THE CLAUSS & ELLISON GROUP OF RAYMOND JAMES

2024 Capital Markets Review

2024 was another big year for US growth stocks, AI and crypto in particular. The S&P 500 finished up close to 25% bringing its 3 year return to 8.8%. Growth beat value, large beat small, and US trounced foreign stocks as the dollar strengthened approx. 7%. To some degree, it seemed the most aggressive, speculative, and possibly even imprudent investments performed the best.

Per the WSJ, Palantir was S&P 500's top performer, finishing up over 300%. With a market cap close to $180 billion, Palantir now trades for over 200x earnings and 65x sales. Doge Coin was up over 270%, MicroStrategy 350% and the Mag 7 stocks collectively finished up over 60%.

2024 was a continuation of recent trends and it has been a bear market in diversification for some time. Predicting inflection points with any kind of precision is impossible while investing around them can be incredibly challenging. Although 2024 was a strong year for growth stocks, the equal weighted S&P 500 finished up 12% and bonds were up just 1.3%.

2022 was a challenging year and interest rates have been on the rise, thus the 3 year return for a global balanced portfolio, 60% MSCI All Country and 40% bonds is up just +2.4%. Returns for all equities since 2000, i.e. the last 25 years converge around 7-8% per year.

	2004	3 years	10 years	Since 2000	2000 - 2008
S&P 500	**24.5%**	**8.7%**	**13.0%**	**7.6%**	**-3.7%**
Nasdaq 100	**25.4%**	**9.4%**	**18.2%**	**7.8%**	**-11.5%**
Int'l Small Cap	**7.9%**	**4.6%**	**6.0%**	**8.6%**	**8.5%**
Emerging Value	**6.2%**	**3.4%**	**4.8%**	**7.3%**	**7.4%**
Energy	**4.6%**	**19.5%**	**4.8%**	**7.4%**	**8.1%**
Gold	**27.6%**	**12.7%**	**8.4%**	**9.3%**	**13.0%**
Bonds	**1.2%**	**-2.4%**	**1.2%**	**3.7%**	**6.1%**

	2004	2022
MicroStrategy	**359%**	**-74.0%**
Doge Coin	**273%**	**-58.7%**
Nvidia	**171%**	**-63.9%**
Palantir	**340%**	**-64.7%**
S&P 500 Equal wt.	**12.4%**	
Russell 1000 Value	**13.6%**	
Small Value	**11.8%**	
Japan Small Value	**1.5%**	
International, EAFE	**3.8%**	
Magnificent 7	**62.7%**	

Performance & Markets:

Nvidia was up close to 3x in 2024 and its $3.4 trillion market cap now exceeds the total stock market value of Germany, Canada, France and the UK. US stocks are now close to 75% of the total global stock market value despite only about 25% of global GDP and less than 5% of the population. MicroStrategy, issues bonds to buy the cryptocurrency, a levered bitcoin investment, was up nearly 5x. MicroStrategy trades at nearly 3x the net asset value of its bitcoin holdings while Destiny Tech 100 trades for well over 10x its net asset value.

"I can calculate the motion of heavenly bodies, but not the madness of men." *--Sir Isaac Newton*

The total ***Cryptocurrency*** market cap is estimated close to $4 trillion, while the MSCI energy index is about $3 tril. The former requires or uses about $20 bil. per year in electricity while the latter produces about $220 bil. in annual profits. Traditional energy still provides about 80% of worlds primary energy and public energy companies likely provide close to half of that. Doge coin sports a $65 bil. market cap, as does EOG, a North American exploration and production energy company. However, EOG produces about $6 bil. per year in profits. Doge is up 3x in 2024, EOG was flat.

There are many parallels today to the ***late 90s*** including valuations, sentiment, and trailing performance. In the last couple years of the late 90s bull market, i.e. 1997 thru 1999, US Growth stocks, went up 35% per annum, +2.5x cum. in 3 years. Then from March of 2000, the markets finally hit an inflection point, in the following 3 years, growth stocks lost close to 20% per year, resulting in a cumulative loss of about 50%.

During that same late 90s run up, diversifying assets including small, foreign, value, gold and bonds underperformed tremendously. Small caps were up 14%, bonds 6%, energy and emerging 3%, while REITs and gold were down.

In the ensuing bear market, from 2000 thru 2002, when many of the biggest stocks like GE, Microsoft, Cisco and Oracle were down 50%, 60%, 70% or more, diversifying assets were broadly up, some meaningfully. At the end of the 2nd bear market in 2008, almost a decade from the 2000 peak, a ***$1.00 invested in gold and energy stocks was worth close to 10x vs. $1.00 invested technology stocks***. A dollar invested in Bonds, Real estate and Emerging markets was worth 3x growth stocks.

	1997-99	2000-02	P2	2000-08	P2
Growth	36%	-20%	$0.52	-6%	$0.56
MSFT	78%	-24%	$0.44	-10%	$0.40
CSCO	96%	-38%	$0.24	-12%	$0.30
ORCL	82%	-27%	$0.39	5%	$1.55
GE	48%	-21%	$0.50	-10%	$0.40
BRK	18%	9%	$1.30	6%	$1.72
Bonds	6%	9%	$1.31	6%	$1.70
gold	-8%	6%	$1.20	13%	$3.00
Energy	3%	10%	$1.32	14%	$3.28
Reits	-2%	14%	$1.47	9%	$2.08
Emerging	3%	-1%	$0.98	4%	$1.45
Small cap	14%	-7%	$0.80	1%	$1.12

Other Notable Inflection Points:

Time Period	1929 Peak (S&P 90)	1990 Peak (Nikkei 225)	2000 Peak (S&P 500)	2000 Peak (Nasdaq)
3 Years Before	104%	102%	137%	246%
3 Years After	-83%	-42%	-46%	-74%
5 Years After	-86%	-35%	-18%	-61%
10 Years After	-47%	-55%	0%	-45%

Of course, no one knows when or even if an inflection point will be reached. This time indeed may be much different, and one must give some credence to the possibility ***AI*** will be transformative in ways beyond our traditional economic models or historical precedent. Opinions widely vary on AI, from Kurzweil's utopian singularity to Hinton and Yudkowski's catastrophic p-doom warnings. Will the large monopolistic companies continue to expand, further exacerbating recent winner take all dynamics. Will the world increasingly rely on just a few platforms, toll roads, taxing users of their ecosystem, Amazon, Apple, Facebook etc.

Thought Experiment

The US stock market has averaged close to 13% the past 10 years, but the long-term return from equities is a little over 6% above inflation per year. As an analogue, if you bought a rental property, paying $100k for the investment and it netted $6,000 a year, and rents grew at the rate of inflation, that would provide a similar 6% real return.

But what if the property went up in value far faster than the rent grew, in a short time, say 5 years. What if the property price doubled but the rental income remained the same inflation adjusted. The trailing returns on the investment would be fabulous, north of 15% per year, with the price doubling in 5 years. But what about the future, the yield or rental income would now be 3%, $6,000 on $200,000.

Should investors expect future returns in line with the past, the last 5 years, 15% per year, 12% real? Or should investors expect the long-term historical average, i.e. 6% real yield? Should investors expect lower returns, given that yields are now just half the historical rate 3%. Today the US Shiller PE is close to 40x, providing about a 2.5% real earnings yield. If one assumes that is the new normal, adding inflation, math, logic suggests US equities might return 5% to 6%.

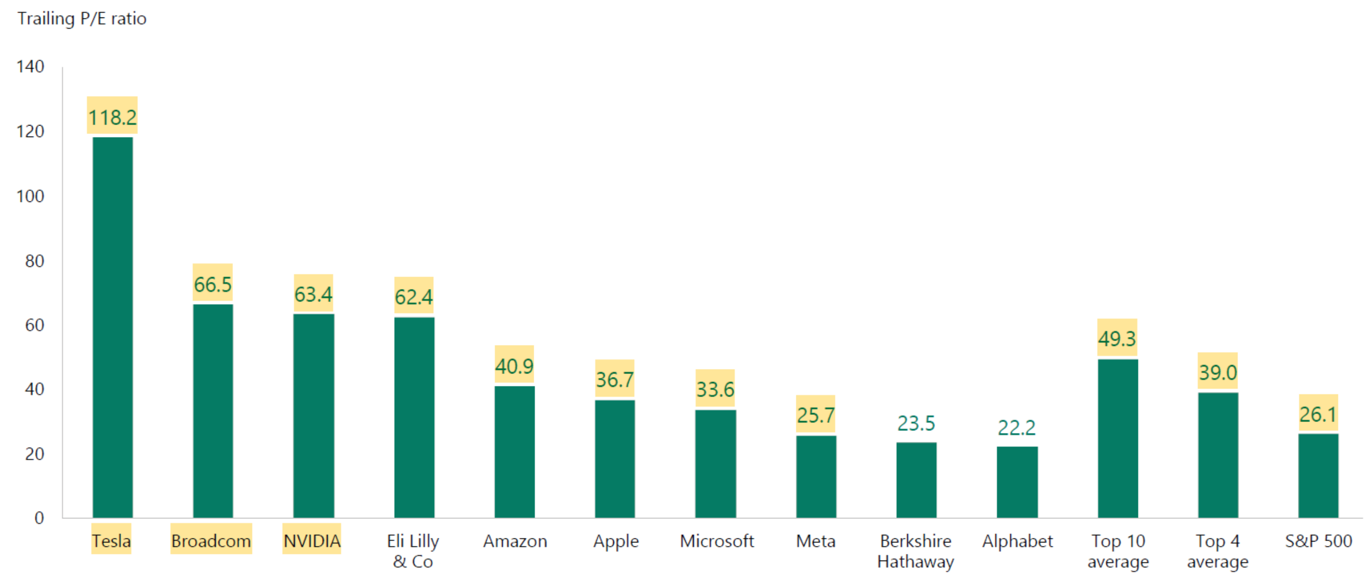
Valuations:

> ***"In the short term the mark is a voting machine, in the long term it is a weighing machine."*** *--Ben Graham*

Today, nearly all US long term valuation metrics, i.e. a series that relates price to any fundamental are at the very upper ranges, price to sales, price to book, to cash flow, to earnings etc. Said another way, high valuations today mean US equity investors are getting historically low fundamental yields relative to price. Perhaps this is why Warren Buffet has reduced his Apple holdings by 70% to stockpile cash and to add to Occidental petroleum. Yet in 2024, Apple is up 30% YTD, Oxy is down 20%. https://www.barrons.com/articles/warren-buffett-berkshire-apple-stock-occidental-7e2cff9c Check out the table below of current valuations for leading US franchises:

Exhibit 46: The average P/E ratio of the top 10 companies in the S&P 500 is almost 50

TRAILING P/E RATIO OF THE TOP 10 COMPANIES IN S&P 500 BY MARKET CAP



Data as of November 4, 2024.
Sources: Bloomberg, Apollo Chief Economist

Jean Marie Eveillard, who famously ran First Eagle for a long time, often said … “the future is uncertain” … but we can study the past and make reasonable assumptions to glean possible insights. ***Merrill Lynch*** observes their most historically reliable 10 yr. model now forecasts **US stocks to earn 0-1% for the next 10 years**. 10 year Capital Market forecasts for the S&P 500 range from about minus 5% per year for GMO on the low end to 0% to 3% for Merrill Lynch and Goldman to 4-5% for Vanguard. Market cap or stock price value (green) vs. real output, GDP (blue) below:

Debt, Deficits & the Dollar

Renowned strategists including Ray Dalio, Jeff Gundlach and Matt McLennan suggest a sovereign debt crisis may be on the horizon. The US is running ***7% deficits*** at a time unemployment is at historical lows, truly ***unprecedented***. If or when the economy slows, the unemployment rate typically rises and deficits tend to proportionally increase. Will the bond market allow us to run double digit deficits? As more debt is repriced from ~ 1% to 4.5% the challenge only increases. Might we then be forced to cut spending and raise taxes in a recession? If we are forced to borrow, quantitatively ease (print money) to meet our debt service, what are the implications for inflation, interest rates and the dollar?

Capital Allocation:

Looking ahead, perhaps more than ever, it is critical to maintain discipline and to trust the markets will value earnings, cash flows, assets, i.e. be a weighing machine. Today, with US growth stocks trading at roughly 2x their historic normalized valuations, and with reasonable forecasts ranging from low single digits to deeply negative, some degree of caution seems warranted. An investor taking just 4% from the Nasdaq starting in 2000 was out of money by 2009. With the US at 75% of the MSCI All Country World index and just 7 stocks representing about 1/3 of the US market cap, broad indices provide less diversification than ever. Ray Dalio has suggested diversification is the most important investment tenant, and the holy grail is 15 uncorrelated return streams.

Not only avoiding the most speculative pockets of a potentially overheated market but an increasing focus on quality and value, while avoiding leverage also seems prudent. ***Foreign stocks***, despite some cases of economic malaise and political challenges appear attractive with valuations often half that of the US. The ***S&P 500 yields 1.2%*** while foreign stock dividend yields often exceed 4% and in some cases 7%, i.e. Brazil. Deeply discounted Japan small, Germany and the UK appear attractive. For perspective, the Causeway International Small Cap fund portfolio sports a weighted price to earnings ratio of 8.8x and price to book value of 1.1 vs. the S&P 500 close to 25x PE and 5x P/B as of 10/31/2024.

US value stocks trade a historic discount to growth stocks. Old economy stocks like Exxon, Pfizer, Citigroup trade at discounted levels and have attractive dividend yields in 4% to 6% range. Even some high quality growth stocks like Google and Medtronic trade a reasonable valuations.

Bonds

Yields in 4-5% range also provide a reasonable ballast. **Gold** is increasingly preferred as a reserve currency, a hedge vs. growing geopolitical risks, sovereign debt largess and possibly very full valuations in US large cap stocks. Lastly, economically essential, and historically discounted **natural resource stocks** fulfill an important portfolio role. Resource equities are highly uncorrelated to the broad market in the long run, as well as inflation protecting, and in many cases now offer double digit free cash flow yields.

Below are a handful of 2025 Capital Market Outlooks. Recurring themes are valuations, the Fed and potential economic trajectories. Plenty of discussion on the impact from possible policy shifts on tariffs, migration, regulation and taxes. Despite significantly elevated valuations, which seem universally acknowledged, there are no obvious signs of an imminent decline on the immediate horizon. As a result, most strategists remain bullish in the near term even though long term forecasts are underwhelming at best. Said another way, historically reliable models expect long term returns well below historical averages but forecast 2025 in the 8-10% range. There is plenty of discussion of Artificial Intelligence, impacts on growth, productivity, and employment. Primary risks are valuations, geopolitics, a trade war, sovereign debt levels and bullish sentiment.

2025 Outlooks:

- **Robeco** - 5-Year Expected Returns: Atlas Lifted ***Link***
- **Goldman Sachs** - Macro Outlook: Tailwinds (Probably) Trump Tariffs ***Link***
- **Goldman Sachs** - Global Equity Outlook: The Year of the Alpha Bet ***Link***
- **First Eagle**: https://youtu.be/TZDhYs30MSY?si=qwylzN0b0vC-55Pf
- **Vanguard,** Economic and market outlook for 2025: Beyond the landing ***Link***
- **Horizon Kinetics**, inflation and energy: https://horizonkinetics.com/app/uploads/Horizon-Kinetics-Q3-2024-Commentary_Final.pdf
- **Jeff Gundlach,** debt & deficits: https://www.economist.com/by-invitation/2024/12/13/americas-debt-cannot-keep-stacking-up-says-jeffrey-gundlach
- **Ray Dalio**: https://youtu.be/dJ7ro6bAW6M?si=Z0NPZ0CaxIyD7JGK
- **Gundlach**: Fed, rates, economy, debt & deficits implications, https://youtu.be/YF_-OHDJNso?si=GU82uLF3GBQxsfQR and https://youtu.be/EeuvXSm1FX0?si=0Hv_tq7Hy_LBXsg3
- **John Hussman**: https://www.ft.com/content/abec3526-32ae-493e-bf59-2d30ccb4e50f

More Capital Markets:

- **Richard Bernstein Advisors** - Certainties for an uncertain world ***Link***
- **Charles Schwab** - 2025 U.S. Stocks and Economy Outlook ***Link***
- **KKR** - 2025 Outlook: Glass Still Half Full ***Link***
- **Cambridge Associates** - 2025 Outlook ***Link***
- **J.P. Morgan Asset Management** - 2025 Year-Ahead Investment Outlook: Out of the Cyclical Storm and into the Policy Fog ***Link***
- **Apollo** - 2025 Economic Outlook: Firing on All Cylinders ***Link***