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QUARTERLY INVESTOR LETTER

In 2024, we disagreed with consensus forecasts regarding Fed policy, interest rates, inflation, and the bond market outlook. For example, we felt Wall Street strategists were excessively optimistic with respect to the number of rate cuts. Our stance informed strategy in that context as we felt longer maturity bonds offered insufficient yields, an outlook we have maintained since 2022. For the past three years, the average annual return of money market funds has exceeded the benchmark bond index by a wide margin. In fact, the bond index's three-year annualized return is negative. The best performing bonds have been those with the shortest maturities, consistent with our outlook.

The monetary cycle reversed in 2024 as the Fed began to cut rates in a process they called "recalibration." The Fed justified the shift in policy because, when compared with theoretical guideposts, policy had become too restrictive. Thus, they sought to avoid a policy error – i.e., leave rates too high and impede an already slowing economy.

Therein lies the risk for 2025 and beyond. In our view, the Fed cut rates prematurely and risks a different policy error – i.e., reduce the policy rate unnecessarily and stoke resurgent inflation.

We note that, for the first time in history, the yield on the 10-year Treasury rose 1.00% as the Fed cut policy rates 1.00%. This is anomalous market behavior that should prove unsustainable long-term. Nevertheless, as a market signal, it recommends vigilance toward inflation.

The shift in interest rates restored a positive slope to the Treasury yield curve, which both removes distortions and facilitates traditional

fixed income strategies. The positive slope also improves margins for the banking sector. However, higher market yields increase the cost of capital for borrowers, which could reduce both economic activity and equity valuations.

To the extent inflation proves recalcitrant, the Fed might confront a future dilemma regarding the direction of policy. The Fed would have two choices. They could disregard theoretical guideposts and raise policy rates, demonstrating respect for market signals regarding growth and inflation. On the other hand, the Fed could follow theory and reduce rates further, risking an inflation surge. It is certain that the stock and bond markets would not welcome a shift back to restrictive Fed policy. In this manner, the Fed's commentary and policy actions in the New Year could trigger market volatility.

With regard to equities, US stocks outperformed International in 2024. Large caps outperformed small caps. A concentrated portfolio of the largest US stocks outperformed broad-market and equal-weighted indexes. These performance divergences were contrary to consensus expectations at the beginning of 2024. In our view, the performance divergences primarily reflect fundamentals. For this reason, it is possible that concentrated portfolios of large cap US equities remain market leaders for an extended period.

We are constructive for 2025 and agree with consensus that anticipated de-regulation should expand corporate margins and boost activity. However, we have long-term concerns that rolling back safeguards in certain industries, particularly financial services, could lay the groundwork for future instability.