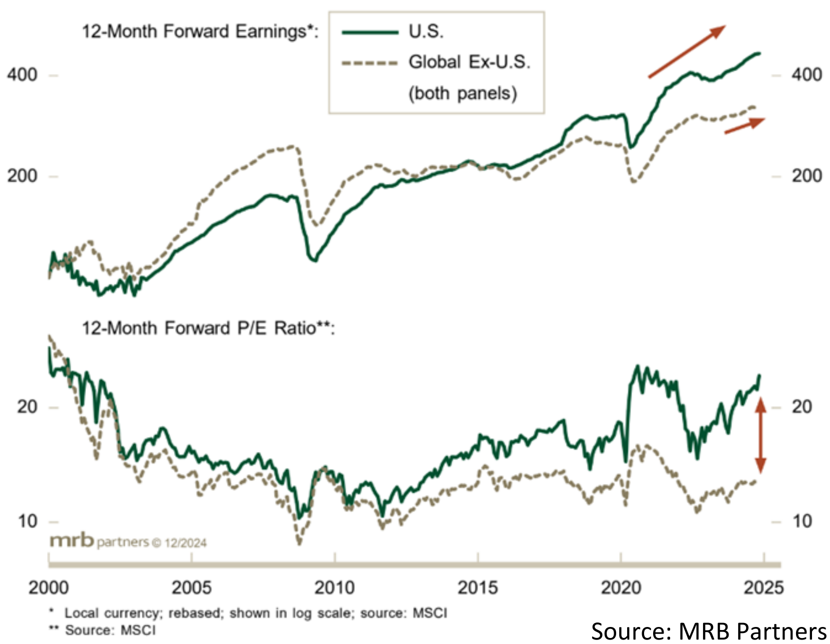
ENCORE INVESTMENT ADVISORS

DECEMBER 2024 MARKET REVIEW

	12/31/2024 Level	QTD Change	1 Year Change
S&P 500	$5,882	2.4%	25.0%
MSCI ACWI Ex USA	$306	-7.6%	5.5%
MSCI Emerging Markets	$574	-8.0%	7.5%
Bloomberg US Aggregate	$2,189	-3.1%	1.3%
10 Year Treasury Rate	4.58%	+77 BP	+70 BP
Bloomberg Commodity Index	$239	-0.5%	5.4%
Bitcoin	$92,627	41.1%	119.4%

Despite a bumpy December, 2024 turned out to be a tremendous year for most global investors. Santa may not have delivered a rally late in the year, however, US equity investors have little to be upset about after consecutive 20%+ annual returns (2023 & 2024) for only the 7th time in the past 100 years. From a global perspective, stocks (as measured by the MSCI ACWI Index) returned 17.5%, lifted higher by the US and dragged lower by international markets, which, on the whole, saw mid single digit returns (MSCI ACWI ex-US Index). Many diversifying assets performed strongly in 2024 as well; bitcoin may have been the standout with a return greater than 100%, hedge funds averaged 10% returns according to PivotalPath, and commodities returned over 5% in a volatile year. Fixed income focused investors had a more difficult year; US corporate bonds returned 2.1% and US treasuries returned a barely positive 0.6%; both underperformed short-dated treasury bills, which returned 5.3%.

The emergence (and expectations) of AI technology was the theme that dominated markets last year, however, that is only part of the story. Under the hood, it has been extremely difficult for the average US (or international) company to keep pace with the headline S&P 500 index due to the outperformance of the biggest US companies. The winners in 2024 were surely mega-cap technology companies who have seen their share prices inflect significantly higher due to sky-high expectations of the AI revolution. Five companies (Nvidia, Apple, Amazon, Alphabet, and Broadcom), were responsible for nearly half of the S&P 500's total return for the year. If an investor has had an oversized concentration of exposure to these companies, congratulations, you have essentially won the lottery. For the rest of us, the good news is that these companies comprise a significant portion of the indices that many investors track via indexed ETFs (or mutual funds). The bad news is that due to the highly concentrated nature of US equities, and global equities by default, many actively managed portfolios have been underweight these securities due to concerns around valuation and regulations protecting investors from overly concentrated portfolios.



Source: MRB Partners

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The surprisingly solid US economy, with growth better than expectations coupled with falling inflation, has underpinned technological innovation. There has seemingly been a never-ending stream of issues across Europe and Asia that the US has (somehow) managed to avoid; economic stagnation, political instability, poor regulatory environments, and war have plagued many countries outside of the US. US exceptionalism over the past decade in many pivotal industries has led to a global equity market that skews significantly towards the US, and to expectations that the US will continue its streak of outperformance. Looking ahead to 2025 and beyond, the two questions that we will shed some light on are (1) whether the bull market can continue and (2) whether an "America first" president can deliver "America first" returns, in line with recent history.

In short, we believe that the equity market can continue powering higher in the coming year, although the high starting point in valuations will likely constrain returns, outside of a mania phase similar to the late 1990's. We prefer not to provide a pinpoint forecast for markets in the coming year(s) and will instead provide potential drivers for a continued bull market, and potential drivers of a downturn in 2025.

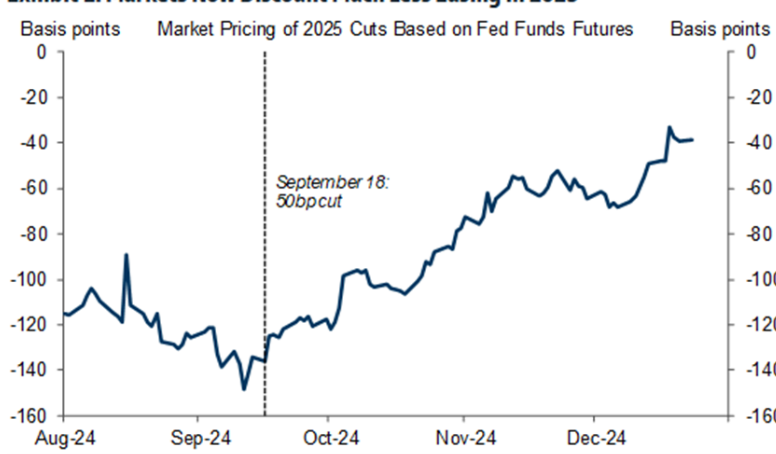
Thesis for Continued Equity Market Strength in 2025:

Animal spirits can continue to power markets higher. Earnings are expected to be solid due to mildly higher sales figures and expanding margins. The development of AI use cases expands, and the market begins to appreciate the positive impact AI can have on a broader swath of global companies. While many questions exist, it is expected that the second Trump regime will push business friendly policies and make changes to certain regulations that have perhaps hampered growth and innovation in recent years. Inflation continues to trend towards the 2% target, and global interest rates trade within a fairly narrow range. Even in this scenario, it is difficult to foresee many central bank interest rate cuts. There may be some volatile periods in equity markets, but the march higher continues.

Thesis for A Wobbly Equity Market in 2025:

Take 2018 as an example. US and global equities fell over 4% and 8%, respectively, in 2018. Earnings in the US increased by ~20% year-over-year in 2018 despite the fall in index levels, which means that valuations fell significantly over the course of the year. A similar series of events could occur in 2025 where earnings hold up well, but the expensive relative starting point in equity market valuations has only one way to go. The catalyst to drive this downturn could be a fiscal, monetary, or geopolitical policy misstep. A second Trump term brings about a level of uncertainty that markets may not be able to digest well. Large changes to the United States' stance on tariffs, immigration, and the tax code are all on the table. Whether the Fed and other central banks admit it, these looming policy adjustments complicate their decision-making framework and make difficult their forecasting ability. The good news in this scenario is that strong expected earnings, attractive valuations outside of the US, the fundamental strength from the Mag 7 companies, and the avoidance of a true economic recession are factors that may help alleviate a large-scale sell off.

Exhibit 1: Markets Now Discount Much Less Easing in 2025



Source: Bloomberg, Goldman Sachs Global Investment Research

Given an environment of increased uncertainty, we are not expressing many major views in portfolios. Most portfolios have large positions in passive vehicles (mainly ETFs), and the active exposures we do have are with extraordinary managers in less efficient areas of the investing universe. We believe that the risk to portfolios sits in the treasury market. A solid economy and pesky inflation have the ability to push mid and long treasury rates higher, directly impacting bond prices and indirectly dragging down equities. As such, we are holding less bond exposure in portfolios, and the exposure we do have is in shorter-term maturities, while we pay close attention to the movements of interest rates.

While, so far, we have focused on the situation in the US, our client portfolios are globally diversified. As we have discussed, there are good reasons to invest in the US, but we also believe there is reason to invest internationally. The recent strength in US equities has driven a massive divergence in expectations of American companies relative to international companies. From the CIO of Bridgewater Associates, "*US stock prices reflect expectations of continued strong earnings growth, much stronger than what is expected for other equity markets. This means that other countries' companies that perform relatively poorly in earnings can still beat US companies in price performance.*" Based on the below chart from Bridgewater, the large hedge fund believes that, over the next decade, US equities need to achieve earnings growth 3.6x that of international markets to earn a normal return over and above bond markets. So, while US equities can still earn returns in line with history, earnings may need to be better than expectations and clear an already high bar, while international companies can drive performance through clearing a much lower bar. It is impossible to forecast winners and losers in any given year and the US may continue to outperform every other market, but we are not ready to abandon our international exposure as valuations provide a level of safety in international markets that US equities simply do not.

US equities in aggregate need 9% annualized EPS growth to earn a normal return above bonds; the rest of the world needs only 2.5% annualized growth.

Source: Bridgewater Associates