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Minot DeBlois Advisors LLC – Year in Review and Investment Outlook
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Despite continued weakness in China's economy and ongoing conflicts in Africa, the Middle East, and Ukraine, in 2024 global economic growth continued apace. Even with heightened tensions surrounding the November elections, the U.S. economy demonstrated above-trend growth, while inflation continued to recede. In this environment, it is not surprising that the U.S. dollar appreciated significantly against almost all other currencies and that U.S. stocks in aggregate once again delivered returns far above those of most foreign markets.

Benchmark	Total Return One Year	Annualized Return Five Years	Annualized Return Ten Years
S&P 500 (US Large Cap Stocks)	25.0%	14.5%	13.1%
MSCI EAFE (Foreign Developed Large Cap Stocks)	4.4%	5.3%	5.7%
Barclays Aggregate Bond Index (US Investment Grade Bonds)	1.3%	-0.3%	1.3%
US Short-Term Treasury Bills (US Government Money Market Fund)	5.1%	2.5%	1.8%

The S&P 500 Index is a broad measure of US large capitalization stocks; the MSCI EAFE Index is a broad measure of mid-large capitalization stocks in developed international markets; the Barclays Aggregate is a broad index of US investment grade fixed income securities; the 90-Day US Treasury Bill represents short-term government money market funds. Returns are provided by sources deemed to be reliable but are subject to change or revision.

U.S. stock returns were the result of strong earnings growth of over 10% (driven by almost equal amounts of revenue growth and profit margin expansion) and multiple expansion (or higher stock valuations), while dividends only added 1% to total return. Foreign stocks faced the headwind of a strengthening U.S. dollar as well as slower earnings growth.

U.S. stock market leadership remained largely concentrated[i] among just seven technology and related stocks: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla. Dubbed the *Magnificent Seven* by financial journalists, these stocks' combined market cap now represents almost 35% of the total value of the S&P 500, and they accounted for the majority of the index's return in 2024 (as they did in 2023). The strong performance of these technology stocks over the past two years has resulted in an approximately 30% return differential between the market-weight S&P 500 index and the equal-weight index, which is the largest return disparity since the creation of the equal-weighted index in 1990.

We have had a long-standing bias toward U.S. large cap stock exposure, which has of late been beneficial to absolute returns. From a fiduciary standpoint, the attractiveness of U.S. large cap stocks includes the ease and low cost of trading them, confidence in the U.S. rule of law, and the fact that our clients' liabilities are primarily in U.S. dollars.

With that said, there is value in owning other asset classes, including foreign developed and emerging market stocks, given their diversification benefits. With U.S. stocks having performed so well – and the P/E ratio of our market being much higher than that of many overseas markets – it is especially important to keep in mind that there have been multi-year periods when foreign assets (both stocks and bonds) outperformed domestic markets.

Given the United States' economic stability and growth profile, it may well be the case that domestic stocks will continue to out-perform their foreign counterparts for a time. However, future gains remain dependent upon earnings growth meeting investors' expectations and valuation multiples not contracting. Expectations for both are high, and U.S. stock performance is especially reliant on Artificial Intelligence (AI) "working": i.e., investors need to remain comfortable with massive capital spending by tech companies, and AI-based products with broad appeal outside of the tech sector need to reach the market soon.

Although investors enter 2025 focused on the success of large technology companies, inflation and interest rates are of concern, albeit to a lesser degree than was the case one year ago. Any complacency regarding inflation may be misplaced, however. The economic policies of the incoming administration may well reignite inflationary pressures. Furthermore, structural forces that have kept inflation low in the past, such as outsourcing and globalization, are no longer as dominant, and government debt continues to climb across major economies. Finally, consumer finances are beginning to fray, especially for moderate income households.

Given their valuation and the risks outlined above, we believe that long-term investors should treat U.S. large cap stocks with caution – especially stocks such as the Magnificent Seven which have performed so well. As we write, the S&P 500 has advanced approximately 50% from where it stood two years ago, while during the same period bond yields have risen. Thus, investors have more attractive options for "banking" some of the wealth created in the stock market, and over the course of 2025 we are likely to shift incrementally[ii] toward more risk control assets such as cash, Treasury Inflation Protected Securities (TIPS), and short- to intermediate-term U.S. Treasury Notes. All three of these asset classes appear attractive both for their yields and their protective qualities in a downturn.

Furthermore, long-term investors in particular should bear in mind that prospective returns for U.S. stocks will almost certainly be materially lower for the next decade than they have been for the prior ten years. Goldman Sachs and Vanguard, for example, are forecasting returns of less than 5% per annum for U.S. stocks. As investors make retirement, gift and expenditure plans, they would be well advised *not* to extrapolate recent portfolio returns into the future.

We realize that, with stocks having performed so well, selling securities can be an expensive proposition for taxable accounts, but we believe that disciplined rebalancing of portfolios lays the groundwork for superior risk-adjusted returns. Over long periods of time, and particularly during economic declines and market downturns, this balanced approach has provided strong risk-adjusted returns.

We remain focused on protecting capital by investing in stocks of durable companies with reasonable valuations and mitigating risk by diversifying investments across sectors and geographies. The risk control portion of our portfolios is invested in high quality bonds where we favor intermediate-term investments with minimal credit risk. The portfolios we manage are therefore balanced, and headlines blaring historic declines (and increases) in the stock market rarely translate directly into the experience of an individual investor.

As we embark upon a new year, we appreciate your continued confidence in us, and most importantly, we wish all of our clients, friends, and colleagues a **healthy and happy new year**.

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Greg — Gregory Gullickson CFA

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[i] Of the top 10 stocks in the S&P 500 only Berkshire Hathaway is not a technology-related stock.

[ii] The idea of dynamically allocating among asset classes based on excess return provided by the risky asset was developed by Robert Merton and highlighted recently in an *Economist* article on the "Merton share" formula.