DIVIDENDCAFE | PODCAST TRANSCRIPTION

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Hello, this is David Bahnsen. I am the managing partner of The Bahnsen Group, and this is The Dividend Cafe annual Year Behind Year Ahead White Paper. I'm going to introduce to you today in this video and podcast all the things that I have to say about the year that just was in 2024. We're going to rate some of the themes and thoughts we had about the year a year ago, give a little report card on, on how we did in our projections for the year.

And then we're going to go offer more of the same for 2025. We want to look ahead to what the year ahead is likely to bring and the big thing. themes that we're seeing when we think about the economy and financial markets. This is an annual tradition. It's going to be a fun one. So let's jump on into the Dividend Cafe.

The genesis of this endeavor goes back to before I ever left Morgan Stanley, we were doing an annual kind of summary. And we've sort of just grown it over the years. I don't honestly recall if it used to be as long as it is now. I think I probably used to do a little bit shorter of a version, but there wasn't really ever any point that we targeted a certain length.

That just sort of organically gotten up to be, you know when I'm submitting it pre edited, I think this year it was 26 pages and almost 10,000 words. And, and there are about 20 charts as a matter of fact, there's exactly 20 charts in the PDF of the paper. We're going to put a lot of those charts up on the screen for you here.

For those of you watching the video, we probably won't put all of them up, but we want you to be able to see some of the kind of visual support for some of the things we're talking about. 2024 is a year in which a lot of investors have a chance to say, or not just investors, but, but observers of the market, pundits and commentators, there's ample opportunity to say, wow, I'm really surprised at what has happened in markets. And there is a part of that sentiment that I can relate to. And there's a part that I want to offer up as a cautionary tale. Let's start with just the, the broad cautionary side that I think is important to remember philosophically, you really ought not ever be.

Surprised by markets in the sense that markets are there to surprise you. I don't view what happens in markets as ever surprising because of the fact that we expect to be surprised. There is a permanence to this condition. And I feel the amount of time I've now been doing this in my adult life, the lesson ought to ring true, but you know, every now and then I still find myself saying things like, Oh, wow, I'm really surprised by what's happened in markets.

But what exactly happened last year that ought to surprise us? Well, you say, okay, well, the S&P was up over 20 percent the year before, and then it was up to over 20 percent again. And that is not something that happens a lot, but it's not something that's never happened. I believe last year was actually the eighth time that you've had back to back years of 20 percent plus returns, so it's by no means unprecedented.

One could argue it's almost never happened. When happening, you know, eight different times in a, in a century now you could say, well, we were expecting the economy to do worse and then it didn't do worse than that. And that's certainly understandable, but given how the economy did given that profits grew yet again, another 10 percent given that the, monetary tightening of 2022 that we got through 22 and 23 and now 24 and the quote unquote lag effects of tighter monetary conditions.

Did not put the economy in recession. We did not end up having significant contraction of employment. and that now we're on the other side of that tightening period where the Fed has actually began cutting rates and it looks like the big expected negatives. of credit tightening didn't create any substantial hangover.

I mean, shouldn't the patient in this case, the market be allowed to feel relief that things didn't go worse. So I think that's, that's a legitimate point. didn't the markets end the year with news of a new administration coming in that's talking about cutting taxes or, you know, talking about deregulation.

Now there's, as I've gone over and over in The Dividend Cafe, there's a mixed bag of expectations around some of the political uncertainty, but net net, from energy to deregulation to tax, those are legitimate reasons to view them as some form of tailwind. So I think a couple of things can be true at once.

There, there are things that people We're not expecting to take place in 24 that did. It was a very robust year for risk takers, but I don't know that I would use the word surprise. I think that when all was said and done the good outweighed the bad. And when you look into the liquidity conditions and profit conditions that usually drive markets we shouldn't be altogether shocked.

that ended up being a positive year in markets. So some of the specifics of that I want to get into now, you know, the S&P 500 made 57 new all time highs last year. Why do I bring that up? Because I just want to make sure you're not buying into the logic that 56 of those times everything was fine and on the 57th you're all of a sudden supposed to have gotten Concerned.

This is just sort of a reminder of something that ought to be both mathematically and logically clear. I believe market valuations are high. I talk about all the time. I'm going to get into some of the market valuation metrics that concern me and why I do think there's good reason for a certain healthy paranoia for those who have their whole investment strategy connected to a cap 500.

But when people bring up the point of the market being all time high. You know, I remember early in my investing life in the 1990s when the Dow hit 10,000 and everyone said, Oh my gosh, we've just hit a new all time high. And the Dow was at

an all time high at 10,000 and now here, let's call it 43000, you know, it's laughable.

But of course, because of math, 10 was once the all time high, and then 11, 20, and so forth and so on. And so when I say that the S&P made 57 new highs last year, and that the Dow made 47 new highs, the Nasdaq made 38 new highs, you know, all we're talking about is that it's a point in history And which we call it an all time high in the present tense, but in the future, we're going to refer to it as a lower point than where we are now, because that's what we mean by markets moving throughout the ebb and flow of history.

Now in 2024 the first quarter, all the market indices were going higher. quarterly earnings started off the year very strong. That's where we got pretty early indications. The corporate profits were not about to go into a profit recession, that any weight on profits from the Fed tightening had seen their worst of days in the middle of 23.

And they really only ever dropped about 5% which is one of the most benign impacts on the profit cycle from a Fed tightening period we've ever seen. You know, the 10 year bond deal did start off the year at, I think, around 3.7-3.8, and it did move higher. And that was a theme throughout the year of, okay, well, is the bond market going to put weight in, into equities?

But a lot of it just was the fact that real GDP growth was still doing quite well. And even though we were expecting Fed rate

cuts to begin in March even as those rate cuts did not materialize and expectations for rate cuts got pushed out more and more throughout the year. The first quarter was just a benign period in the markets.

Now, April, they sold off quite a bit, but by the time anyone could read their statement from April into the month of May, they started immediately rebounding. And then you did have a period there into May, June, where markets themselves were doing very well, but it was in that period quite concentrated within Nasdaq and some of the very big cap markets.

And so there was a sense in which, yeah, overall market's doing fine, but it's really very poor breadth. It didn't feel like it was evenly distributed and therefore sustainable. You had a pretty good optimism as we got to the midway point of the year about corporate profits. You may recall it was the very end of June that you had that what will be historically memorable Presidential debate between President Biden and candidate Trump that ended up leading to President Biden dropping out of the race, but from all the developments that were taking place throughout the year in the political cycle, markets just completely shrugged all of it off. Then we got into the middle part of the year.

And in Q3, we did have the one period of, of, you know, real volatility from let's call it about the second week of July to about the first week of August, the NASDAQ dropped about 13

percent that the Dow is only down. Oh, I want to say. 6%, the S&P about 8%. So there was a period of heightened volatility.

Those drawdowns feel severe when they're happening. I don't ever want to take away from that. When you're in the middle of markets going down 3%, you don't know that it's not going to go down 10, but in. Hindsight when you see that the worst drawdown of the year was S&P eight and Dow six or seven, and that that's not even close to the average drawdown that we get.

It's hard for me to, with the gift of hindsight look at it as a very severe event. But at the time, the yen carry trade was getting unwound. There was a brief period. It did not last long of fundamental concern were the healthy labor markets eroding that those kinds of questions were surfacing in late July, early August, and then markets rebounded quite significantly in August.

And we got into September and the Fed was really confident that the labor was something that they felt could worsen if they didn't cut rates. But then on the same time, the labor data did not worsen. And in fact, weekly jobless claims really stayed in a pretty benign range of about 220, 000 for a very long period of time.

The unemployment rate that had gotten up to 4. 3 percent. Came back down to 4. 1, 4. 0. you, you just didn't have a period where fundamentals in the economy eroded. And yet

the Fed was cutting. Profit growth was still looking good. Guidance into future profit growth was holding up. It wasn't expanding, but it wasn't worsening.

And, and it really led to a good period in markets. I'll put a chart up. Right now one issue that I think is noteworthy, as the Fed began cutting rates, is the 30 year mortgage rate did finally drop. Now when I say it dropped, it had been running at about seven percent, and it came all the way down to about six.

I think the Fed needs mortgage rates to get something to, to somewhere with a five in front of it, maybe even a four in front of it. If you're not going back to three or two, at least I certainly pray we're not, there's reasons for that, But the Fed does need to see something unfreeze in the mortgage market.

And the mortgage rates dropping from 7 to 6 started to give a little indication that maybe there was some thawing out in the housing market that would allow transactions to continue. But then as you'll see in the chart, mortgage rates plummeted. Came right back up. And, and so the Fed's cutting on the short end of the curve did not have staying power in mortgages.

And in fact, we didn't get all the way back up to seven, but got very much near where we were, had been before the Fed started cutting rates. Now Q4 definitely became a quarter in markets that was dominated by talk about the election. And you basically had the Dow drop a little bit in October, not much, but then rally massively in the month of November.

And not only the day after the election, but in the weeks that followed, the cyclicals rallied, financials rallied, energy rallied around optimism of incoming president, energy policy. But pretty much everything rallied. Small cap on the economic side, the small business optimism, CEO confidence all moved higher.

Then in December, you got a little bit of a reality check the combination of the fact that things were all ready. quite overvalued. Nvidia, which had been carrying a lot of markets on the year kind of was running in place. It was still back to where it had been sort of in July. I had been trading sideways.

So you weren't getting a big boost from some of the big tech side. And then I think that the general feeling that some of the election trade was a little overdone caused markets to give a lot of that back in the month of December. You still ended Q4. net net with markets higher because of the big strength in November.

And of course the year ended very, very positively. How, how positively, when we look at a market summary for 24, we'll put a slide up showing all the major asset classes of 2024. The NASDAQ again, leading the way up almost 29%. The S&P up over 23%. Internationally, the Nikkei led the way. It was up 19, but still well off of highs.

Chinese stocks ended up being up 12.5%, not bad, but they've been lagging significantly. They had been down much of the

year. The Russell 2000 well first the mid cap up 12, small cap up 10. Good returns, and yet those are kind of the weaker parts of the U.S. equity market. You see how good things were in credit in a period where interest rates went up on the year a little bit.

High yield bonds were still up 8 percent as spreads contracted. The Fed. And the commodity sector was up a little bit, two and a half percent, the U.S. bond market, even with rates going higher because of the good coupon they were offering. We're still barely in a positive territory. Tips were up, corporates were up, treasuries were up a little.

The only thing that was really down, global REITs, The U. S. REITs were up a little, global REITs were down a little, and then Brent crude oil was down just 3%. But I bring this up to point out, and you can see the visual in the chart, that almost every asset class was up on the year. And if we were looking at a chart from 2022, almost every asset class was down on the year with just a couple outliers that were up.

So you had a very big difference in 22 versus where we were in 24. Now I think that issue about small caps is worth pointing out. Here's the chart showing you the delta between 500 is done and the Russell 2000, which is largely small caps. And look over the last 10 years, the S&P is up about 14 percent and small cap is up about seven.

It's, it's a little bit, the Delta is a little less than that, but I mean, almost a doubling for a 10 year period per year. That's massive. But it's even more than that in the last four years. Post COVID, small cap is not even up 4 percent per year, with the S&P up around 14 percent per year. So you have a 10 percent per year difference, an almost quadrupling of the return per year, big cap versus small cap, and you see this, how this plays out in the chart on the screen.

What I would say is some have said, okay, well, that has to revert to the mean that Delta will come back. And that either means big cap stocks like the S&P have to drop or small cap stocks like the Russell have to rally. But one way or the other, that Delta has to narrow. And I don't necessarily disagree with it, but I don't think it's been a very good call from a timing standpoint.

And, and so, you know, that, that remains to be seen what the relationship between small and big capital proved to be. Now there's a chart we want to put up here to show you the 10 year, because I think this is fascinating. Many would say, well, you know, stocks rallied at the end of 2023 bond yields came down a lot.

They'd been over 5 percent and they got down below four. So sure. It's understandable. Risk assets would rally, but look at how the 10 year in 2024 went way up from where it had been starting the year, then came way down, especially as the Fed began cutting rates. But then in the last few months, even after

the Fed began cutting rates, the tenure actually moved up quite a bit.

As I'm sitting here talking now, the tenure is a hundred basis points higher. than it was after the Fed began cutting rates. And yet risk assets are all still up. So I dangle that out there because I'm going to be making a bigger point about the bond yield in a moment. you know, from a sector standpoint, communication services, technology, consumer discretionary all led the way.

They were the same three sectors that were top three the year before. But then financials did very well, better than the market did. the only sector down on the year was materials and it was only down 1. 8%. Last year, the worst performing sectors, utilities, consumer staples they all did much better this year.

Certainly utilities were up almost 20%. but I think it's a mixed bag within some of the sectors. Okay. For example, financials yeah, you're talking about 28 and a half percent for the sector, but some of the asset managers that were up 70 and 80 percent energy, it was only up 2. 3%. A lot of upstream producers, drillers did not do well.

Midstream. The pipelines, the transport oil and gas were up over 40%. So there just wasn't a monolithic outcome within some of these sectors. the U. S. dollar we'll put a chart up on the screen here. The U. S. dollar had its best year in nearly a

decade. Now that weighed on some international markets. It certainly impacted the emerging markets performance, which was only up about 4 percent but was giving up some return from the strengthening US dollar relative to emerging local currencies.

But again, when people say, well, gold was up a lot, crypto was up a lot, and these are kind of anti dollar investments, and yet the dollar is having its biggest year in the decade. So that narrative, and I say this all the time, there's nothing I deal with in finance where people are more wrong and more consistently than their thoughts and predictions around The U.S. Dollar. You know, you certainly had a year in which the Magnificent Seven, those big seven companies that had done so well in 2023, had another big year. Six of the seven did better than the market. One did much worse than the market, but was still up. and, and yet you saw their total weighting in the S&P go from 28 percent all the way to 38%.

Fascinating. now, would I refer to the Mag7 as shiny objects? No, I would not. These are wildly profitable companies. I think there are too many people who own them that have never seen things go down before and I think it's gonna prove to be a little bit vulnerable of an investor base, but that's not what I refer to when I refer to shiny that that really is also a comment sometimes not only on the faddishness and, and trendiness and popularity of a certain sector, but also oftentimes lower quality.

that, the one thing I'd say is that outside of Mag7, you did see things in the blockchain space, the gaming sector, mobile payment, cybersecurity, cloud, that don't necessarily have the same cash flows and earnings and revenue growth that some of these big Mag7 do, and they all did extremely well too. So I do start seeing a little bit more 2021 kind of behavior here.

and, and again, I, it's a permanent. belief of mine that big performance and shiny objects is almost always followed by something, some form of wheels falling off the bus. the economy likely grew at 2. 7 percent real GDP growth last year. We'll get our final Q4 number soon enough, but that's where projections are.

So again, you had a good year of economic growth above the trend line of the last 15%, obviously still below the trend line since World War II, but that's, that's to be expected. Well, I think if you were to sup last year, it was, A pretty top heavy year. the weight of the amount of companies that are 3% or more of the s and p, they now make up about 30% of the market.

The top 10 companies make up almost 40%, so there is a top heaviness in the market as a lot of these big Mag seven names just had huge years. The Growthy momentfactor. was up quite a bit. I, I would say that there is generally a pretty consistent period through history. We'll put a chart up on the screen now of momenthaving a big year and then we'll usually a big drop off followed by a period of very muted returns.

Momentis just by definition, not a very easily repeatable factor. And yet a lot of people right now are wanting to trade into what they consider to be growth. It's really chasing momentum. And you know, sometimes runners get tired. the economy did not get bad. In 2024 that's not to say everything is great.

Longer term issues still linger, especially around excessive government indebtedness and a drain on growth that comes from that. but nevertheless the, the economy grew at a good clip, as we've mentioned. And then I think that the idea that the Fed's tightening was going to slow down the economy to me, proved to be the big upside surprise that the Fed would be loosening monetary policy anyways, and this chart here is one of the more important components about 2024, is the Fed's belief that this maturity wall of so much debt and commercial real estate and corporate borrowings.

This, to me, represents a huge reason why the Fed feels the need to be cutting rates, even with the economy growing, and in a way, this, some people call it a no landing, some call it a soft landing, some refer to it as Goldilocks, a not too hot, not too cold, there's all these terms that are thrown out there, but that ended up being the big economic story.

of 2024. Okay. Well, as I move on through this, I last year did make, as I'm about to do for 25 as well some forecasts, some projections, some broad themes that represented what we most cared about going into 2024. And I want to report card

ourselves because they were you know, important themes that affected a lot of our positioning, the way we thought about the economy and the markets coming into the year.

And it gives us a chance to be held accountable and allow you to make fun of us in some cases, or be impressed in other cases. It's really actually none of the above. I mean, I think that. More or less, we don't believe in managing client money around the prediction business. We don't believe in managing money around being all in on a particular theme that we could very well be wrong about.

I, I, I bring these up to talk about macroeconomic themes that are important to us. And yet we still want to constantly manage money with the narrative at play That we don't want to have a big impact on client portfolios where we can be wrong about something. So risk management has to undergird all that we're doing.

But one of the A pluses I want to give us was our first theme of 24 was that Fed realities would be overrated. And if you look at this chart here about the number of rate cuts that were priced in through the end of 25, we started off the year believing that there were going to be 8 rate cuts. And then that did come way down, but markets still went up.

Then that expectation for rate cuts at the end of 25 went up again. Market still went higher, but then those expectations collapsed in the final few months of the year, as you see on this

chart, and yet again, the market still stayed up. So the market was just simply not trading around rate expectations, as those rate expectations themselves the expectations for cuts, went way up then down, then up and down.

And, and I think that through the up and down expectations and rates and just general changes and posture on what the Fed might be doing in the year, you did not see markets say, other than the day, the Fed was talking or day after as there was time volatility around trading. It just was a significantly overrated part of markets all year, which was a big theme of ours.

I'd be lying to say that we deserved any less than an A plus for that theme. But I talked about something a little bit more granular the contest between de globalization and a CapEx renaissance, that there was an opportunity for heavy business investment sometimes driven by the very on shoring that de globalization was creating to provide an economic spark, And at the same time, there would be a cost in the economy around de globalization, and that there would be a tug of war around how these things would play out.

The problem with that theme is that it really wasn't limited to 24. I think that theme is perpetual, I think it still exists, and we saw some interesting things take place in that. I'm giving us a B on this. But I don't think that the story ended at the end of 24. And, and you look at, these are both kind of small charts, but I want to put them up on the screen about the increase

we've seen in equipment investment into new equipment, the increase you've seen in manufacturing orders in terms of capital goods when you take out aircraft, you really do have significant business investment being made that ought to be driving productivity that ought to offset impact from de globalization.

But I think the capital goods story needs more time to play out. So that's why I thought a B was a good, honest score on that. Now, quantitative tightening, I said, was going to be an underrated story. And I'm giving us a D here because the Fed did continue quantitative tight. And when you look at the balance sheet here this chart shows that they basically have gotten 2 trillion off of their balance sheet.

it had been at 9 trillion. They've got it down below 7 trillion. Now, the reason I gave us a D instead of an F is because they did dramatically slow the pace of quantitative tightening. The amount, month by month, that is rolling off of their balance sheet of proceeds when bonds mature that they own, that they're not reinvesting, that's come down to about 20 billion a month.

That had been about 5 trillion. 50 billion a month, and prior to that had been about 80 billion a month. So they've slowed the pace, but nevertheless, the need to reverse quantitative tightening in back into quantitative easing, or the need to just stop tightening altogether and leave the balance sheet in place.

That didn't play out in 24. Now as you're about to see, it's gonna be a theme for ours in 25. but out of integrity, I'm going to give us a D on this call. number four, Japan to split the baby on Japanification, excuse me, China to split the baby on Japanification. We talked about the deflationary period that China found themselves in.

Economy slowing, a bit of a real estate and property bubble being unwound. A lot of economic activity adjacent to that that was not taking place. And their need to go use fiscal stimulus and potentially monetary stimulus following the playbook of Japan and then subsequent to Japan, the United States and Europe in, in dealing with these deflationary situations.

And my prediction was that they'd split the baby. They'd go into fiscal, but not monetary. And I think you can see here, the chart on the screen shows that their policy rate has stayed pretty constant. They did not get dramatic in cutting rates. I think it's an approp their central bank was appropriately using rate policy last year, very modestly, very prudently.

And yet that's happening even as they're dealing with significant deflationary forces. when you see inflation dropping that much, that quickly, that negatively, and their policy rate that constant, that speaks to them not leaning into the monetary tool, but certainly on the fiscal tool. China did go about as we would have predicted.

Now, they didn't do the things that we wish they would do, which is become a free country, abandon communist control, allow for the free flight of capital in and out of the country, and allow for the free flight of people in and out of the country, but nor did I have a prediction that they would. The fifth theme of 2024 was that we thought there would be broader market participation and indeed there was.

I'm giving us a B here because you still had a very high performance from some of the bigger aspects of the market but utilities were up almost 20 percent, financials were up almost 30 percent, better than the market itself. At one point, the delta between the S&P cap weight, cap weighted and even weighted was almost 10 percent difference.

That really evened out by the end of the year and, and I think that broader market participation, it did happen, but it, the reason I'm not giving this an A is it didn't happen as much as we would have thought it would. So that's why the need to kind of, you know, Use some, some judgment in how we score this.

Now, I said that 2025 earnings, this was our sixth theme of the year, would dictate 2024 performance. And this is definitely an area that played through that as companies were not guiding expectations lower throughout the third and fourth quarter of 24, they were largely reiterating profit growth expectations somewhere around it's gonna be between 13 and 15 percent year over year profit growth.

That allowed markets in 24 to hold a very firm bid because expectations for 25 were, were quite robust. So we didn't have a call, by the way, that earnings expectations were gonna be lower or gonna be higher. We just simply had a call that markets in 24 were gonna respond to what earnings guidance for 25 was.

And as you can see from this chart here, the Consensus expectations for earnings growth really held up and it put, it kicked up from where it had been in late 23 and early 24 into a bit better of an environment for expectations in 25. That had a lot to do with how markets did in 24. Markets are always better.

Forward looking. The idea that the presidential extra would be a major news story, but not a market one. I'm giving us a B plus and I kind of there's part of me that feels like we deserve an A here, but there's a reason to least pick down a little bit just the way in which markets responded right after the election.

But, you know, before we got to the election, just throughout the course of the year, you had felony charges come up against the president. You had a Republican primary that no one paid any attention to at all. you had the democratic party skipper primary altogether, no opposition to president Biden.

you had that disastrous debate night for president Biden that led to him dropping out of the race a few weeks later, a few

weeks of a lot of uncertainty as to what he was going to do when a whole pressure campaign was launched for him to drop out. President Trump ran away with the nomination and, and all the volatility that would go around that.

He had an assassination attempt that came within an inch of of taking away his life and the markets just never responded to any of it. So that was my theme for the year and it exactly played out. Up, down, good news, bad news, good for this candidate, good for this candidate, bad for this, bad for that.

It just didn't make a difference. Now look, you could say, well, the Dow It went up huge. The Nasdaq s and p went up huge after Trump was reelected. That's true. But just a little research I did. the Dow eight weeks after the election closed the year 42,544. You know what the Dow was the day that was exactly 14 days before the election.

42,544. So from two weeks before the election. All the way to the end of the year, the Dow didn't move at all. And I want this chart to go up on the screen now showing you, you got a big move up in small caps after the election, in energy, in the treasury yield, in financials, but then where you see it red circled there, the market gave a lot of that back in December.

Again, the presidential election just proved to not be much of a market story. There is a big implication from the election going into 25, as we're going to talk about in a moment, what it will mean in tariff policy, what it will mean in tax policy. what it'll

mean in various aspects of markets in 2025, but in 24, it was a big news story, but it was largely irrelevant for markets.

The last issue I got to give us a D plus on was our theme of enhanced volatility. we did not have enhanced volatility. Now, there was that period I talked about in July August. There was the drawdown in December where markets had come up huge in November, but then gave over half of that back in December.

but when you look at day to day volatility, when you look at bond market volatility, it was extremely suppressed market volatility on fixed income was much lower than normal. And if you're talking about the number of days that are up or down over 1 percent intraday up and down movements I think it was about 18 percent of days in 2024 that saw a up or down movement over 1%.

where we had been averaging 23 percent of days going back since 2013, but we had had, you know, 2022, 2020 over 40 percent of days. So you actually had much lower than both recent and, and longer term average volatility. ultimately the enhanced volatility prediction I don't think came to fruition. So three A's, three B's, and two D's on the year that, that's about normal par for the course.

Lucas, don't stop recording, I'm just doing a timeout because I gotta tell Will I'm running late, so let me just text him. Hang tight. I'll be right back to do the 2025.

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Okay three two and one. So, let's close the books on 2024 and look at our themes going into 2025, allow you to hear from us some of the themes that are driving our thinking for the year. tariff volatility Is an underappreciated it is underappreciated tariff. Pandemoniis overthought. We do not expect a global catastrophe or Smoot Hawley debacle from what Trump 2.

0. We'll end up doing with tariffs, but we also do not expect this to all transpire without some chaos. I think there's a great way to just sup without my thinking on this, by using a visual reinforcement, this chart you see on the screen, thinking about tail risks. On one hand, you could get a very unexpectedly negative response.

If tariffs unleashed some global stagflation especially with the U S price, the way it is that that represents what we would call a big left tail risk. And that's what we do not expect to happen for a massive amount of contraction of global trade around a massive amount of actually imposed tariffs, but then this right tail risk of all of a sudden there being a plaza cord where a huge currency deal is struck.

There is absolutely no volatility or unexpected downside from tariff discussion and causing the cyclicals and the financials to rally. We wouldn't really expect that either. Now those are definitely the right and left tails respectively. But I think when you look in kind of the middle of this bell shaped curve, we would expect More business as usual.

And there being some volatility around that. I do expect president Trump to lean into some chaos here to, to threaten certain things that might give the market some disruption. tweets and announcements and threats can definitely be underappreciated right now. And yet they also don't become the actual implemented policy.

And our expectation is that the worst case and best case outcomes are both unlikely to happen when it comes to tariffs. Now, speaking of best case and worst case, the number, second thing has to do with the 2025 tax bill, I think it is a very, very important. Policy reality for markets. And the fact that I don't even know if it'd be one bill or two bills, we know they're going to go through budget reconciliation.

We know they're indicating one big bill that they want to see happen. Now if they go with one bill it will take longer. They go with two bills, one bill will happen quickly. But the second part, which is where the tax stuff will mostly be, not be till even longer, that becomes worse for markets as it just embeds more uncertainty for the year.

So my general view is that there is the possibility of certain things that were not talked about much in the campaign coming through the tax bill that could be very unexpectedly positive for markets. 100 percent business expensing, bonus depreciation. You know, beyond some of the potential unexpected things in, in the business tax side, the, on the

individual tax side, I don't think markets have priced in what could happen with the salt deduction that perhaps the cap will be lifted to a higher number than is expected, which will result in kind of a backdoor middle class tax cut.

Those are things that are on the table that aren't necessarily, necessarily the centerpiece of what the Trump campaign was. I think no tax on tips is the most necessary component for him politically. I think that the no tax on social security is the least likely to happen in terms of real life.

The no tax on overtime wages is somewhere in the middle. So they have some pretty heavy lifting to do. And in the meantime, also extending the tax cuts that are set to sunset from the 2017 tax bill. So this is an important policy reality. and from the very structure of how they're going to do it, there's a lot of uncertainty.

That's our number two theme. Number three, by far, the most out of consensus view is that the China relationship with the United States will improve in 25, not worsen. Now I'm on a limb on this one. A lot of people think it will get much worse. A lot of people think that Trump likes the bluster with China.

I want to point out that he did not reappoint Bob Lighthizer to be his US trade representative, who was definitely much more of a China hawk and China adversary he did bring Pete Navarro back as one of the most adversarial people in the

Trump administration with China, but he gave him a very token sort of un unimportant role.

Trump is talking about not going forward with the ban on TikTok. There is ample room to see China play a role in ending the, the Russia Ukraine war. There is ample room to see Russia, excuse me, China improve and increase its purchase. of U. S. goods, particularly energy related, but also agricultural related.

There is room for a currency arrangement. So I would suggest that there will be some public posturing But I think that based on China's worse position as to where they were six, seven, eight years ago, and a lot of these other factors I bring up, I think it's a somewhat out of consensus view for me to say that the U.

S. China relations have a better chance of improving next year than worsening.   our fourth theme is that financial deregulation will prove to be a big cata The big catalyst for growth. I stand behind that. I think there's a lot of room for regulatory improvement a lot of room for streamlining, for cost cutting, things that could bring an enhanced return on equity to some of the big banks.

and, and drive a better book value and, and a better ratio of the price to book value for a lot of our financial companies. so not only is there a potential economic catalyst there, but there's

definitely deregulatory catalyst. Number five, that earnings disappointment is a bigger risk than earnings surprise.

And I do not mean, That's what will happen. What I mean is that earnings disappointment will hurt markets more than earnings surprises will help markets. That there's already a certain expectation of very robust profit growth. And if you outperform that by 10%, you know, you were going to be up 15 and you end up being 16 or 17.

First of all, I don't think that's going to happen. But even if you did, you're not going to get the same boost at these valuations. Out of that as you would decline in valuation if instead of being 15, we ended up coming in at 13 or 12, if you underwhelm, the impact is going to be disproportionately worse than if it goes higher.

So earnings disappointment has an asymmetrical risk reward component to it relative to earnings upside. I do believe number six that corporate activity is going to skyrocket. you know, just quickly, I want to throw a chart up of private equity exits to investments. You've seen basically the ratio of sales in the private equity space relative to new investments made dropped substantially.

And then this very next chart as a follow up to that shows the amount of dry powder. There's a lot of money that private equity has that can be deployed. Those two charts put together tell a story. There is a lot of room for activity. You can't put

money to work unless you've had more sale events, and there is a need for more sale events, and these are not distressed sale events, okay?

These, these, these are, are successful investments, but nevertheless, whether it was the interest rate environment, the regulatory environment, I think a new policy disposition around M&A new people at the Federal Trade Commission, new capital markets appetite for IPOs and private market M&A, you're going to see a lot of corporate activity in 2025.

Number seven, probably a little out of consensus too, like my China talk. I think deficits are coming down. Part of it is, I think, revenues and outperform expectations. If the U.S. stock market was up 11 trillion last year, then our friends at Strategas Research estimate that that is going to produce another 255 billion of tax revenue.

There's a model they have that kind of estimates that it's not, you know, a perfect science. but that's revenue that the CBO is not scored as coming in. And that adds to the revenue side of the equation. You take out some of Biden's student debt forgiveness, you take out potentially some of the cost in the Ukraine support.

and then you take out some of the interest expense on the debt because of interest rates dropping and a lot of our short term debt rolling over into lower cost. No, you're not going to get a trillion dollars out of the deficit, and no, you're almost

certainly not going to get a huge avalanche of fiscal responsibility.

When deficit's coming down, I'm talking about a few hundred billion. And I'm saying it for reasons outside of the spectrof fiscal responsibility, but nevertheless, that will have an impact in bond yields, that will have an impact in some of the expectations in liquidity and financial markets. And then speaking of liquidity and financial markets, the eighth prediction is a, the eighth theme, if you will, is a reiteration, a reinforcement of one that I had to take a D on in 2024, which is quantitative tightening coming to an end.

I do believe. That 2025 will represent the year that they put an end to quantitative tightening, that they take the victory lap for getting over 2 billion out of the balance sheet. I think that they may not go back to quantitative easing right away, unless there is some benefit to them in the way they're trying to structure the, the yield curve the, the kind of term structure of, of governmental debt and whatnot, and not to mention the Fed zone balance sheet.

but more than likely you just have a cessation quantitative tightening and that is a story in financial markets. It affects liquidity. And it's one of our themes for 2025.   let me just conclude by saying that the 10 year bond yield matters a lot. And when many people doing year ahead forecast, year ahead themes, year ahead commentary feel compelled to say, We

think the S&P 500 is going to end the year up 12 percent or up 6 percent or whatnot.

First of all, most of these analysts are year after year after year, just simply saying they expect the S&P is going to go up. What its average is that it goes up is somewhere around eight, nine or 10% even though the S&P gets to eight, nine or 10 percent by being up 23%, like it's been the last two years or down 18 percent like it was the year before that.

So just predicting that the S&P will do what its own average is when the S&P very rarely does that. is a kind of unhelpful way to approach it. But also I don't have a prediction of what the S&P will do. I don't think it is predictable. What I do believe is that the 10 year bond yield has a very paradoxical relationship to how financial markets and risk investors are going to do in that you could argue as I would.

That the market could do really well by the bond yield going higher, and it could do really poorly by the bond yield going higher and vice versa. There could be a big benefit to the 10 year bond yield dropping, and there could be a big problem with the 10 year bond yield dropping because in both cases, higher or lower, the market impact is related to magnitude.

and reasoning. If the 10 year gets up around 4.8 percent because of real GDP growth doing quite well, inflation expectations aren't going higher, and 4.8 percent feels like good growth and yet not killing the high valuations of the

market. That could be a good thing. Now, if the bond yield gets up to five and a quarter, five and a half Even if it's a good reason with real growth expectations at a 22, 23 times S& P, you have to think it cuts into valuations.

Inversely, if the bond yield drops to 4.2, real growth expectations are okay, but they're not as robust.   but then you get a little benefit devaluations by a declining bond deal. That could be a sweet spot. If all of a sudden you get to 3. 8, 3. 6 is that good for valuations, but indicating some deterioration and economic fundamentals, so there's this sweet spot that is measured, not in S&P prices or multiples, it's measured in the bond deal.

It is all at once a thing that affects investors and savers and borrowers and lenders and governments and central banks, the major economic actors but it also is something that reflects it and then creates an impact. And I would say the 10 year bond yield is the pivotal piece of information going into 2025.

Will the economy grow or will its growth disappoint and will valuations hold up or will valuations have to adjust? These are the two big questions that have to be held in tension. They have to really be held in tension for an index investor holding on to something at 23 times earnings. And I think represent an unknown variable that I'm grateful is not The centerpiece of our decision making.

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We don't know exactly what the economy will do. We don't know exactly evaluations will go that focus on individual company performance, a bit outside of politics, a bit outside of Fed decisions. the, this to me represents a permanent philosophy that I stand behind. And am quite excited for as we go into 2025.

It's been a heck of a year for investors in 24. the year behind certainly did not leave a lot of people with regrets other than people that weren't invested. In 2025 there's a lot of questions. Earnings environment valuation but ultimately the 10 year is a great metric that we're going to use as we evaluate that.

And we expect volatility around tariffs, around tax, around trade but we also expect a lot of great opportunity around energy policy, around deregulation, especially deregulation in financial markets. And then of course we, we think that this corporate activity perhaps improve relations with China all represent the opportunity for some tailwind.

There's our themes for 2025. Thanks for bearing with this long podcast, a long video. I hope it's been helpful. I can't. Emphasize enough how much I hope you will print out the PDF of the white paper found at DividendCafe. com. All the charts there to study, look over and please do share this paper far and wide.

Obviously it's something I enjoy doing every year and it's a big part of our messaging going in the new year. So feel free to

democratically share it as you see fit. And with all that said, I'll welcome us into 2025 yet again by saying thank you. Thank you for reading. Thank you for watching. And thank you for listening to The Dividend Cafe.

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