DCL&A
Douglas C. Lane & Associates
REGISTERED INVESTMENT ADVISOR

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VIEWS FROM THE ROAD

Hopes, Fears, and some Pragmatism for the New Year

With the presidential inauguration around the corner, we think it is prudent to remember that our federal government and its corresponding agencies and institutions are large, complex and, somewhat by design, difficult to change. Although President Trump's pre- and post-election rhetoric and administrative appointments suggest large scale overhauls at the federal level, we suspect that the incoming administration will likely fall shy of its lofty ambitions. Things won't change as much as people hope or fear.

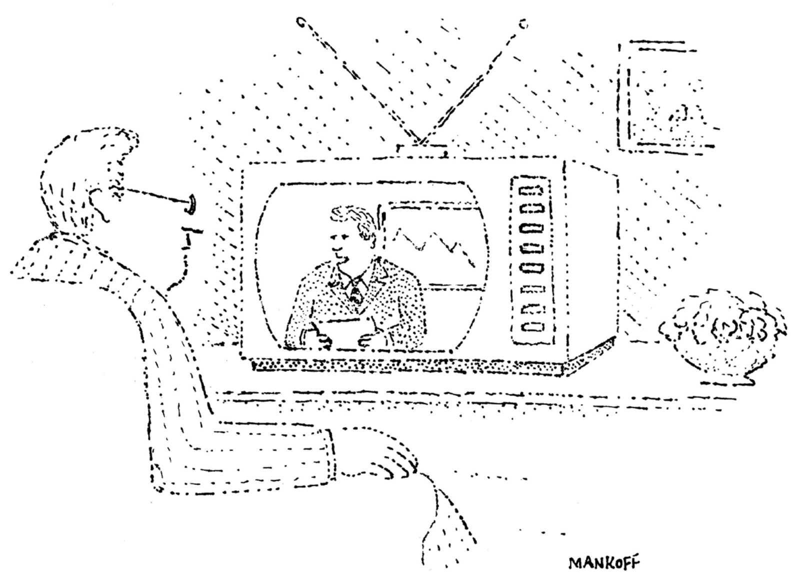
Politics aside, we applaud efforts to create more efficiency and reduce waste at the federal level (just as we do at the corporate level). The desire to try, in and of itself, represents a marked change in mindset about accepting the status quo of the federal government. In the business world, it is common to pursue best practices, search for cost efficiencies and sometimes attempt a major restructuring. Companies that have grown complacent typically require a third-party (a new CEO, an activist investor, a new owner) to catalyze support to review the people and processes involved and, ultimately, the products and services delivered to customers. Trump's second term may provide that catalyst for parts of the government and for parts of the economy.

In addition to tackling the size of government, President Trump has also indicated his administration will work to reduce red tape and regulation at the federal level. Both impede new business formation and capital markets activity and tend to suppress economic growth. Banking activity, including lending, mergers, and acquisitions, should increase if the DOE, DOJ, FTC, and FCC exhibit a lighter touch, while still fulfilling their important mandates.

Whether this administration succeeds in these efforts is only one of many factors that will determine how the stock market performs over the next four years. A lot can happen. Stepping back, we didn't pursue "Trump trades" ahead of his first administration nor did we pivot to "Biden trades" in 2020. For the last 30 years, we've made investments in companies based on fundamental factors, lasting competitive advantages, and their potential for creating value. Today, there is an abundance of uncertainty, guesswork, and punditry as to who the winners and losers will be under the new regime.

What is clear is that the S&P 500 index currently trades at 22x forward earnings estimates, reflecting continued optimism about the investment landscape and this new administration. The combination of record high index levels and near record valuation multiples creates a high bar for continued S&P 500 index performance. Consensus estimates for 2025 are for the S&P 500 to grow earnings per share in excess of 14%. We suspect that these estimates represent the very upper bounds of what is likely in 2025 and, therefore, a more modest price appreciation environment should be expected. Further, if the Federal Reserve determines that benchmark interest rates should remain higher for longer to combat inflation, which seems more probable with each passing day, that posture will act as a headwind to valuation multiples across industries. Given these views, we expect dividends and contributions from recently underperforming sectors to represent a larger portion of total returns in 2025.

However, there are reasons to remain optimistic. The U.S. economy has consistently demonstrated more resilience and a better ability to adapt to changing conditions compared



"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates."

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to global peers. This is a testament to the country's innovative spirit and entrepreneurial drive. U.S companies lead in critical technologies like artificial intelligence, machine learning, and cloud computing that will shape the next decade. In addition, advancements in energy independence have reduced U.S. reliance on foreign sources, bolstering energy security and decreasing the risks associated with geopolitical instability. The U.S. benefits from high labor participation rates, low unemployment rates, and thus far the Fed appears to have engineered a soft landing after raising interest rates in response to persistent post-COVID inflation. Against that constructive backdrop, diminished regulation and lower corporate taxes could be further tailwinds for U.S-centric companies.

Technology related companies continue to dominate the S&P 500. The Magnificent 7 constitutes 33% of the index's total market capitalization, trading at a premium 27x forward earnings. Stripping out the Mag 7, the S&P 500's other 493 stocks produced a total return of 11% in 2024. Technology will remain critically important, but some of the value that has accrued to the largest technology companies selling microchips, cloud computing capabilities, AI-as-a-service, and software will ultimately shift closer to the end-users leveraging those technologies. That value could be realized in medical diagnostics or drug discovery within the Healthcare sector. It might be in revolutionary advances in design, automation, and remote monitoring and mitigation in the Industrial sector. It could be through a lower cost to serve in the Communications Services, Financial or Utility sectors. It may manifest itself in lower exploration and production costs in the Energy or Materials sectors. Within all of these sectors, current valuation levels are widely distributed, and many individual companies represent attractive investments. This is why we continue to believe in the importance of a well-diversified portfolio. The market leaders of today are often replaced by companies poised to create the most incremental value tomorrow.

While we are calling out the need to be mindful of current stock market valuation levels, history has shown us that being overly conservative from an asset allocation standpoint can prove very costly over time. Investors are presently struggling to reconcile whether or not the sum total of the actions being floated by the Trump administration could be inflationary if his rhetoric becomes policy. Inflation is the ultimate destroyer of real wealth and purchasing power. The best way for investors to overcome the impacts of inflation is to own assets whose returns outpace inflation over time. However, in the short-term term, any Federal Reserve actions required to combat inflation would likely dampen the investment returns on those assets. The tension between those two concepts has already resulted in a volatile market thus far in January.

We still believe an investment strategy focused primarily on U.S. equities offers the best potential for wealth creation in 2025. In 2024, the U.S. was the best house on the global block, and that should remain the case in 2025. While many investors view Trump's presidency as an economic catalyst, we try to present a more balanced view. A diversified portfolio will be essential for absorbing the market's inevitable fluctuations in 2025.

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Douglas C. Lane & Associates (DCLA®) manages approximately $8 billion in total assets for high net worth individuals, institutions, trusts, pension and profit sharing plans and endowments through customized, individually managed portfolios. Based in New York City, DCLA® is a core investment manager that creates customized portfolios of common stocks and bonds using tax-efficient strategies based on individual client needs. Investments are a result of our own fundamental research. Portfolios are not style constrained and hold large and small cap, growth and value, domestic and international stocks. The personalized nature of our client relationships enables us to complement investment results with a full suite of wealth management services.

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