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Dear MFC Clients,

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“MUSIC IS THE LANGUAGE OF THE SOUL”

Music, like life, politics, and economics, has plots, sub plots, major & minor chords, and more innuendos & codas than a Shakespeare plot. 2024 was a year of slow building, through countless anti-climaxes, to an epic crescendo. ‘Sotto voce’ was non-existent and bombastic percussion was all the rage. The thundering horns presaged the dawning of a new era. The high notes in most market indices were hit in January followed in staccato fashion by 57 new highs in the S&P500 (DOW 47, NASDAQ 38). The fading drumbeat of inflation, unemployment, and recession moderated to a pianissimo by the 4th Q. We are witnessing the opening refrains of a symphony with new musicians and an eccentric conductor.

As Dickens said in A Tale of Two Cities, **every human creature is constituted to be that profound secret and mystery to every other.** Thus, collections of humans are even more opaque and mysterious. Knowing this, politicians play on our emotions in contrapuntal beats of doom, disparagement and despair, all the while promising paradise and more benefits if you vote for them! However, democracy proved its resilience in that 70 countries, representing over half of the world’s population, voted in 2024. Incumbents were generally punished, coalitions were encouraged, and a few outcomes came perilously close to installing a ‘kakistocracy’, the Economist’s Word of the Year meaning ‘government by the least competent’. Despite a wealth of information, the global economy is shaped by unforeseen forces and remains a ‘profound secret’ to everyone.

The recent 5 years, from Jan 2020 thru Dec 2024, have arguably been the most ‘shocking’ in modern history. Shock #1 was the pandemic and shuttering of most economic activity. This was followed by the ‘re-opening shock’ with its tangled supply chains, #3 was the inflation shock (20-25% over 3 or so years), and lastly the rate shock. Perhaps 2025 will bring us the Trump shock or equally possible is a slow transition to normalcy. Supporting the latter argument is the fact that inflation and GDP growth have moderated to 3% levels, capital expenditures and consumer demand remain strong, 2.2 million new jobs were added in the US in 2024, and the earnings outlook is favorable. All prognosticators have positive outlooks for 2025 and that near unanimity might be the greatest cause for concern. Uncertainty, reversion to the mean, and the law of unintended consequences are all very much alive and capable of causing pain. Africa, the Middle East and the Eurasian land mass are facing more wars and economic strife than ever. While we are broadly in agreement with the positive outlook, we are also actively looking to realize some gains and reduce the portfolio risks. Given that the 10 & 30 year yields are north of 4 & 6% respectively, thus providing a ‘real’ yield to investors, we see many attractive investment opportunities in nearly all asset classes outside the large cap growth sector.

Very few pundits forecast the strong market rallies that occurred in 2023 & 2024 with the major averages posting gains north of 20%. Only 2 years back at the end of 2022, there was real concern for the economy and markets with many calling for a recession. The inverted yield

curve and high interest rates were the guaranteed harbingers of bad times to come. Instead, the unlikely 'soft landing' materialized with inflation moderating and no reduction in employment, wage gains, or general business conditions. Housing was the most impacted by higher rates but both prices and demand have remained firm. All 11 S&P 500 sectors showed positive returns in 2024 with the top and bottom three being Communications Services (+40%), Tech (+36.6%), and Financials (+30.6%); and Materials (0%), Health Care (+2.6%), and Real Estate (+5%). Oil and corn ended the year flat, gold rose 42%, and overall commodities were strong with cocoa rising 178%! Bad for chocolate lovers! Don't even ask about bitcoin where 'Doge Quixote' and his side kick, Sancho Ramaswamy, lead the charge. They, and others, see AI as bigger than transubstantiation, a portal to Nirvana, but the jury is out on whether this is an incremental gain, a productivity boost, or truly a revelation. Thankfully, the inverted yield curve is history for those days, along with near zero interest rates, are over. The risks of a correction remain elevated for we are one standard deviation above the norm for P/E ratios and the CAPE ratio is lofty at nearly 38x. Also, the recent increase in global bond rates reminds us that the bond vigilantes are alive, as is inflation. Remember the adage that bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria. We might be bordering on euphoria but remember that we are all a complete mystery to each other!

As you will see in your year-end reports, our portfolios participated in the rising equity markets though the simultaneous concentration and dispersion of returns in the equity market is worrying. The former refers to the magnificent 7 stocks and the latter is shown by the DOW advancing less than half the rate of the NASDAQ and S&P500. Growth assets once again nearly doubled the returns in value investments and our philosophy of roughly equal weighting these 'styles' has resulted in some underperformance. As expected in a rising tide, passive strategies generally outperformed active managers in the equity markets, but the opposite was true in the fixed income and some alternative sectors like real estate. Small caps, international, and equal weight indices generally underperformed setting them up for hopefully decent gains in 2025. In reality, there are pockets of opportunity across all asset classes and with cash still yielding north of 4%, a barbell mixture of low and high risk assets has its attractions.

The 2025 outlook seems to be stuck on "cloudy with a chance of meat balls" and in keeping with our musical theme, the score will be full of high and low notes. There are many reasons to be positive for we should never underestimate the multiplier effect of Deregulation in the financial, commercial, and public spheres. This plus tax reform could provide nice tailwinds. While the stock market and its gyrations gather our attention, it is the humble 10 year T-bill rate that is 'middle C' in the note register and around which the 'symphony' revolves. If it holds steady, cue the woodwinds and oboes for ballast, if it rises or falls by 1%+, call up the drums and bugles, batten the hatches! Since there is no way to forecast this number, we adopt a strategy of building a diversified pool of investments with low cost passive and active managers in both equity and fixed income markets. Our keystone is diversification across all major asset classes coupled with the provision of sound advice on all the other aspects of wealth management. It is a marathon of 'wish, rinse, and repeat'. Yes, markets do rise by the staircase and fall by the elevator shaft and rest assured that we are riding along with you. There are many reasons for hope coupled with a dash of prudence. Please contact us with any queries.

Best, Lanny