VESTGEN
INVESTMENT MANAGEMENT

2025 OUTLOOK

2025 OUTLOOK

The theme of our 2024 Annual Outlook was "a return to normalcy", reflecting optimism that the primary driver of 2024 market returns would be corporate earnings and profitability, rather than central bank policy decisions. With markets feeling somewhat fatigued from Fed-watching after years of pandemic-driven rate cuts and subsequent hikes, it made sense that corporate fundamentals would begin to matter again. As it turned out, the Fed did seem to hold less sway over markets in 2024. Despite an extremely hawkish downgrade from the initially expected six rate cuts to just three actually delivered in 2024, the S&P 500 index delivered a total return of 25% (23% price based, 2% dividends) during the year. From a price-only perspective, the 23% increase far exceeded the most optimistic Wall Street banks' 2024 projections, none of which were in double digits and many of which forecasted negative returns.

Figure 1. Wall Street Massively Underestimated 2024 Performance

Wall Street Banks' 2024 Projections vs Actual S&P 500 Performance			
S&P 500 Closing Price Year end 2023	4,770		
S&P 500 Closing Price Year end 2024	5,882		
Actual 2024 S&P 500 Index Return*	**23%**		
Firm Name	**Year End 2024 Projection**	**Projected Return**	**Underestimation Percent**
JPMorgan Chase	**4,200**	-12%	**35%**
Morgan Stanley	**4,500**	-6%	**29%**
Wells Fargo	**4,625**	-3%	**26%**
Jefferies	**4,700**	-1%	**25%**
UBS Global Wealth Management	**4,700**	-1%	**25%**
RBS Capital Markets	**5,000**	5%	**18%**
Bank of America	**5,000**	5%	**18%**
Citigroup	**5,100**	7%	**16%**
Deutsche Bank	**5,100**	7%	**16%**
Goldman Sachs	**5,100**	7%	**16%**

**Performance measures index price gain only, ignores dividends*

Source: Factset, chart by VestGen Investment Management

P (888) 641-7100 | 3393 Bargaintown Rd. | Egg Harbor Township, NJ 08234 | www.vestgenim.com

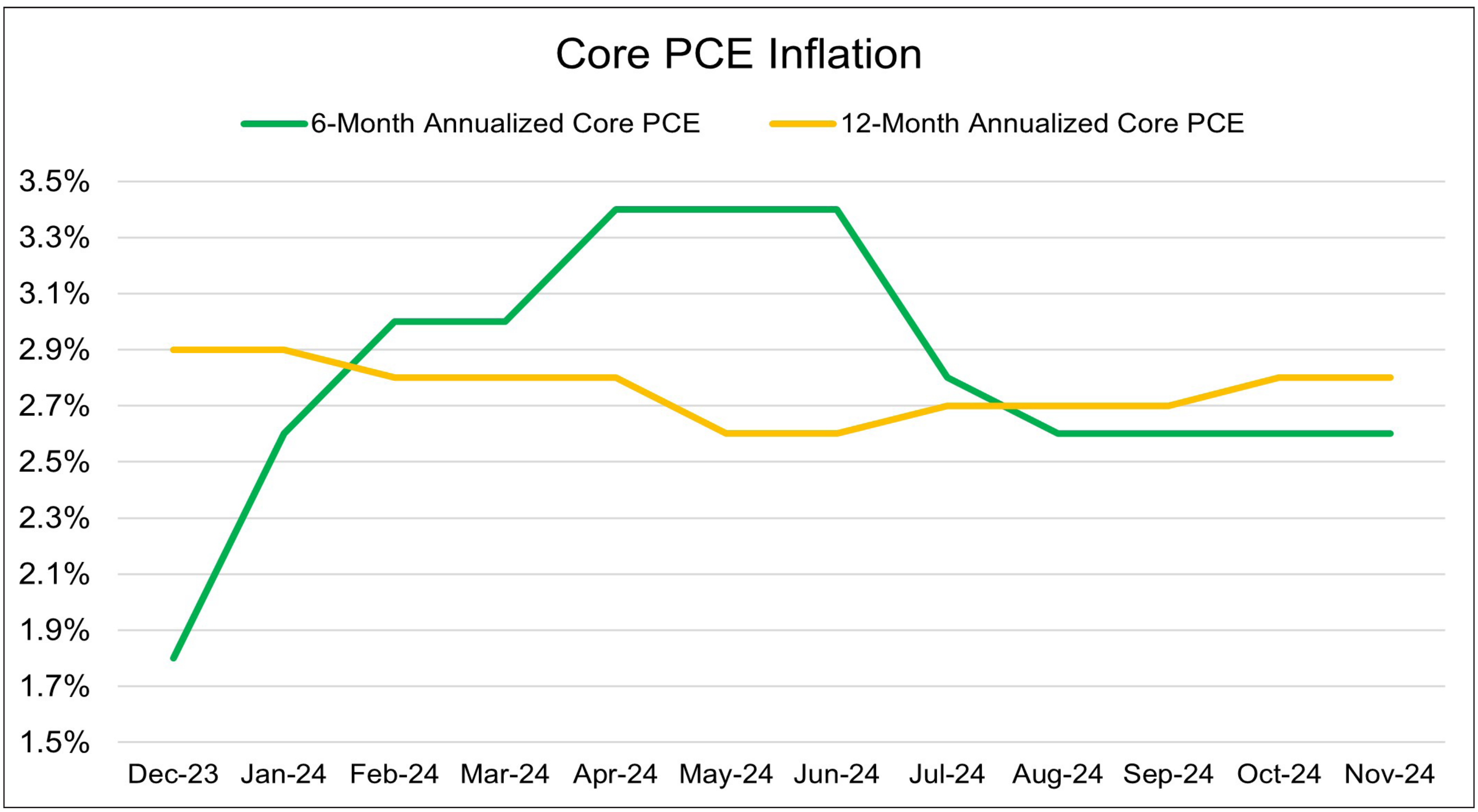
2025 OUTLOOK

The US economy and stock market have outperformed the predictions of market forecasters in consecutive years, withstanding a previously implemented aggressive rate-hiking cycle from the Fed without slipping into recession. Now, having exceeded expectations, one must ask if stock valuations are justified and if the US consumer will reach exhaustion in 2025 after keeping the post-pandemic economy afloat. As the recap of 2024 S&P 500 predictions demonstrates, a lot can change during the year, so it is crucial to remain flexible when making forecasts. Rather than trying to nail a specific market return, the goal of any annual outlook should be to inform the reader of the potential upside and downside risks on the horizon to best position portfolios for the coming year.

ECONOMIC BACKDROP FOR 2025

Inflation remains the focal point of the economy as we begin 2025, with some progress to show for 2024 despite the Fed keeping rates higher for the first three quarters. The Fed's preferred measure of inflation, the Core Personal Consumption Expenditures Index (Core PCE), experienced an early-2024 increase that has kept inflation well above the Fed's 2% target. On an annual basis, Core PCE barely budged, starting at 2.9% in January 2024 and ending at 2.8% in December 2024. The six-month trend gives some insight into present conditions, which aren't much better at 2.6% and are a significant downgrade from the sub-2% trend from late 2023.

Figure 2. Six- and Twelve-month Annualized Core PCE Inflation



Source: US Bureau of Economic Analysis, chart by VestGen Investment Management

2025 OUTLOOK

Despite the stall in the decline of inflation as measured by Core PCE data, the Fed saw enough underlying progress to justify three rate cuts. The most significant driver of inflation, shelter, has steadily declined from the March 2023 peak of 8.2% to its present level of around 4.8%. The Fed has repeatedly pointed out that shelter data is a lagging component. However, the Fed also completely missed the mark on forecasting shelter. In late 2023, the San Francisco Fed predicted year-over-year shelter inflation "may even turn negative by mid-2024", yet we enter 2025 with shelter inflation just below 5%, albeit slowly improving.

The behavior of shelter inflation highlights the challenge of accounting for human behavior in economic models. Logically, the Fed's rate hikes should have exerted downward pressure on home prices since the mortgage cost of home ownership increased significantly. However, the Fed's economic models failed to consider the increased demand from cash buyers with excess savings from the pandemic. On the supply side, the Fed's prior extreme environment of near zero interest rates created the "lock-up" effect of homeowners with sub-3% mortgages who became unwilling to list their homes and lose out on their favorable borrowing rates. These two factors, increased demand and decreased supply, have kept home prices elevated and driven the cost of shelter, and overall inflation, higher.

With three rate cuts on the books and sticky inflation, the Fed is almost certainly going to take a breather for a few meetings and reassess further cuts in the second quarter. Doing so will also provide time to see whether any of the incoming Trump administration's campaign rhetoric of tariffs, tax cuts, and mass deportations come to fruition. Any of the above being enacted in a meaningful way could be inflationary in the short term and would likely be followed by discussion of a Fed reversion back to rate hikes.

The good news is that, while the Fed awaits clarity on the new administration's plans for delivering on its mandate, US Gross Domestic Product (GDP) growth is likely to clock in at 3% or better for Q4 2024, marking a third consecutive quarter. The economy has been driven by consumer spending, which accounted for nearly 80% of GDP growth in the first three quarters of 2024. While US GDP growth is impressive, it remains insufficient to cover the ever-expanding Federal deficit. While the proposed tax cuts would likely further expand the consumer-driven economy (at the cost of higher inflation), it will be a tough sell for the Trump administration to lower taxes without corresponding cuts to federal spending, given the continual debate over the deficit and debt ceiling in Congress. Cuts in federal government waste and spending, however, are both a campaign promise made by Trump, and definitely the intention of this administration.

2025 OUTLOOK

US EQUITY

2024 was another remarkable year for US equities, although the top-heavy concentration of ten stocks remains a concern. The top ten companies in the S&P 500 continue to grow disproportionately in market capitalization, and their concentration has swelled to over 38% of the index, a record by far. While many have cited this overconcentration as a concern, the fact of the matter is that these companies continue to deliver on earnings quarter after quarter and are also at the forefront of the highest-growth industries such as artificial intelligence and autonomous vehicles.

Figure 3. 2024 Performance of S&P 500 Growth vs Value Stocks

Source: Stockcharts.com

P (888) 641-7100 | 3393 Bargaintown Rd. | Egg Harbor Township, NJ 08234 | www.vestgenim.com

2025 OUTLOOK

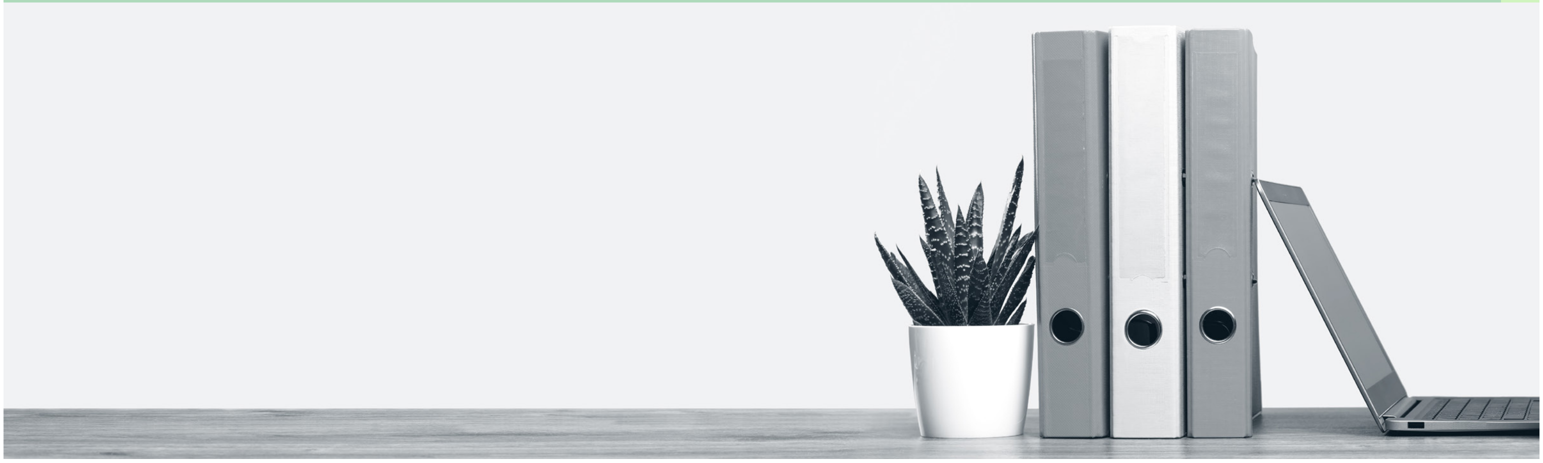
While the recent trend has seen Growth outperforming Value by a significant margin, it is likely that we will see more balanced distribution of market performance, known as market breadth, in 2025. The broader market is expected to narrow the gap in earnings growth relative to the “Magnificent Seven” of Nvidia (NVDA), Meta (META), Tesla (TSLA), Amazon (AMZN), Alphabet (GOOG), Microsoft (MSFT), and Apple (APPL). While the “Mag 7” stocks accounted for 63% of S&P 500 returns in 2023, their contribution decreased to 47% in the first three quarters of 2024, and this trend is anticipated to continue into 2025.

We believe the hype surrounding AI and robotics is justified, as these technologies have already positively affected bottom-line results for the companies at the forefront of embracing technology. As the cost of implementing these new technologies declines, productivity gains will extend further into the market. We view the large tech companies as the “first wave” of AI, and their customers as the second wave that will find new and innovative uses for natural language processing (NLP), large language models (LLMs) and generative AI. Additionally, the support system for AI – think data center REITS or Utilities providing electricity for servers and water cooling for chip fabrication – will be a secondary beneficiary of the increased capital investment in AI.

The Technology sector will most likely see the largest EPS growth in 2025, with earnings per share (EPS) projected to grow at 34%, per Standard and Poors. Yet, there is also EPS growth projected to be found in less “exciting” sectors such as Healthcare (projected 33% EPS growth) and Materials (projected 25% EPS growth). Overall, S&P 500 earnings could grow at 15-16% in 2025, which would equate to a Price-to-Earnings multiple of around 21.6 times the current valuation of the index. Markets are always forward-looking, and soon investors will start factoring in 2026 earnings growth projections. It is not much of a stretch to assume the market can attain 12-16% EPS growth in 2026, especially if recent advances in artificial intelligence continue their present trajectory. Under such an earnings growth assumption, we could see the S&P 500 trade near 7,000 at a sub-23 P/E forward multiple, which would constitute a 16% price appreciation from the recent 6,000.

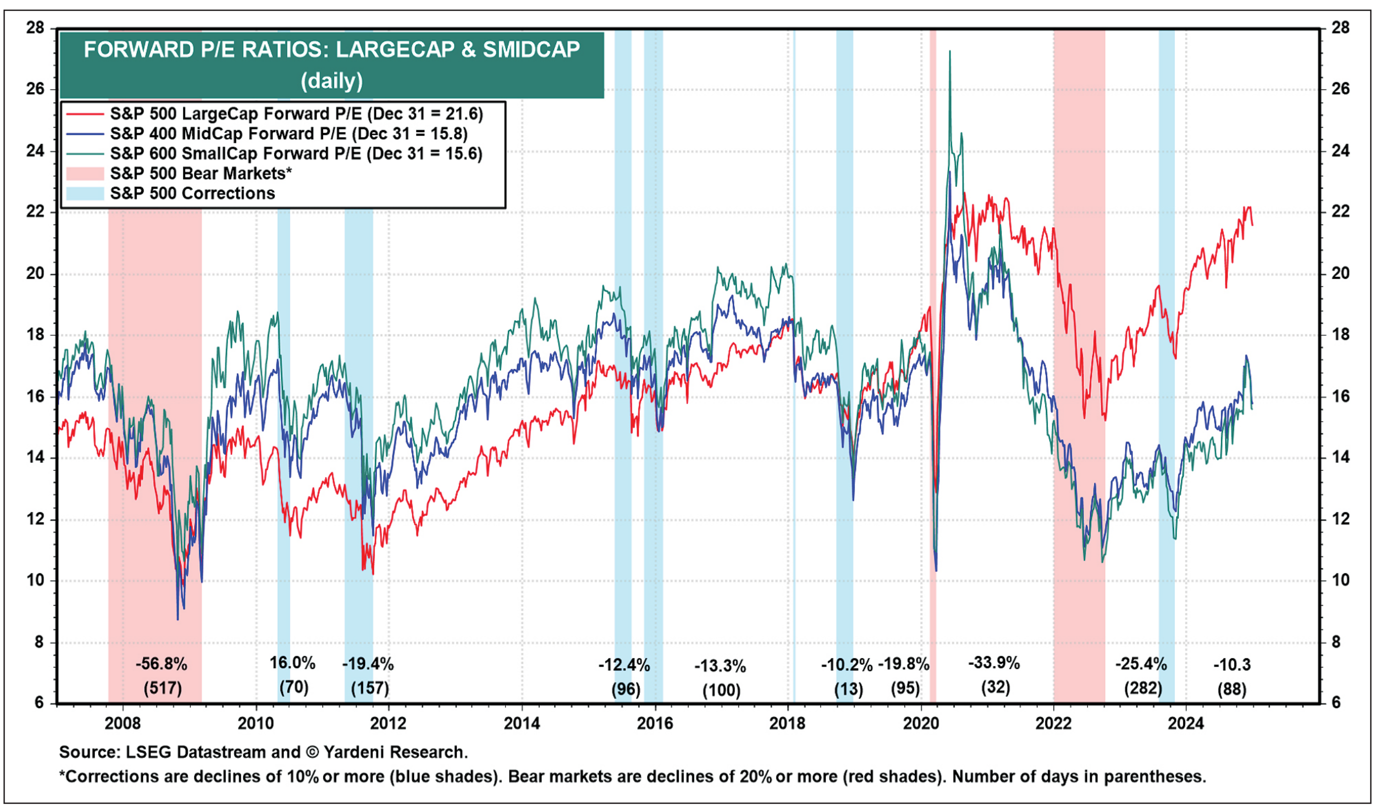
Of course, it is difficult to predict earnings one year out, let alone two, and as with economic forecasts, there are of course many new variables at play with the transfer of Presidential power. If tax cuts are enacted, corporations would likely be the biggest beneficiaries, and EPS should increase across the board. On the other hand, tariffs would be a headwind for large multinational corporations as they would bear the cost of the import taxes. US-based multinationals could also suffer from a stronger US dollar, since overseas revenues in foreign currencies lose value when converted back into US dollars. However, a stronger dollar would be a relative benefit for domestic small cap stocks, as they typically do not deal with currency volatility.

Small and Mid-Cap US stocks remain an enticing value proposition, albeit a frustrating one for investors who have been patiently waiting for a return to “normalcy” in the relationship between the P/E ratios of small, mid, and large cap stocks. Historically, US Small Caps have almost



always traded at a higher P/E multiple than Large Caps, reflecting the inherent risk of investing in smaller, early growth companies, and their historically faster growth rate. Yet during the pandemic, that relationship reversed, and Large Caps have traded at a higher P/E multiple ever since. The gulf between the forward P/E of Large Caps (21.6) and Small Caps (15.6) is near the largest in decades.

Figure 4. Historical Forward Price-to-Earnings Multiples of Large, Mid, and Small Cap Stocks



Source: Yardeni Research

2025 OUTLOOK

When Small Cap stocks rally, the gains can occur swiftly, as was the case post-election in November 2024 when the Russell 2000 Index surged 5.8% in a single day. Those November gains have deteriorated, however, and Small Caps have fallen out of favor again with the likely pause of further rate cuts. Despite the potential for rates to remain higher for longer, Small Cap stocks are forecast to grow earnings at nearly 21% in 2025, exceeding that of their Large Cap peers.

DEVELOPED INTERNATIONAL EQUITY

US equities have continued to assert their dominance over the global economy, relegating developed international market peers to an ever-shrinking share of the global market capitalization. Europe has fallen far behind the US in Technology-related industries, and its stock market performance reflects that shortcoming. While the S&P 500 gained 25% in 2024, the MSCI Europe, Australasia, and Far East (EAFE) Index returned a paltry 3.5% for the year, the latest in a long stretch of underperformance that has seen the S&P 500 grow at over three times the rate of developed international markets in the last decade.

The deck appears to be stacked against developed international stocks in 2025 with a less-friendly US administration set to take control. Eurozone inflation is a bit more tepid than that of the US, at 2.2%, but GDP growth is averaging a lackluster 0.3% over the first three quarters of 2024. Tariffs on European goods would be a major blow to their economy, particularly for the automotive industry, which was already one of the worst-performing sectors in European stock indices. Political turmoil in Germany and France has put further strain on European markets and in particular, the Financials sector which is the largest component of the MSCI Euro Index at 20%.

Japan is the largest individual country within the EAFE Index at a roughly 23% weighting. 2024 started out strong for Japanese markets thanks to the Yen “carry trade”, through which investors borrowed Yen at low interest rates and invested in high growth stocks and bonds in other currencies such as the US Dollar. The carry trade blew up in spectacular fashion in August following the Bank of Japan’s decision to raise interest rates from 0% to 0.25%, resulting in the largest single-day drop in the Nikkei 225 since the 1987 Black Monday sell-off. Japanese stocks ended the year up around 7%, disappointing considering they had kept pace with their US peers through the first half of the year.

The counterargument in favor of holding EAFE exposure going into 2025 remains the same as prior years – EAFE

P (888) 641-7100 | 3393 Bargaintown Rd. | Egg Harbor Township, NJ 08234 | www.vestgenim.com

equities are historically cheap relative to US stocks, trading at just a 15.7 P/E ratio. Japanese equity markets remain a vital part of the global economy, and corporate reforms have recently been implemented to improve governance and refocus on shareholder value. Aggressive US policies towards China may also force Beijing to pursue closer trade relationships with European partners. Lastly, the potential for a ceasefire to be reached in Ukraine would present a significant upside for the Eurozone economy, although President Trump's initial foray was rebuffed by Putin of Russia. Yet, with US political goodwill diminished, Kiev may soon have no alternative but to seek peace. For investors concerned that US equity valuations have become stretched, EAFE exposure offers a potentially less volatile way to diversify equity exposure. They generally pay higher dividends than US large cap stocks, which is an added benefit if rates move lower in the latter part of 2025.

EMERGING MARKETS

Despite giving up some market share to India in recent years, China dominates the Emerging Markets landscape at roughly 27% weighting in the MSCI Emerging Markets Index. Investing in China requires a high-risk tolerance due to the unpredictability of the frequent intervention from Beijing lawmakers. After several disappointing years, investors are waiting for the moment when the Chinese government unleashes stimulus upon the economy and prompts the euphoric equity buying that has marked prior government intervention moments. For investors expecting such stimulus in 2025, there may be disappointment, as thus far the measures announced have been limited in scope.

The Chinese property crisis remains an unresolved issue, with economists estimating as many as 90 million unsold housing units remain vacant amidst a shrinking population that is expected to fall by another 204 million people over the next three decades. The government has attempted to spur municipalities to purchase the homes for conversion into affordable housing, but those measures are dwarfed by the enormity of the problem, and only 4% of the allocated funds had been used in the first two months of the program.

China's GDP, which in prior years was the world's envy at double digit growth rates, will likely be less than 5% in 2025. If aggressive tariffs are imposed, this could be closer to 4%. Unlike most of its global peers, China's economy is experiencing deflationary pressures, with prices in decline for six consecutive quarters and roughly 40% of the components of the country's consumer price index declining annually. Deflation can be catastrophic for an economy.

There are securities available that invest in Emerging Markets excluding China exposure, however, markets are interconnected and all roads lead through China, to some extent. The iShares MSCI Emerging Markets Ex-China ETF (EMXC) launched in mid-2017 and has returned an annualized 3.6% during that period. That return outperformed the iShares MSCI Emerging Market ETF (EEM), but only by 1.8% annually. History shows that when the Chinese government

P (888) 641-7100 | 3393 Bargaintown Rd. | Egg Harbor Township, NJ 08234 | www.vestgenim.com

decides to implement aggressive stimulus, Chinese stocks can surge quickly. Therefore, our view is that for investors seeking exposure to Emerging Markets, including Chinese stocks is preferable on the outside chance that a large stimulus program is unveiled. As always, investing in Emerging Markets requires a high risk tolerance, and should remain at most a small amount of an investor's overall asset allocation.

FIXED INCOME

The Fed's decision to keep rates pinned higher for longer has kept a record $6.9 trillion invested in US money market funds, which until recently offered higher yields than longer term Treasury Bonds. Investors trying to time the market and extend maturities likely saw any gains evaporate in 2024 after yields bounced sharply from the September lows and now are back around their highest levels of 2024.

Figure 5. US 30 Year Bond Yields

Source: TradingEconomics.com

The yield curve has gradually normalized, wherein interest rates on short-term bonds are lower than long-term bonds rates, albeit not in the manner that many expected. Rather than seeing rates fall across the curve as the Fed implemented cuts, rates at the long-term end of the curve have increased while short-term rates have fallen slightly. The 10-Year

Treasury yield, which had fallen to 3.6% in anticipation of the Fed's first cut, has now risen back to near 4.6%.

At this juncture, with rates rising while the central bank is cutting, gradually extending maturities within fixed income allocations seems like a reasonable approach, particularly for investors still holding ultrashort-term money market funds. The Federal deficit is a concern of course, but US debt remains the de facto safe-haven asset globally. Many believe politicians, regulators and bureaucrats to be in charge, but at the end of the day the markets control where rates go, and the markets could send a stern message to Washington in 2025 that it has had it with excessive US budget deficits and an amassing US debt situation, and drive rates much higher.

As always, we advocate for fixed income allocations to be balanced and include corporate credit in addition to government bonds. 2024 was a banner year for high yield corporate bonds, with the ICE BofA US High Yield Index up 8.2% on a total return basis. After such strong outperformance relative to other fixed income, it is reasonable to ask whether there is much further upside in high yield for 2025. The option-adjusted spread on high yield is hovering around 2.9%, which is much closer to the all-time low of 2.4% than the long-term average of 5.3%. Yet the default environment remains benign at 2% for the trailing twelve months as of November 2024. Fitch Ratings anticipates only a slight uptick in defaults in the coming year, to 2.5-3.0%. With the Fed still anticipating at least some rate cuts in 2025, borrowing conditions should remain favorable for high yield bond issuers.

COMMODITIES AND ALTERNATIVES

On the surface, the incoming Trump administration's promise to "drill, baby, drill" would appear highly bullish for US energy production. The reality, however, is that the US is already producing oil output that far exceeds that of any country in history. Oil producers must balance production costs, supply, and demand to maximize profit margins, so they are unlikely to flood the market with cheap oil if it hurts their bottom lines. Nevertheless, the campaign promises of decreased regulatory oversight and carte blanche to drill on Federally owned preserved lands will surely be welcomed by big oil and gas corporations.

Across the board, a stronger US dollar, likely in 2025, will be a headwind to commodities. China's struggling economy is likely to constrain upside for oil prices, and a decline to the $60-range is quite possible. Gold rose to new all-time highs in 2024 amid concerns about inflation and the ever-growing Federal debt. This trend is likely to continue into 2025 with government spending unlikely to undergo any meaningful reforms.

P (888) 641-7100 | 3393 Bargaintown Rd. | Egg Harbor Township, NJ 08234 | www.vestgenim.com

2025 OUTLOOK

Real Estate Investment Trusts (REITs) once again underperformed other asset classes in 2024, returning just 5.5% for the year as measured by the SPDR Select Sector Real Estate ETF (ticker XLRE). Competition from high-yielding, risk-free bonds and concerns over cratering commercial office property values have caused REITs to fall out of favor. For investors willing to take on more granular REIT exposure, there are opportunities, however. Residential REITs look more attractive than their commercial office counterparts, with high mortgage rates and still-elevated home prices confining a generation of potential homebuyers to perpetual renters. Senior care facilities and healthcare REITs also make sense given the aging US population, and data center REITs are arguably the highest-growth segment of the real estate market.

FINAL THOUGHTS

Markets once again defied the odds and outperformed nearly all forecasts in 2024, despite delayed and diminished rate cuts from the Fed. This outperformance was made possible by the resilient US consumer and strong corporate profits from the biggest US companies. With inflation gradually on the mend, there is a path to sustain 2024's momentum, but doing so will likely require a broadening out in stock market breadth that has been slow to materialize. There is some early-2025 uncertainty, and commensurate potential volatility, as we see how much of President Trump's campaign pledges come to fruition, so markets could be a bit uneasy until we have clarity on issues of tariffs, taxes, and deportation. Elsewhere, geopolitical risks are always a concern regarding Ukraine, Iran, and even China. The recently negotiated ceasefire in the middle east is a hopefully the beginning of a more long-term solution.

Yet despite these challenges, the past two years have shown that it is tough to bet against the US. With the wave of technological innovations just getting started, we believe US corporate earnings can deliver on the aggressive EPS growth expectations and keep the momentum going. Here's to a healthy and successful 2025.

Thank you, as always, for the opportunity to let us serve you.

Sincerely,

Sean Hanlon, CFP®
CEO and Co-Chief Investment Officer

George Peller
Co-Chief Investment Officer

P (888) 641-7100 | 3393 Bargaintown Rd. | Egg Harbor Township, NJ 08234 | www.vestgenim.com

VESTGEN
INVESTMENT MANAGEMENT

P (888) 641-7100 | 3393 Bargaintown Rd. | Egg Harbor Township, NJ 08234 | www.vestgenim.com

Disclosure

Commentary by VestGen Investment Management. VestGen Investment Management is an SEC registered investment adviser with its principal place of business in the State of New Jersey with offices at 3393 Bargaintown Rd., Egg Harbor Township, NJ 08234. Being a registered investment advisor does not imply any level of skill or training. VestGen Investment Management and its representatives are in compliance with the current registration and notice filing requirement imposed upon registered investment advisers by those states in which VestGen Investment Management maintains clients. VestGen Investment Management may only transact business in those states in which it is notice filed, or qualifies for an exemption or exclusion from notice filing requirements. This weekly update is limited to the dissemination of general information. Any subsequent, direct communication by VestGen Investment Management with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status, service and fees of VestGen Investment Management, please contact VestGen Investment Management or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). For additional information about VestGen Investment Management, including fees and services, send for our disclosure statement as set forth on Form ADV from VestGen Investment Management using the contact information herein. Please read the disclosure statement carefully before you invest or send money.