Fourth Quarter 2024

MARKET COMMENTARY

SAME AS IT EVER WAS

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OVERVIEW: SAME AS IT EVER WAS

In many ways, 2024 was a continuation of broader trends in place over the past several years. Stocks meaningfully outperformed bonds and U.S. big tech, aka the Magnificent 7 ("Mag 7") of Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla, outperformed just about everything. These trends reminded us of the classic Talking Heads song "Once in a Lifetime", and the dichotomy of its most prescient line, "*same as it ever was.*"

We may very well have experienced a once-in-a-lifetime period of market concentration and dominance by a handful of the largest publicly traded stocks. This is not the first time a handful of companies have captured phenomenal fundamental growth and valuation expansion — it certainly ranks up there with prior periods such as the *Four Horsemen* in the late 1990s or the *Nifty Fifty* in the 1970s. However, the speed at which this concentration has occurred is unprecedented. The Mag 7 have essentially doubled in size, from 17% to more than 33% of the S&P 500 Index over the past five years. Over that time, the Mag 7 generated more than a 500% cumulative return versus approximately 60% for the remaining 493 constituents of the S&P 500 Index.

For the year, the final tally of major asset class total returns stacked up with equities in the lead, bonds and real assets in the rear, and diversifying strategies somewhere in between. Global equities, as measured by the MSCI All Country World IMI, returned 16.4% in 2024. Core bonds and public real assets bounced around over the year but ended up close to where they started, with modest returns of 1.3% and 3.8%, as measured by the Bloomberg U.S. Aggregate Bond Index and the S&P Real Assets Equity Index, respectively. Diversifying strategies fared better, depending upon the underlying managers and strategies, but as a group generated a calendar year return of 5.3%, based on the HFRX Global Hedge Fund Index.

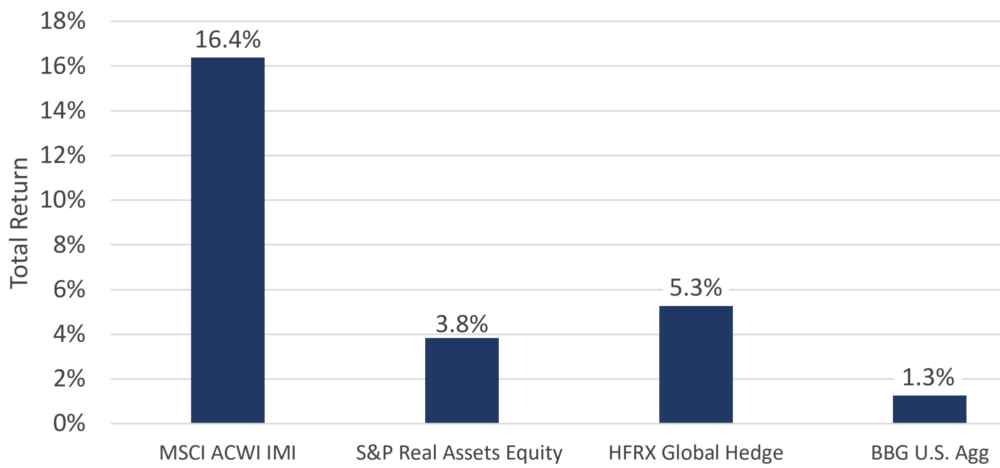
KEY MARKET THEMES AND DEVELOPMENTS

"SANTA CLAUS RALLY" REMAINED ELUSIVE BUT 2024 HANDED INVESTORS BROAD-BASED GAINS

For both the final quarter of 2024 and the calendar year, the overarching theme across global financial markets resembled a longer-term trend. Namely, significant strong performance by both domestic risk sectors and the broader U.S. economy versus key trading partners. For the year, outside a narrow pocket of sectors – global natural resource equities, timber, and international real estate investment trust securities (REITs) – most major asset classes and sub-asset categories posted gains.

FAITH IN RISK ASSETS WAS ONCE AGAIN REWARDED

2024 Total Return Across Major Asset Classes



Data sources: Bloomberg, L.P., Data as of 12/31/2024

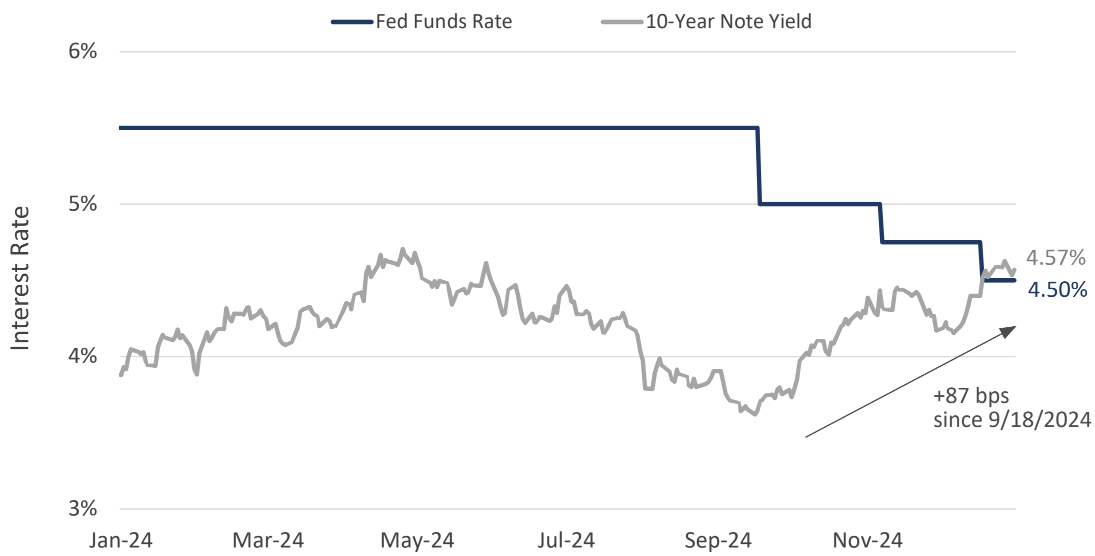
For the fourth quarter, however, the often observed "Santa Claus Rally" was nowhere to be found, although the dominance of the Mag 7 continued. The Bloomberg U.S. Magnificent 7 Index generated a total return of 15.9%, versus an essentially flat return of -0.4% for the Bloomberg U.S. Large Cap (excluding Magnificent 7 Index). For the full year, the disparity was even wider, with the Mag 7 gaining 67.3% versus a more modest 16.5% return for the other 493 members of the S&P 500.

December's volatility came despite a third cut to the policy rate by the Federal Reserve on December 18. The Fed cut the federal funds rate 25 basis points to 4.5%, bringing the year-to-reduction in this key interest rate to a total of 100 basis points. Somewhat peculiarly, at the Fed's mid-December meeting, updates made to the *Summary of Economic Projections* reflected a 30 basis point (bp) increase in expected inflation in 2025, with the Fed upwardly revising their 2025 core personal consumption expenditure (PCE) projection from a 2.2% anticipated pace at their September policy meeting, to an updated projection of 2.5%.

The lowering of the policy rate in December, paired with upward revisions to near-term expected inflation, did little to quell growing concerns the Fed is fanning the flames for a second inflationary wave. With little slack in the labor market, accelerating money supply growth, persistent federal budget deficits, and continued economic expansion, these concerns appear to have merit. The likelihood of increased tariffs following President-elect Trump's November election victory also seems a likely tailwind to cost pressures, as these higher prices are often passed along to end consumers. In light of these forces, Treasury interest rates marched higher and have risen nearly 90 bps since the Fed launched its easing cycle on September 18.

LOWER RATES, PERSISTENT CONCERNS

Fed Funds Rate vs. 10-Year Treasury Note Yield



Data source: Bloomberg, L.P. NBER; Data as of 12/31/2024

Those corners of the financial markets with above-average interest rate sensitivity, such as smaller cap stocks, investment grade corporate bonds, REITs, and longer duration sectors, faced performance challenges amid the latest backup in Treasury rates. Small cap stocks, for example, tend to carry more debt on their balance sheets than their larger cap peers relative to underlying earnings. The cost of this leverage is also higher. As a result, December's 40 bp rise in the 10-Year Treasury note yield was a contributor to their underperformance, despite showing signs of life following the election.

Despite what *felt* like a bumpy ending to a year that actually presented risk-seeking investors with little to complain about, credit markets continued to provide optimism. Spreads on high yield risk premiums, a useful gauge of the health and wellbeing of the business cycle, tightened to within 20 bps of their lowest reading ever during the fourth quarter and hardly budged during December's risk asset pullback.

HIGH YIELD SPREADS HAVE TIGHTENED TO NEAR-RECORD LEVELS

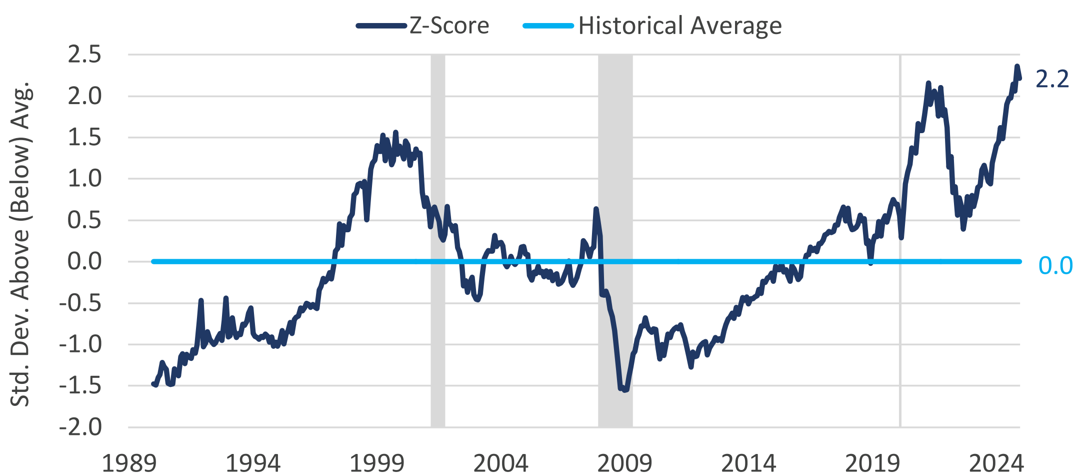
High Yield Option-Adjusted Spreads

Data sources: Bloomberg, L.P., NBER; Data as of 12/31/2024
Note: Monthly yield spread vs. 5-Year Treasury used for 1/1987 – 9/2000; Daily OAS used thereafter.

Unsurprisingly, given the rally in U.S. equities, both sentiment and valuations ascended to new heights. An equal-weighted mix of valuation ratios (enterprise value/EBITDA, forward P/E, price/book, price/sales, and price/cash flow) was more than two standard deviations above its average reading at year end, implying that now is one of the most expensive valuation backdrops in the last 35 years.

VALUATIONS REMAIN STRETCHED

S&P 500 Equal-Weighted Valuation Composite



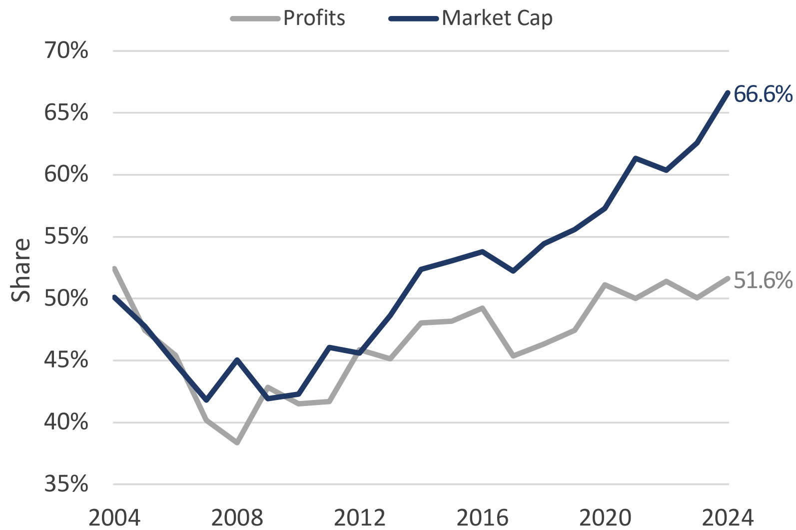
Data sources: FEG, Bloomberg, L.P., NBER; Data as of 12/31/2024
Note: Valuations used: EV/EBITDA, P/E (fwd), P/B, P/S, P/CF; Shaded areas denote recession.

The U.S. economy is dynamic, innovative, and home to many of the best businesses in the world. Additionally, the composition of the S&P 500 Index has evolved over time to a higher quality mix of sectors and businesses. It stands to reason then that U.S. equities would command loftier valuations than those of many other countries, and the S&P should perhaps trade at a higher valuation compared to its own history. The key question is how much good news is already priced in; it is an important and incredibly difficult question to answer. Still, we believe clarity will emerge.

One way to visualize U.S. dominance is to look at the percentage of the global equity market that the U.S. represents. Pictured is a chart plotting that percentage, both by price (market capitalization) and profits. Two things jump out. First stock prices tend to move in the same general direction of profits, albeit imperfectly. Second, prices have moved well ahead of profits. One would expect these lines to converge over time — profits catch up to prices, prices come down, or, most likely, a combination of the two.

U.S. STOCKS AND PROFIT CONTINUE TO GAIN MARKET SHARE IN GLOBAL EQUITIES

U.S. Percentage of Global Equity Markets



Date source: FactSet, SG Cross Asset Research/Equity Strategy; Data as of 12/31/2024

Investment in anything other than U.S. large cap stocks, and growth stocks in particular, has resembled something of a “value trap.” Valuations and growth have remained muted for international developed and emerging market equities. That, combined with the U.S. dollar secular bull run, has been a challenge for globally diversified investors.

The weakness of Chinese equities has garnered appropriate attention. While valuations are at multi-year lows, the fundamental picture remains an immeasurable question mark. A beleaguered real estate market, demographic headwinds, the potential for trade wars, and questionable efficacy of monetary policy adjustments by the People’s Bank of China (PBOC) have justifiably failed to entice risk-seeking investor capital. Thus, a cautious and mostly skeptical approach is required.

CHINA'S ECONOMIC ACTIVITY IS SLOWING

China Real Activity Index

Data source: Bloomberg, L.P., Data as of November 2024

Bloomberg’s *China Real Activity Index* reflects the country’s monthly economic activity and highlights the fundamental weakness plaguing the country in recent years. It spans inputs such as real estate investment, exports of vehicles, thermal electricity production, clean energy electricity production, communication equipment and computers production, among other variables. The index slumped to near-zero as of November, clearly reflecting the economic headwinds the world’s second largest economy continues to grapple with.

GRADUALLY NORMALIZING PRIVATE MARKETS

Private equity activity remains well off 2021 peaks, but is nearing more normalized levels. Exit and deal activity increased modestly in 2024 and is on track to exceed last year's level across most metrics. The themes of the last two years continued through the fourth quarter. The technology sector is still challenged on the exit front as liquidity remains the biggest challenge. Buyout funds did see a methodical rise in exits throughout the year. With the IPO window generally closed and a limited number of M&A events, both limited partners and managers continue to seek solutions in the secondary market. Their volume increased 58% in the first half of 2024 compared to year-ago levels and we expect the second half of the year to have been even busier as pricing continued to rise.

Fundraising for private credit funds remains robust as private debt generated more consistent returns in recent years. Private debt primarily comprises floating rate debt, which will likely be affected by interest rate cuts by the Federal Reserve. The combination of relatively stable distribution rates and private debt's risk-return profile have been contributing factors to improved fundraising. Mezzanine debt pricing remained steady in the second half of 2024 with a relatively stable spread of approximately 450 bps over high-yield.

Real asset performance was mixed in 2024. Falling interest rates may lead to higher valuations in real estate though challenges remain in the office sector. Digital infrastructure continues to gain traction in the market. Data centers and the power generation required to run them remain a popular theme among real asset investors, and for good reason. Following the election, we will be watching how the new administration approaches infrastructure improvements as well as the impact on both traditional and renewable energy.

Reflections and Outlook

> *"You may ask yourself, where does this highway go to?"*
>
> **TALKING HEADS, "ONCE IN A LIFETIME"**

It has been a remarkable ride for investors, particularly those with a domestic equity orientation. Looking to 2025 and beyond, however, there could be twists and turns ahead on the market highway. That said, bull markets do not die of old age, as the saying goes. Just because we have had two stellar years of U.S. equity returns does not mean we are destined to have a bad year in 2025. As we consider the weight of the evidence in front us, we are staying relatively close to home as it were, and not making any meaningful deviations from policy asset allocation targets.

Within equities, we continue to own meaningful amounts of the Mag 7, but not to the extent they are represented in the indices. We have built more diversified portfolios with a bit more in mid and small-cap stocks. Fixed income broadly offers a quality mid-single digit yield, but no major sectors appear to offer significant absolute value, and we are positioned accordingly. Corporate credit spreads, for example, remain historically tight. As such, we are not reaching for yield and own a healthy dose of Treasury bonds, complimented by consumer-oriented asset-backed bonds and, to a lesser extent, corporate bonds.

Over the past two years, some investors in private capital have been singing the Talking Heads line “My God, what have I done?” While private capital has generally helped to drive returns over a decade-plus time horizon, it has been an anchor on returns of late. We are starting to see green shoots with M&A activity starting to pick up, which bodes well for exit activity. We continue to believe that a well-designed private capital program should help drive long-term returns. In particular, strategies focused on buying and institutionalizing smaller founder-led and family-owned businesses are an area of opportunity and focus.

For long-term pools of capital, it is tempting and often easy to overact to short-term views of economic fundamentals, valuations, or politics. Investors are generally better off setting strategy and investment policy with a long view in mind. We believe there are four key risks that every investment committee should consider when it comes to policy: 1) enterprise risk, 2) market risk, 3) illiquidity risk, and 4) maverick risk.

By enterprise risk we simply mean falling short of the return goal of the portfolio; for many, this is a real return that fails to meet a 4-5% objective over the long term. Market risk is our way of saying how much volatility one has the ability and willingness to tolerate over the short-term to meet the long-term return objective. Illiquidity is self-evident; how much can be prudently allocated to private capital. Lastly, maverick risk is another way of saying how similar (or different) fiduciaries are willing to see their portfolio invested versus peers. Ultimately, as Cliff Asness, the founder of AQR Capital Management eloquently stated, “the best strategy is the one you can stick with.” Clearly identifying the potential impact of each of these four risks is integral to identifying what that strategy may be. After all, investing "ain’t no disco." It "ain’t no fooling around."

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The MSCI ACWI (All Country World Index) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 47 country indexes comprising 23 developed and 24 emerging market country indexes. The developed market country indexes included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indexes included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Kuwait, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey, and United Arab Emirates.

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