LMA
WEALTH MANAGEMENT

Review.- Quarter Update

Dear LMA Clients,

That's a wrap—Happy New Year to all and best wishes for 2025!

A year ago, many were uncertain about what 2024 would bring. Inflation was high globally, economic indicators pointed to a potential recession, geopolitical tensions were concerning, and the upcoming presidential elections added a layer of uncertainty.

While many of these concerns were (and still are) valid, 2024 also brought its share of positive developments. Contrary to predictions, a recession didn't materialize, and the U.S. economy proved remarkably resilient. Stock markets posted another strong 20+% return, driven by AI-related companies and the strength of the financial system. Inflation trends improved, though at a slower pace than expected, fueled by economic growth, consumer strength and substantial fiscal spending. Central banks worldwide began easing by cutting rates, though their future paths remain uncertain, providing little hope for sectors sensitive to interest rates.

The U.S. presidential election also proved decisive, sending clear messages from the electorate around border security, inflation, sensible economic policies, and a pushback against "wokeness." While geopolitical uncertainties remain—particularly in the Middle East—the landscape has shifted notably in recent months. Many countries saw changes in direction, including the U.K., Japan, France, India, and the U.S. Mexico presented an interesting contrast, with the incumbent leftist party retaining strength.

In the coming years we're likely to see significant shifts in how our economy functions, driven by interactions between government policies, the rise of AI, and other disruptive technologies. While these changes have the potential to be incredibly beneficial, we acknowledge the challenges ahead.

The venture capital ecosystem, which has been experiencing a historic bear market, is likely to see some recovery in 2025. The IPO window is beginning to open, there's significant dry powder on the sidelines, and many companies are now balancing growth with profitability. These factors should help revive the VC landscape.

After two consecutive years of 20%+ growth in the S&P 500, the market undoubtedly appears stretched, and investors should reset their expectations for the coming years. Any period of volatility could present opportunities for new market leadership, particularly as AI adoption spreads across other sectors.

At LM Advisors, we have not stayed still and continue to invest to provide our clients better service, a more robust platform, and stronger partnerships across our ecosystem. We have continued to grow our team in 2024 to expand our reach, and we are in the process of migrating our financial reporting system to the market leader which we hope will benefit all of our clients (more of this to be announced in the upcoming weeks).

We are deeply grateful to all of our colleagues at LM Advisors for their tireless work, dedication to service, commitment to excellence, and shared mission.

May 2025 be a year of growth, prosperity, peace, and unity for us all. Wishing everyone a fulfilling and successful year ahead!

Fourth Quarter Update

The fourth quarter proved to be a volatile environment for both stocks and bonds. After rising 5.5% in the third quarter, stocks rallied with US election results and then fell at the end of December, closing up around 2.41% for the quarter.

Treasury yields were up in the quarter. While the Fed cut 25 bps in November and another 25bps in December bringing the total 2024 rate cut to a full 1%, expectations of stricter monetary policy going forward weighed on longer-term rates. The 10-year Treasury rate closed the year around 4.57% from 3.8% near the end of the third quarter. As will be further explained later, a persistently strong economy and expectations that inflation will remain elevated have caused the 10-year yield to move higher. The US Agg bond index lost 3% during the quarter, after having a very good third quarter.

In November, inflation reversed its downward trend and increased 0.3% on a year-over-year basis. November Core CPI was 3.3%, while headline CPI came in at 2.7% (also up 0.3% YoY), showing inflation is facing a tumultuous path to the Fed's 2% goal. Consumer confidence fell in December, as consumers were more optimistic about current labor market conditions, but their expectations about future business conditions weakened.

In the November jobs report, payrolls were up 227,000 vs expectations of 200,000. Job report estimates for September and October were also revised upwardly, with the number of employed people being 56,000 higher, showing signs of a resilient economy. Unemployment changed little to 4.2%, with labor force participation decreasing minimally from 62.7% to 62.5%.

According to S&P, the global manufacturing PMI increased to a 3-month high in November, to 52.4, a positive turnaround from previous months. However, it fell back to 49.6 in December, showing slightly deteriorating business conditions. Additionally, S&P noted a "widening US economy outperformance" compared to other major developed economies.

The market's short-term performance and volatility are now largely influenced by the Fed and the incoming Trump administration. Investors expect interest rates to stay higher in 2025 than previously anticipated. Other headwinds include concerns about a cooling labor market, rising credit card delinquencies, and increased asset write-downs at banks due to Commercial Real Estate exposure. Combined with global geopolitical uncertainty, these factors could put pressure on markets in the coming months.

Equity Market View (As of 12/31/2024)

Index Name	Level	YTD %
S&P 500	5,882	25.02%
Dow Jones Industrial Average	42,544	14.99%
NASDAQ Composite	19,311	25.88%
MSCI EAFE	2,262	3.82%

The S&P 500 index posted a gain of +2.41% in the quarter, up 25% for the year.

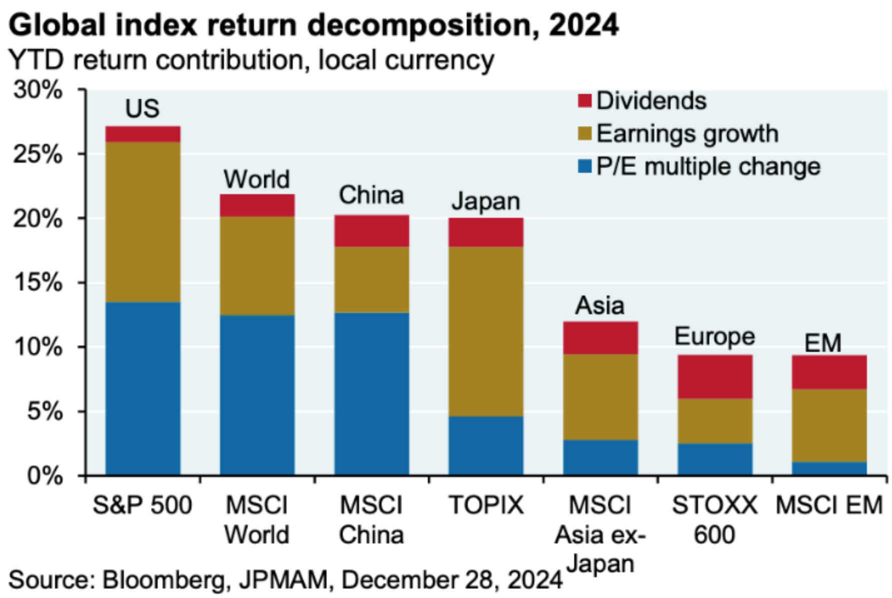
The table below shows S&P trailing 3- and 12-month performance by sectors as of Dec 31, 2024.

		Trailing Returns As Of 12/31/2024	
S&P 500 Sector	Index Weight	Year-To-Date	3-Months
Communications	9.40%	40.23%	8.87%
Technology	32.50%	36.61%	4.84%
Financials	13.60%	30.56%	7.09%
Consumer Discretionary	11.30%	30.14%	14.25%
Utilities	2.30%	23.43%	-5.51%
Industrials	8.20%	17.47%	-2.27%
Consumer Staples	5.50%	12.34%	-4.63%
Energy	3.20%	5.72%	-2.44%
Real Estate	2.10%	5.23%	-7.94%
Health Care	10.10%	2.58%	-10.30%
Materials	1.90%	-0.04%	-12.42%

(Source: Standard & Poor's)

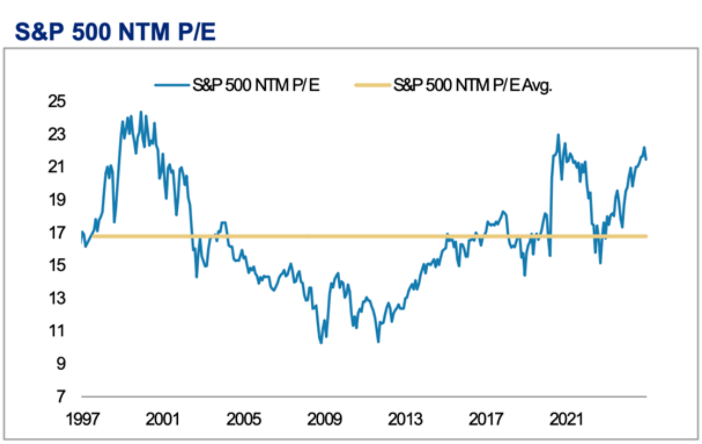
The heavy weighting in information technology and financials, among other sectors, have driven performance for the S&P 500. Energy, Real Estate, Healthcare, and Materials were the worst performing sectors in 2024, mostly due to negative returns posted in the 4th quarter. Looking ahead to the next year, it will be interesting to see how sectors such as consumer discretionary perform with an economic outlook that may see consumers being on tighter budgets. As large secular trends like the proliferation of AI continue to develop, companies that can successfully adopt these technologies could benefit.

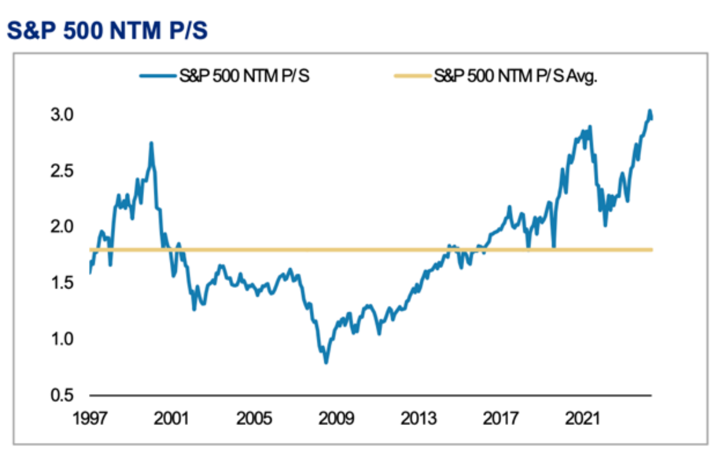
The chart below shows the drivers of 2024 index returns.



The S&P, MSCI World, and MSCI China indexes grew largely due to higher price-to-earnings multiples, driven by optimism about future productivity from technologies like AI. In 2024, investors focused on growth despite the risks of relying on higher valuations. Meanwhile, Japan's market gains came mostly from earnings growth, suggesting a more stable path for the year ahead.

The charts below show historical S&P Price to Earnings and Price to Sales Ratios, from 1997 to the present, courtesy of Morgan Stanley Research and FactSet.





The graph on the left shows the S&P 500's next twelve months (NTM) Price-to-Earnings (P/E) ratio, indicating the price investors are willing to pay for each dollar of expected earnings. The graph on the right displays the NTM Price-to-Sales (P/S) ratio, reflecting the price investors are willing to pay for each dollar of forecasted revenue.

Both ratios are historically high, like levels seen only twice in the last 28 years, during the dotcom bubble and the 2021 post-COVID rally. These developments warrant consideration when looking at potential investments, which drive us to be cautious. After two strong years, another exceptional year for the S&P 500 would require several favorable factors to align. Markets may have already priced in these potential positives, contributing to the current P/E and P/S ratios.

Election Results and Their Impact on Markets

In our previous newsletter, we wrote: “With election day rapidly approaching, Investors worry about the possibility of elections negatively impacting their investments. History reminds us that, while elections can cause volatility in the short term, long-term results are driven by business fundamentals and economic growth.” The election results of a Trump victory immediately reflected increased volatility in markets, with an overall initial positive reaction for domestic stocks and negative for stocks in countries like China, mostly fueled by promises of the Trump campaign.

Given the statements of the Trump team, it appears their policies will be pro-growth but inflationary.

Pro-growth:

- Tackling excessive regulation across industries (Telecom, Financial, Biotech, etc.)
- Extending tax cuts or even lowering tax rates both for corporations and individuals
- Reducing waste in the government budget

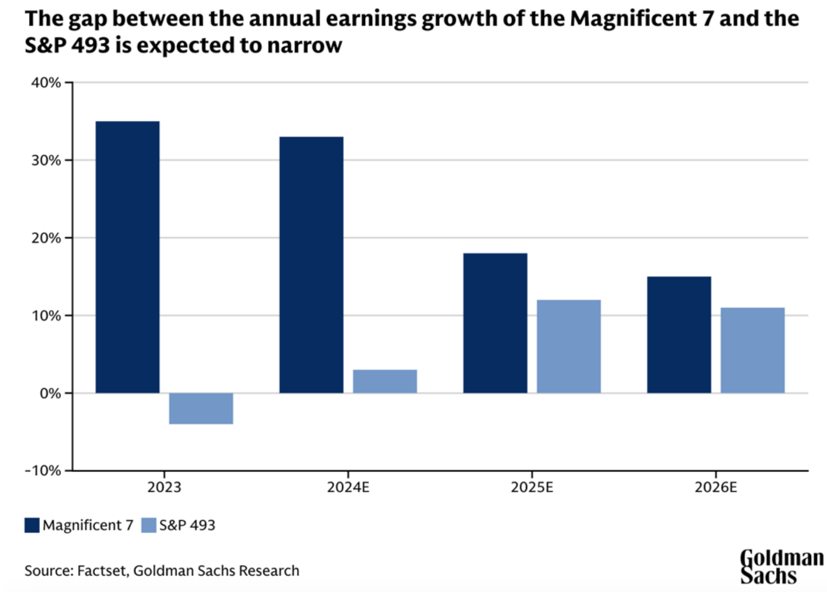
Inflationary:

- Imposing tariffs on main trading partners
- Addressing immigration putting pressure on an already tight labor market
- Increasing deficit levels as the net effect of the expected policies

These implications could have weighed on the recent Fed decision to reduce their expectations for future rate cuts, giving them more room to slow down monetary easing while the US economy remains strong.

Magnificent 7 Earnings Gap

The chart below illustrates expectations for earnings in the S&P 500 comparing the “Mag 7” to the remaining 493 companies in the S&P.



According to Goldman Sachs, the gap between earning growth of the Magnificent 7 (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) is expected to narrow notably in the next couple of years.

This supports the idea that stock market concentration has reached historically high levels as seen in the chart below on which this group of 7 companies account for more of 30% of the total S&P 500 market.

Market cap of largest 7 companies in S&P 500

Percent of total index market cap

Source: FactSet, JPMAM, November 30, 2024

Some of these companies (also know as the hyperscalers) have continue to increase their R&D spend in building their AI infrastructure. Over the next 12-18 months there will be increased pressure for these investments to yield meaningful returns as otherwise their share prices could be under pressure.

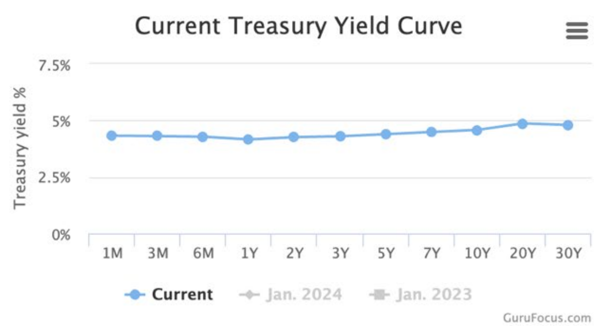
Bond Market

Fixed Income Market View (As of 12/31/2024)

Domestic Fixed Income			YTD %
BBG Barc US Aggregate Bond Index			1.25%
ICE BofA US Corporates			2.76%
ICE BofA US High Yield			8.20%
Global Fixed Income			**YTD %**
BBGBarc Global Aggregate			-1.69%
BBGBarc Global High Yield			9.19%
Preferred Stock Indexes			**YTD %**
S&P Preferred Stock Total Return			9.20%
S&P Floating Rate Preferred Stock			14.83%
S&P Fixed Rate Preferred Stock			7.71%

The chart below illustrates the treasury yield curve as of Jan 3, 2025. The yield range goes from 1 month of maturity to 30 years of maturity.

1-month yield	4.326%
1-year yield	4.16%
2-year yield	4.262%
10-year yield	4.581%
30-year yield	4.801%



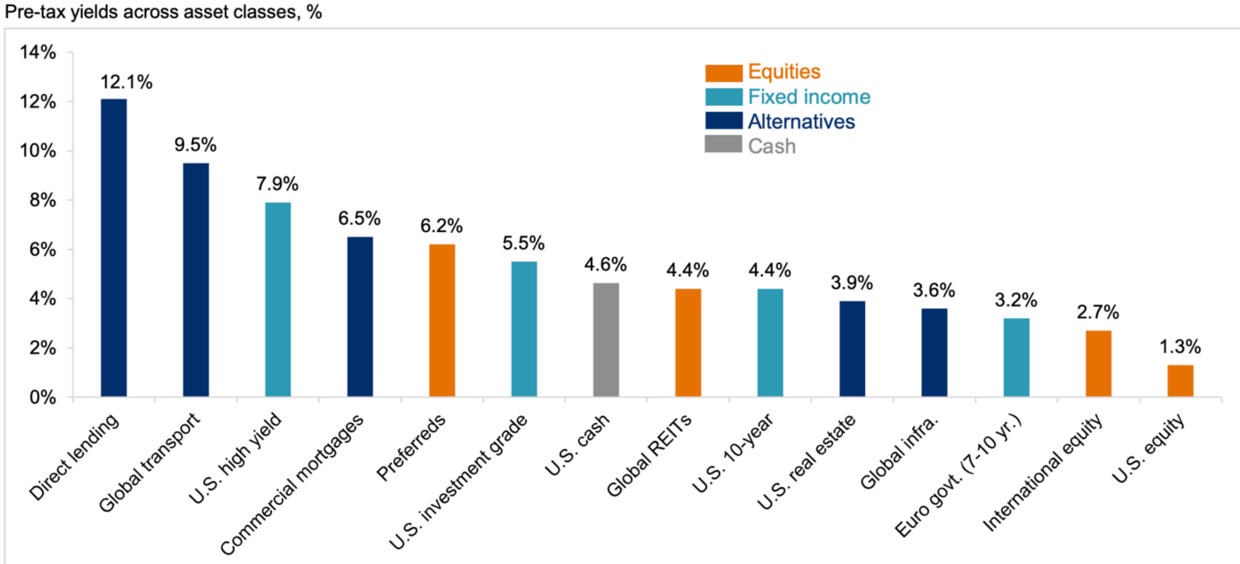
The Treasury yield curve has begun to steepen, which means most short-term yields are lower than long term yields. As the Fed continues its monetary easing cycle, lowering short term interest rates could cause the yield curve to steepen, although other economic factors could also impact the yield curve.

While short-term yields had significantly decreased after the Fed cut rates in September, the 10-year treasury yield is now back up to around 4.5%, as increased geopolitical uncertainty, expected inflationary policies, and other economic factors have made investors more risk averse following the US election results. The 2-year treasury yield was last around 4.3%, up from the recent 3.60% range it was in.

Although the “Soft Landing” narrative continues to be likely, markets are adjusting to the reality that interest rates may remain higher than previously expected.

The chart below shows pre-tax yields across several asset classes.

INCOME: YIELD WILL BECOME MORE VALUABLE AS POLICY RATES FALL
Pre-tax yields across asset classes, %



Sources: BAML, Bloomberg Finance L.P., Clarkson, Cliffwater, Drewry Maritime Consultants, Federal Reserve, FTSE, MSCI, NCREIF, FactSet, Wells Fargo, J.P. Morgan Asset Management. Data as of August 31, 2024.

JP Morgan makes the argument that “yields will become more valuable as policy rates fall.” In our previous newsletter, we talked about assets with excess returns to cash. As the Fed continues to lower interest rates, albeit now at a slower pace, it is important to consider asset classes which can provide higher risk-adjusted yields than cash.

Fed Update

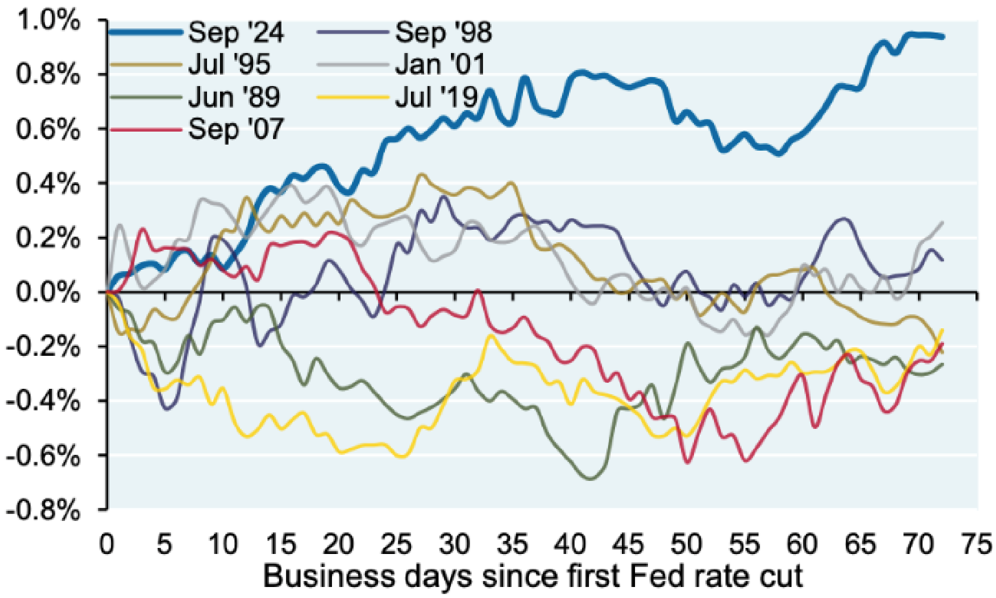
In December, the Fed cut rates by 25 bps. While markets expected three further rate cuts in 2025, the Fed projected two for the next year. This caused volatility in public markets.

Chairman Jerome Powell described inflation as moving toward their 2% objective but remaining “somewhat elevated.” Chair Powell also mentioned that they moved rather fast in cutting rates this year, and with the economy still strong but overall outlook uncertain, the Fed will take a slower approach in 2025 and evaluate their decisions based on incoming economic data. They also mentioned they would continue to reduce their balance sheet.

While the recent Fed rate cut has helped and so have signs of a resilient economy, an uncertain geopolitical outlook has weighed on markets.

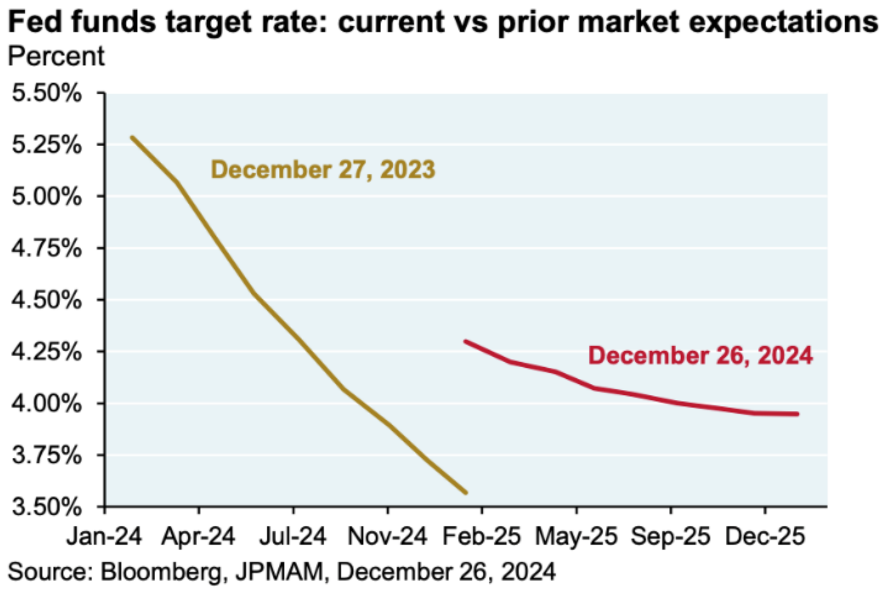
The charts below show historical reactions of 10 yr yields once the Fed starts to cut rates. 2024 marks the first time on which the yield on the 10-yr bond has risen once the Fed started reducing their rate policy which emphasizes how unusual the last quarter has been.

10 year Treasury yield change after the first Fed cut



Source: Bloomberg, JPMAM, December 26, 2024

Similarly, the market expectations for future Fed Fund levels (the rates controlled by the Fed), have clearly changed from a year ago when it was expected the Fed was going to aggressively cut rates in 2024-2025. With a strong economy and elevated inflation levels, the new expectations show more cautious Fed policy expected to keep rates higher for longer.



The reaction of public markets at the end of 2024 shows concerns for continued inflation and expectations of tighter monetary policy.

What This Means for Your Portfolio

We continue to be more constructive on the trajectory of the overall economy. Markets will need to closely watch the implications of new policies to be implemented by the incoming Trump administration and its potential effects on budget deficits and inflationary pressures.

Stocks maintain high valuations and a lower equity risk premium. As such, we are cautiously keeping an underweight stance on stocks with pockets of opportunities in specific regions and sectors.

With long-term interest rates back above 4.5%, we believe investment grade bonds continue to offer compelling yields and should outperform cash if the Fed continues to cut rates in the months ahead.

Generally speaking, we are taking the following actions:

- Actively adding duration if rates remain around 4.5-5%
- Rotating into equity sectors trading at more reasonable valuations or those who could benefit from improving economic conditions. We prefer S&P 500 equal-weight indexes over market-cap indexes which are over-exposed to mega cap names.
- Be ready to take advantage of periods of high volatility or market dislocations, which we expect to occur at some point over the next 12 months.
- Adequate allocation in Alternatives including Private Credit, Infrastructure and Private Equity. We believe this will be an important diversifier in 2025. We especially like infrastructure in 2025 due to the global need to sustain the demand for new data centers and its natural defensibility against inflation.
- Expanding slightly into international developed markets, where we see more reasonable valuations and structural tailwinds (i.e. Japan)
- Less emphasis on maintaining high liquidity if we find compelling ideas to invest in

Each portfolio is based on the individual needs to each LMA client. Please contact your financial advisor to discuss in detail the specific implications for your portfolio and if any adjustments are required.

We sincerely thank you for the trust you place in us. We appreciate it and take it with the outmost sense of responsibility.

Sincerely,
LMA Team