



January 15, 2025

*I can calculate the movement of the stars, but not the madness of men.*

*Sir Isaac Newton*

The past year was one in which “animal spirits” were unleashed in a way the economy has not seen in four years. An NFIB small business optimism index released in November showed its highest reading since June 2021. It may be no coincidence that when November 5<sup>th</sup> arrived the American electorate decided it was time to break some eggs. Whether all this leads to the third boom year in a row for the stock market or simply to a great deal of volatility is yet to be seen.

Two consecutive years of S&P 500 returns in the mid-20 percent range led to a recent Wall Street Journal headline, “Is the Stock Market Doomed? Yes, But Maybe Not in 2025.” The article goes on to extol the influence of AI and the amount to be spent on it by the seven leading tech companies, amounting to more than the U.S. defense department budget; it also refers to “American exceptionalism” and rising productivity contributing to a stock market that it terms wildly overvalued. This leads us to the question of whether the overall stock market may become a victim of its own success, as it has so often in the past. With the S&P 500 very close to its all-time high and the price-to-earnings ratio for U.S. stocks at 22.5 times forecasted earnings, also a record high, this is worth pondering.

One development that is positive is that nobody is talking about TINA any more, as in **There Is No Alternative** to the equity market. With little effort and not much risk, we and others in the investment community have been building short-term US Treasury Note ladders for our clients, currently yielding between 4.20% and 4.40%. Non-taxable muni bond ladders yield less but can also be effective. This provides a consistent and predictable stream of interest payments as well as a safe harbor for money that most likely would be battered by heavy volatility in the stock market in the next few years.

The Federal Reserve, chaired by Jerome Powell, is well aware of the strength of the economy and the optimism that continues to buoy the stock market, and Powell remains intent on maintaining his long-term goal of reducing inflation to the 2% range. He raised interest rates aggressively in 2022 and 2023 but recently has been carefully reducing them to what he now calls a neutral rate of interest, which is around 3%. “We don’t know exactly where it is, but...what we know for sure is that we’re a hundred basis points closer to it right now,” Powell recently said. The best analogy for what the Fed is attempting would be trying to dock a large ship by making small corrections as the boat approaches the slip to avoid slamming into it.

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Our companies in the Model Portfolio\* continue to populate the top echelon of the annual Drucker Institute's "Management Top 250," with nine of our businesses in the leading 60. Apple and Alphabet (Google) have become so dominant that they both have drawn the attention of the Department of Justice, which is concerned about them illegally monopolizing their markets. The outcome of these cases will no doubt be influenced by the attitude of the incoming President; spinoffs or partial breakups seem possible at this point but the final results are anybody's guess. Our companies are not the sole targets of the DOJ, as it also has filed complaints against Amazon and Meta.

Looking forward to 2025, what are the coming risks? One is the likelihood of an increase in inflation, thanks to the new President's threats of aggressive tariffs worldwide. Another is the near certainty of increased market volatility. Most concerning would be a large decline in the stock market. With that prospect in mind, we have long been advising and positioning our clients to ensure their capacity for tolerating risk is realistic and even trending towards conservative. This means maintaining a healthy cushion of cash and short-term fixed income instruments to help ride out whatever foul weather might come our way. It is also vital to point out that the companies in our Model are all strong financially, some with fortress-like balance sheets and record amounts of cash on hand. Berkshire Hathaway, as an extreme example, has accumulated \$325 billion in cash and T-Bills.

We appreciate the trust you have placed in us and will continue to work hard to earn it. Please consider passing our contact information to anyone you know who needs help with building and maintaining financial security. We are happy to share our perspective with them and to explore if there would be a good fit for working together.

Best regards,

Noel F. Bennett

*\*The Model Portfolio is not a real cash portfolio. It represents the core direction of our portfolio management strategies. Individual client portfolios are managed in accordance with the clients' specific objectives and constraints. Historical information is available upon request.*