Q4 MARKET INSIGHTS

Winter 2024

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During the fourth quarter, U.S. equities continued their positive momentum, buoyed by investor optimism over the expectations of pro-business policies to be implemented by the incoming Trump administration. The election of Donald Trump proved to be a bullish catalyst, as investors embraced the prospects of deregulation, reductions in corporate taxes, and a renewed focus on trade protectionism aimed at prioritizing domestic industries. Excitement over the impact that President Trump's agenda could have on economic growth and corporate profitability helped the S&P 500® Index post a return of 2.39% for the fourth quarter. For 2024, the index recorded its second straight year of 20%-plus gains, rising 24.99% and enabling the index to achieve its best two-year performance since 1997-1998. Internationally, foreign markets underperformed the S&P 500 in the fourth quarter, realizing negative returns thanks to lackluster growth prospects and bouts of political uncertainty in both developed and emerging markets. In Europe, economic momentum weakened significantly as the manufacturing sector was particularly hard hit due to a combination of high energy costs, damaging regulation, and a lack of export demand coupled with government-subsidized competition from China. This was compounded by political turmoil in both France and Germany, where fiscal pressures and the rise of populist parties fractured the political consensus. Foreign developed markets, represented by the MSCI EAFE Index, registered a negative 8.06% return for the quarter and finished up 4.43% for the year. Emerging markets were pressured by a political crisis in South Korea and continued worries about domestic growth in China. The MSCI Emerging Markets Index fell 7.85% during the quarter, but ended the year with a 7.97% gain. Switching to fixed income markets, the Bloomberg Barclays US Aggregate Bond Index, the leading benchmark for bonds, realized a negative 3.06% return in the fourth quarter as concerns about U.S. federal deficits combined with expectations for fewer rate cuts in 2025 to force bonds lower. Nevertheless, the benchmark did log a positive 1.25% gain for 2024.

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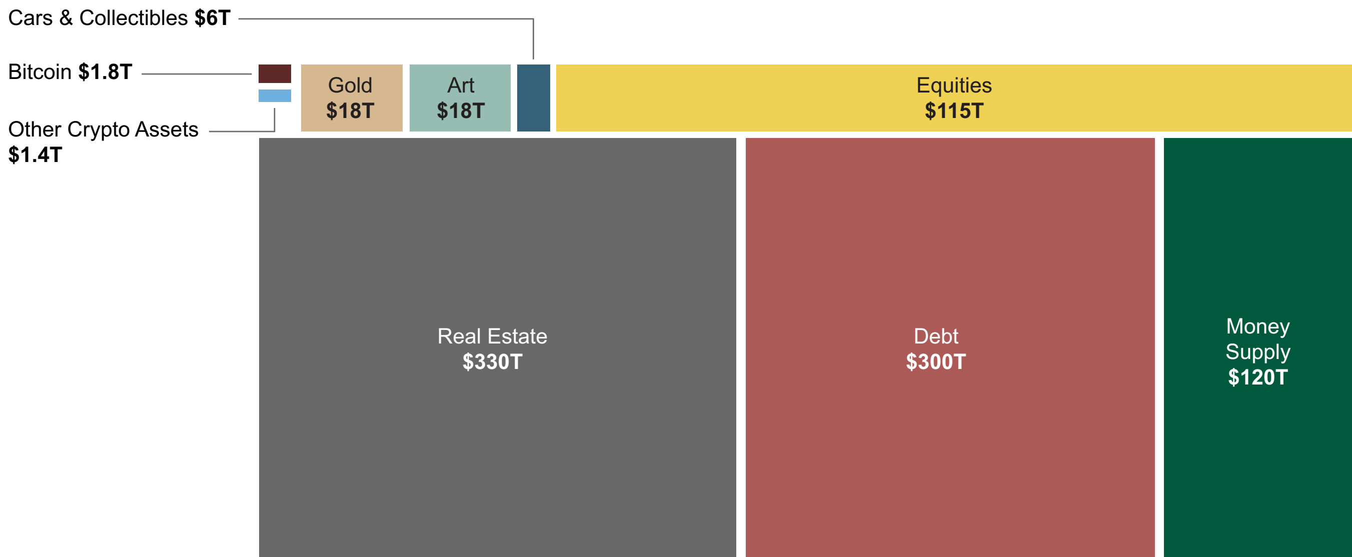
CHARTING THE COURSE: NAVIGATING THE INVESTMENT LANDSCAPE

As we look ahead to 2025, we'd like to take a moment and examine the evolving investment landscape. Markets have navigated a dynamic mix of opportunities and challenges, shaped by central bank policy, geopolitical developments, and transformative technological advancements. For investors, understanding the broader picture is a valuable tool for determining the appropriate asset allocation. In this spirit of reflection, we'll assess where global markets stand today, and examine the opportunities and risks that lie ahead. Whether it's the performance of traditional asset classes, the growing influence of alternative investments, or the expanding adoption of digital assets, this retrospective will provide a foundation for charting the course into the new year.

The global financial landscape encompasses a diverse array of asset classes, which, according to data we compiled from multiple sources, totals approximately $910 trillion (see chart on next page). As you can see, real estate is the largest asset class in terms of size. This is made up of residential (which represents 79% of the total), agricultural (11%) and commercial real estate (10%). Debt includes both publicly traded bonds as well as private credit, and consists of debt accumulated by governments, corporations, and households. Money Supply, or cash, represents the total value of the world's coins, banknotes, and money market accounts, as well as saving, checking, and time deposits. Equities include both stocks that publicly trade on global exchanges as well as

Total Global Market Portfolio: $910T (estimated as of December 31, 2024)



Source: UBS, Savills, The World Gold Council, CoinMarketCap, Deloitte, the IMF and the World Bank

private equity. Art, gold, cars & collectibles, bitcoin, and other crypto assets make up the rest of the investable universe. Taken together, these can be seen as the de facto proxy for the investable opportunity set available to investors globally.

Our journey begins with bonds––given their foundational role in risk management and income generation––before progressing to equities and beyond.

BONDS

Throughout the most recent presidential campaign, we maintained that no matter who won the election, the budget deficit would continue to grow. For the first quarter of fiscal year 2025, which began in October for the U.S. government, the budget deficit reached $711 billion—an increase of 39% compared to the same period last year—and is on track to approach $3 trillion for the year. Addressing the ongoing deficit situation is something that nobody in Washington D.C. seems to want to deal with, as it involves a range of politically challenging options. Despite President Trump asking Elon Musk and Vivek Ramaswamy to advise on cutting wasteful spending across Federal agencies, the impact on the deficit is likely to be minimal, as only 26% of the Federal budget is categorized as discretionary spending. Efforts to cut wasteful spending within discretionary categories—while symbolically significant and potentially helpful in reducing inefficiencies—are unlikely to make a significant dent in the overall deficit. Meaningful reductions to the deficit require unpopular choices such as cuts to mandatory spending (Social Security, Medicare, Medicaid, and other entitlement programs) or raising taxes, neither of which appear to be on the incoming administration's agenda.

The U.S. government's fiscal position has increasingly posed a challenge to the Federal Reserve (the "Fed"). The persistent fiscal deficits are generating a steady increase in national debt. As interest rates have risen in recent years, the cost of servicing that debt has become a significant burden, consuming a significant share of federal tax revenues. At current levels, it is estimated that at least 21% of fiscal year 2025 tax receipts will go towards servicing debt. This dynamic presents an additional issue, as the higher borrowing costs will exacerbate the deficit unless further cuts are made to discretionary programs and public investment. While the Fed operates independently, its policy decisions are not immune to the broader fiscal environment. If debt servicing becomes unsustainable at high interest rates, the Fed may face pressure––either implicit or explicit––to accelerate the pace at which it lowers rates. As of year-end, the Fed Funds futures market is pricing in just under two 0.25% rate cuts for 2025. However, the Fed may be forced to cut more than 0.50% in 2025 to reduce interest costs. Compounding the issue is the fact that inflation has proven to be sticky. While the Consumer Price Index ("CPI") has fallen from its high of 9.1% in June of 2022, the last few months have seen inflation data accelerate rather than fall further. The CPI has increased

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in each of the past five months, posting a December reading of 2.9%. Meanwhile, disinflation in the prices of goods has moderated, and inflation for services remains stubbornly high. This is still well above the Fed's 2% target inflation rate. If the Fed is forced to take a more accommodative stance to ease fiscal tensions, the inflationary impulse could put upward pressure on medium and long-term bond yields.

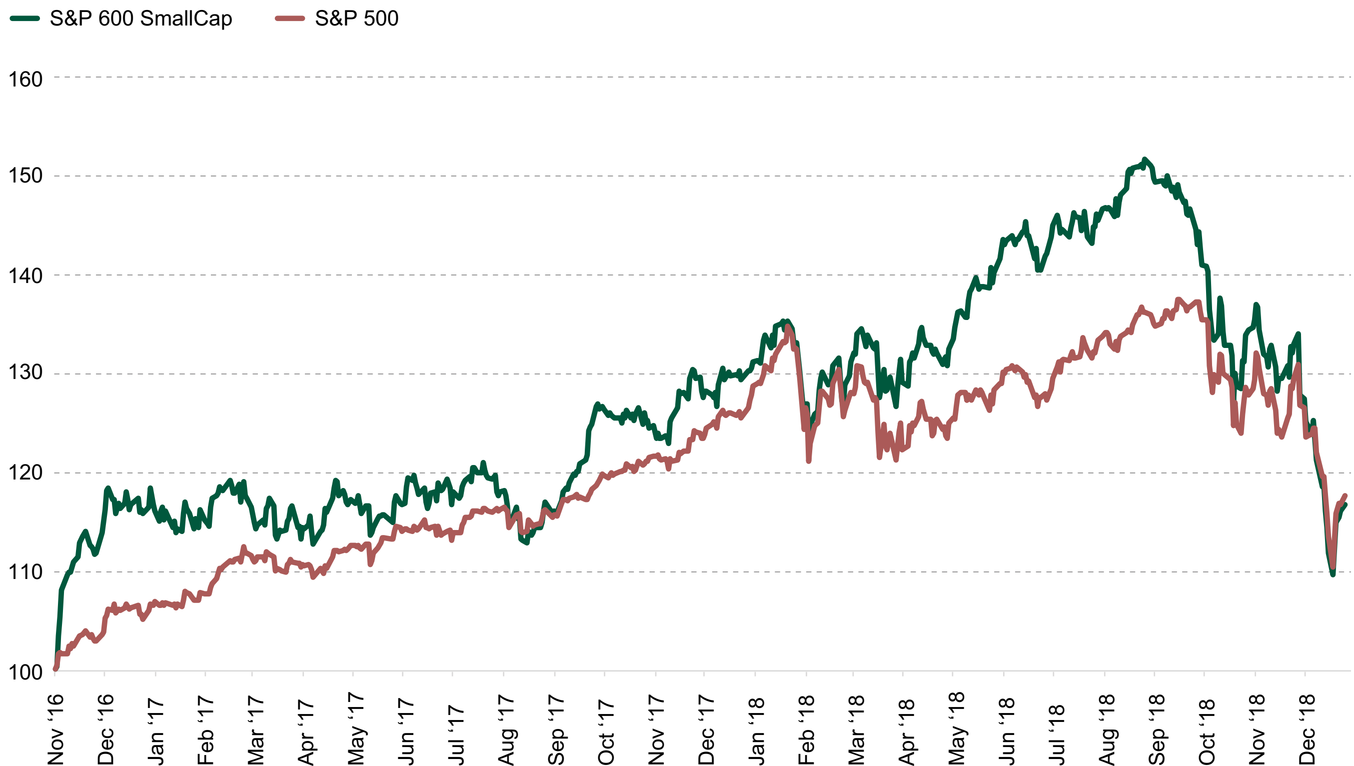
Given this backdrop, we believe it is prudent to maintain exposure to short-term bonds within fixed-income allocations, as they are less sensitive to inflation and interest rate risk. Specifically, we prefer U.S. Treasuries relative to publicly traded investment grade and high-yield bonds, as credit spreads remain near multi-decade lows. As a reminder, the credit spread is the difference in yield between two bonds of similar maturities but different credit quality. This comparison often involves Treasury bonds (considered risk-free) and corporate bonds (which carry default-risk), where the spread reflects the perceived risk of corporate bonds compared to government bonds. Given how low spreads are on both investment grade and high-yield bonds, we believe investors are not being properly compensated for taking on credit risk. Aside from short-term U.S. Treasuries, private credit may offer some potential opportunities, as these strategies typically offer higher yields relative to traditional fixed-income investments. Private credit has gained traction in recent years, as traditional banks have reduced lending capacity due to regulatory constraints put in place after the financial crisis of 2008. Private credit investments often carry higher yields due to the borrower's underlying creditworthiness as well as the inherent illiquidity of the investment. Consequently, investments in private credit may not align with every investor's financial needs or risk profile. However, we do like the risk-reward profile of select private credit offerings.

EQUITIES

After back-to-back years of 20%-plus gains in the S&P 500, investors are right to question whether this level of performance is sustainable. Historical precedent provides a mixed picture. There have been three previous occasions in the index's history where this has occurred: One time, it was down 39% in the following year (1937); one year, it edged out a slight gain of 3% (1956); and the other time it was up 31% (1997). While history shows that two consecutive years of 20%-plus gains are rare, a third year of strong performance is not unprecedented.

In our opinion, the sustainability of such returns depends on the balance between earnings growth, macroeconomic conditions, and valuations. Much like 2023, the majority of the S&P 500's strong performance during the past year was driven by the so-called "Magnificent 7" stocks—Apple, Alphabet, Microsoft, Amazon, Meta, Tesla, and NVIDIA—which accounted for 57% of the gains in the S&P 500 index. The reason why these seven companies have continued to outperform is largely due to their exceptional earnings growth, fueled by rapid advancements in artificial intelligence. EPS growth for 2024 is expected to be 34% for the Magnificent 7 (calculated on a market cap weighted basis) versus 3% for the remaining 493 companies that make up the S&P 500. As we look ahead to 2025, earnings growth looks solid, with analyst expectations for the S&P 500 to achieve earnings growth of 14.5%. Within this projection, the Magnificent 7 are expected to deliver robust EPS growth of 21%; however, the remaining 493 companies in the index are also anticipated to realize EPS growth of 13%, indicating a healthier balance of contributions to the overall market's earnings performance. We believe that the odds of the S&P 500 meeting this forecast in 2025 are favorable, given that we see a very low likelihood of a recession occurring here in the U.S. over the near term. Several underlying conditions indicate the macroeconomic environment remains strong enough to support corporate earnings growth. Job growth has remained remarkably strong, highlighting the resilience of the labor market despite higher interest rates. Throughout the past twelve months, the U.S. economy has consistently added jobs at a healthy pace, keeping unemployment levels near historic lows (the unemployment rate was 4.1% as of December). In addition, as mentioned above, high-yield credit spreads relative to U.S. Treasuries remain near multi-decade lows. Historically, sharp increases in the high-yield spread have preceded economic recessions and significant market downturns, giving it a high degree of predictive

Small Cap Stocks vs. S&P 500 from Election Day 2016 through Year-end 2018 (Indexed to 100)



Source: Bloomberg

power. This is because the high-yield market consists of debt issued by companies with lower credit ratings, making it more vulnerable to economic slowdowns. As such, when investors become concerned about economic prospects, they demand significantly higher returns to hold these riskier bonds. When that happens, the spreads increase (or widen) as a warning of increasing risks. According to research from the Fed, the widening of high-yield spreads has successfully anticipated every U.S. recession since the 1970s. Lastly, the index of Leading Economic Indicators (LEI) provided a noteworthy shift in economic sentiment, as it rose in November 2024 for the first time since February 2022. This increase marks a potential turning point, as this metric is no longer sending signals of an impending recession. The LEI had been steadily declining for nearly two years, signaling economic headwinds, but November's uptick reflects improving dynamics across the economy. With a positive outlook for earnings growth and improving macroeconomic conditions, future equity returns will depend significantly on valuations. History tells us that stock prices and earnings have shown a strong long-term correlation. The extent to which stock prices exceed or lag earnings is largely influenced by valuation levels and market sentiment. Over the past two years, the Magnificent 7 stocks have driven significant market performance, leading to above-average valuations. For example, as of year-end, the S&P 500 was trading at a Price/Earnings ("P/E") multiple of 21.5X fiscal year 2025 earnings—higher than its 5-year average of 19.7X and its 10-year average of 18.2X. While valuation ratios are useful for gauging expected long-term returns, they have historically been poor predictors of short-term market movements. Given this context, while there is precedent for equities to continue delivering double-digit returns, we believe investors should be prepared for the possibility of more muted returns and increased volatility for equities in the coming year.

Donald Trump's return to the White House may create a favorable opportunity for U.S. small-cap stocks. The incoming administration's proposals for trade restrictions, potential tax cuts, and a reduction in regulations could deliver a favorable environment for small-cap companies. Unlike their large-cap counterparts, small-cap stocks tend to be more domestically focused with less exposure to international trade and currency fluctuations, which may position them to benefit disproportionately from such policy measures. There is a historical precedent for this dynamic. Small-cap stocks, as represented by the S&P SmallCap 600 Index, outperformed the S&P 500 following Trump's election in 2016 (see chart above). This period of outperformance coincided with the initial implementation of tax cuts and deregulation. The rally faltered in late September 2018, with

the S&P SmallCap 600 Index outperforming by 8.3% (green line) when the Fed began raising interest rates. That was when Fed Chair Jerome Powell indicated that the Fed was on "autopilot" in hiking rates, which led to a sharp broad market sell-off toward the end of 2018.

U.S. equities have consistently outperformed their global peers in recent years, as the U.S. continues to lead the world in economic growth and innovation. As we look ahead, foreign markets continue to face difficulties that suggest this trend may continue. Europe's economic momentum has faced significant headwinds recently, and these challenges raise questions about the region's short- to medium-term investment potential. Excessive regulations such as aggressive climate policies have increased the operating costs for businesses, particularly German manufacturing (Europe's main growth driver), making it less competitive on the global stage. This has been exacerbated by the war in Ukraine, which has pushed energy costs higher. In addition, political turmoil in France and Germany, coupled with rising fiscal pressures, could lead to austerity measures. The French government has faced ballooning public debt, partly due to pension reform battles, social unrest, and subsidies to combat inflation and energy costs. With the government facing debt levels approaching or exceeding 110% of GDP and the inability to print its own currency, severe fiscal reforms might become unavoidable. Meanwhile, Germany, which has a strict commitment to keeping deficits in check, has seen its debt levels rise due to pandemic-era and energy crisis-related spending, thereby increasing the need to restore fiscal discipline. With the European Union's Stability and Growth Pact (which enforces debt and deficit limits) back in focus post-pandemic, both nations face pressure to adhere to tighter fiscal discipline. To avoid sanctions, France and Germany may need austerity-like policies that could lead to sluggish economic growth. Moving to emerging markets, we believe that economic prosperity will be heavily dependent upon China. China's role in emerging markets is pivotal, given its size, influence, and economic integration with these economies. China has been grappling with deflationary pressures, largely stemming from domestic over-investment in real estate. As property prices have fallen, Chinese citizens have reduced spending in an effort to reduce debt, weakening the domestic demand for goods and services. The Chinese government has signaled a willingness to stimulate the economy, but the specifics remain unclear. Therefore, potential returns for emerging market equities will likely be dependent upon how much fiscal and monetary policy the Chinese government deploys and how effective it will be.

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REAL ESTATE

Real estate as an investment class has long been a cornerstone of wealth building, offering diversification, income potential, and the possibility of long-term appreciation. The fundamentals in U.S. real estate could not be more different when looking at the residential versus the commercial segments of the market. Residential real estate is experiencing a significant supply shortage, which has created opportunities for investment in multi-family housing. In contrast, commercial real estate presents a more mixed set of circumstances, where trouble in the office and retail sectors remains a major concern. While there may be opportunities for some distressed assets in these sectors, investments in industrial warehouses, fulfillment centers, and data centers appear to offer more favorable fundamentals and risk/return dynamics.

GOLD & BITCOIN

We believe investments in gold, bitcoin, or a combination of both are prudent given the potential for elevated inflation. Both assets are regarded as stores of value due to their scarcity—gold's limited supply and bitcoin's fixed supply of 21 million coins. As finite assets that cannot be easily created, they are not subject to devaluation like fiat currencies through excessive money creation by a central bank. Allocating to these assets, based on how they align with your risk tolerance and investment objectives, can serve as a valuable strategy to aid in preserving purchasing power in an inflationary environment.

ART AND CARS & COLLECTIBLES

Investing in rare cars, vintage wine, limited-edition items, art, and other collectibles has become an increasingly popular alternative investment strategy. These types of assets offer unique opportunities for investors seeking to diversify their wealth beyond financial assets. However, they tend to have very high transaction costs and come with specific considerations that require specialized knowledge and expertise that are beyond the scope of this review.

OTHER CRYPTOCURRENCIES

We believe that bitcoin remains the most reliable option in the digital asset space as a store of value and a hedge against inflation. We are less enthusiastic about other cryptocurrencies.

IN CLOSING

Overall, the interplay between asset classes will remain a defining characteristic of the global investment landscape. Money flowing from one asset class to another, driven by shifts in market sentiment, macroeconomic factors, and investor objectives, creates ripple effects that shape value across the spectrum. It is equally important to note that some asset classes stand to benefit disproportionately from such reallocations, as even modest inflows can significantly increase their value due to their relative size. For example, a one-percent shift from bonds to bitcoin would have a far greater impact on the value of bitcoin than a similar shift from bonds to equities would have on the value of stocks, due to bitcoin's relatively small market size. This dynamic underscores the importance of understanding the nuances of emerging opportunities alongside traditional options like equities and bonds. Ultimately, a well-structured, long-term, and diversified asset allocation—tailored to your financial goals, risk tolerance, and time horizon—remains the cornerstone of navigating an evolving investment environment with confidence.

We thank you for your ongoing confidence and trust. Please reach out to your relationship manager if you have any questions or you wish to discuss your portfolio allocation.

PERSONNEL UPDATE

We are pleased to announce that Phil Dubuque has decided to forgo retirement and will continue to serve as Co-Chief Investment Officer, working closely alongside Brandon Beauvais. Phil's vast experience, strategic insight, and unwavering commitment have been invaluable to our organization, and we are happy to have Phil remain in this pivotal role. Phil and Brandon will continue to collaborate, leveraging their combined expertise to drive Beaumont's overall asset allocation and investment strategy. We look forward to their vital contributions as they help drive the continued growth and success of our firm.

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Definitions:

S&P 500® Index is a registered trademark of Standard & Poor's Financial Ser¬vices LLC, a division of S&P Global ("S&P"). S&P 500 Index is an unmanaged index used as a measurement of change in U.S. equity markets. Performance numbers for the index are total return with dividends reinvested in the index.

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The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the U.S. & Canada. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the U.S. and Canada. With 913 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Indices are not managed and do not incur fees or expenses. Performance numbers for the index are total return with dividends reinvested in the index.

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries*. With 838 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Performance numbers for the index are total return with dividends reinvested in the index.

The Bloomberg Barclays US Aggregate Bond Index provides a measure of the total return performance of the U.S. dollar denominated investment grade bond market, which includes investment grade government bonds, investment grade corpo¬rate bonds, mortgage pass through securities, commercial mortgage backed securities and asset backed securities that are publicly for sale in the United States.

S&P SmallCap 600® Index is a registered trademark of Standard & Poor's Financial Ser¬vices LLC, a division of S&P Global. The S&P SmallCap 600 Index seeks to measure the small-cap segment of the U.S. equity market. The index is designed to measure the performance of 600 small-sized companies in the U.S., reflecting this market segment's distinctive risk and return characteristics. Measuring a segment of the market that is typically known for less liquidity and potentially less financial stability than large caps, the index was constructed to be an efficient benchmark composed of small-cap companies that meet investability criteria.

The Consumer Price Index (CPI) is issued by the U.S. Bureau of Labor Statistics and is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas.

Leading Economic Indicators (LEI), a composite of economic data points put together by The Conference Board designed to signal peaks and troughs in the business cycle. The Conference Board is a global independent business membership and research association working in the public interest.

The Conference Board is a non-profit business membership and research group organization. It counts over 1,000 public and private corporations and other organizations as members, encompassing 60 countries. The Conference Board convenes conferences and peer-learning groups, conducts economic and business management research, and publishes several widely tracked economic indicators. It's Consumer Confidence Survey reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitudes, buying intentions, vacation plans, and consumer expectations for inflation, stock prices, and interest rates. The Present Situation Index is based on consumers' assessment of current business and labor market conditions. The Expectations Index is based on consumers' short-term outlook for income, business, and labor market conditions.

The Price-to-Earnings (P/E) Ratio is the comparison of an index or stock's price to its earnings per share (EPS), indicating its market value relative to profitability. It is used to assess how much an investor is paying for each dollar of earnings.

Please contact us for more information on how we can assist you with your financial needs.

Disclosures:

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