

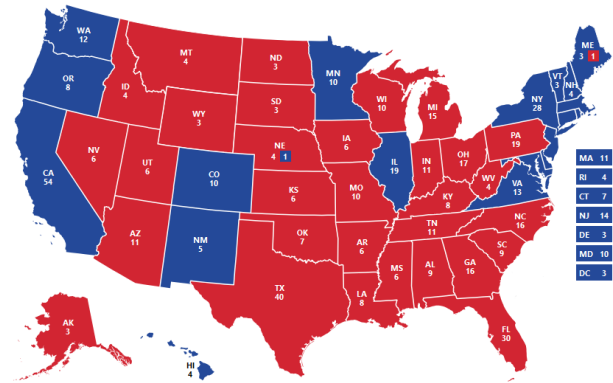
Dear friends of Arcus Capital Partners,

We hope this letter finds you well and that you had a wonderful end to 2024. The fourth quarter was packed full of market-moving events and saw the conclusion of the much anticipated presidential election, with Donald Trump winning by a decisive margin of 312-226 electoral college votes (Chart 1). The Federal Reserve (Fed) continued its cutting cycle by lowering short-term interest rates in November and December. Heightened animal spirits and the anticipation of a business-friendly administration sent domestic equities to new all-time highs. At the same time, their international counterparts lagged due to the strong US dollar and fear of fresh tariffs. Interest rates across all tenors began pricing a Trump victory early in the quarter and continued higher into year-end. Commodities remained volatile and varied under the surface, while the US dollar made new highs on the year. We hold a cautiously optimistic view of equities and expect increased volatility this year. We still prefer private credit to public markets within fixed income, but we think some high-quality parts of the market (e.g. US Treasuries) are attractive. Finally, we encourage investors to keep a long-term perspective and stand ready to add to positions during times of weakness.

I. Market & Economic Overview

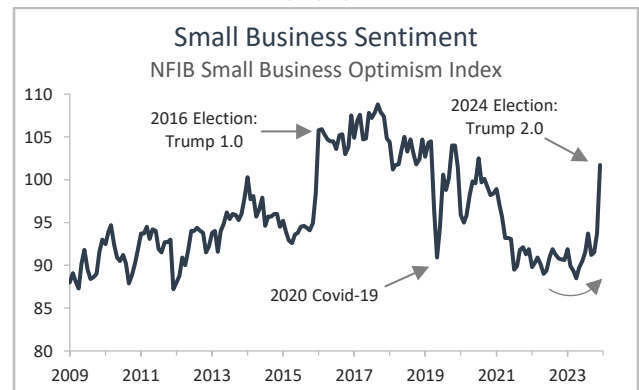
The last quarter of 2024 capped off a year where a record number of global citizens went to the polls. More than 70 countries, which comprise ~44% of the world population, held elections.¹ In the US, Donald Trump handily defeated VP Kamala Harris and was elected to his second term in office. Trump ran on a pro-business platform centered on tax cuts, deregulation, and the implementation of new tariffs to protect American business interests. The outcome immediately sent small business optimism back to pre-covid levels (Chart 2) and

Chart 1



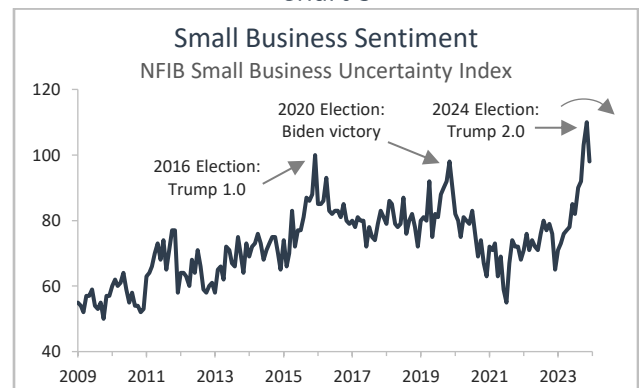
Source: Polymarket

Chart 2



Source: Bloomberg; Arcus Capital Partners

Chart 3



Source: Bloomberg; Arcus Capital Partners



eased uncertainty over future policy in Washington (Chart 3). On the macro front, the US Economic Policy Uncertainty Index focused on Trade Policy revisited levels not seen since the US-China Trade War in 2018 – indicating nervousness concerning new tariffs. That said, recent guidance from the incoming administration has started easing tension and should result in the index calming over the coming months (Chart 4).

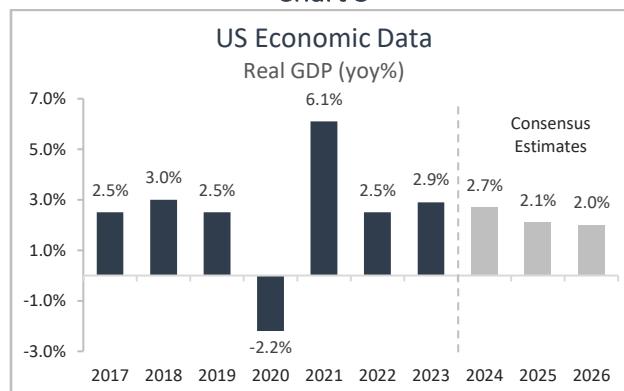
Chart 4



Source: Bloomberg; Arcus Capital Partners

Shifting to the US economic outlook, the Trump administration is inheriting a healthy economy supported by strong consumer spending and massive fiscal stimulus. For context, in 2008/09, the US government authorized two programs that injected roughly \$940B into the economy to stave off recession. This response compares to the fiscal action taken during the 2020 pandemic, which included over \$5.2T of stimulus through enhanced unemployment benefits, direct payments to households, and various other federal programs.² Furthermore, an additional \$2T of spending was passed in 2021/22 via the Bipartisan Infrastructure Law (BIL), the CHIPS & Science Act, and the Inflation Reduction Act (IRA).³ Although the initial stimulus has run its course, the latter programs are scheduled to be spent over a decade and should continue to support domestic growth (Chart 5). In addition to fiscal spending, the US consumer remains a powerful driver of economic strength and continues to spend. A rock-solid jobs market, healthy personal balance sheets, and record-level asset values (i.e. investments, real estate, etc.) have allowed consumers to enjoy a period of unprecedented discretionary spending.

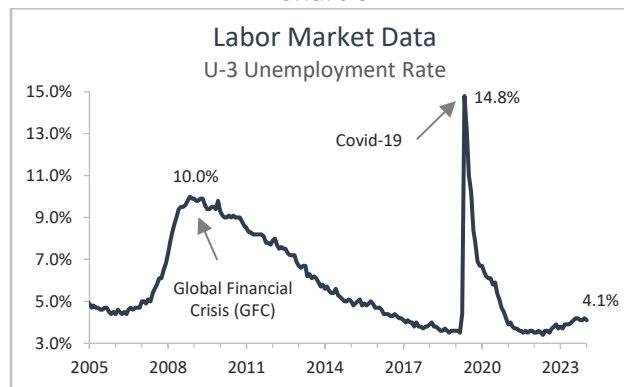
Chart 5



Source: Bloomberg; Arcus Capital Partners

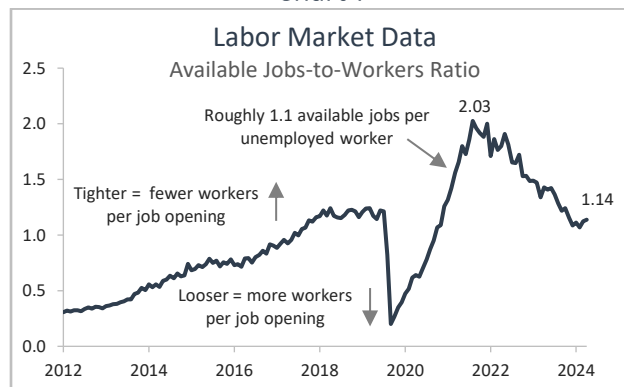
The jobs market has been a tailwind for consumers, and no major cracks are forming. This positive backdrop is best conveyed by the unemployment rate, which has stabilized after rising for a few quarters (Chart 6). Additionally, labor market tightness has normalized to 2019 levels as the labor supply has gradually increased and job openings have decreased (Charts 7).

Chart 6



Source: Bloomberg; Arcus Capital Partners

Chart 7

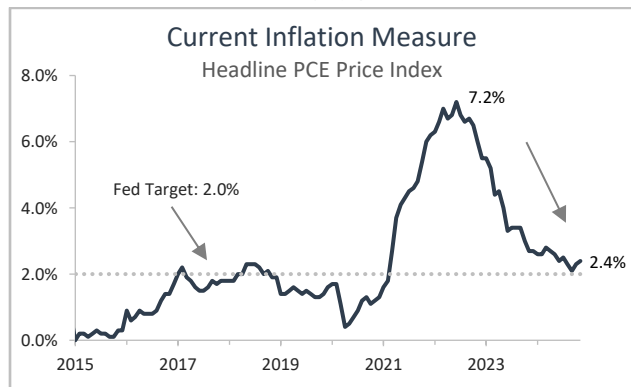


Source: Bloomberg; Arcus Capital Partners; data shown is the ratio of US JOLTs Job Openings and total unemployed workers.



During the pandemic, labor market tightness forced employers to pay higher wages for less productive employees. This outcome led to higher inflation as wages fed through to end-user prices, and fewer goods were available due to less productive employees. Now that the labor market has normalized, wage growth has slowed, the supply of goods and services has increased, and inflation has returned to the Fed’s target level (Chart 8). However, it is still too early to declare victory, as several market-based indicators are warning of a possible second wave of inflation.

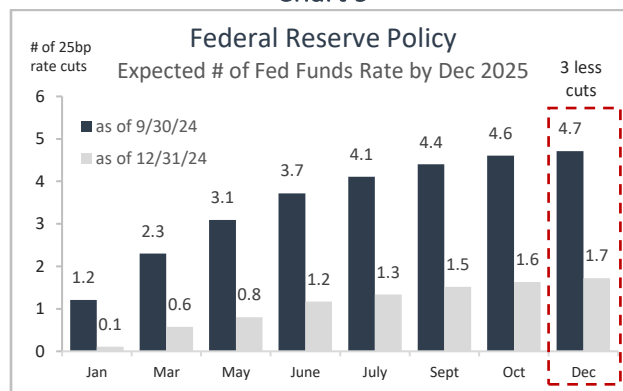
Chart 8



Source: Bloomberg; Arcus Capital Partners; PCE or Personal Consumption Expenditure.

As noted, the Federal Reserve continued cutting short-term interest rates during the quarter and has reduced rates by 100 basis points (100 basis points = 1.0%) since its September meeting.⁴ This policy decision was centered upon the belief that restrictive policy measures were no longer warranted – inflation had returned to the Fed’s preferred level, and the jobs market had normalized. From here, the total number of future cuts will depend on the upcoming data releases – the Fed will emphasize inflation readings and the labor market numbers. That said, it is unclear if additional rate cuts will be needed. The market is currently pricing less than two more 25 basis point (or 0.25%) cuts this year, down from almost five in September (Chart 9). The US economy’s underlying strength and stubbornly sticky inflation have forced the Fed to reassess its plans to continue cutting rates in 2025. Additionally, the incoming Trump administration’s policy decisions (e.g. tax cuts) have the potential to stimulate the economy and drive inflation higher.

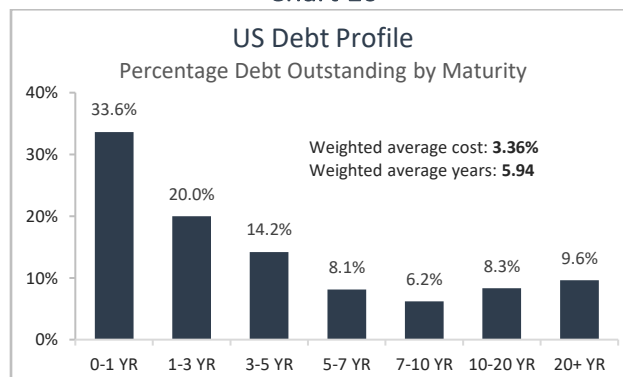
Chart 9



Source: Bloomberg; Arcus Capital Partners

Another data set the new administration and Federal Reserve are closely watching is the upcoming maturity wall of US debt – over 50% of outstanding Treasury debt is maturing over the next three years (Chart 10). Refinancing this debt will unleash a significant supply of new issuance at much higher interest rates. With interest costs now totaling ~9% (or ~\$870B) of tax receipts, any additional expense must come from spending cuts or require larger deficits.⁵ Unfortunately, without spending cuts (which are unlikely), the Treasury will be forced to issue more debt, which has the potential to keep rates higher (i.e. the more debt one has typically leads to higher interest charges on each new dollar of borrowings). By the end of 2024, the Treasury market started pricing this outcome, and interest rates across all maturities moved back towards the cycle highs. Barring any major economic setbacks, the Federal Reserve will likely remain on hold for the next few quarters as it accesses all the incoming data and receives more clarity from the Trump administration.

Chart 10



Source: Strategas; Arcus Capital Partners



The outlook for the domestic economy remains bullish, and the odds of a recession are low, but vulnerabilities exist. Persistently high prices and elevated interest rates are weighing on borrowers. Although inflation has slowed from its blistering pace in 2022, prices continue to rise cumulatively and outpace wage increases (Chart 11). This shortfall has stressed consumers with limited savings and heavy dependence on credit, especially with borrowing rates near all-time highs (Chart 12).

Chart 11

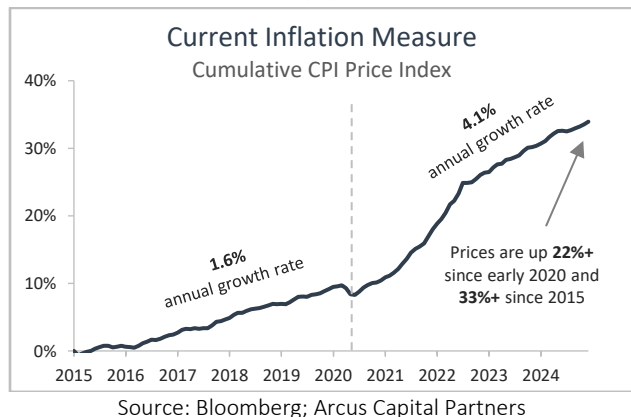
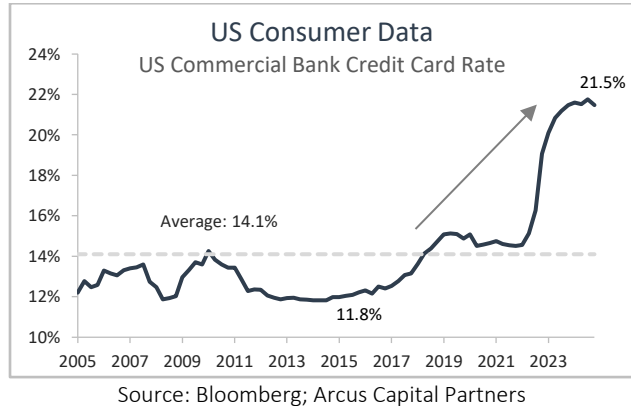


Chart 12



Credit card and auto loan delinquency data have been rising over the last few quarters and have reached levels not seen since the Great Financial Crisis (Charts 13-14). Most of the weakness is within the lowest income and youngest (18-39) cohorts; however, older (39-49) and higher-income borrowers have started falling behind.⁶ Depleted savings, record borrowing costs, and record high prices have all played a part. With consumption making up nearly two-thirds of domestic GDP, this is an area we are monitoring closely.

Chart 13

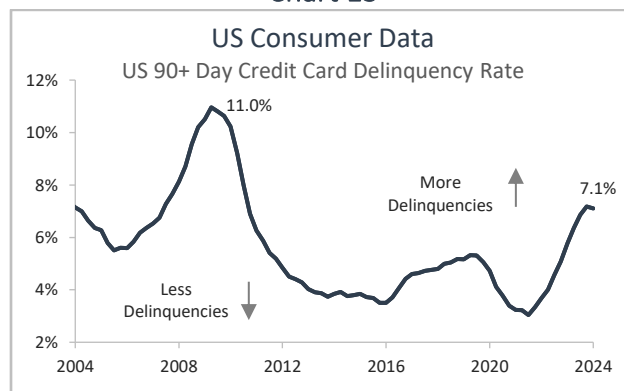
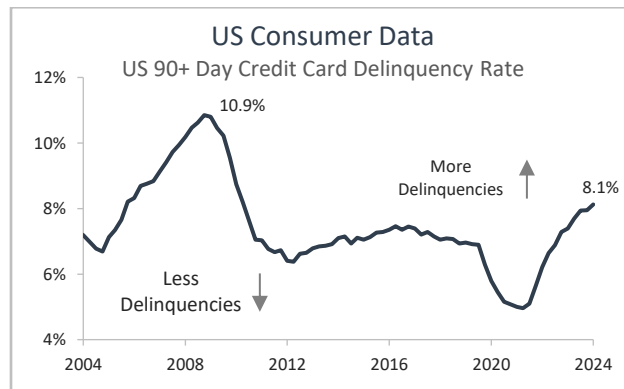


Chart 14



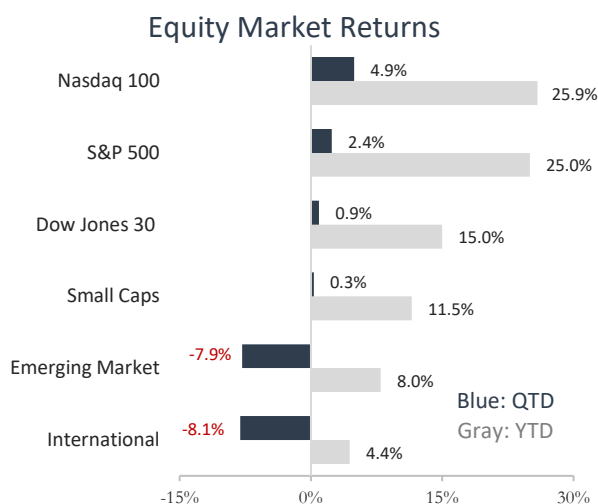
The fourth quarter was rife with market-moving headlines but provided clarity on several outstanding issues. Donald Trump’s victory alleviated uncertainty surrounding the much-anticipated election, and the Federal Reserve continued to normalize its monetary policy by cutting short-term interest rates two more times. Nevertheless, new developments opened the door to a wide range of outcomes in 2025. Sticky inflation data, fears over mounting fiscal deficits, and looming tariffs forced the Fed to convey a more hawkish tone. From here, the Fed must walk a tightrope to avoid keeping policy too tight, staving off potential growth, or too loose, sparking a second wave of inflation. Our baseline expectation is for the Fed to lower interest rates two or three times in 2025 and conclude its cutting cycle in early 2026. Given all this, we expect more market volatility and drawdown risk relative to 2024, requiring investors to remain patient and nimble.



II. Global Equities

Domestic equities ended the quarter higher but experienced an uptick in volatility. Even so, the S&P 500 finished up **2.39%** in Q4 and **25.00%** for 2025 – here are some interesting stats from the quarter and the full year^{7,8}:

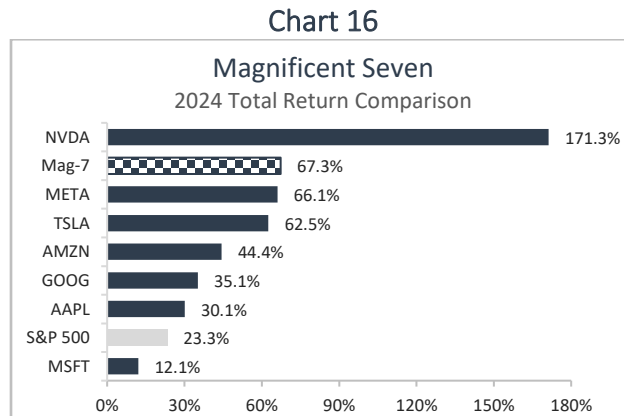
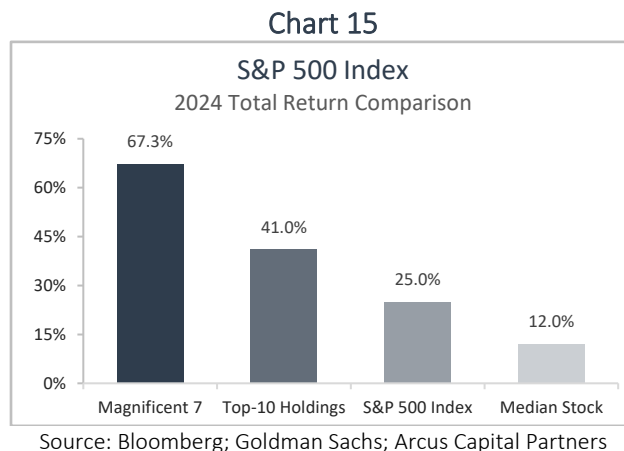
- Best Sector in Q4: Consumer Discretionary **+14.3%**
- Worst Sector in Q4: Materials **-12.4%**
- Best stock in Q4: Palantir (PLTR) **+103%**
- Worst stock in Q4: Celanese Corporation (CE) **-49%**
- Bitcoin total return for 2024: **122.5%**
- New all-time high closes made in 2024: **57**
- Percentage of days higher in 2024: **58%**
- Household ownership of the US stock market: **60%**
- Hedge fund ownership of US stock market: **2%**



Source: Bloomberg; Arcus Capital Partners; returns include the reinvestment of dividends; blue = QTD; gray = YTD.

The storyline for equities in 2024 remained the same as the prior year: the Magnificent 7 vs. everything else (Chart 15). Six of the seven names outperformed the S&P 500, accounting for over half the market’s 25% gain (Chart 16).⁹ Additionally, the group added over \$6T of market cap in 2024 and now comprises over 30% of the index.¹⁰ That said, the Mag-7’s earnings growth has drastically outpaced the rest of the market over the last few years. In 2023, they grew earnings by 36% compared to -3% for the rest of the S&P 500, and in 2024, they are expected to generate earnings growth of 33% compared to 3% for the remaining 493 stocks in the index.¹¹ This exceptionalism

warrants strong outperformance; however, it has led to a high degree of concentration within the index – the top ten largest stocks make up 40% of the S&P 500. This statistic is not bearish on its own, but it does put the onus on these companies to continue performing – a stumble by this cohort could bring the entire index down with it. The good news is that analysts anticipate a broadening out of earnings this year, which should reduce the concentration risk and balance out returns across the index.



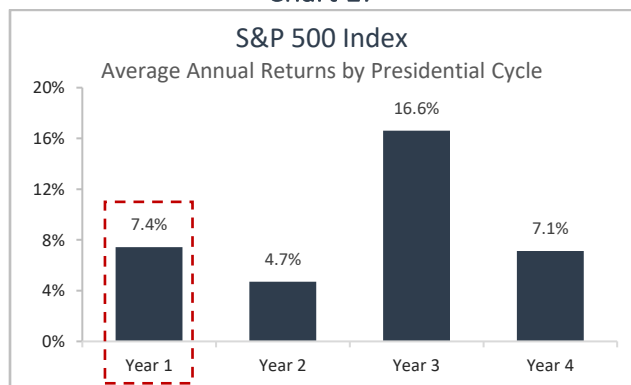
Source: Bloomberg; Arcus Capital Partners; returns include the reinvestment of dividends; Mag-7 constituents = Nvidia (NVDA); Meta (Meta); Telsa (TSLA); Amazon (AMZN); Google (GOOG); Apple (AAPL); and Microsoft (MSFT)

With the new administration coming into office, it is worth reviewing how the market has performed during past presidential cycles. The data show that equities tend to perform the best during the first and third years of the presidential term (Chart 17). During the first year, the market is excited about the prospects of new policies, especially when they



are pro-business. Then, by around year three, the results usually start to show up in the data, which should correlate to positive growth and earnings.

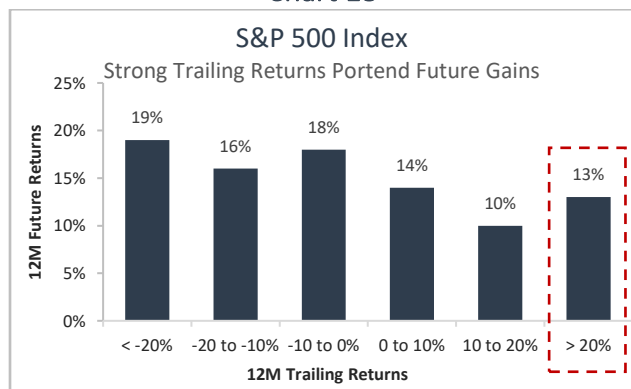
Chart 17



Source: Strategas; Arcus Capital Partners

One criticism of the current market environment is that equities have rallied too far since bottoming in late 2022 – the S&P 500 rose by 20%+ in 2023 and 2024. Nevertheless, statistics show that this alone does not portend negative returns, and future performance tends to be above average (Chart 18).

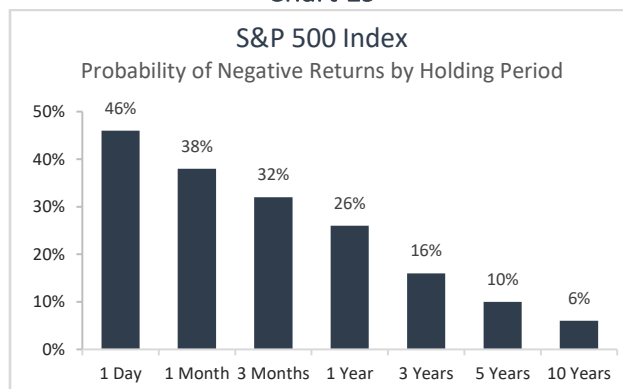
Chart 18



Source: Goldman Sachs; Arcus Capital Partners

On the other side of the ledger (i.e. downside risk), market participants must maintain a long-term view when investing in the equity markets. Historical return data show that increasing your holding period reduces the odds of experiencing negative performance (Chart 19). In fact, the odds of suffering a negative outcome decrease from 46% to 16% by increasing one’s timeframe from one day out to three years. This data supports the idea that the market rewards patient investors who stay invested for the long haul.

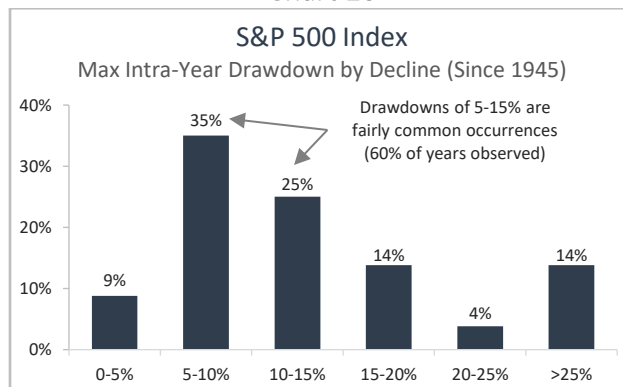
Chart 19



Source: Bank of America; Arcus Capital Partners

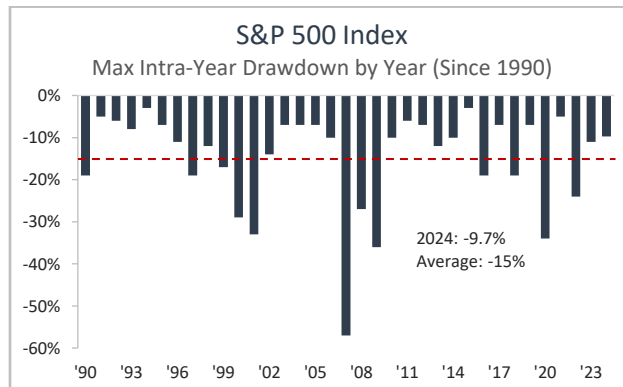
It is also worth noting that 5-15% selloffs are common and should be used to add to positions (Chart 20). The market typically declines by an average of 15% annually, and drawdowns are usually even smaller during non-recessionary periods (Chart 21). The past year was no different as the market only fell by 10% in August and before quickly making fresh all-time highs.

Chart 20



Source: Strategas; Arcus Capital Partners

Chart 21

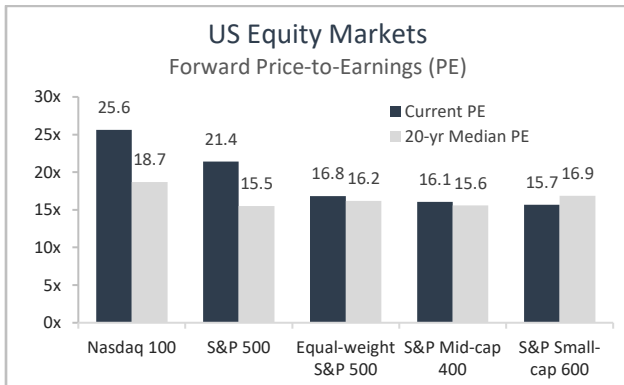


Source: Strategas; Arcus Capital Partners



Elevated valuations are another topic worth discussing, as some indexes are trading above their historical norms (Chart 22). Specifically, the S&P 500 trades at a price-to-earnings ratio (PE) of 21.4x compared to the 20-year median of 15.5x (Chart 23). It is worth noting that the median stock within the index trades at a relatively lower valuation, as do small and mid-cap stocks. As previously mentioned, the S&P 500 has a high concentration of growth stocks (e.g. Mag-7), which trade at higher multiples due to their growth prospects.

Chart 22



Source: Bloomberg; Arcus Capital Partners. The data shown represents forward PE based on EPS estimates over the next twelve months.

Chart 23



Source: Bloomberg; Arcus Capital Partners. The data shown represents forward PE based on EPS estimates over the next twelve months.

High valuations are not necessarily bearish and have little short-term predictive power of future returns. Instead, they create a vulnerable backdrop for stocks that require superior earnings growth, supportive economic data, and other favorable variables to maintain their elevated levels. Unfortunately for stocks, analyst expectations for

Q4 24 (8% EPS growth) and FY 25 (11% EPS growth) may be too optimistic and result in companies failing to exceed such a high bar.¹² Recent headwinds include rising borrowing costs, a strong US dollar, and higher commodity prices. Conversely, above-trend economic growth and declining inflation should provide support. Either way, the US equity market is currently “priced for perfection” and may require a period of consolidation before moving higher.

We continue to favor equities but recognize that volatility is unlikely to remain at the depressed levels seen over the last two years. Lower interest rates, disinflation, and positive economic growth should support corporate earnings. That said, headwinds exist, and expectations are high, which has the potential to create pockets of elevated downside volatility. We prefer domestic shares due to their higher-quality characteristics and growth potential. Specifically, we like large-cap companies that can buy back shares or return cash to shareholders in the form of dividends. We are also constructive on small and mid-cap stocks that benefit from rate cuts and trade at more attractive valuations. Non-US developed and emerging market stocks have lagged behind their US counterparts, but recent positive developments could help them close the gap this year.

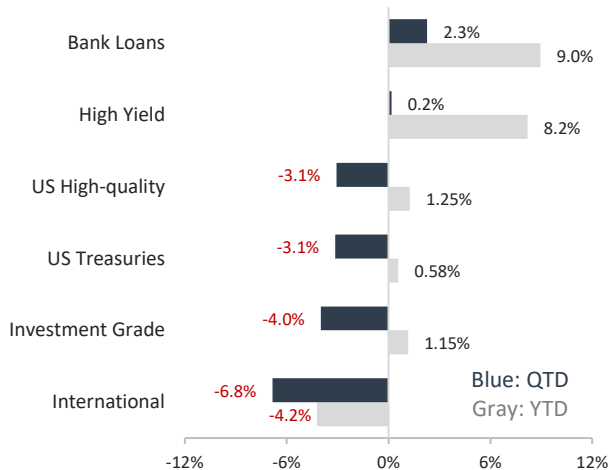
III. Fixed Income

Interest rates retraced their third quarter move lower as firmer economic data, the expectation of additional fiscal stimulus, and hawkish Fed messaging overcame recessionary fears. The US 10-year yield rose by over 80 bps to finish the quarter at **4.57%** – here are some interesting comparative stats from the quarter¹³:

- US 10-year Treasury Yield (today): **4.61%**
- US 10-year Treasury Yield (2020 low): **0.40%**
- High Yield Money Market Rate (today): **4.19%**
- High Yield Money Market Rate (2020): **0.01%**
- 30-year Mortgage Rate (today): **7.08%**
- 30-year Mortgage Rate (2020): **3.08%**
- Effective rate of all outstanding mortgages: **4.00%**



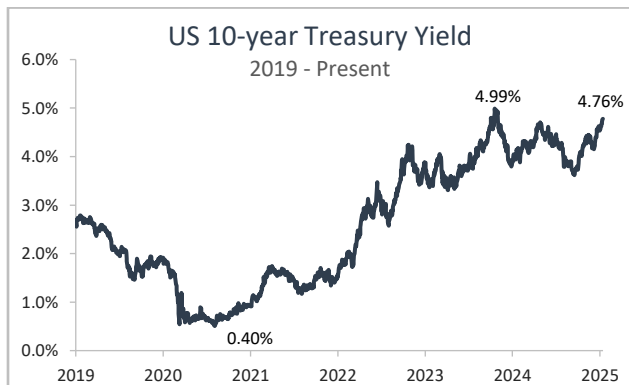
Fixed Income Returns



Source: Bloomberg; Arcus Capital Partners; returns include the reinvestment of dividends; blue = QTD; gray = YTD.

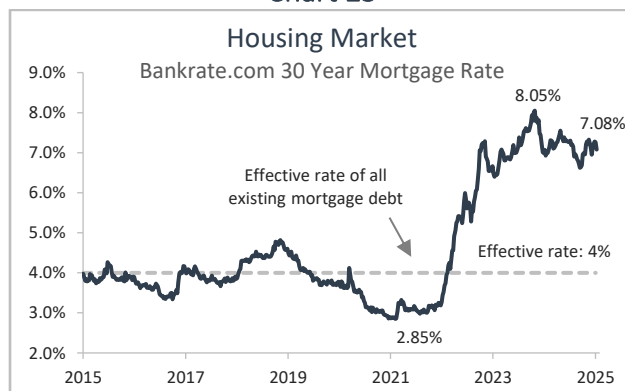
In a reversal of the prior two quarters, interest rates moved higher and are back near the cycle highs from 2023 (Chart 24). Much of the repricing came after Donald Trump’s victory due to his plan to cut taxes and increase the deficit. Fears over a second wave of inflation and a pause in the Fed’s rate cut cycle also played a role. The increase in long-term interest rates sent reference rates, such as the 30-year fixed-rate mortgage, back above 7% (Chart 25). Higher rates will likely continue weighing on new housing sales due to the additional borrowing cost. The same applies to existing home sales – current homeowners are unlikely to move and take on a new mortgage after locking in historically low interest rates during the pandemic. The effective rate for all outstanding mortgage debt sits around 4% or 300bps lower than current mortgage rates.

Chart 24



Source: Bloomberg; Arcus Capital Partners

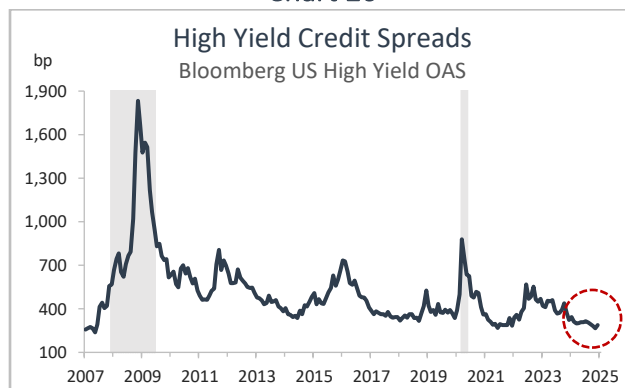
Chart 25



Source: Bloomberg; Arcus Capital Partners

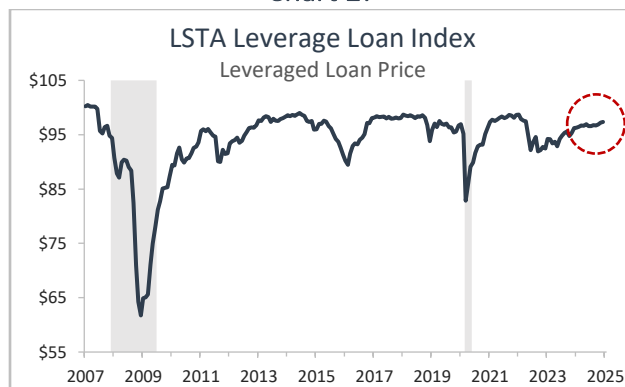
In line with the last few years, credit spreads (a barometer for the fixed-rate corporate bond market) are in great shape and remain well below recessionary levels (Chart 26). Similarly, leveraged loan prices, representing floating-rate borrowers, are healthy and trade above levels that have historically hinted at borrower stress (Chart 27).

Chart 26



Source: Bloomberg; Arcus Capital Partners; gray shaded areas are National Bureau of Econ Research (NBER) recessionary periods.

Chart 27



Source: Bloomberg; Arcus Capital Partners; gray shaded areas are National Bureau of Econ Research (NBER) recessionary periods.



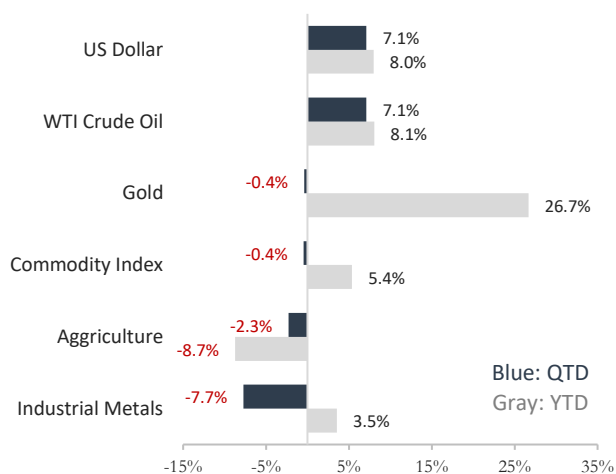
We think the Federal Reserve will pause for a few quarters to assess the incoming inflation and jobs data before cutting in the second half. Barring any economic setbacks, interest rates should remain elevated over the near term before settling lower over the second half of the year. We have a positive view on high-quality bonds (e.g. US Treasuries), which now offer attractive yields and may provide a hedge against equity risk. We are neutral on publicly traded credit (e.g. high yield), as current yields and spreads leave little room for error. Finally, we maintain a long-standing favorable view of the private credit market due to their higher all-in yields and less volatile return profile.

V. Commodities

The commodity complex ended the quarter slightly down as the US dollar strengthened on the news that Donald Trump had won the presidential election. Under the surface, the broad commodity index saw mixed performance – here are some interesting comparative stats from the quarter¹⁴:

- National Average Gas Price (today): **\$3.07/gallon**
- National Average Gas Price (2020): **\$2.19/gallon**
- Wholesale Egg Prices (today): **\$4.49/dozen**
- Wholesale Egg Prices (2020): **\$1.35/dozen**
- Euro (€): **1.03 /dollar** (almost at parity)
- British Pound (£): **1.22 /dollar**

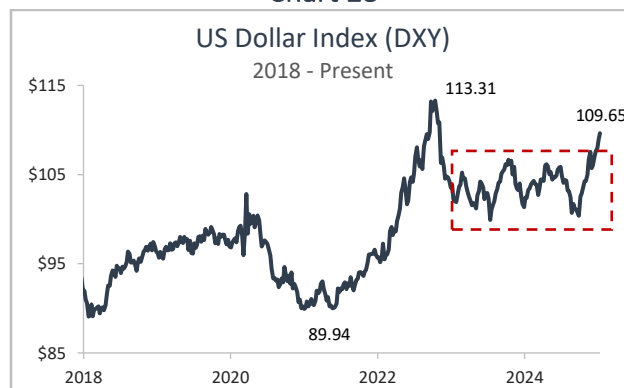
Commodity Returns



Source: Bloomberg; Arcus Capital Partners; returns include the reinvestment of dividends; blue = QTD; gray = YTD.

The US dollar broke out of the range it had been trading in over the past few years and reached levels not seen since 2022 (Chart 28). Strong relative growth compared to the rest of the world, high interest rates, and fears over new tariffs all played a part in the move.

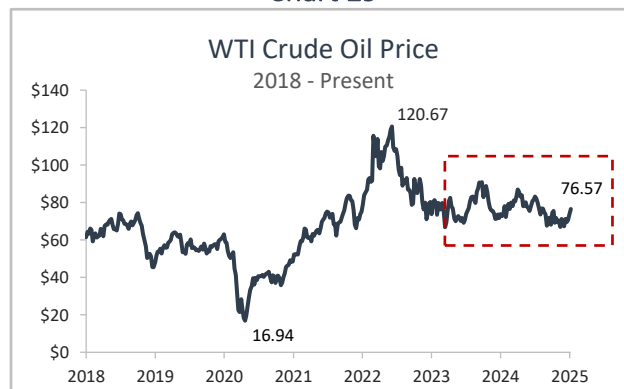
Chart 28



Source: Bloomberg; Arcus Capital Partners

Crude oil rallied during the quarter, even as the US dollar strengthened, and the Trump administration promised to reduce energy regulation and increase output (Chart 29). Improving Chinese growth prospects and new sanctions on foreign oil producers helped boost prices. That said, crude prices face several headwinds, and the outlook remains uncertain. Domestic supply should rise as President Trump’s ‘Drill, baby, drill’ energy agenda paves the way for US producers to add more barrels. Additionally, the increased likelihood of a truce in the Middle East and between Russia and Ukraine will likely remove the war premium embedded in prices. These crosscurrents are net bearish for crude oil over the coming quarters.

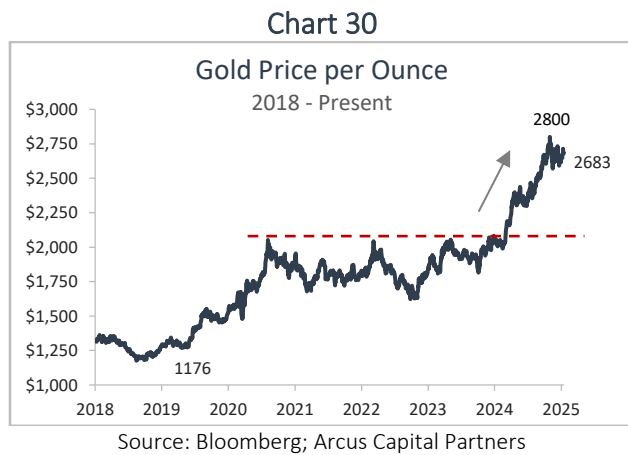
Chart 29



Source: Bloomberg; Arcus Capital Partners



Gold was flat during the quarter but held up well, considering that the US dollar had strengthened and interest rates increased (gold typically moves inversely to the dollar and interest rates). Nevertheless, gold performed well in aggregate during the year, outpacing equities and making new all-time highs (Chart 30). Continued central bank demand, unstable geopolitics, and the prospects of lower interest rates supported prices. The current setup remains attractive, but a near-term consolidation might be necessary before the next rally can begin.



We remain neutral on economically sensitive commodities (e.g. energy) as several lingering headwinds could weigh on prices over the near term. The setup for gold is bullish, but investors may get a better entry later in 2025. Lastly, the US dollar is poised to stay elevated over the next few quarters as US growth continues to outshine the rest of the world; however, we expect it to start weakening during the back half of the year once the Federal Reserve restarts its cutting cycle and non-US growth stabilizes.

IV. Looking Ahead

We hold a constructive view of equities for the year ahead and anticipate positive returns, albeit not as

positive as the prior two years. Durable economic growth, robust corporate earnings, and policy support from the incoming Trump administration should act as tailwinds and outweigh potential downside risks. Nevertheless, we expect an increase in volatility this year as valuations have reached the upper end of their historical levels and policy uncertainty remains elevated. In turn, this will require investors to stay patient and use any periods of equity weakness to add to positions. We favor domestic companies trading at attractive valuations that can return capital to shareholders through dividends and buybacks. We also like small and mid-cap stocks as they trade at attractive valuations and should benefit from President Trump's 'American First' policy agenda.

Longer-term interest rates have recently retested the cycle highs but should stabilize around the current levels before moving modestly lower. We foresee the Federal Reserve cutting interest rates 2-3 times in 2025 and once or twice in early 2026. We like higher-quality bonds (e.g. Treasuries) that offer an attractive yield and can provide downside protection during equity corrections. Lastly, we prefer the private credit market (e.g. middle-market lending), which provides higher yields and less correlation to interest rates and the public markets.

Finally, cyclical commodities such as crude oil face several near-term headwinds and are biased to the downside. On the other hand, gold remains attractive and could offer upside potential if interest rates and the US dollar decline or equity market volatility spikes.

As always, we are available to discuss these items and address any questions. Thank you for the trust you place in our firm.

Sincerely,

Arcus Capital Partners



Sources:

1. CNN
2. Apollo
3. Mckinsey & Company
4. Bloomberg
5. Strategas Research
6. Apollo
7. Strategas Research
8. Goldman Sachs
9. Bloomberg
10. Bloomberg
11. Bloomberg
12. Goldman Sachs
13. Bloomberg
14. Bloomberg

Important Risk and Disclosure Information

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