

2025 GLOBAL ASSET ALLOCATION REVIEW

INTRODUCTION

The Aureus annual asset allocation review evaluates the risks and opportunities available in global financial markets and their potential impact on our clients' investment portfolios. Our Asset Allocation Policy describes our positioning for the coming year and may be adjusted as market conditions evolve.

Beyond this annual perspective on global allocation, Aureus develops a customized investment policy for each client based on their specific goals and objectives.

SUMMARY

The Aureus 2025 global asset allocation review combines critical interpretations of global market factors with a focus on:

2025 Analysis			
Market Factors	<ul style="list-style-type: none"> US Economy Global Economy Corporate Profitability Interest Rates & Inflation Geopolitics 	Asset Classes	<ul style="list-style-type: none"> Lower Risk Moderate Risk Higher Risk

Asset classes are grouped into three risk categories: Lower, Moderate, and Higher. The allocation presented below represents a 'base case' composite for portfolios. In practice, each client is adjusted based on risk and return factors specific to their investment objectives. Specific allocations below represent our opinion over the course of 2025. They are subject to changing information and market movement and may be higher or lower at certain points during the year.

2025 Asset Allocation Summary

Risk Category & Asset Class	Risk Level	2025 Allocation	2025 Direction	2024 Allocation	2023 Allocation	2022 Allocation	2021 Allocation
Lower Risk		22%	↑	20%	23%	23%	23%
Cash	Lowest	2%	=				
Absolute Return	Low	10%	↑				
High-Quality Bonds	Low	10%	=				
Moderate Risk		14%	↑	11%	7%	9%	8%
Directional/Credit Strategies	Moderate	4%	↑				
Real Estate	Moderate	3%	↓				
Private Credit	Moderate	7%	↑				
Higher Risk		64%	↓	69%	70%	68%	69%
US Equities	High	48%	↓				
PE/VC	High	4%	↑				
Int'l Developed Equities	High	7%	↓				
Int'l Emerging Equities	High	5%	↓				
Total		100%		100%	100%	100%	100%

2025 ASSET CLASS COMMENTARY

This year's changes generally reflect an overall near-term concern for the higher risk categories, particularly in valuations among US equities and the growth challenges in international equities. Higher interest rates from medium-term bonds - combined with historically high price/earnings multiples for equities - increase the relative attractiveness and risk/return profile of lower and moderate risk categories.

LOWER RISK: LOWER RISK ASSET ALLOCATION INCREASED TO 22%.

Treasury Bill yields have decreased year on year due to Fed rate cuts in late 2024. Currently 4.3%, against inflation of roughly 3.0%, they are projected to deliver a positive real rate of return. While short-term rates have begun to fall, yields remain meaningfully higher than in the decade following the 2008 financial crisis. While this means cash can currently earn an attractive yield, assuming inflation remains on a path toward 2%, the Fed is expected to continue with rate cuts in 2025. Consequently, we maintain a low cash allocation (2%) primarily for liquidity. We believe that gradually moving further out on the yield curve in fixed income to "lock in" higher rates will provide a more attractive source of incremental yield.

Absolute Return investments are designed to provide a 5-7% annual return, or inflation plus 2-3%, with less volatility than equities and a lower correlation to interest rates than fixed income. As this has performed well over the past several years, and is expected to continue, we increased the allocation to 10%. While inflation has been trending down, some of the Trump administration's economic policies around tariffs and immigration create new sources of inflation risk. Absolute Return provides an attractive vehicle to generate uncorrelated returns that are not subject to volatility in interest rates as investors react to changes in inflation expectations. Therefore, the increase in the Absolute Return allocation is a useful diversifier: expected returns modestly higher than fixed income with a lower correlation to interest rate volatility.

After a meaningful increase in our allocation to high-quality bonds last year, we maintained a 10% allocation for 2025. In contrast to short-term, which declined, yields for 5 and 10-year maturities rose 1% in the last 4 months of 2024, with current yields of roughly 4.5%. As a result, the yield curve, which had been inverted since mid-2022, "normalized" and is upward-sloping again—longer rates are higher than shorter. We are optimistic that bonds will serve their traditional role of providing current income and, absent a return of inflation, producing returns negatively correlated with equity markets.

When taken together, high-quality bonds and Absolute Return investments comprise 20% of the lower risk allocation.

MODERATE RISK: MODERATE RISK ASSET ALLOCATION INCREASED TO 14%.

For 2025, we again increased our allocation to moderate risk categories.

Our allocation to Directional/Credit strategies increases to 4%. We added "Credit" to this segment in 2025 to reflect opportunities available from broader credit-related strategies. The goal of this category is to provide higher returns than available in lower risk fixed income while maintaining a lower correlation to equity markets to provide protection from stock market volatility.

Private credit continues to be an attractive area in the moderate risk category. We are slightly increasing the allocation to 7% for 2025. We maintain our 0% weighting to high-yield publicly traded investments, preferring private credit strategies. The private credit space continues to grow, filling a void previously occupied by banks, and a significant number of new managers have entered the market. Investors should remain focused on managers with deal sourcing advantages, strong fundamental credit skills, maintenance of strong loan covenants, and low loan-to-value characteristics.

We modestly reduce our allocation to Real Estate. Heading into 2024, expectations were that long-term interest rates would decline as inflation rates faded. This would provide some relief to the real estate sector, which has been under pressure due to elevated vacancy rates, high labor costs, and higher financing costs. Higher interest rates mean relief from falling financing costs is no longer imminent, creating additional credit risk. Opportunities may surface if financing costs fall or vacancy rates improve, given the lack of new supply added in recent years.

HIGHER RISK: HIGHER RISK ASSET ALLOCATION DECREASED TO 64%.

Higher risk assets are reduced by 5% to 64% for 2025.

The outlook for US economic and corporate earnings growth remains strong for 2025. Consequently, our largest allocation remains with US Equities at 48%. However, we are reducing our allocation following two consecutive years of 20%+ returns for the S&P 500. We believe the combination of higher interest rates than we have seen over the past two decades and historically elevated valuation levels mute the prospects for future returns relative to where we have been in recent years. The concentration of the US market (S&P 500) in the ten largest stocks is nearly 40%. These stocks, primarily made up of the “Magnificent 7”, have delivered over 50% of the market return for the last two years. The group’s valuation is approaching a 30x price/earnings multiple, 140% of the historical average. The “other 493”, or remaining stocks in the S&P 500, have returned a solid 13% in each of the last two years. This group’s valuation is a more reasonable 18x price/earnings multiple which is only 115% of its historical average. We expect market returns to broaden to include the “other 493” as earnings growth accelerates for non-Magnificent 7 stocks.

We are reducing our exposure to international equities in 2024 to 12%, with a slightly higher allocation to developed markets. From a valuation perspective, international equities look cheap compared to the US markets. Repeating the same comments from 2024 - when looking under the hood, international equity markets - relative to US markets - are significantly underweight to the faster growth sectors of Information Technology and Communication Services and overweight to the slower growth sectors of Financial Services, Industrials, and Materials. Japan looks particularly attractive in this category as its economic fundamentals continue to improve. Conversely, we remain concerned about China as it struggles with leadership stifling innovation, geopolitical tensions with the US, an ongoing credit crisis, and unfavorable demographic headwinds.

We are slightly increasing the allocation to Private Equity/Venture Capital to 4%. Higher interest rates are a headwind in this category, and realizations and fundraising have been below trend. However, investing in this category requires a contrarian view, as investors typically commit capital that will be gradually invested over the next 5 years. Higher financing rates and valuations today may lead to opportunities in the future when capital is being invested. In general, these investments offer limited to no liquidity, and the realization of returns can take upwards of 7-10+ years. For those clients with sufficient liquidity, longer time horizons, and suitable risk appetite, PE/VC offers attractive return potential. For clients that don’t meet these criteria, newer perpetual capital vehicles may provide an attractive alternative to gain exposure to investment in private companies.

2024 YEAR IN REVIEW

Investment Return Summary

Asset Class/Index	Asset	2024	2023	2022	2021	2020	2019	3 Year	5 Year	10 Year
Cash										
BofA ML U.S. Treasury Bills	Treasury Bills	5.3	5.1	1.3	0.1	0.7	2.3	3.9	2.5	1.8
Fixed Income										
Barclays US Aggregate	US Fixed Income	1.3	5.5	-13.0	-1.5	7.5	8.7	-2.4	-0.3	1.4
Barclays US Intermediate Agg.	US Fixed Income	2.5	5.2	-9.5	-1.3	5.6	6.7	-0.8	0.3	1.5
ICE BofA High Yield	US High Yield Bonds	8.2	13.5	-11.2	5.3	6.2	14.4	2.9	4.0	5.1
Global Equities										
S&P 500	US Large Cap	25.0	26.3	-18.1	28.7	18.4	31.5	8.9	14.5	13.1
S&P 500 Equal-weighted	US Large Cap	13.0	13.9	-11.5	29.6	12.8	29.2	4.5	10.8	10.3
Russell 2000	US Small Cap	11.5	16.9	-20.4	14.8	19.8	25.5	1.2	7.4	7.8
MSCI EAFE	Developed International	3.8	18.2	-14.5	11.3	7.8	22.0	1.7	4.7	5.2
MSCI EMF	Emerging International	7.5	9.8	-20.1	-2.5	18.3	18.4	-1.9	1.7	3.6
Alternatives										
HFRX Global Hedge Fund	Hedge Funds	5.3	3.1	-4.4	3.7	6.8	8.6	1.2	2.8	2.0
HFRX Market Directional	Hedge Funds	7.6	7.5	-14.3	13.7	9.0	6.8	-0.3	4.2	1.7
HFRX Absolute Return	Hedge Funds	4.9	2.9	0.8	2.1	2.7	4.4	2.9	2.7	2.4
S&P GSCI	Commodities	9.3	-4.3	26.0	40.3	-23.7	17.6	9.6	7.1	1.2
S&P GSCI Gold	Gold	26.6	12.8	-0.7	-4.3	20.9	18.0	12.4	10.4	7.4
Inflation										
CPI Core	Inflation	3.2	3.9	5.7	5.5	1.6	2.2	4.3	4.0	3.1

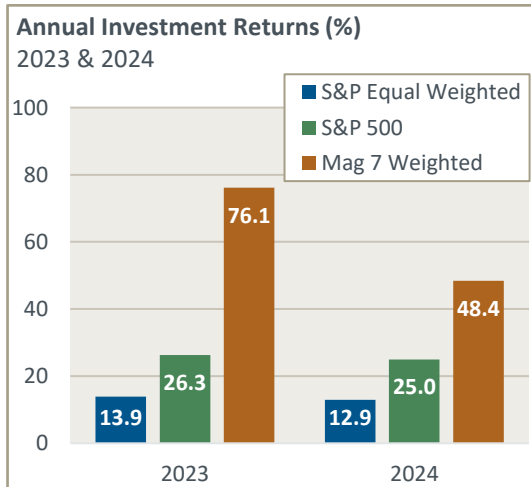
■ Best performing ■ Worst performing

US equities were the best-performing asset class in 2024, a repeat of what investors experienced in 2023. US stocks posted their second consecutive yearly return of over 20% and have posted positive returns of >18% in 5 of the last 6 years. International stocks again trailed the US with mid-single digit positive returns. After anticipation of lower interest rates in 2024, fixed income investments returned only 1.3-2.5% for the year and delivered an annualized 5-year return of close to 0%. Hedge fund indices returned mid-single digits in 2024, slightly better than in 2023.

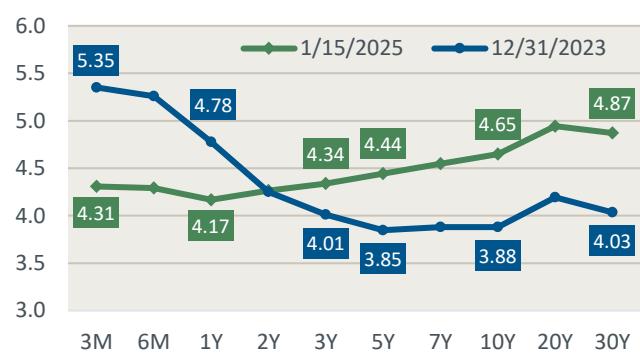
US equity returns were highly concentrated in mega-cap tech stocks for the second consecutive year, primarily the “Magnificent 7.” These seven behemoths — Apple, Nvidia, Microsoft, Amazon, Alphabet, Meta, and Tesla — accounted for 53% of the S&P 500 return in 2024.

The average S&P 500 stock returned 12.9%, which is a very healthy return by historical standards, particularly on the back of strong returns in 2023. However, this return pales in comparison to the “Magnificent 7” returns. Historically, large moves up or down in a small handful of stocks have not materially impacted overall market returns. However, the incredible size of these companies means that is no longer the case.

The Federal Reserve has made significant progress in moving inflation toward its 2% target. Inflation for the last half of 2024 was below 3%, which allowed the Fed to begin cutting rates in September. To date, the Fed has lowered short-term rates three times, from 5.5% to 4.5%.



US Treasury Yield Curve (% YTM)



Interest rates also made dramatic moves in 2024, with the yield curve shifting dramatically over the course of the year. The yield curve “inverted” — a condition where short-term yields are higher than long-term yields — in July 2022 and only returned to a more normalized, upward-sloping curve in September 2024. The 1-year interest rate started 2024 at 4.8% and ended the year at 4.2%. The 10-year interest rate started at 3.9% and ended the year at 4.6%. An inverted yield curve is often a harbinger of recession. However, the US economy has now recorded 10 consecutive quarters of positive Real GDP. Expectations for the Fed’s interest rate hikes to spark a recession never materialized, and consensus forecasts do not expect a recession in 2025.

Mortgage rates for 30-year fixed-rate loans peaked at 7.8% in October 2023 and drifted down to 6.6% at the beginning of 2024. Expectations were that they would continue to trend lower. Lower mortgage rates have the potential to spur additional economic growth because current higher borrowing costs have significantly dampened affordability, and consequently demand, for homes. By September 2024, mortgage rates were down to 6%, which sparked a notable uptick in mortgage applications (both new and refinance activity). However, the relief was short-lived, and mortgage rates climbed back to 7% by year end, dampening housing turnover and spending. Investment-grade corporate bond spreads — the excess return lenders demand over a risk-free government bond — remained historically narrow at <1%. High-yield bonds were similarly tight, with spreads oscillating between 2.5% and 3.5% for the year, a historically narrow recompense for lower-rated corporate bonds. This indicates that investor expectations for economic stress and credit defaults are currently very low.

Geopolitical risks remained elevated as neither the Russia/Ukraine war nor the Israeli/Hamas conflict was resolved during the year. Both fights increase the risk of a broader global conflict as other sovereign nations are drawn into fighting. This has already occurred in both scenarios, but any potential contagion has remained contained heretofore. It remains unclear whether the new administration in Washington will materially change the trajectory of either conflict.

2025 MODEL FACTORS

MODEL FACTOR 1: FUNDAMENTALS

Key considerations include economic prospects, inflation expectations, and the corporate earnings outlook.

ECONOMIC OVERVIEW

SLOWING GROWTH

Global GDP is projected to grow 3.3% in 2025, which is relatively consistent with growth levels in 2024. For the US, the average of the top 10 forecasts is 2.5%, while the average of the bottom 10 is 1.9%. Advanced economies are expected to see GDP growth <2%, while Emerging markets and Developing economies are forecast to grow >4%. Globally, governments are walking a delicate line, trying to help boost economic growth without reigniting inflation.

	Annualized % Change in Real GDP from Prior Quarter								
Country/Region	2021 y/y	2022 y/y	2023 y/y	Q1 2024	Q2 2024	Q3 2024	Q4 2024E	2024E y/y	2025E y/y
United States	6.1	2.5	2.9	1.6	3.0	3.1	2.3	2.7	2.1
China	8.4	3.0	5.2	1.5	0.9	1.3	1.3	5.0	4.5
Japan	2.8	0.9	1.5	-2.2	2.2	1.2	1.2	-0.2	1.2
Germany	3.5	1.7	-0.3	0.2	-0.3	0.1	-0.1	-0.1	0.4
United Kingdom	8.6	4.8	0.4	0.7	0.4	0.0	0.3	0.9	1.3
France	6.8	2.6	1.1	0.2	0.2	0.4	0.0	1.1	0.7
G20 OECD Total	6.8	3.3	3.3					3.3	3.3

The US economy has proven resilient, and we have not experienced a recession since Q2 2020, the height of the pandemic. Most industries impacted by the rolling recessions of the past few years have found demand troughs. However, for some, recovery has been slower to materialize as higher interest rates and election uncertainty dampened demand. Corporations have managed through the recent bout of inflation, balance sheets are solid, and corporate earnings are growing. For bulls, optimism is riding high that the Trump administration will drive growth with a more business-friendly regulatory backdrop and lower corporate tax rates. For bears, the fear is that tariffs, trade wars, and anti-growth immigration policies will offset growth tailwinds and create inflationary risks.

Some factors to focus on as we move through 2025 are:

- **The path of inflation toward the Fed's 2% target.** Many inflation components are running at or below the 2% level, particularly for consumer goods. The largest CPI component is shelter, which comprises 35% of the index, has been slow to come down, and is currently running in the 4-6% range. Shelter inflation will need to ease for the inflation rate to continue moderating. Tariffs create an upward risk to goods inflation, while harsher immigration policies create wage inflation risk.
- **The timing and scale of Fed rate cuts in 2025.** The market is currently expecting 25-50bps of additional rate cuts over the course of the year, while the Fed has committed to being data dependent. Long-term interest rates have recently seen unusually large levels of volatility around short-term economic data points. We believe this underscores how uncertain investors are about the future path of inflation.
- **The employment picture.** Employment remained healthy in 2024, finishing the year with an unemployment rate of 4.2%. There are signs of stress on lower-income households, but overall, wages are rising faster than inflation, which is positive for consumer spending. Immigration policy has the potential to create labor shortages and/or spark wage inflation, both of which could negatively impact the outlook for economic growth.
- **Political Policy.** We discuss this in more detail below.

A NEW ADMINISTRATION

Well, not exactly. With Donald J. Trump's election as the 47th President, the country will experience a Trump 2.0 agenda. He enters this term with Republican majorities in both the House and Senate. We expect to learn more in the coming weeks about what is real and what was simply campaign rhetoric.

Here is a laundry list of issues we can expect will occupy the news cycle.

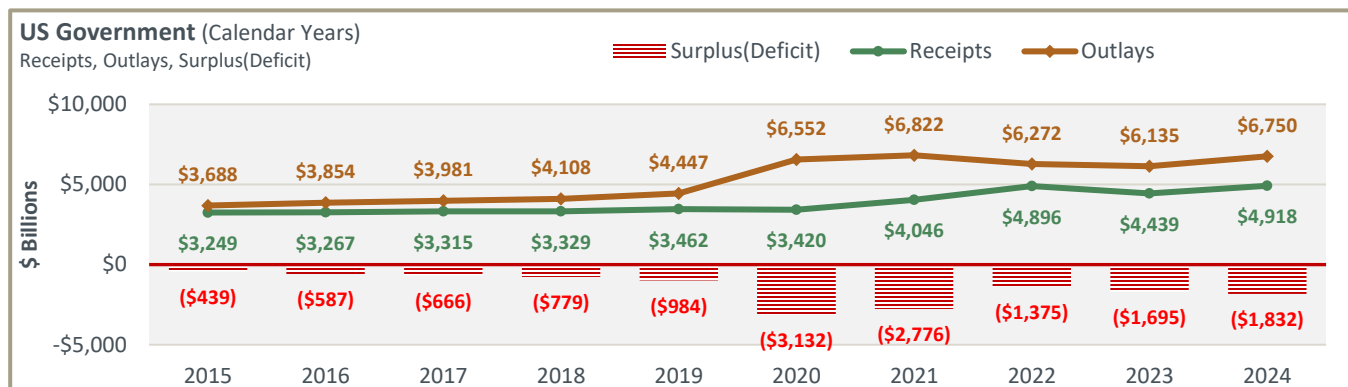
Initiative/Issue	Current Rhetoric	Possible Impact
Tariffs	Tariffs will be a central tool of economic policy. Increase across countries and industries.	Presidents have significant latitude in imposing tariffs. Tariffs have historically been inflationary. Magnitude, duration, and scope of tariffs lack specifics.
Immigration and Deportation	Close the borders and complete the border wall. Engage the military. Construct detention facilities. Ending birthright citizenship. Deport undocumented individuals.	Economic impact of deporting critical immigrant labor force. Social impact of separating families. Legal challenges to these policies may delay implementation time.
Energy	Eliminate restrictions on production. Rollback electric vehicle sales volume requirements.	Lower prices for fossil fuels. Negative impact on climate initiatives.
Crypto industry	US will be the crypto capital of the internet. Establishment of a US Bitcoin Reserve.	Focus legislative resources and priorities to establish a regulatory framework for stablecoins and digital assets.
Extension of 2017 TCJA	Will address an extension and explore lower specific taxes.	A priority item on the agenda given that 2017 tax rates are scheduled to sunset at the end of 2025.
DOGE (Department of Government Efficiency)	Stated opportunity to cut \$1-2 trillion of government expenditures. Streamline operations and eliminate overlap or agencies.	Perhaps the most visible initiative given the presence of Elon Musk. The concept of improving government efficiency is noble. Implementation and resulting impact on jobs and risks of service disruption will be closely followed. The actual cost savings may take years to realize.
Deregulation	Regulatory freeze. Rollback climate-related regulations/agreements.	Actions may be related to DOGE proposals.
Government M&A	Make Canada the 51 st state. Acquire Greenland. Reclaim the Panama Canal. Rename the Gulf of Mexico.	Who knows... and what else will we hear?

FEDERAL BUDGET

The US Federal Debt and budget deficit have become, justifiably, a primary topic of discussion. At the end of 2024, the total public debt outstanding was \$36.1 trillion, roughly double the 2014 level of \$18.1 trillion.

Federal Debt is currently >120% of GDP, exceeding the level of 119% experienced in 1946, following WWII. As recently as 2007, this ratio was 62%, but since the Great Financial Crisis began, the debt ratio has surged, passing 100% in 2024 on its way to current levels.

The last time the US Government had a budget surplus was in 2001. Since then, we have experienced 23 consecutive years of budget deficits. For 2024, the projected federal deficit is \$1.8 trillion. As we know, the deficit is an output of the difference between federal receipts and federal outlays. The chart below makes it clear that the primary cause of our recent deficits is spending. This spending accelerated during the pandemic to stimulate the economy. However, expense levels have remained elevated each year since then, even as the economic weight of the pandemic has dissipated. Clearly, this fiscal problem needs to be addressed.



CONSUMER ECONOMY

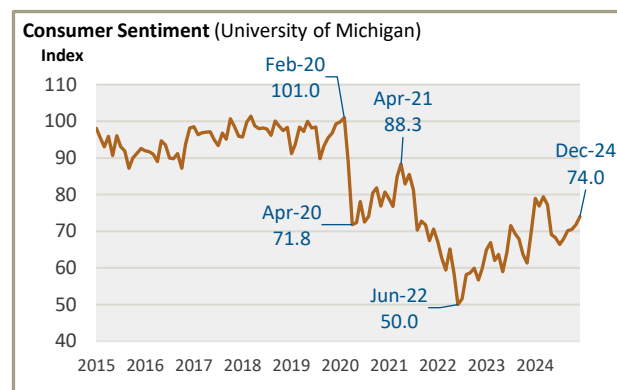
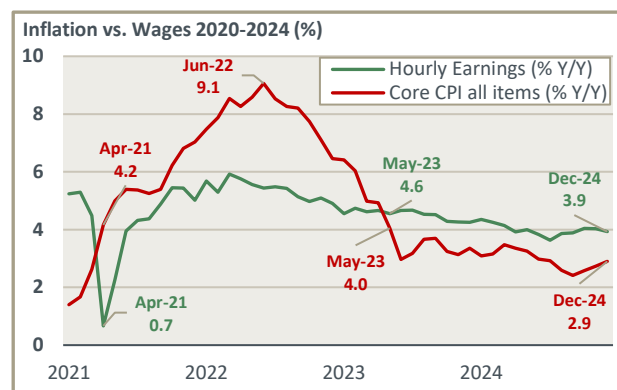
EMPLOYMENT, INFLATION & WAGES

The national unemployment rate has been around 4% since the end of 2021, or essentially full employment. After reaching 9% in June 2022, inflation has declined below 3%. Wage growth is currently running at 3.9% and has exceeded inflation since May 2023, providing real wage gains for consumers. This has historically been positive for consumers' willingness to spend. Job openings remain higher than pre-pandemic levels, providing a very solid employment picture going into 2025.

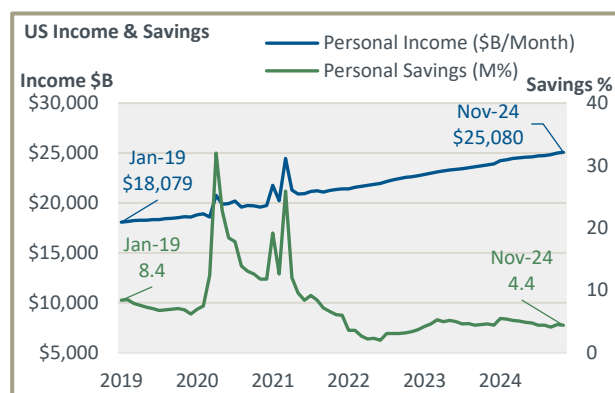
CONSUMER SENTIMENT

Consumer Sentiment, an indicator of consumers' willingness to spend, remains decidedly below that of pre-pandemic levels. The muted sentiment score is somewhat surprising given the strength in many positive indicators (e.g., a healthy job market, real wage growth, strong market returns, and fading inflationary pressures).

During the election cycle, inflation was front and center. However, food inflation has been running below 2.5% (Y/Y), and gasoline prices (before taxes) stand at \$2.13/gallon, well below the \$4.00 levels experienced in 2022. It is possible the political divisions evident in an election year and the constant drumbeat of negative media are responsible. It is also possible that the American dream of home ownership, financial security, and a dignified retirement seem distant to many in this country.

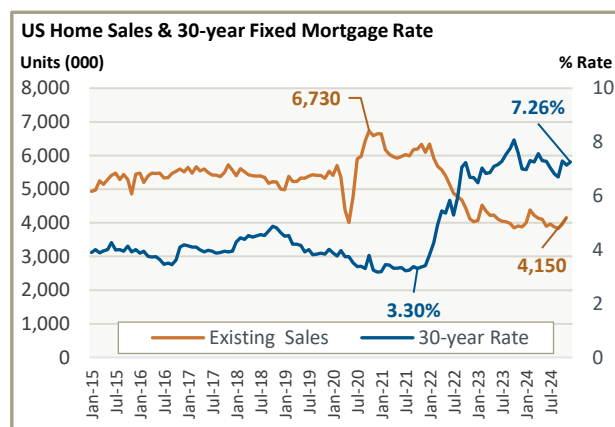


Income inequality continues to be a concern. We know the wealth gap has widened as individuals who own stocks have seen an appreciable increase in net worth since 2022. An important element of being able to invest is having a savings rate sufficient to allow for an allocation to investments. Over the past 5 years, US Personal Income has grown at an annual rate of 6.8%. However, the Personal Savings Rate, which benefitted from government support checks in 2020-2021, has since fallen below 5%, as elevated inflation levels have increased the cost of living.



MORTGAGE RATES & HOUSING ACTIVITY

Fed rate hikes over the past two years have had a pronounced impact on the housing market. As recently as 1Q22, consumers could receive a 30-year mortgage with an interest rate below 3%. Mortgage rates climbed alongside the Fed funds rate, peaking at almost 8%. This created two notable headwinds for housing turnover: (1) Owners locked into low-rate mortgages became reluctant to move and lose their current attractive interest rate – hurting supply; and (2) Buyers looking to acquire were faced with high interest rates that dramatically increased the monthly cost of home ownership – hurting demand. These conditions have depressed existing home sales to the lowest levels since the housing crisis of 2008-2010. The lack of supply helped support home prices (the largest source of wealth among many families).



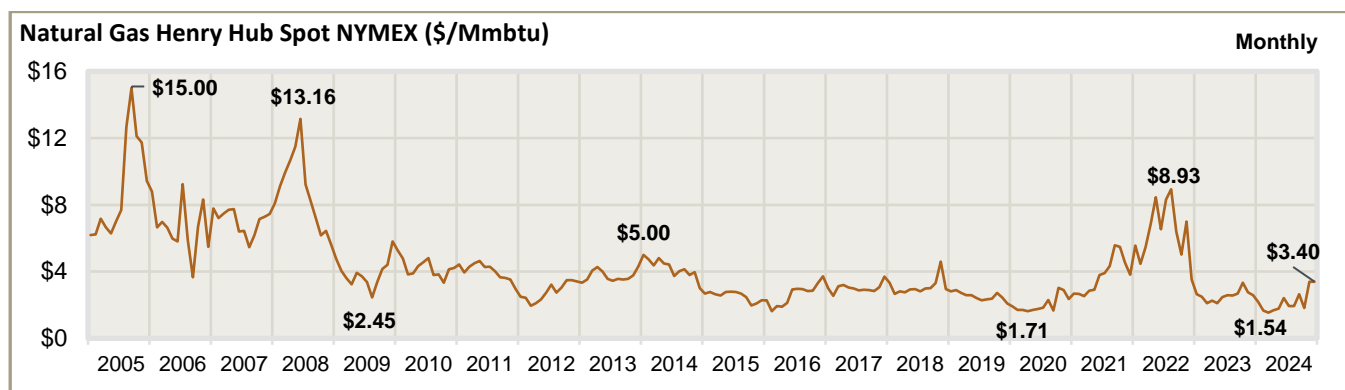
The lack of housing turnover has been a drag on the economy — because home purchases usually drive remodeling activity and spending on furnishings for two years following purchase. The hope for 2024 was that Fed rate cuts would reduce mortgage rates and unlock the housing market. However, after declining for most of the year, interest (and mortgage) rates began climbing again in 4Q24. This could be due to concerns about the future rate of inflation or deficit hawks expressing concerns over the unsustainable pace of government spending. Regardless, housing turnover remains well below historical levels, with little visibility of when this trend might abate.

GLOBAL MONETARY POLICIES

Prior to 2024, most central banks were tightening monetary policy to rein in high inflation, initially ignited by pandemic-related trade disruptions and the prior monetary easing cycle. The latest tightening cycle ended for most major economies in either late 2023 or early 2024. The US was a little later to this easing cycle, waiting until September to begin cutting the Fed funds rate. The US had the luxury of waiting to ease in large part because its economic performance has been unusually robust compared to most of its global peers. Part of this has been due to accelerating capital investment spent on artificial intelligence, power and energy, and security. This economic strength also limits the amount of easing that is necessary and/or possible by the Fed, which needs to be careful not to overheat the economy. The combination of higher interest rates and strong economic growth compared to trade partners drove a 6.5% appreciation in the US Dollar on a trade-weighted basis. Dollar strength is a headwind to US exports and to US-dollar denominated profits generated by US companies internationally.

OIL PRICES

Oil prices remain volatile, although less so than in 2022, trading in a range of \$70-90 per barrel in 2024. In 2024, rising non-OPEC production offset supply cuts by OPEC+ members. There is also a significant amount of additional non-OPEC international production expected to come online in 2025. Additionally, the Trump administration has announced a pro-production stance on US oil and plans to remove many of the production constraints put in place by the prior administration. Given muted demand from China and the potential for progress towards resolution of large geopolitical conflicts, we expect the oil market in 2025 will be characterized by strong global growth in production and slower demand growth. This should keep a cap on prices in 2025.



Natural gas prices climbed higher in 2024 after beginning the year at severely depressed levels. In addition to typical seasonal price volatility (e.g., cold weather means more home heating), we believe prices are supported by optimism about future demand trends. 2025 should begin to see early signs of incremental electricity demand from data center construction, a trend that is expected to continue over the next decade. Natural gas remains the most readily available and affordable source of energy to provide this power. Additional US LNG facilities should also begin to come online in 2025, which could drive additional exports to Europe and Asia.

INFLATION

The Consumer Price Index ("CPI") finished 2024 with a 3.3% year-over-year increase, a material decrease from the 9% level observed in June 2022. Whether the reduction was due to Fed-induced dampened demand, waning consumer spending desire, or improvement in supply chains, inflation is at a very different place in 2024.

The Fed did its part, raising the Fed funds rate from 0.25% to 5.5% – eleven increases over sixteen months, for a total increase of 5.25%. Currently, the Fed Funds rate is 4.50%, down 1.0% since the start of cuts in September 2024. Further cuts will likely require additional progress toward the Fed's 2.0% CPI target or a weakening of the labor market. This may take some time as the more stubborn components, such as shelter and services, tend to move more slowly.

CORPORATE EARNINGS

While not all companies have reported Q4 earnings at the time of this publication, earnings growth for the S&P 500 is estimated to have grown by roughly 9% in 2024. This growth rate is a meaningful rebound from 2023's 1% earnings growth. Revenue growth in 2024 was tepid, rising just ~1.5%, while margin expansion (productivity and cost cuts) was the primary driver of earnings growth. This earnings growth can be further distilled into "Magnificent 7" earnings growth (+34%) and non-Mag 7 growth (+3%). This mimics the similarly extreme divergence these groups experienced in 2023 (+31% versus -4%).

Unsurprisingly, on a sector basis, sectors containing "Magnificent 7" stocks were the three best performers in 2024 (Communication Services +39%, Information Technology +36%, Consumer Discretionary +29%). The four worst performers were Materials (-2%), Health Care (+1%), Real Estate (+2%), and Energy (+2%).

Thematically, 2024 felt divided into AI-related and non-AI related stocks. Stocks related to AI included semiconductor companies, companies supplying equity to semiconductor companies, companies building large language models for AI, companies benefiting from the buildout of data centers and all the equipment and labor that entails, and companies expected to provide the power for said data centers. In many cases, accelerating earnings growth at these businesses has been further rewarded by abnormally high valuation multiples applied to the higher earnings. The first phases of AI investment have been highlighted by the massive amount of capital investment spent and committed. Moving forward, AI benefits will begin to be more broadly shared by other industries and companies.

Looking forward, the earnings outlook is more evenly balanced. In 2025, the "Magnificent 7" stocks are expected to produce +21% earnings growth, which is still robust, although a step function lower than in prior years. The "493" non-Mag 7 stocks are expected to see earnings growth accelerate to +13%, a 10pp increase in growth rate as compared to 2024. We believe this should help lead to broader stock participation in 2025.

ECONOMIC GROWTH

UNITED STATES

Real GDP in 2024 is projected to grow 2.7%, a modest downtick from 2023's 2.9% growth rate. Expectations for 2025 are for the growth rate to continue to moderate closer toward 2.0%+. The US appears to have achieved the "soft-landing" scenario. While there is always the potential for unexpected economic shocks, we are optimistic that with the Fed funds rate well north of 0% (where it hovered for much of the last 15 years), there is now meaningful ammunition available to stimulate the economy if trends sour. In particular, a drop in interest rates could meaningfully boost housing market activity and real estate investment in general.

Factors	Influence
▪ Government fiscal spending	=
▪ Inflation	+
▪ Employment	+
▪ Higher interest rates	-
▪ Supply chain improvements	-
▪ Consumer spending	+

EUROPE AND JAPAN

We remain cautious on Europe due to persistent economic challenges and geopolitical uncertainties. The region faces cyclical headwinds, with sentiment and earnings dependent on external factors. Internal political instability, particularly in Germany and France, adds to the uncertainty. Moreover, the threat of US tariffs looms large, with Europe struggling to provide a unified response. Despite some attractive sector-level valuations, these risks outweigh potential opportunities in the near term. Japan presents a more

Factors	Influence
▪ Geopolitical tensions (Europe)	-
▪ Trade tension risks (Europe)	-
▪ Corporate governance reforms (Japan)	+
▪ Supply chain de-risking beneficiary (Japan)	+
▪ Strong labor markets (Japan)	+

compelling investment case. The country is moving out of a long period of deflation and stagnant growth, with inflation normalizing and a tight labor market driving wage increases. Ongoing corporate governance reforms are leading to record-high buyback announcements and increased M&A activity, potentially boosting shareholder returns. Japan's strategic role in de-risking global technology supply chains further enhances its appeal. While Yen volatility remains a concern, the expected stabilization as interest rates normalize gradually supports the case for maintaining or increasing allocations to Japanese equities.

EMERGING MARKETS

The outlook for emerging markets presents a mixed picture. China continues to face significant economic challenges, with persistent real estate issues and weak consumer confidence. Despite government stimulus efforts, the scale may disappoint investors, and potential US tariffs pose additional risks. However, opportunities exist in innovative sectors like business technology. Other emerging markets show more promise, with India standing out due to strong earnings momentum and robust services export growth.

Southeast Asian markets may benefit from supply chain shifts and its position as a leading "friend-shoring" destination, while Taiwan gains from the tech cycle boom and AI infrastructure build-out.

Factors	Influence
▪ US trade/tariff policies	-
▪ Chinese economic challenges	-
▪ Supply chain reconfiguration	+
▪ Commodity Price Volatility	-
▪ Monetary easing	+

MODEL FACTOR 2: VALUATION

Key considerations are valuation and yields, viewed historically in absolute and relative terms.

EQUITIES

Global Equity Valuation Comparison

Country/Region	10 Year P/E Ratio			Jan.	Jan.	10 Year Price/Book Ratio			Jan.	Jan.
	High	Low	Avg.	2025	2024	High	Low	Avg.	2024	2023
US	24.8	14.7	19.0	22.3	19.7	4.2	2.3	3.2	4.2	3.6
Europe	18.3	10.7	14.1	13.6	12.9	1.9	1.3	1.7	1.8	1.7
Japan	18.9	11.7	14.6	14.0	14.6	1.5	1.0	1.2	1.3	1.3
Emerging Mkts	19.2	11.8	14.8	15.1	13.8	2.3	1.5	1.9	2.0	1.9

Source: FactSet, January 2025. Forward P/E and P/B ratios.

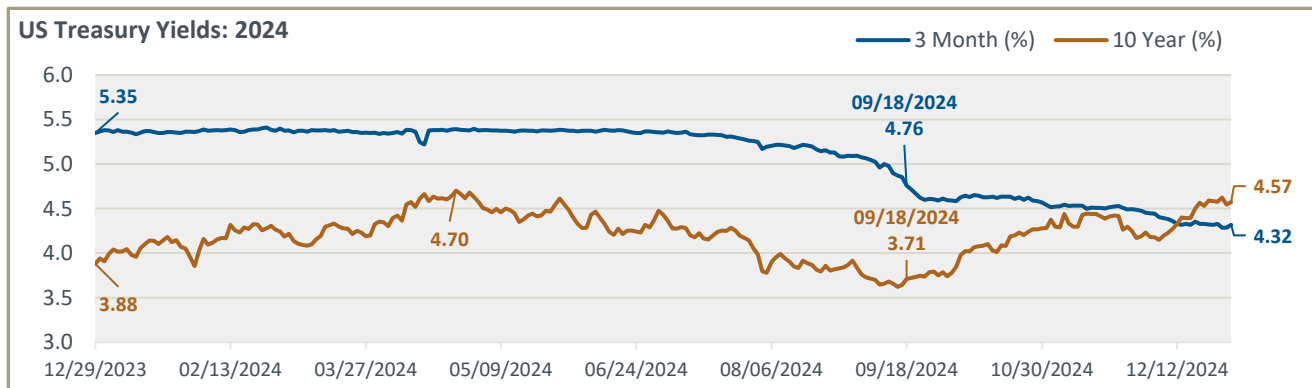
The US market price/earnings ratio finished the year at 22.3x forward earnings, expanding from 19.7x one year ago. This puts it above its 10-year average but below the high of 24.8x. Frankly, we are surprised that the multiple continued to expand in 2024, particularly given that the unfavorable move in the 10-year interest rate should have negatively impacted valuations (all else equal). It speaks to the level of investor optimism around the pace of future earnings growth, particularly as it pertains to AI — with many people comparing its potential economic impact to that of the industrial revolution. It is difficult to get overly negative on equity markets when recession risk appears low, there is a pro-business administration in the White House, and corporate earnings growth is expected to accelerate. Still, history tells us that the future potential for annualized equity returns is low single digits when your starting valuation point is as elevated as it is currently. Only time will tell if "this time is different."

Equity valuations in Europe, Japan, and Emerging Markets remain at meaningful discounts to the US. However, valuation alone is not a justification for purchase, and when we look at the prospects for equity returns internationally, we believe investors need to remain selective. Japan and India stand out as attractive, while China and Europe have a less clear path higher.

BONDS

The bond market was a large part of the story in 2024. Falling inflation and moderate economic growth provided the cover needed for the Fed to reverse direction and begin lowering short-term rates from the 5.5% level. The FOMC cut 0.5% in September, followed by another 0.25% in both October and December, bringing the total reduction to 1% and a level of 4.5% as of year-end.

The chart below shows the path of the 3-month Treasury Bill and the 10-year Treasury note over the course of 2024. A few items of note. The 3-month remained at roughly 5.3% until investors were confident we would see a rate cut. With the 1% cut over the fourth quarter, yields fell and currently stand at 4.3%. The 10-year followed a very different path, starting the year at 3.9%, trading up to 4.7% in April, trading down to 3.7% in September (the day of the first Fed rate cut), and finishing the year at 4.6%. The divergent path of short and longer rates moved the yield curve towards a more “normal” positive slope – meaning longer rates higher than short rates – from the inverted yield curve that had been with us since July 2022.



Additional rate cuts are likely to be data dependent as they have been all along. Given the Fed’s dual mandate of price stability (low inflation) and sustainable employment (strong labor market), if we see inflation moving toward the Fed’s 2% target and unemployment remaining around the 4% level, we can expect a gradual decline in short rates. Unknowns include tariffs, which have historically been inflationary, which could cause the Fed to reassess. On the longer end, rates may remain in a higher range, given the forecast for continued positive economic growth in the US economy. Long rates in the 4-5% level are not historic outliers. In fact, over the last 40 years the average yield on the 10-year Treasury has been 4.8%.

As is the practice in Washington, the debt ceiling needs to go higher – most likely at the last possible moment. While we expect this to occur, the rise of fiscal conservatives in the House heightens the risk of making this uncomfortable for bond investors and adding volatility to interest rates.

Except for the UK, most developed market bonds continue to yield below those in the US. Most developed markets followed (lagged) the US in efforts to lower inflation by raising interest rates, due to uncertain economic conditions and existing geopolitical risks. We expect the same to hold true as inflation comes down in their economies and resumption growth moves higher on the priority list.

MODEL FACTOR 3: GEOPOLITICAL

Key considerations are government and political conditions in specific geographies that may impact economies and investment markets.

UNITED STATES

The ongoing conflicts in Ukraine and the Middle East continue to demand US attention and resources, with the potential for escalation posing significant risks to global stability. Relations with China remain a critical concern, as trade tensions persist, and the threat of increased tariffs looms large. The potential implementation of new US tariffs could trigger severe economic slowdowns with trading partners, potentially leading to a broader global economic impact. The outcome of these geopolitical dynamics will have far-reaching implications for global trade, economic growth, and international security, with the US playing a central role in shaping the evolving world order.

EUROPE

The Russia-Ukraine conflict continues into its third year, with no clear resolution in sight, adding to geopolitical uncertainties and potentially impacting European energy markets. Internal political uncertainty looms large, with German elections and an unstable French government contributing to potential instability. The region is under pressure to increase defense spending substantially, likely straining fiscal policies. Trade tensions with the US persist, with the threat of new tariffs adding to economic uncertainty. Europe struggles to provide a unified response to these external pressures, potentially weakening its global position.

EMERGING MARKETS EX-CHINA

The geopolitical outlook for emerging markets ex-China is marked by heightened uncertainty and potential volatility. Trade tensions, particularly with the US under the Trump administration, pose significant risks to export-oriented economies. However, this also presents opportunities for some countries to benefit from trade diversion and supply chain diversification. India stands out as an attractive destination for investors seeking alternatives to China. Meanwhile, concerns over geoeconomic confrontations, including sanctions and tariffs, are expected to intensify. Emerging markets must navigate these challenges while also dealing with domestic political shifts, evolving regulatory landscapes, and the ongoing need for economic reforms.

CHINA

China's economic slowdown persists, with GDP growth expected to decline significantly over the next decade. The ongoing real estate crisis has hurt consumer confidence, with housing prices falling sharply across major cities. Internationally, China faces significant trade tensions, particularly with the US, where potential increased tariffs could trigger a severe economic slowdown. These economic challenges are compounded by negative foreign direct investment in recent quarters, indicating reduced international confidence. President Xi Jinping's government faces pressure to implement more forceful economic stimulus measures while navigating complex global relationships. The situation with Taiwan remains a critical flashpoint, with potential for escalation depending on US-China relations.

MODEL FACTORS: SUMMARY TABLE

Region	Economic Fundamentals	Valuation & Risk	Geopolitical
US	<ul style="list-style-type: none"> Unemployment levels remain low, and wage growth exceeds inflation, boosting consumer balance sheets, which remain healthy. The inflation rate of ~3% appears headed toward the Fed target of 2% barring significant negative impact from tariffs or immigration policy. Modest Fed rate cuts are expected in 2025 if inflation remains <3%. However, longer rates may be range-bound at 4-5%. With the change in Administration and one-party control of Congress there is the risk of major policy shifts and accompanying uncertainty. 	<ul style="list-style-type: none"> With the fundamental outlook generally positive, perhaps the biggest risk to market returns is valuation of risk assets (equities). US Equity valuation as measured by P/E Ratio is bifurcated with the largest 10 companies trading at 150% of their historical average and the remainder trading at just 115% of their historical average. Higher longer-term interest rates (although not outliers by historic standards) add pressure to corporate and consumer balance sheets. 	<ul style="list-style-type: none"> A US first agenda in Washington, by definition, implies that other regions and economies are of secondary importance. An output of this may be an opening for other countries such as China to fill the void. Trade tension remains elevated given the threats of larger and expanded tariffs from the US. Immigration policies and expanded deportation will add to tensions. Continued regional conflicts in Russia/Ukraine and the Middle East create risk of escalation.
Developed Markets	<ul style="list-style-type: none"> European economies face cyclical challenges, with sentiment and earnings dependent on a rebound in China, manufacturing upturn, or stronger consumer spending. Japan is moving out of a long period of deflation and stagnant growth, with inflation normalizing and a tight labor market potentially driving wage increases. 	<ul style="list-style-type: none"> European equities are trading at a discount to US equities, but this discount is justified due to lower exposure to fast-growing sectors and a slower economic recovery. Japanese equities have experienced higher earnings due to exposure to cyclical industries, but ongoing corporate governance reforms are leading to record-high buyback announcements and increased M&A activity. 	<ul style="list-style-type: none"> Europe faces internal political uncertainty due to German elections and an unstable French government, along with pressure to materially increase defense spending. Japan is relatively insulated from US trade pressures compared to other countries and can potentially play a strategic role in de-risking global technology supply chains.
Emerging Markets	<ul style="list-style-type: none"> EM is expected to continue making the strongest contribution to world GDP. Non-recessionary Fed rate cuts and easing by other EM central banks are expected to provide support, potentially boosting economic growth and investment flows. China's trade relations with the rest of the world, particularly the US, remain a source of risk. 	<ul style="list-style-type: none"> Emerging market equities trade at a sizable discount to developed markets, offering potential value opportunities for investors. However, absolute valuations in some key EM markets, particularly India and Taiwan, are at their highest levels in the past decade, potentially limiting performance. 	<ul style="list-style-type: none"> The shuffling of supply chains and reshoring creates opportunities for EM countries, especially in Southeast Asia. US/China relations are unlikely to revert to previous levels due to political differences and China's growing influence, but efforts are underway to establish a new normal.

EXPECTED RETURNS

2025 Asset Allocation: Expected Returns

Asset Class	Risk Level	Expected Nominal Return	2025 Allocation	Expected Nominal Return Attribution
Cash	Lowest	3.0% — 5.0%	2%	0.1% — 0.1%
Fixed Income	Low	4.0% — 5.5%	10%	0.4% — 0.6%
Absolute Return	Low	5.0% — 8.0%	10%	0.5% — 0.8%
Directional Alternatives	Moderate	5.0% — 8.0%	4%	0.2% — 0.3%
Real Estate	Moderate	7.0% — 9.0%	3%	0.2% — 0.2%
Private Credit/High Yield	Moderate	7.0% — 9.0%	7%	0.5% — 0.6%
US Equities	High	7.0% — 10.0%	48%	3.4% — 4.8%
Private Equity/Venture Capital	High	7.0% — 12.0%	4%	0.3% — 0.5%
International Developed Equities	High	6.0% — 10.0%	7%	0.4% — 0.7%
International Emerging Equities	High	6.0% — 10.0%	5%	0.3% — 0.5%
Total Portfolio Nominal Return			100%	6.2% — 9.1%
Less Expected Inflation				(2.5%)
Total Portfolio Real Return				3.7% — 6.6%

Calculating expected returns is mainly a quantitative exercise to establish a range of returns for asset classes and an overall “average” portfolio. History has shown that these asset classes rarely deliver these expected returns during any one calendar year, given the cyclicity and volatility of individual asset classes. For example, US equities returned -4.4% in 2018, followed by 31.5% in 2019, 18.4% in 2020, 28.7% in 2021, -18.8% in 2022, 26.3% in 2023, and 25.0% in 2024. Looking over the last 20 years, the annualized return is 10.3% for US equities – a more appropriate number for this exercise. Over longer periods, these more volatile one-year returns are smoothed, and returns generally move toward longer-term asset-class averages. The expected nominal returns in the table above incorporate factors specific to our view of the current market environment. They allow us to express our assumptions and apply them to a client’s portfolio.

For 2025, following another strong year in stocks and a moderate return year for bonds, we expect more “normal” returns from asset classes. Some clients may require rebalancing after the strong performance in the US equity markets over the last two years, and our opinion is to slightly reduce the US allocation to 48%. In a base-case portfolio implementation, we would expect a diversified portfolio to generate expected nominal returns in the 6.2% to 9.1% range; with inflation estimated to be 2.5% (lower than 2024), the real return could be in the range of 3.7% to 6.6%.

As always, we remain diligent in our approach to the financial markets and managing our clients’ investment portfolios. As new information becomes available, we will update our models and adjust our allocations when market conditions warrant.

We appreciate the opportunity to share our views and welcome your questions and comments.