INVESTMENT STRATEGY STATEMENT | January 3, 2025

Cautiously Optimistic

by Darren Hinshaw, Pierre G. Allard & Christopher Fidler

Performance Review & Outlook

Fed Continues Policy Pivot
The Federal Reserve lowered its benchmark borrowing rate by 0.25% in December but pointed to fewer rate cuts in 2025.

2025 Expectations
We are cautiously optimistic that equity markets can continue to perform well, albeit unlikely at the same pace we've seen over the last 2 years.

We Could See Increased Rate Volatility
As the market absorbs the results of the election and the policy implications, we could see an elevated level of interest rate volatility.

Equity Markets Gave Back Some Gains in December
The S&P 500 was down by -2.5% in December following the strong gains in November.

The Probability of a Soft Landing has Moved Higher
While inflation has been stickier just above the Federal Reserve's target rate, we continue to believe a strong economy and lower inflation set up well for a soft landing.

Traders Debating How Much the Fed Will Cut Next
Futures markets have lowered the number of cuts they are expecting next year, currently pricing in ~ 0.50% of easing.

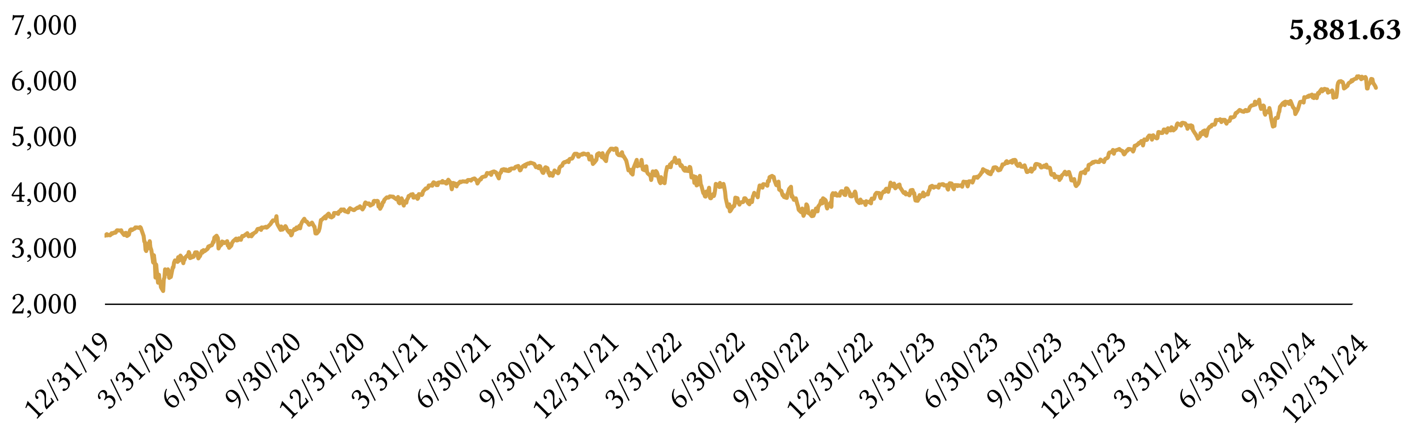
Equity Market Overview

+23%	**S&P 500**
+29%	**Nasdaq**
+13%	**DJIA**
+10%	**Russell 2000**

As of December 2024

After closing at record highs in November, equity markets gave up some of their gains to close out the year in December. For the month, the S&P 500 fell -2.5% to close at 5,882. The technology-heavy Nasdaq was actually higher by 0.5% for the month, while the more value-oriented Dow Jones Industrial Average was down -5.3%. Small caps fared the worst this month, with the Russell 2000 falling by -8.4%.

S&P 500 Price Index (12/31/19 - 12/31/24)



For the full year, the S&P 500 finished higher by 23%, while recording 57 record closes along the way. Combined with 2023, this was the best 2-year performance for the index since 1997-1998. The Nasdaq finished higher by 29%, powered by high growth technology and AI related stocks. The Dow Jones Industrial Average was higher by 13% and the Russell 2000 was up by 10%.

Looking forward to 2025, we believe that equity market performance will be dependent upon the continued growth of the economy and, as a result, continued growth in corporate earnings.

Current expectations are for S&P 500 operating earnings growth for 2025, according to Standard and Poor's, of 16%. It is possible that the strong performance we've realized in 2023 and 2024 have borrowed some of the forward returns, but we are cautiously optimistic for continued equity market gains in 2025.

While we don't like to set year-end price targets (markets are too dynamic for us to believe we can be precise enough to call where they'll end any given year), we'll continue to give guidance along the way and provide an overview of current market tailwinds and headwinds.

Fixed Income Market Overview

Fixed Income markets in 2024 showed signs of stabilization and cautious optimism compared to the previous year. Core inflation, although still above central bank targets, shows signs of retreating towards more manageable levels, which saw bonds perform better in the second half of the year. The Federal Reserve maintained a tight monetary policy for much of the year but adopted a more loosening approach to end the year by finally beginning rate cuts starting in September and continuing three consecutive meetings through December. The 10-year U.S. Treasury climbed from a low of 3.61% to a near year high of 4.53% to close out the year with most of the movement coming between September and December amid Fed rate cuts.

As NBCS Asset Management predicted, following the longest inverted yield curve in U.S. history, the possibility of a spike in intermediate-term rates and beyond did indeed exist as we sought to normalize the yield curve.

Municipal bonds, a popular choice for tax conscious investors, continued to show value versus taxable offerings throughout the year with investment grade taxable equivalent yields exceeding 6.50% for most of 2024. As we look forward to 2025, the big question facing many retail fixed income investors is, "How much will the fed cut this year?" NBCS Asset Management expects the Federal Reserve to slow the pace of rate cuts in 2025.

10 Year U.S. Treasury Yields

The overall economy and job growth remain strong as inflation continues to moderately fall, but the prospect for possible tariffs under a new administration should lead the Fed to be cautious with further cuts. Fed Chairman Powell stated in his post FOMC meeting press conference, "I think that a slower pace of (rate) cuts really reflects both the higher inflation readings we've had this year and the expectations that inflation will be higher" in 2025. Hinting at the fact that tariffs could impact future Fed policy. But continued, "Nonetheless, we see ourselves as still on track to cut." As we look back on 2024, we see a fixed income market that has normalized. The days of 0% interest rates are gone and markets now offer real yields for investors. Yields also mean the Fed has the ability to cut rates should the economy deem necessary and yields also allow the bond market to act as it should as protection against downside turns in the equity market.

Overall, 2024 was a good year for bonds. We are looking forward to continued normalization and possibly even slightly higher intermediate and long-term yields in 2025.

Economic Overview

Key Economic Indicators

JOB MARKET

October Employment Report
Total nonfarm payroll employment resumed its growth in November following the stagnation in October caused by two hurricanes and a strike at Boeing. Jobs increased by 227,000 and the unemployment rate changed little to 4.2%, according to the U.S. Bureau of Labor Statistics. Notably, we are now at the third-longest employment gains streak on 47 months.

Initial Jobless Claims
Initial Jobless Claims averaged 223,000 in December, slightly higher than the 217,000 in November. We remain near historical lows on initial claims, indicating continued strength in the labor markets.

HOUSING MARKET

House Prices
The S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index reported a 3.6% annual increase for October, down from a 3.9% gain in September. After accelerating during the first quarter, year-over-year home price gains have moderated recently and are closer to their long-term average.

RETAIL SALES & PERSONAL SAVINGS:

Personal Income & Spending
November personal income grew by 0.3% over the prior month and 5.3% over the last 12 months. November Personal Spending grew by 0.4% over the prior month and 5.5% over the last 12 months.

Economic Overview

Key Economic Indicators

INFLATION

CPI
The Consumer Price Index for All Urban Consumers (CPI-U) rose by 0.3% on a seasonally adjusted basis. Over the past year, the overall index increased by 2.7%, slightly higher than the 2.6% in October due to base effects.

PCE
The PCE Price index recorded a year-over-year increase of 2.4% in November. The Federal Reserve's preferred measure of inflation, Core PCE Prices, increased 2.8% y/y in November. While this is still above the 2% target, it is well below the highs seen in 2022 and we believe is consistent with a path towards 2%.

Conclusion

With inflation lower and the economy continuing to grow, we believe the likelihood of an economic soft landing remains high. With backward looking measures of inflation inching closer to the Fed's 2% target and expected breakeven inflation rates over the next couple years currently at 2%, the disinflation narrative appears to be drawing to its conclusion. This has allowed the Federal Reserve to begin shifting monetary policy to support a normalizing economy and should continue to do so. As the economy continues to grow, this should support earnings growth going forward.

The analysts at Standard & Poor's currently forecast the 2025 S&P 500 operating earnings will grow 16% in 2025, supporting current market valuations and growth moving forward. While we don't like to set year-end price targets (markets are too dynamic for us to believe we can be precise enough to call where they'll end any given year), we remain cautiously optimistic for 2025 equity performance. We'll continue to give guidance along the way and provide an overview of current market tailwinds and headwinds.

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Disclosures