate. In addition, these dynamics should disproportionately benefit small and mid-cap stocks.

Lower energy prices should have a cascading effect on other sectors, such as manufacturing and transportation

INVESTMENT OUTLOOK

The current environment is constructive for investing, with small- and mid-cap growth stocks poised to deliver double-digit returns over the intermediate term. Key drivers include robust corporate earnings growth of over 10%, a more accommodative monetary policy stance, a moderate inflation outlook, and improving investor sentiment. Additionally, policies from the Trump Administration support favorable market conditions.

We forecast S&P 500 (SPX) operating earnings per share to grow 12.5% this year to $270, following a 9% increase last year to an estimated $240 per share. Productivity enhancements are playing a critical role in driving earnings during this expansionary phase. Companies offering productivity solutions, such as those leveraging artificial intelligence, are delivering above-average growth, while firms implementing these solutions are achieving margin expansion. Interest-sensitive sectors, including banks, should also contribute meaningfully to SPX earnings with a rebound from cyclical lows.

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At present, the SPX trades at 22.3x forward earnings, compared to a long-term historical average of 16.6x and a 10-year average of 18.2x. In contrast, the Magnificent Seven (Mag 7) are trading at 42x forward earnings, reflecting their superior growth prospects and cash flow generation. Aggregate Mag 7 earnings are expected to grow 22% year-over-year in the fourth quarter of 2024, compared to 9.7% growth for the remaining 493 companies in the index. This would mark the highest growth for the broader market since the second quarter of 2022. Looking ahead, Mag 7 earnings are projected to grow approximately 17% in 2025, compared to 9% growth for the rest of the SPX. This superior earnings growth has driven the Mag 7's outsized contribution to index performance, accounting for nearly two-thirds of the SPX's 25% return in 2024, with the average Mag7 stock return of 107%. However, we anticipate an inflection point coming where other companies will close the gap relative to the Mag 7's growth.

From a supply-and-demand perspective, three significant trends warrant attention. First, we foresee a constructive environment for mergers and acquisitions, supported by reduced antitrust scrutiny, improved business confidence, and greater access to capital. U.S. M&A activity reached $1.32 trillion in 2024, a 5% increase from the prior year. Second, consistent with bull markets, and IPOs increased 46% in 2024, with 225 IPOs compared to 154 in 2023. Third, the broader stock market has experienced narrowing breadth as investor focus has concentrated on mega-capitalization stocks. This has created a two-tiered market where equally weighted indices have underperformed. Looking forward, we expect a broadening of investor focus. Emerging trends favor a rotation into overlooked segments of the market, particularly small- and mid-cap stocks, amid a supportive macroeconomic and policy backdrop.

We are in a pro-growth market environment with modest GDP growth, moderating inflation, normalizing monetary policy and double-digit earnings growth

There is an old saying, "as January goes, so goes the year." Since WWII, when the stock market increases in January, the year is up 85% of the time with an average return of 16.5%. Also, this is an inaugural year of a newly elected president and, since 1945, the SPX rose 85% of the time with an average gain of 13.1%. Additionally, this is the "Year of the Snake" according to Chinese tradition, which is a symbol of wisdom, intuition and strategy. The SPX was up 32.4% in the last snake year (2013) and up 31.7% in the snake year of 1989. However, in the snake year of 2001, the SPX was down -11.9%, but the Russell 2000, a small cap index, was up 2.5%. That was a year of divergence.

The financial markets are entering a renaissance period after several years of uncertainties. The 500 basis points of interest rate increases in 2022-23 created fears of recession as did

the signaling from the inverted yield curve. Fortunately, the worst fears did not come to pass, and the U.S. economy nailed a "soft landing." It turns out the sluggish period in 2022 was a "pause that refreshes" and not the beginning of deep downturn. Today, we are in a pro-growth market environment with modest GDP growth, moderating inflation, normalizing monetary policy and double-digit earnings growth. Additionally, the Fed's quantitative tightening program will likely end in 2025, lending further support to asset prices. It is important to remain alert and cautious about signs of a re-ignition of inflation as that would change the market's outlook on interest rates and valuations. The key risks include China's slowdown, collateral damage from tariffs or immigration policy, a slowdown in earnings growth, geo-political conflicts, higher inflation, and an unexpected worsening of corporate credit. In our opinion, quality small and medium-sized growth companies remain likely to achieve above-average annual returns over the next few years.

Appendix: Summary of Key Economic and Financial Measures

	Yearend 2023	Yearend 2024	Difference/ Change
Fed Funds Rate (%)	5.50	4.50	-100 bps
10 Yr. Treasury Yield (%)	3.88	4.57	+69 bps
Inflation (CPI y/y % ch.)	3.40	2.90	-50 bps
Gold ($/oz.)	$2,063	$2,641	+28.0%
Oil ($/barrel)	$72	$72	0.0%
Euro per Dollar	0.91	0.97	+6.6%