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INVESTMENT MANAGEMENT

PORTFOLIO INSIGHTS

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Acropolis was born from a simple idea:

In an industry where high quality, objective advice is hard to come by, we make a difference by putting the client's interests above our own.

TECH BOOM TEMPERS MILDLY

The simultaneous stock and bond selloff in 2022 was a painful experience- one of the worst periods for balanced investors in over a decade.

Since then, stocks have done very well, and the bond market has chugged along just fine. The S&P 500 is the standout winner, rising 60 percent cumulatively since then, which works out to an annualized rate of 27 percent.

Some of those gains are due to a more resilient economy than expected (remember that recession on the horizon?), inflation inching closer to target, and the Federal Reserve's rate-cutting campaign.

And, of course, some of those gains are due to tremendous excitement and expectations about the recent developments in artificial intelligence.

Technology stocks are up almost 120 percent during this period, nearly 50 percent per annum. The Magnificent Seven has done even better still.

One or two quarters don't make a trend, but interestingly, tech stocks have cooled off recently.

In the second half of 2024, they've only risen by low-to-mid single digits, which isn't so bad, except compared to their more typical mid-double digit gains in all of the other quarters since 2022 (except one mild loss in the third quarter of 2023).

It's reasonable to ask how long this technology trend can continue, especially since it's been going on almost continuously since the 2008 Global Financial Crisis.

The valuations have been expensive for a long time and can continue getting more expensive (see page four for more details).

At some point, artificial intelligence will have to be profitable to turn the hype into utility, but it will take years of quarterly earnings calls to see how it plays out.

In the meantime, excessive new regulation, some high-profile failures, or a electric grid that can't keep up with the power needs of the software could be catalysts for change, but at this moment, the current level of optimism is still very high.

STOCK MARKET SUMMARY

By David Ott

The fourth quarter was a turning point for many securities, sectors, and asset classes, partly due to the election.

Perhaps the most dramatic difference is seen on the chart below, where developed and emerging markets fell in the fourth quarter, while all three US asset classes were higher (albeit modestly).

The losses in the fourth quarter are explained mainly by the strong dollar, which is something that President-elect Trump supports. It also hurts US dollar investors in overseas markets.

Developed markets, as measured in their home currencies, were flat, up approximately 0.1 percent, but the dollar gained about eight percent against these currencies, taking the return for US investors down.

The effect was less in emerging markets but still substantial. In local terms, emerging market stocks fell by -4.3 percent, and the strong dollar another -3.7 percent, taking the total loss to 8.0 percent.

A similar effect occurred in healthcare, communications, and consumer discretionary stocks.

Healthcare stocks were up 14.4 percent in the first nine months of the year but lost -10.3 percent in the fourth quarter, so the gain for the year was just 2.6 percent. Sectors sensitive to interest rates, like real estate and utilities, fell in the fourth quarter, but financials gained.

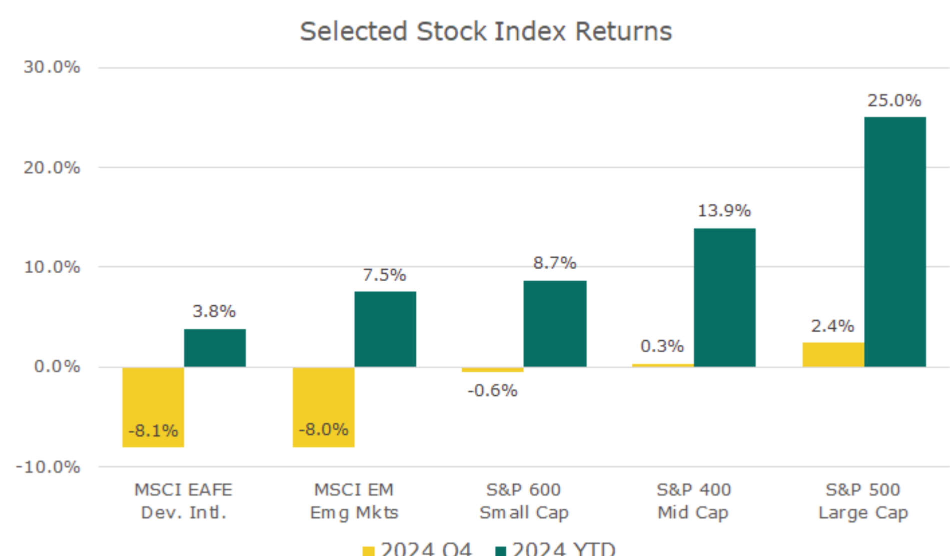
At the other end of the spectrum were consumer discretionary stocks, which had been up 13.9 percent in the first nine months and finished the year up 30.1 percent. While several factors were at play, it helped that the second-largest company in the sector, Tesla, jumped 54.4 percent in the fourth quarter.

Growth and momentum stocks were strong again in the fourth quarter, with growth stocks up 6.2 percent and momentum stocks up 4.9 percent, compared to a -2.7 percent loss for value stocks and flat results (-0.1 percent) for high-quality stocks.

Investors shouldn't read too much into the immediate reaction to the election since markets often overreact both ways.

"Gratitude is not only the greatest of virtues, but the parent of all others."

Cicero
Roman Statesman
106 - 43 BC



Data Source: Bloomberg

BOND MARKET REVIEW

By Ryan Craft, CFA

The US Treasury yield curve has been inverted for nearly two years, where short-term rates are higher than long-term rates. This resulted from the Federal Reserve hiking overnight rates to combat inflation.

Over the past few months, the Federal Reserve has cut rates by 100 basis points while longer-term rates have jumped up by 75 basis points. The result is a yield curve considered "normal," as long-term rates are now higher than short-term rates.

These moves resulted in a difficult broad bond market performance. Short-term bonds performed much better, nearly breaking even for the quarter, while long-term bonds posted steep declines of nine percent.

The Fed began to lower short-term rates as it was concerned the high rates would negatively impact employment. Instead, the economy has remained strong through year-end.

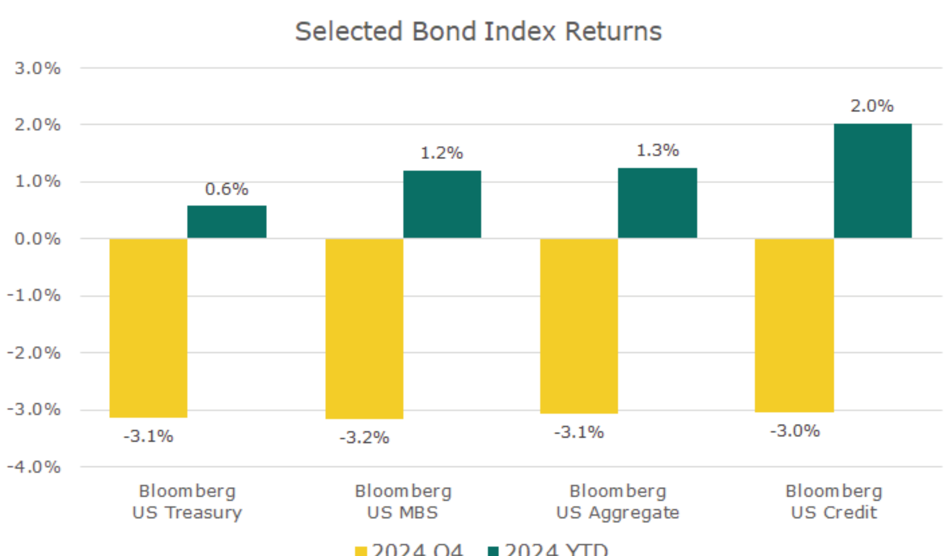
Employment has remained steady, yet inflation has been stickier than expected by the Fed. At the December meeting, the Fed cut rates but signaled to the market that this would likely be the last cut for a while.

Long-term rates made a significant move up throughout the quarter. Some of this move was simply a reversal of yields falling too fast over the summer.

A portion of this move also increased the market's expectation for future inflation. Comparing various market yields suggests that inflation expectations account for about half of the move in higher rates.

The rest of the move is likely a supply/demand issue. The US government has been running massive deficits since the Covid economy, and the market may demand even higher rates to absorb the increased supply.

Looking forward to 2025, fixed-income investors can still enjoy 4-5 percent yields on safe bonds. Stock and bond markets will likely experience higher volatility as the economy sits at an inflection point with much uncertainty in the near term.



Data Source: Bloomberg

"Success is achieved and maintained by those who try and keep trying."

W. Clement Stone
American Philosopher & Author
1902 - 2002

WHY NOT ALL TECH?

By David Ott

Last quarter, I devoted this space to the incredible returns of US technology stocks in the previous ten years and showed that most of the excess return of the S&P 500 compared to international markets is due to our strong dollar and tech stocks.

One way to measure the tech boom is to look at one of the oldest technology ETFs, the Select Spider Tech fund (ticker symbol XLK), which has earned more than 20 percent annually through December 31st. A $10,000 investment in that fund in 2014 would have been worth $64,172 at the end of last month.

Even though I know better than to drive forward while looking through the rearview mirror, I can't help it: I want that return, so I wonder whether we shouldn't overweight tech stocks or stop underweighting them.

Recency is the phenomenon of taking recent past events and extrapolating them, but I can't help thinking: Is ten years that recent? Isn't it evident that tech stocks will keep crushing the market (which earned an astounding 13.2 annually percent during that same period but still feels paltry)?

So, my itch is that I want this performance, and to scratch that itch, I have to look at the history in more detail and think about where things could go from here.

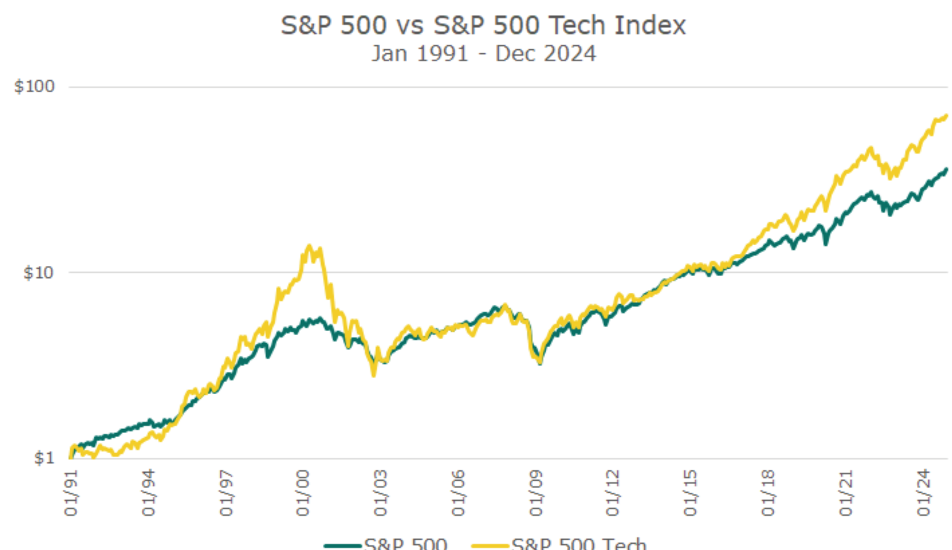
Let's start with the history. I pulled the S&P 500 technology index returns to 1991. I started using XLK, but it only dates back to 1999, so you get most of the tech bubble bursting but not much of the bubble itself. Using the index data, I see the good and bad parts of the bubble.

I'm showing this data in logarithmic terms, which allows you to see the impact of the bubble. You couldn't see the bubble if I didn't do that because the recent performance obscures everything else.

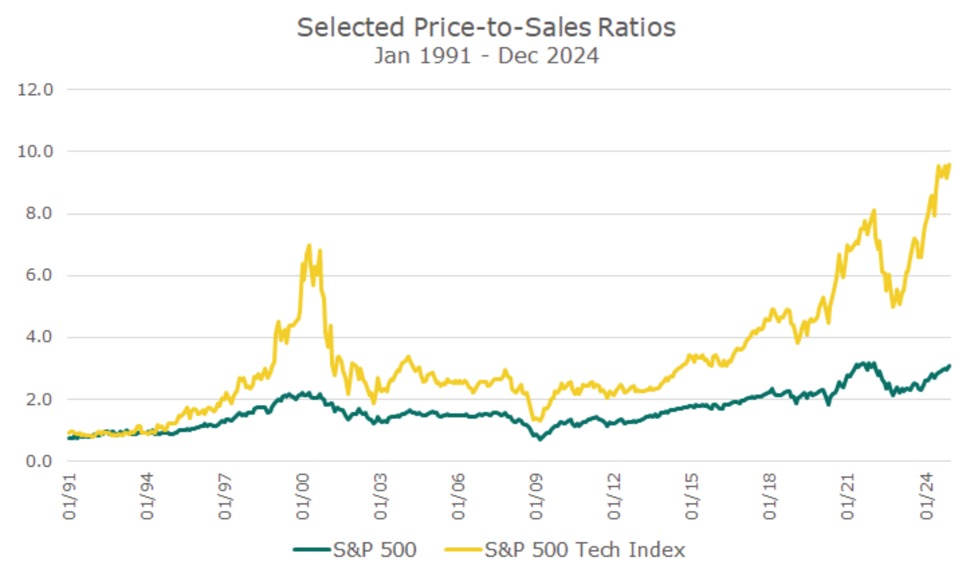
What's interesting to me is that for 25 years, from 1991 to 2016, tech stocks didn't outperform the overall market. Sure, they did in the late 1990s, but they underperformed just as much

"No matter how far a person can go, the horizon is still way beyond you."

Zora Neale Hurston
American Anthropologist
1891 - 1960



Data Source: Bloomberg



Data Source: Bloomberg

in the early 2000s. As noted already, bubble and burst.

Next, I decided to examine valuations. I studied the price-to-earnings and price-to-book ratios before settling on the price-to-sales ratio, and they all tell the same story: tech stocks are expensive.

I went with price-to-sales (P/S) because it's simple to understand: there is no management manipulation to achieve earnings, you can have negative earnings, and there is no question about the company's book value (tangible vs. intangible), etc.

The chart above shows that tech stocks are always expensive compared to the overall market. That makes sense because they grow faster.

But I was amazed that tech stocks are more expensive on a price-to-sales basis now than in the late 90s tech bubble. I'm not calling this a bubble, but I find it unsettling.

You can also see that the market is more expensive today than in the late 1990s. The following chart divides the price-to-sales ratio for the tech index over the price-to-sales ratio for the overall market to show its relative expansiveness.

Measured this way, tech stocks still look frothy – about the same level as in the tech bubble. Interestingly, the take-off point for the expansiveness appears to be 2016, when tech stocks started to outperform the overall market.

I wish I had earned those returns, but they feel less desirable if the valuations are higher.

I'd much prefer it if the fundamentals were getting better and better, which they did, just not as much as people's willingness to pay higher prices.

I want to reiterate that I am not saying this is a bubble—it could go on for years or last forever. At the same time, I've scratched the itch and am perfectly content to remain underweight in tech stocks.

This article first appeared in our weekly newsletter, Acropolis Insights. Please get in touch with us to subscribe.

"The mind is not a vessel to be filled, but a fire to be kindled."

Plutarch
Greek Philosopher
46 - 119 AD

INSIDE THE ECONOMY: GDP

By: David Ott

Not only did the economy avoid a widely expected recession in 2023 and 2024, but economic growth was strong, coming in at 3.1 percent year-over-year in the third quarter of 2024.

Consumer spending represents about two-thirds of US economic activity and has expanded at a pace of 3.7 percent. Exports climbed, and government spending, particularly in defense, rose materially.

As of year-end, consensus estimates by economists suggest growth in the fourth quarter will be around two percent, but the Atlanta Federal Reserve GDPNow forecast suggests it could be as high as 3.1 percent.

The current level of economic growth is impressive for two reasons.

First, the economy expanded nicely despite much higher interest rates. It's impossible to know, but it's interesting to consider what growth might have been if the Federal Reserve had been less aggressive in raising rates.

Second, growth rates around the world aren't nearly as strong.

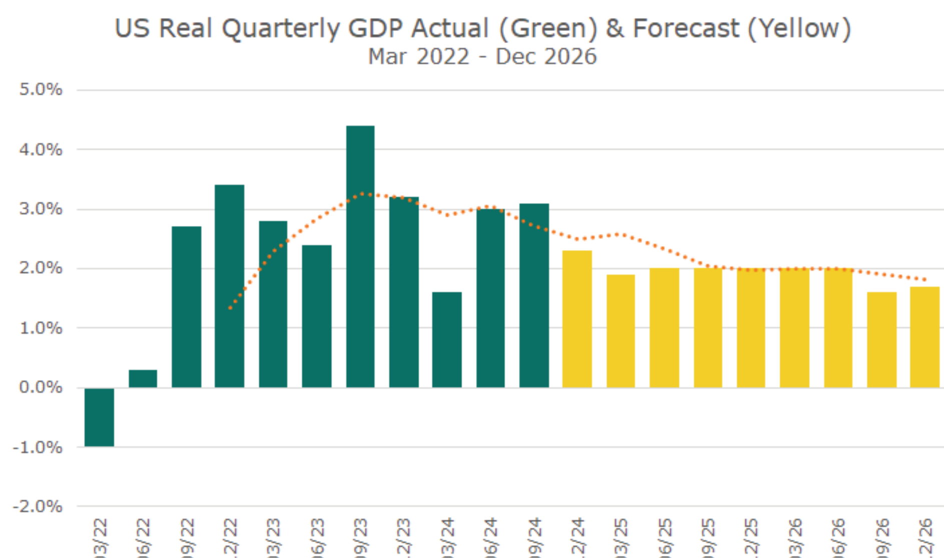
In the G10 economies, the US ranked third, well ahead of the Eurozone and the United Kingdom, which both expanded by 0.9 percent. Japan was barely positive at 0.5 percent, and New Zealand's economy contracted. Only Denmark and Norway fared better than the US, and those are much smaller economies.

Germany has historically been the backbone of the Eurozone economy, but it was one of two countries to contract in the year ending in September (Austria was the other).

Germany's economy struggles with an aging workforce, bureaucracy, and other structural problems. Lately, it has been adversely affected by the energy disruptions related to the Russia/Ukraine war, which has increased production costs and hurt industrial output. Chancellor Scholz's coalition government collapsed recently, and new elections are scheduled for February.

"Reason and judgment are the qualities of a leader."

Tacitus
Roman Historian & Politician
56 - 120 AD



Data Source: Bloomberg

RATES RISING AND FALLING

By: David Ott

Not long ago, I talked to a client who said, "My bonds aren't doing well because yields are increasing, but the Fed just cut rates. I don't understand."

The first part of their comment states that bonds aren't doing well because the yields are increasing. That is true, and the simple way to remember it is that yields up = prices down and vice-versa.

The chart below shows that the yield on the Bloomberg Aggregate started rising in mid-September from just over four percent to just under five percent.

At almost precisely the same time, the Federal Reserve cut interest rates from 5.25 percent to 4.25 percent, which caused the question: why are yields going up while rates are going down?

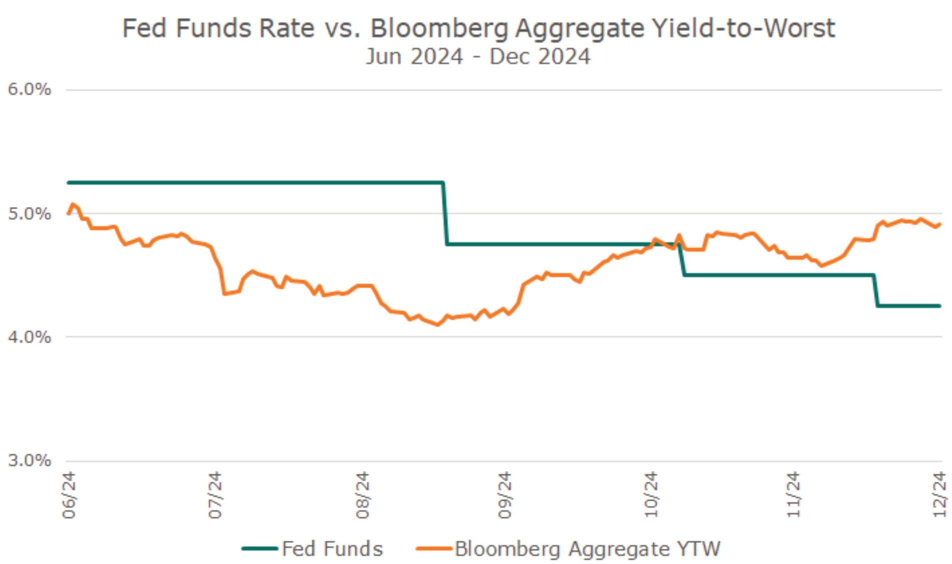
The first thing to know is that the Federal Reserve sets the Fed Funds rate to effect monetary policy. The Fed has a dual mandate to maintain price stability and maximum employment, and one of its main tools is changes in the Fed Funds rate. Changing the cost of borrowing and lending alters the financial conditions that affect the labor market and inflation.

Investors control the rest of the yields in the market, whether it's the two-year Treasury or a 30-year corporate bond. The Agg contains all investment-grade, taxable bonds except for inflation-protected bonds, so it's an excellent summary of the market prices.

Over the last six months, the Fed cut rates because they feel they have done most of the work needed on inflation and don't want to affect the labor market negatively.

The market isn't so sure, so the market yield is diverging from the Fed Funds rate in recent months.

After two years where the yield on the Agg was less than the Fed Funds rate, the recent divergence was enough to 'normalize' the yield curve, meaning the yield on that medium- and long-term bonds are now higher than short-term bonds.



Data Source: Bloomberg

"In charity, there is no excess."

Sir Francis Bacon
British Politician
1561 - 1626

Major Indexes	2024 YTD
Dow Jones	14.99%
S&P 500	25.02%
S&P 400 Mid-Cap	13.89%
S&P 600 Small-Cap	8.65%
MSCI EAFE (Intl)	3.82%
MSCI Emerging Mkt	7.50%

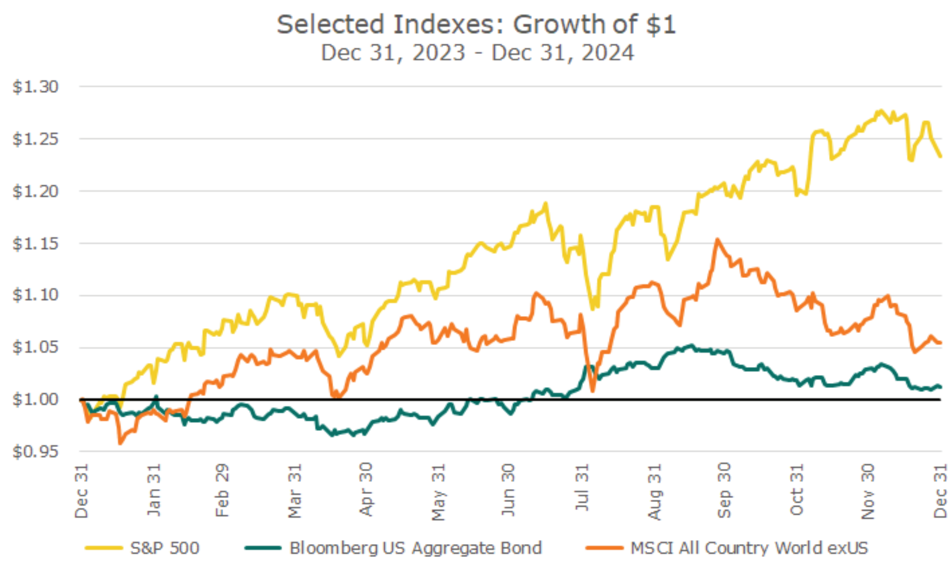
Equity Styles	2024 YTD
S&P 500 Growth	35.9%
S&P 500 Value	12.3%
S&P 500 Quality	25.7%
S&P 500 Momentum	46.0%

S&P Sectors	2024 YTD
Basic Materials	0.0%
Communications	40.2%
Consumer Discretion.	30.1%
Consumer Staples	14.9%
Energy	5.7%
Financials	30.5%
Healthcare	2.6%
Industrials	17.3%
REITs	5.2%
Technology	36.6%
Utilities	23.4%

Interest Rates	2024 Q4
Fed Funds	4.5%
Prime Rate	7.5%
3-mo. Treasuries	4.3%
2-yr. Treasuries	4.2%
5-yr. Treasuries	4.4%
10-yr. Treasuries	4.6%

All Data as of 12/31/24

THE BIG PICTURE



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