**Pavlic Investment Advisors Inc.**

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# 4th Quarter 2024 Review & Outlook

Dear Alex & Lindsey,

Happy New Year. We hope you are had a wonderful holiday season with friends and family. Although the Santa Claus rally fizzled in thin trading during the last few weeks of the year, 2024 was a very strong year in the markets with few pull backs—the second year in a row of such performance after a challenging 2022 when inflation first started to rise. During 2024 we saw an even greater variability in performance across asset classes compared to 2023 as large cap growth companies in the technology sector such as NVIDIA and Apple continued to carry the bulk of the workload taking stock indicies to new heights (chart right). Although small caps and value stocks underperformed their larger brotheren, they still offered double digit returns fueled by optimism around potential for deregulation and corporate tax cuts. Our **core portfolio of stocks*** continued its strong performance in the fourth quarter significantly outperforming the Dow Jones Industrial Average, the equal weighted S&P 500, and the Russell 2000 on both a gross and net of fees basis, while falling short of the heavier technology-weighted indexes such as the S&P 500 market cap weighted index and the all-technology NASDAQ index. In our stock portfolios we ended the year in a conservative stance with our largest position at an average 8% weight in the Schwab Value Advantage Money Market Fund which delivered 4.71% for the year, and on a current yield basis is earning 4.30%/year (As of 12/31/24).

| Equity Style Snapshot | | | 12/31/24 |
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| **YTD** | Value | Blend | Growth |
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This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

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## In Depth Stock & Bond Market Review

**The elusive "soft landing" achieved (for now).** We closed out 2024 the same way we exited 2023 with one of the best back-to-back returns for our stock investors that we have seen since our company's founding in 1997. The economy largely achieved its elusive soft landing as growth has been stable yet soft enough to allow the Fed to cut rates. Inflation fell close enough to the Fed's 2% target to allow them to deliver one hundred basis points of rate cuts in the last five months of the year. Meanwhile, AI optimism remained rampant and surging earnings growth from tech companies kept upward pressure on stocks while other tangential risks to markets, including negative geopolitical and political events, never materialized. Given this backdrop, it is not a surprise markets delivered another banner year in 2024.

As we start 2025, these positive factors remain broadly in force even with the drawdown we had in the last three weeks of the year. However, unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Investor sentiment is now decidedly bullish as almost all the bears have capitulated. For stocks to keep the rally going, things are going to have to either stay good or get even better against these lofty expectations. To offer insight into whether we are in for some mild disappointment in the coming months, we are closely watching employment, earnings, inflation, and the Fed:

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**Bond Investors see a welcome reversion to a normal shaped yield curve.** While the US economy is expected to post steady growth in 2025 without overheating or sliding into recession, inflation is expected to remain rangebound as well. It is noteworthy that inflation remains above the Federal Reserve's target of 2.0%, which we believe continues to bolster our "higher for longer" messaging on interest rates. Against that backdrop, the Federal Reserve is seen as unlikely to make substantial changes in monetary policy unless unforeseen economic conditions occur. We believe this means a bond market that bounces back and forth in well-defined ranges during the year. For the US Treasury 10-year note, we see a range like that of 2024 with 3.75% on the low end and 4.75% on the high end. We are locking in yields across the 10-year bond ladder between 4.5% on the short end, to as high at 5.7% when looking at investment grade bonds 10 years out to maturity. We see the money market fund offering great liquidity, but at lower rates of return—low 4%'s to start the year and trending lower to end the year in the low-to-mid 3% range.

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# 4th Quarter 2024 Review & Outlook

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This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

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# 4th Quarter 2024 Review & Outlook

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This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

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# 4th Quarter 2024 Review & Outlook

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# 4th Quarter 2024 Review & Outlook

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**Pavlic** Investment Advisors Inc.

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# 4th Quarter 2024 Review & Outlook

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| Equity Style Snapshot | | | 12/31/24 |
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This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

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**The elusive "soft landing" achieved (for now).** We closed out 2024 the same way we exited 2023 with one of the best back-to-back returns for our stock investors that we have seen since our company's founding in 1997. The economy largely achieved its elusive soft landing as growth has been stable yet soft enough to allow the Fed to cut rates. Inflation fell close enough to the Fed's 2% target to allow them to deliver one hundred basis points of rate cuts in the last five months of the year. Meanwhile, AI optimism remained rampant and surging earnings growth from tech companies kept upward pressure on stocks while other tangential risks to markets, including negative geopolitical and political events, never materialized. Given this backdrop, it is not a surprise markets delivered another banner year in 2024.

As we start 2025, these positive factors remain broadly in force even with the drawdown we had in the last three weeks of the year. However, unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Investor sentiment is now decidedly bullish as almost all the bears have capitulated. For stocks to keep the rally going, things are going to have to either stay good or get even better against these lofty expectations. To offer insight into whether we are in for some mild disappointment in the coming months, we are closely watching employment, earnings, inflation, and the Fed:

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# 4th Quarter 2024 Review & Outlook

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**Pavlic** Investment Advisors Inc.

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# 4th Quarter 2024 Review & Outlook

Dear Karen,

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This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

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As we start 2025, these positive factors remain broadly in force even with the drawdown we had in the last three weeks of the year. However, unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Investor sentiment is now decidedly bullish as almost all the bears have capitulated. For stocks to keep the rally going, things are going to have to either stay good or get even better against these lofty expectations. To offer insight into whether we are in for some mild disappointment in the coming months, we are closely watching employment, earnings, inflation, and the Fed:

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# 4th Quarter 2024 Review & Outlook

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# 4th Quarter 2024 Review & Outlook

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This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

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# 4th Quarter 2024 Review & Outlook

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# 4th Quarter 2024 Review & Outlook

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# 4th Quarter 2024 Review & Outlook

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# 4th Quarter 2024 Review & Outlook

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This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

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# 4th Quarter 2024 Review & Outlook

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## In Depth Stock & Bond Market Review

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As we start 2025, these positive factors remain broadly in force even with the drawdown we had in the last three weeks of the year. However, unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Investor sentiment is now decidedly bullish as almost all the bears have capitulated. For stocks to keep the rally going, things are going to have to either stay good or get even better against these lofty expectations. To offer insight into whether we are in for some mild disappointment in the coming months, we are closely watching employment, earnings, inflation, and the Fed:

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As we start 2025, these positive factors remain broadly in force even with the drawdown we had in the last three weeks of the year. However, unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Investor sentiment is now decidedly bullish as almost all the bears have capitulated. For stocks to keep the rally going, things are going to have to either stay good or get even better against these lofty expectations. To offer insight into whether we are in for some mild disappointment in the coming months, we are closely watching employment, earnings, inflation, and the Fed:

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# 4th Quarter 2024 Review & Outlook

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| Equity Style Snapshot | | | 12/31/24 |
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| YTD | Value | Blend | Growth |
| Large | 16.0% | 25.2% | 32.7% |
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As we start 2025, these positive factors remain broadly in force even with the drawdown we had in the last three weeks of the year. However, unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Investor sentiment is now decidedly bullish as almost all the bears have capitulated. For stocks to keep the rally going, things are going to have to either stay good or get even better against these lofty expectations. To offer insight into whether we are in for some mild disappointment in the coming months, we are closely watching employment, earnings, inflation, and the Fed:

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**Pavlic** Investment Advisors Inc.

integrity ♦ prudence ♦ performance

# 4th Quarter 2024 Review & Outlook

Dear Travis & Kasey,

Happy New Year. We hope you are had a wonderful holiday season with friends and family. Although the Santa Claus rally fizzled in thin trading during the last few weeks of the year, 2024 was a very strong year in the markets with few pull backs—the second year in a row of such performance after a challenging 2022 when inflation first started to rise. During 2024 we saw an even greater variability in performance across asset classes compared to 2023 as large cap growth companies in the technology sector such as NVIDIA and Apple continued to carry the bulk of the workload taking stock indicies to new heights (chart right). Although small caps and value stocks underperformed their larger brotheren, they still offered double digit returns fueled by optimism around potential for deregulation and corporate tax cuts. Our **core portfolio of stocks*** continued its strong performance in the fourth quarter significantly outperforming the Dow Jones Industrial Average, the equal weighted S&P 500, and the Russell 2000 on both a gross and net of fees basis, while falling short of the heavier technology-weighted indexes such as the S&P 500 market cap weighted index and the all-technology NASDAQ index. In our stock portfolios we ended the year in a conservative stance with our largest position at an average 8% weight in the Schwab Value Advantage Money Market Fund which delivered 4.71% for the year, and on a current yield basis is earning 4.30%/year (As of 12/31/24).

| Equity Style Snapshot | | | 12/31/24 |
|---|---|---|---|
| YTD | Value | Blend | Growth |
| Large | 16.0% | 25.2% | 32.7% |
| Mid | 14.0% | 15.2% | 16.5% |
| Small | 12.4% | 14.2% | 16.5% |

This year's wide performance dispersion underscores the importance of rebalancing portfolios as we believe some sectors large runs have left valuations high and susceptiable to pull backs in certain areas of the market. The biggest potential headwinds we see in the year ahead are rising federal deficits (both in the US and around the globe), elevated valuations for the "Magnificent Seven" stocks including their lofty earnings expectations, and an inflation rate that remains above the Federal Reserve's target. To track these risks, we are continually asking these 5 questions:

1. Is economic growth stable as measured in GDP?
2. Is the Fed still in an interest rate cutting cycle?
3. Is inflation continuing to fall over the medium term?
4. Is earnings growth expected to remain in double-digit territory?
5. Is the unemployment rate below 4.5%?

As long as the answers to all of these questions remain "yes," then pullbacks, especially those that are 5%-10% in size, should be viewed as entry points to buy high quality stocks. Sectors such as health care, energy, industrials, and selective consumer discretionary names is where we are seeing the greatest number of potential buying opportunities. We are balancing these opportunities with a large weighting to the money market fund which would likely be our funding source should volatility arise.

We have been actively engaging with clients utilizing our new financial planning software tool. While life and market conditions will continue to change, we are implementing a software-based approach to give the best holistic advice as possible. We cover financial decisions such as when to tap Social Security, appropriate rates of retirement spending, tax and savings rates, and tax efficient Roth IRA conversions just to name a few examples. While investment performance will always be our number one priority, many clients have appreciated this additional service offering. If you have not yet sat down with us to get a demonstration of the tool, please let us know and we would be happy to set up an in-person meeting or a video conference.

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## In Depth Stock & Bond Market Review

**The elusive "soft landing" achieved (for now).** We closed out 2024 the same way we exited 2023 with one of the best back-to-back returns for our stock investors that we have seen since our company's founding in 1997. The economy largely achieved its elusive soft landing as growth has been stable yet soft enough to allow the Fed to cut rates. Inflation fell close enough to the Fed's 2% target to allow them to deliver one hundred basis points of rate cuts in the last five months of the year. Meanwhile, AI optimism remained rampant and surging earnings growth from tech companies kept upward pressure on stocks while other tangential risks to markets, including negative geopolitical and political events, never materialized. Given this backdrop, it is not a surprise markets delivered another banner year in 2024.

As we start 2025, these positive factors remain broadly in force even with the drawdown we had in the last three weeks of the year. However, unlike 2024, the market does not have low expectations and a "wall of worry" to climb. Investor sentiment is now decidedly bullish as almost all the bears have capitulated. For stocks to keep the rally going, things are going to have to either stay good or get even better against these lofty expectations. To offer insight into whether we are in for some mild disappointment in the coming months, we are closely watching employment, earnings, inflation, and the Fed:

1. **Employment.** We have not forgotten that the Sahm rule was triggered in the late summer of 2024. While unemployment has stayed in the low 4%'s, a move above 4.5% would give the markets a "growth scare" as the economy is driven by the American consumer, and the American consumer only spends if they have jobs and are getting paid well—both of which still holds true today.
2. **Earnings.** The only way valuations for this market are not prohibitive is if we get substantial earnings growth in 2025. Consensus 2025 EPS growth is close to ~15%--more than double the historical average. If earnings season offers warning signs on earnings growth, especially from the large cap growth names that drove indices to their highs in 2024, it will exacerbate the valuation issue with the market. We would expect the long sought after "broadening out" to then occur, where other areas of the market would provide defense as compared to companies with lofty valuations and slowing growth.
3. **Inflation.** The political backdrop we are now in arguably calls for tariffs (higher price pressures), government austerity (anti-government stimulus), and potentially increased labor pressures (again, higher price pressures). Although the Fed does not say this aloud, we believe they guided to fewer rate cuts in 2025 because of the culmination of these forward factors. We see the Fed taking a "wait and see" approach on inflation as CPI and PPI inflation metrics have not yet reached the Fed's long-term target of 2.0%.
4. **The Fed.** Just as the Fed drove increased volatility to end 2024, we think this trend will continue in 2025. The Fed continuing to cut rates (even if it is slowly) is a critical piece of this bull market and if the Fed hints it may pause cutting rates at its first meetings in 2025, that will be a stronger headwind for equities.

In summary, the fundamentals for this market are good as we enter 2025, but there are also lofty expectations baked in and not meeting those expectations will determine if we see a continuation of the declines of the past three weeks of the year. We continue to be focused on balancing return and risk in our equity portfolios, while overlaying our strategy with each client's individual asset allocation policy mix between stocks, bonds, and the money market fund.

**Bond Investors see a welcome reversion to a normal shaped yield curve.** While the US economy is expected to post steady growth in 2025 without overheating or sliding into recession, inflation is expected to remain rangebound as well. It is noteworthy that inflation remains above the Federal Reserve's target of 2.0%, which we believe continues to bolster our "higher for longer" messaging on interest rates. Against that backdrop, the Federal Reserve is seen as unlikely to make substantial changes in monetary policy unless unforeseen economic conditions occur. We believe this means a bond market that bounces back and forth in well-defined ranges during the year. For the US Treasury 10-year note, we see a range like that of 2024 with 3.75% on the low end and 4.75% on the high end. We are locking in yields across the 10-year bond ladder between 4.5% on the short end, to as high at 5.7% when looking at investment grade bonds 10 years out to maturity. We see the money market fund offering great liquidity, but at lower rates of return—low 4%'s to start the year and trending lower to end the year in the low-to-mid 3% range.

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