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INVESTMENT STRATEGY STATEMENT | January 31, 2025

Elevated Headline Volatility

by Darren Hinshaw, Pierre G. Allard & Christopher Fidler

Performance Review & Outlook

2025 Expectations
We continue to be cautiously optimistic that equity markets can continue to perform well, albeit with elevated headline and concentration related volatility.

FOMC Meeting Went as Expected
The Federal Reserve maintained its benchmark borrowing rate at a range of 4.25%-4.50% and reiterated its data-dependent approach to monetary policy.

Benign Bond Markets
Stability was the word of the month for fixed income markets, as economic data and the Fed meeting did little to move rates

Equity Market Concentration Downside on Display
We saw the potential pitfalls of equity market concentration on January 27th.

Even Given the Volatility, Equity Markets Finished Higher
Broad gains across the board as investor sentiment remained high, with positive data and earnings offsetting tariff and interest rate concerns.

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

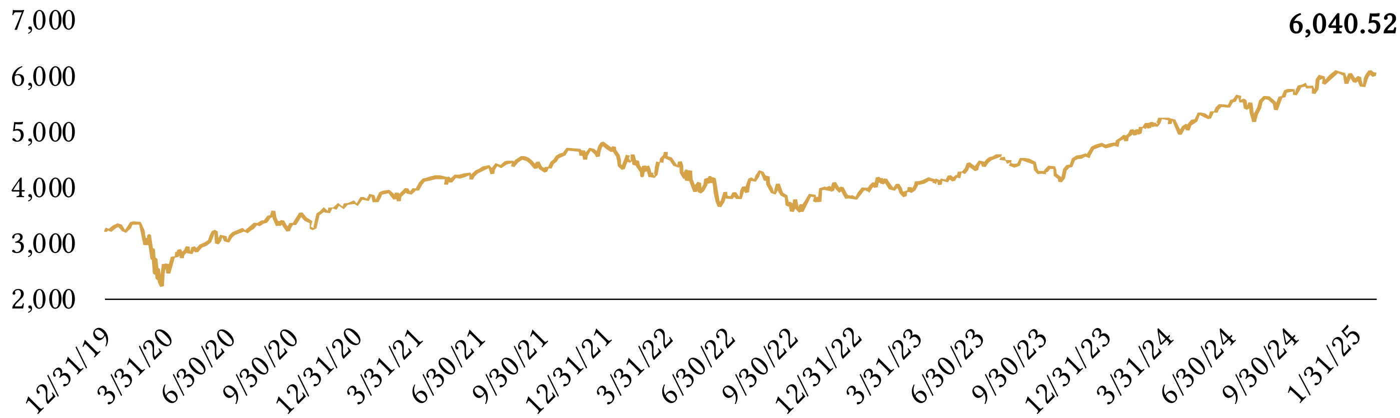
Equity Market Overview

+2.8%	S&P 500
+1.7%	Nasdaq
+4.8%	DJIA

As of January 2025

US Equity indices got off to a good, albeit volatile, start to 2025, with broad gains across the board as investor sentiment remained high. The positives outweighed the negatives, with resilient economic data, continued corporate earnings growth offsetting investor concerns about potential tariffs, interest rates remaining higher for longer, and an AI-related selloff in technology shares.

S&P 500 Price Index (12/31/19 - 1/31/25)



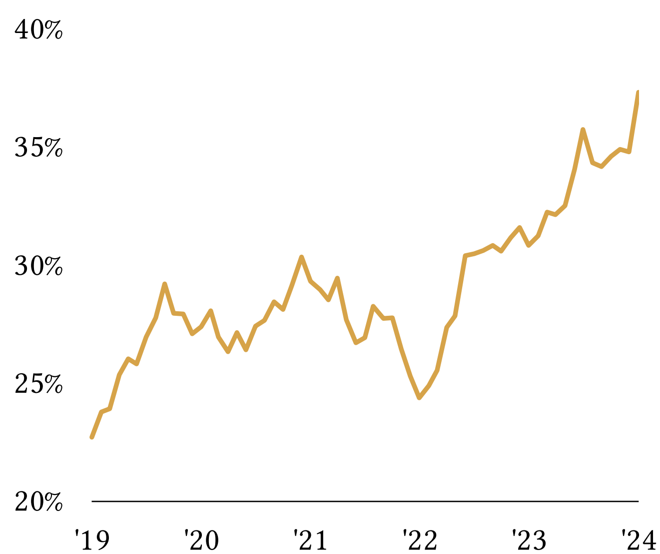
In terms of S&P 500 sector performance, Communication Services performed the best, driven higher by strong earnings reports from Meta and Netflix. The worst performing sector was Technology, mainly as a result of the DeepSeek-related sell-off on January 27th.

Digging into January 27th, we can glean some information about market structure and how the current concentration in the largest technology names can lead to more volatility. We won't try and tell you with any certainty how the release of DeepSeek's latest large language model will impact the evolving artificial intelligence landscape. We'll leave that for AI experts.

What we can observe is that with the S&P 500 more concentrated than it has been in over 20 years, any moves (both higher and lower) have an outsized impact on the overall markets.

Consider that Nvidia Corp lost $589 billion in market cap on one day alone, the biggest one-day loss of value for any public company in history. Because of its large weighting in the S&P 500, Nvidia accounted for almost 80% of the overall -1.5% index decline. Consider also that on that same day, 351 companies in the S&P 500 were higher on the day. This is further evidence that having a well-diversified portfolio that has exposure to companies outside of the top 7 names is beneficial in the long run.

S&P 500 Top 10 Member Weighting



While we do think there will be elevated potential headline volatility given some of the policy initiatives, concerns about higher for longer interest rates and the impact of high concentration, we believe that 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 realized in 2023 and 2024 have borrowed some of the forward returns in equity, but we are cautiously optimistic for continued equity market gains in 2025.

Fixed Income Market Overview

As we close the first month of 2025, U.S. bond markets started and finished the month essentially flat, with the 10-year U.S. Treasury Note hovering around the 4.55% level. The 10-year Note peaked mid-month at 4.79%, but yields cooled as a combination of economic slowdown fears and tariff concerns drove investor demand for safe assets higher toward the month's end.

The headline for bond markets in January isn't much of a "headline" at all. In fact, bond markets were quite boring this past month. For the better part of the past three years, bond markets have dominated the news cycle as the Federal Reserve first raised and then finally began lowering its target rate in September of last year. However, when it comes to bond markets, "boring" is not a bad thing. In general, it means conditions are relatively stable.

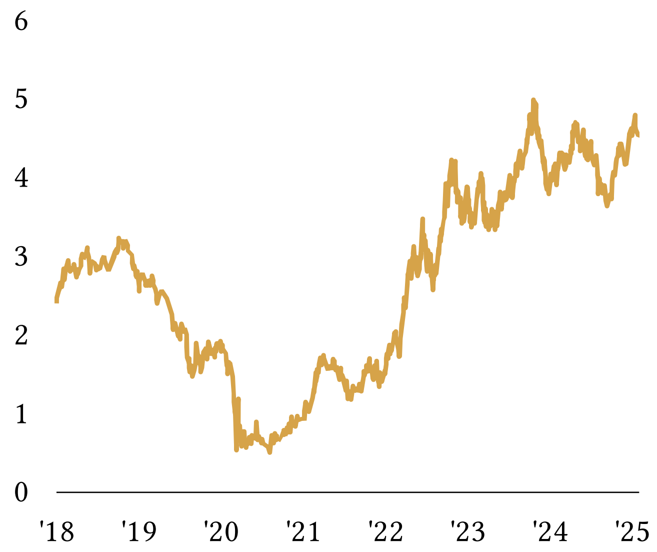
As we have highlighted in previous ISS publications, a target rate of 4.25%-4.50% provides the Fed with the flexibility to cut interest rates if needed to counteract recessionary trends or economic slowdowns and to raise rates if necessary to combat inflation.

This past month's January 2025 FOMC meeting followed a similar pattern to the overall bond market, passing with little to no major headlines. Chairman Jerome Powell emphasized that the labor market remains strong, with the unemployment rate stabilizing at a low level, though he acknowledged that inflation is still "somewhat elevated." Powell reiterated that there is no urgency to adjust the policy stance further, signaling a cautious approach to future rate changes. Overall, the meeting proceeded largely as expected by the markets.

This meeting also marked the first under President Donald Trump's new term, introducing potential uncertainties due to anticipated policy changes, including possible tariffs and immigration reforms.

Despite external pressures, Powell reaffirmed the Federal Reserve's commitment to making decisions based on economic data, maintaining its independence in setting monetary policy.

10 Year U.S. Treasury Yields



The Fed's "wait and see" approach to monetary policy and economic data has been refreshing. In a world dominated by uncertainty and sensationalist headlines, perhaps taking an even-keeled, "Jerome Powell" type of approach isn't such a bad thing at all.

Economic Overview

Key Economic Indicators

JOB MARKET

Employment Report
Total nonfarm payroll employment continued to grow in December, besting the gains we saw in November. Jobs increased by 256,000, and the unemployment rate fell to 4.1%, according to the U.S. Bureau of Labor Statistics. Notably, we are now at the third-longest employment gains streak at 48 months.

Initial Jobless Claims
Initial Jobless Claims averaged 212,500 in January, lower than the 223,000 in December. 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 3.75% annual increase for November, slightly higher than the 3.6% gain in October. Home price gains have moderated over the last year and are closer to their long-term average.

RETAIL SALES & PERSONAL SAVINGS:

Personal Income & Spending
December Personal Income grew by 0.4% over the prior month and 5.3% over the last 12 months. December Personal Spending grew by a healthy 0.7% over the prior month and 5.7% over the last 12 months. The personal savings rate was 3.8% in December.

Economic Overview

Key Economic Indicators

INFLATION

CPI
The Consumer Price Index for All Urban Consumers (CPI-U) rose by 0.4% on a seasonally adjusted basis. Over the past year, the overall index increased by 2.9%. The Core CPI, which strips out food and energy, was higher by 0.2% for the month and 3.2% over the past 12 months.

PCE
The PCE Price index recorded a year-over-year increase of 2.6% for December. The Federal Reserve's preferred measure of inflation, Core PCE Prices, increased 2.8% y/y in December. We believe the recent inflation data is consistent with a path towards 2%, although it is taking longer than originally expected.

Conclusion

While we do think there will be elevated potential headline volatility given some of the policy initiatives, concerns about higher for longer interest rates and the impact of high concentration, we believe the US economy and consumers will remain resilient and continue to believe the likelihood of an economic soft landing remains high. 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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