



Quarterly Update – December 31, 2024

2024 was a very good year for risk assets as US growth stocks led the way once again. Over the course of the year, equities were driven by the resilient US economy, FED rate cuts, a strong consumer, and an AI hyper growth cycle. In addition, most risk assets rallied post-election as investors anticipate new pro-growth policies from the Trump administration. The S&P500 returned 25.02% which marks the second consecutive year posting at least a 20% return, a feat only accomplished seven times in the last 100 years.

The breadth of the market really started to improve throughout the back half of 2024. Small caps, midcaps, and dividend payers all performed well posting double-digit returns. The bond market retreated in the 4th quarter as interest rates started to rise across the longer end of the curve. The Barclay's Aggregate Bond Index ended the year up just 1.25%. We also saw international stocks give up much of their gains in the 4th quarter, but they held on to post a small positive return for the year.

Here are the returns of the major asset classes at the end of the 4th quarter 2024:

Asset Class	Index	4th Q	YTD	1yr	3yr*	5yr*
US Large Cap Stocks	S&P500	2.41%	25.02%	25.02%	8.93%	14.51%
US Mid Cap Stocks	Russell Midcap	0.62%	15.34%	15.34%	3.79%	9.91%
US Small Cap Stocks	Russell 2000	0.33%	11.54%	11.54%	1.24%	7.40%
Dow Jones Industrial Avg	DJIA	0.93%	14.99%	14.99%	7.55%	10.54%
US Dividend Paying Stocks	DJ Select Dividend	-1.85%	16.62%	16.62%	6.60%	8.85%
NASDAQ	NASDAQ	6.17%	28.64%	28.64%	7.26%	16.55%
Int'l Developed Mkt Stocks	MSCI EAFE	-8.11%	3.82%	3.82%	1.64%	4.72%
Int'l Emerging Mkt Stocks	MSCI EM	-8.01%	7.50%	7.50%	-1.92%	1.70%
US Bonds	Bar Aggregate Bond	-3.06%	1.25%	1.25%	-2.41%	-0.33%

YTD = Year to Date

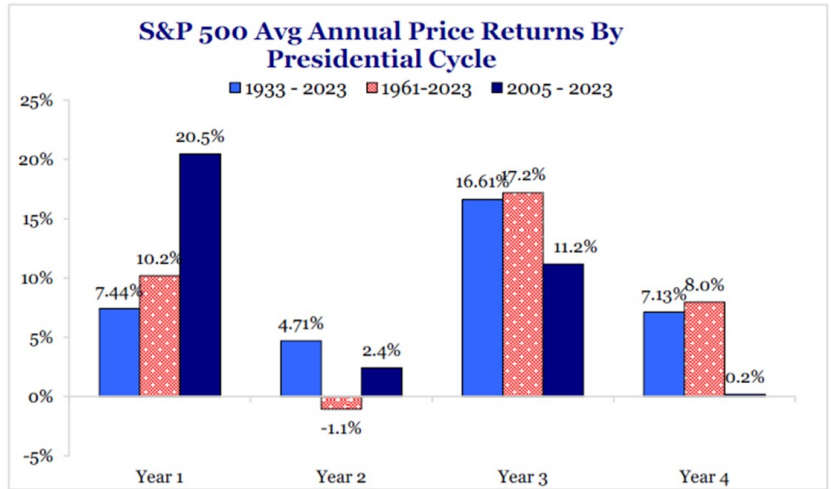
*return is annualized

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As we enter 2025 we remain cautiously optimistic about both the US economy and the markets. Currently we believe there are a number of positives that may drive the market. We think that corporate earnings are showing strong momentum, corporate balance sheets are in great shape, inflation is cooling, and central banks globally have cut rates over the last 6 months. Additionally, money market balances are at all-time highs and we expect a number of pro-growth policies (tax cut extension, reduced regulations, and possibly improved government efficiency). Finally, we anticipate a conscious effort to grow the manufacturing base, expand sources of power generation, and continued expansion of AI capabilities in the US.

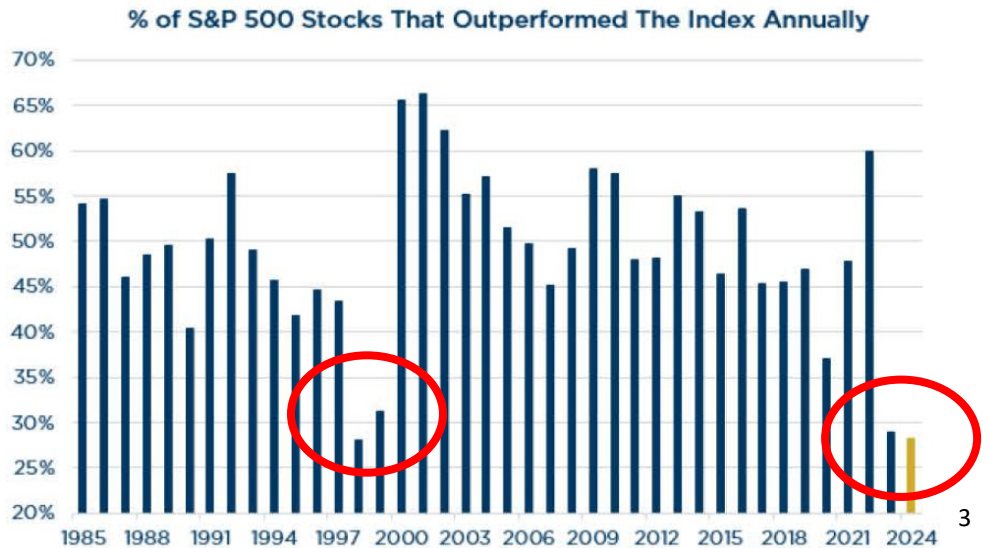
¹ Source: Raymond James Client Center Reporting

Another reason for optimism is the history of presidential cycles. The chart below shows the first year of a new presidential cycle has typically been positive for the stock market. In fact, the S&P500 has been positive in the first year nine of the last ten administrations. Clearly there is no guarantee 2025 will be great for the stock market, but the trend is very favorable.



We have outlined a number of positive economic and market factors, however we still have issues to worry about. We remain concerned about the stretched valuations of the mega cap companies, the impact tariffs and other policy decisions will have on inflation, and the cost of the ballooning federal deficit.

We see a bit of complacency creeping into investor behavior as valuations rise and muted volatility masks some of our economic and geopolitical issues. We have a market trading near all time highs while only a small percentage of stocks actually beat the market over the last two years. We have not seen this type of “top heavy” performance in the S&P since the late ‘90s. The animal spirits of the late 90s led to the internet bubble bursting in 2000 and brings back bad memories for many investors.

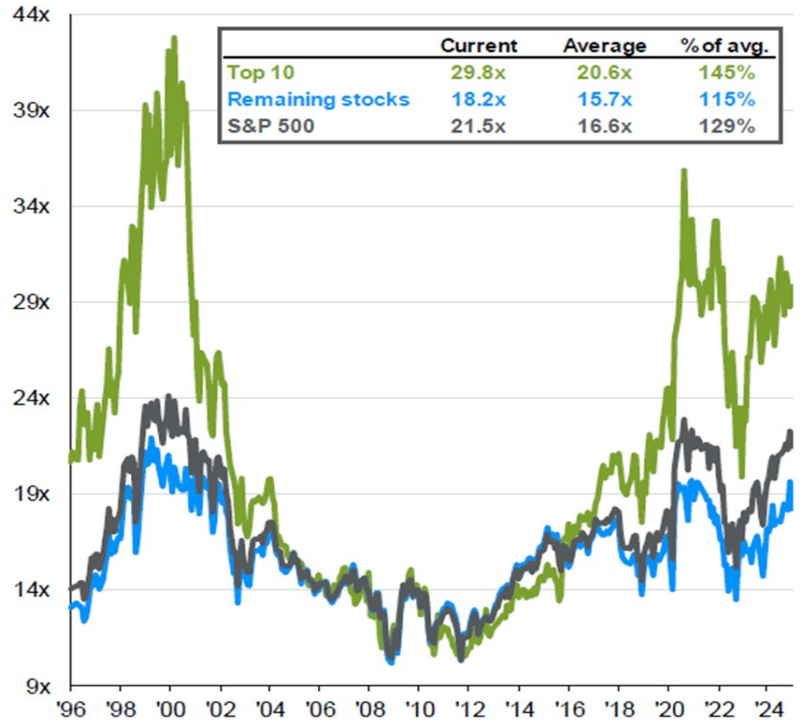


In our opinion, this “top heavy” market state is an issue that may actually create great opportunities if the economy continues its growth trajectory. We believe that slightly lower interest rates, cooling inflation, and modest wage growth combined with deregulation, onshoring manufacturing, and domestic infrastructure improvement efforts will likely benefit small and mid-sized businesses over the next several years. Generally the companies outside the top ten stocks in the S&P500 are trading at meaningfully better valuations when compared to the top ten market cap companies. We believe this environment may be better for diversified portfolios and active investment managers.

² Source: Strategas, “Q4 2024 Quarterly Review in Charts” p. 10

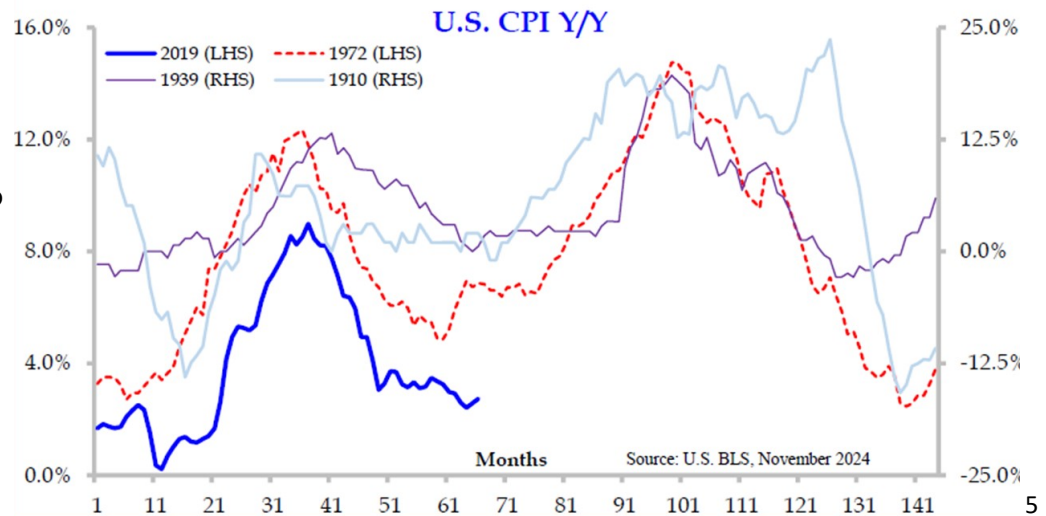
³ Source: The London Company, “Client Letter—Q4 2024” p. 3

Here is a chart showing the current valuation (the P/E ratio) of the top ten stocks vs the rest of the S&P500. The top stocks have a current market valuation of 29.8x which is higher than the historical average of 20.6x and significantly higher than the 18.2x valuation of the remaining 490 stocks. We believe this valuation gap will eventually tighten and highlights what we believe will be an opportunity for small/midcap investors.



Shifting to our views on inflation, we think core inflation will slowly drift lower primarily based on moderating wage growth, slowing rent trends, and limited growth in the money supply. However there is risk of headline inflation rising if tariffs disrupt supply chains and/or energy prices rise.

We think the Trump administration plans to increase output in the energy sector by reducing regulation. If successful, that should keep a lid on energy prices. In addition, we believe the new administration will use tariffs tactically as a bargaining chip to improve outcomes with our trading partners. If applied appropriately, we don't think it will have a major impact on inflation in the near term. We will wait and see.

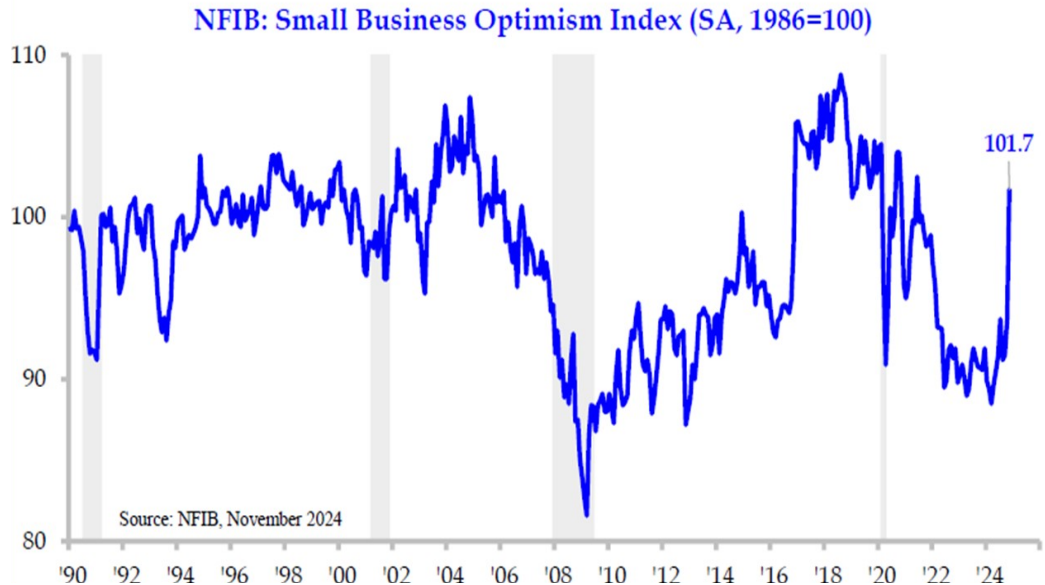


The recent path of inflation is drifting lower, but history shows us several examples of inflation reacceleration. The chart above shows three examples of CPI reacceleration from 1910, 1939, and 1972. There is a clear trend that shows inflation was initially lowered, but 12 to 24 months later, a second wave of inflation roared back. This is the chart that the FED worries about and this is why there is so much conversation around new policies from the Trump administration that may be inflationary.

⁴ Source: JP Morgan, "Guide to the Markets-1Q 2025" p. 12

⁵ Source: Strategas, "4Q2024 Quarterly Review in Charts" p. 27

Since the election in November, we see investor and small business optimism rising. Investor optimism can be a powerful thing when we have trillions of dollars parked in money market mutual funds. When you evaluate the impact of small business optimism, you typically see this level of optimism convert to action relatively quickly. We expect to see an uptick in capital spending and business expansion. We think this capital spending may give a boost to small/midsize businesses and lead to an acceleration in revenue and EPS growth.



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We think 2025 may be a good year for diversified portfolios as we are staying cautiously optimistic about stocks and believe bonds will perform better in 2025 than they did in 2024. We believe there are many trends that will persist over the coming years. We see very strong growth trends in themes such as AI adoption, cybersecurity, energy expansion, and infrastructure improvement. Since the mega cap growth companies have performed so well over the last two years, we think investors should keep portfolios balanced between growth and value at this point. We also believe most investors should continue to increase allocation to small and midcap companies. International investments have shown the occasional signs of life, but as long as the dollar stays strong, we expect the US to outperform most of the developed world.

We are positive on corporate and municipal bonds as corporate and state government balance sheets are strong. We suggest short to intermediate term duration for the bond portion of the portfolio for most investors. Closing out the year, the FED was expected to cut interest rates several times in 2025. Given the current questions surrounding the direction of inflation and economic growth, the FED may stay on pause longer than expected. This will be positive for short duration bonds and money market investors.

As always, we thank you for the trust you place in our team. Please reach out to us with any questions.

-Shaw Investment Management

⁶Source: Strategas, “4Q 2024 Quarterly Review in Charts” p. 31



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