

4Q 2024 Recap & 1Q 2025 Outlook

Services

Investment Management

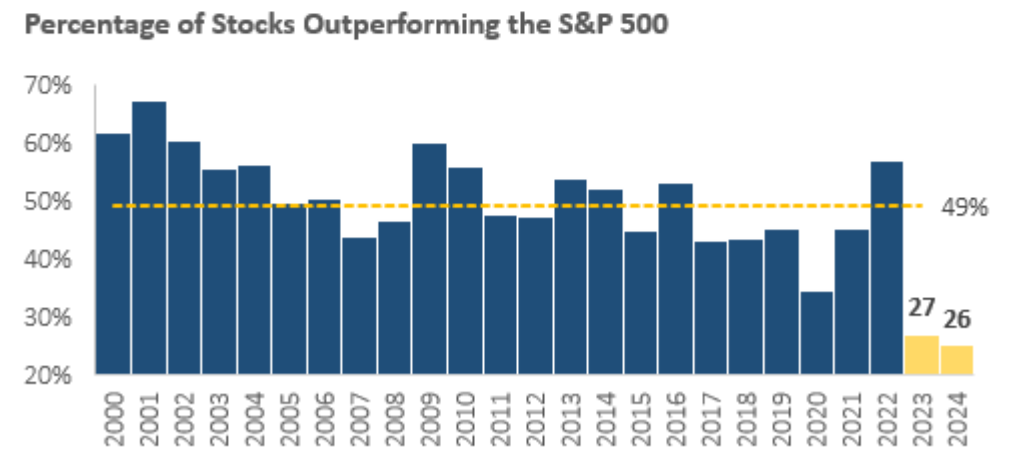
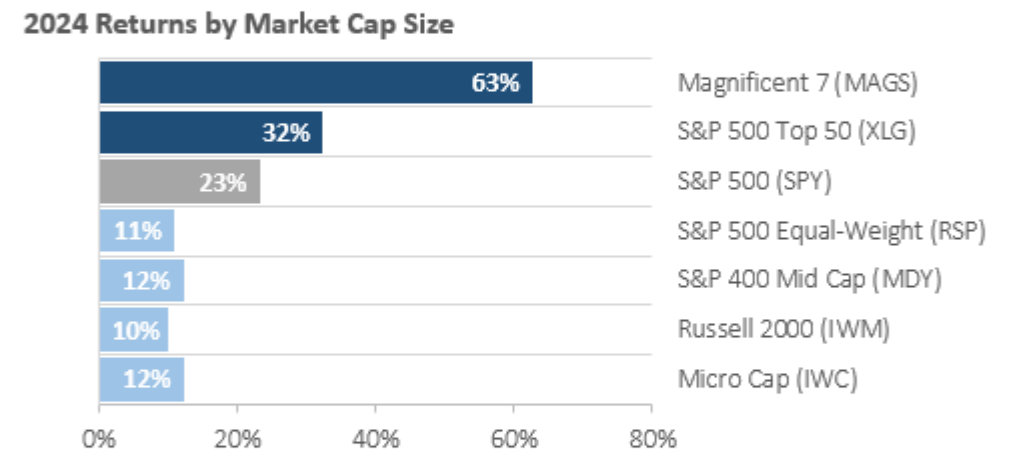
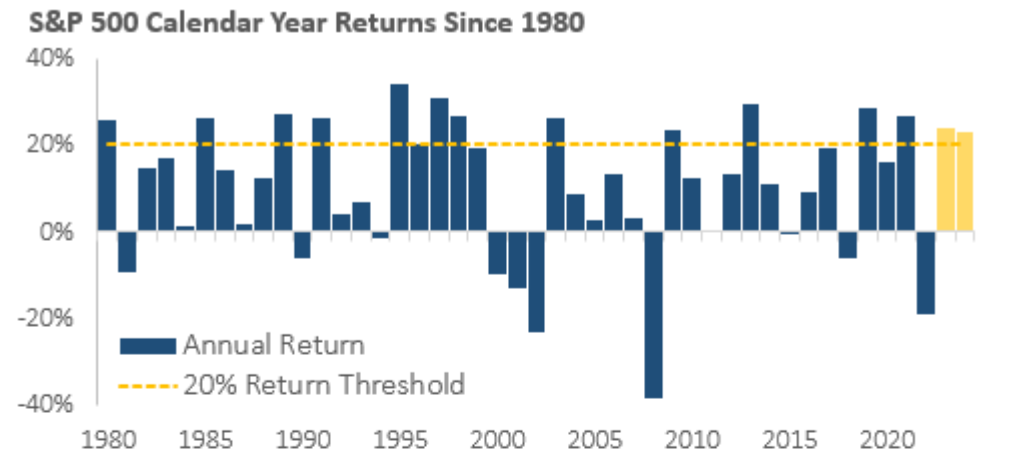
January 1, 2025

Key Updates on the Economy & Markets

There was no shortage of market-moving events in Q4. The stock market opened the quarter with a slow start in October, but the outcome of the presidential election triggered a broad rally in November, which faded as the year ended. The credit market was equally active in Q4, with the Federal Reserve cutting rates by another -0.50%. The major development was the changing 2025 outlook. The Fed and the market both now expect fewer rate cuts in 2025 compared to the end of Q3, which resulted in a sharp rise in Treasury yields in Q4. This letter recaps the fourth quarter; looks back on the 2024 stock market rally; provides an update on the economy and the Fed's rate-cutting cycle; and looks ahead to 2025.

Looking Back on the 2024 Stock Market Rally

FIGURE 1 – Recapping the 2024 Stock Market Rally



Source: Standard & Poor's. Past performance is no guarantee of future results. All performance data represents price returns. Latest available data as of 12/31/24.

The past two years have been remarkable for investors, with the S&P 500 delivering strong returns in back-to-back years. The three charts in Figure 1 take a closer look at the stock market's rally in 2024, a year in which the S&P 500 set more than 55 new all-time highs. The top chart, which graphs the S&P 500's return for each calendar year since 1980, shows the index posted gains of over +20% in 2023 and 2024. It marked the first time since the 4-year stretch from 1995 to 1998, and like the late 1990s, large-cap technology stocks played a major role in the S&P 500's gains.

The middle chart shows the 2024 price returns of seven ETFs, each reflecting exposure to companies of different market cap sizes. The chart reveals a significant gap between the returns of large-cap and small-cap stocks in 2024. The top bar tracks the Magnificent 7, a group that includes Microsoft, Apple, Alphabet, Meta, Amazon, Nvidia, and Tesla. These seven companies, which now account for more than 33% of the S&P 500, returned over +60%. When the group expands from the Magnificent 7 to the 50 largest S&P 500 stocks, the return falls to +32%, still impressive but around half of the Magnificent 7's return.

Broadening the group further to include all S&P 500 companies reduces the index return to approximately +23%, and weighting companies equally rather than by market capitalization lowers the return to +11%.

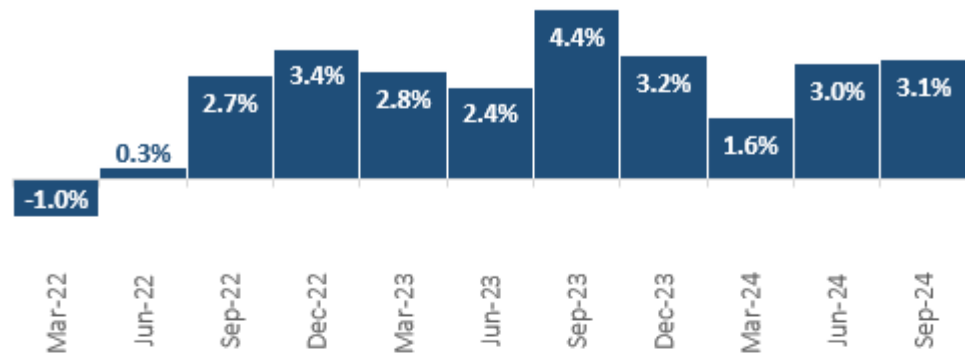
The key takeaway is that the largest companies contributed a significant portion of the S&P 500's return in 2024. Smaller companies delivered solid returns around +10%, but they underperformed on a relative basis. An index of mid-cap stocks returned +12%, while small-cap and micro-cap stocks returned +10% and +12%, respectively.

The concentrated stock market rally, which was driven by the outperformance of the largest companies, led to an unusual outcome. The bottom chart tracks the percentage of S&P 500 companies that outperformed the index during each calendar year. For the second consecutive year, fewer than 30% of S&P 500 companies beat the index in 2024. This is significantly below the average of 49% since 2000 and highlights the dominance of the largest companies in 2024.

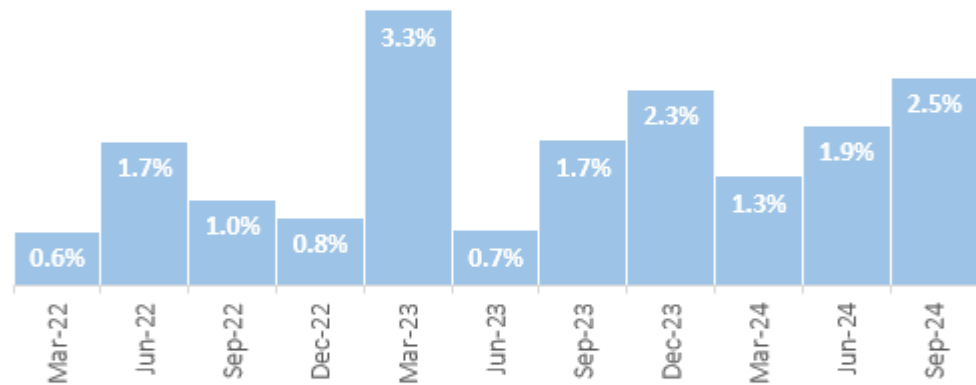
Data Highlights the U.S. Economy's Resiliency

FIGURE 2 – Drivers of U.S. Economic Growth Since 2022

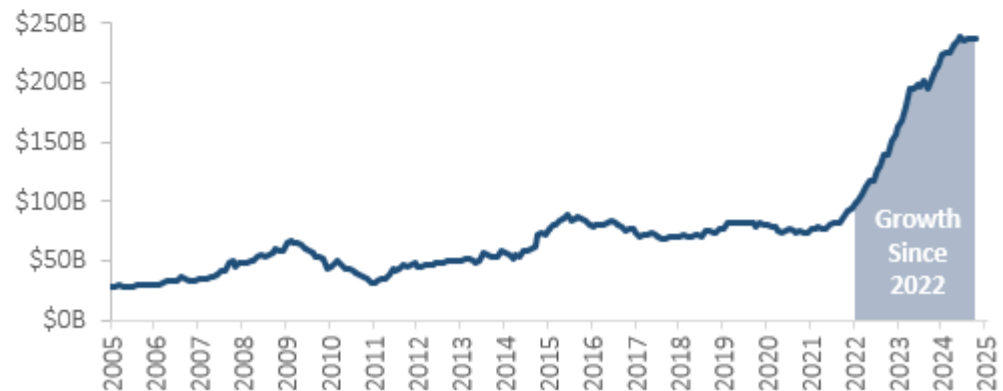
Real GDP Growth (% q/q)



Personal Consumption Expenditures, Contribution to GDP (% q/q)



U.S. Spending on Manufacturing-Related Construction



Source: Federal Reserve, U.S. Bureau of Economic Analysis, U.S. Census Bureau.
 Latest available data as of 12/31/2024.

The U.S. economy has consistently defied expectations of a slowdown since the Fed started

raising interest rates in March 2022. Economists and market participants initially expected growth to slow as the Fed raised interest rates. However, it has now been nearly three years since the Fed's first rate hike, and the economy continues to grow at an above-trend rate. While higher rates have slowed housing demand and weighed on business investment, the U.S. economy has managed to defy expectations with solid GDP growth. The top chart in Figure 2 shows the U.S. economy grew at a +3.1% annualized pace in 3Q24, marking the third quarter in the past four with growth above +3%.

The bottom two charts show key drivers of economic growth since early 2022. The middle chart tracks the contribution of personal consumption expenditures (i.e., consumer spending) to U.S. GDP growth. Despite high interest rates, consumer spending has remained a steady driver of growth in recent quarters. Multiple factors have increased household net worth and bolstered consumers' financial strength, including record-high stock prices, rising home values, and solid wage growth. Additionally, many borrowers locked in low interest rates during the pandemic, which has made the U.S. economy less sensitive to rising interest rates this cycle.

The bottom chart shows the surge in manufacturing-related construction in recent years. For a long time, manufacturing construction was relatively modest, as most activity was outsourced to China, Mexico, and elsewhere. However, that changed in late 2021, around the time Congress passed trillions in new spending on infrastructure, green energy, and subsidies to incentivize U.S. manufacturing. These spending bills have been extremely supportive of the U.S. economy and created a boom in the manufacturing of semiconductors, electric vehicles, batteries, and solar panels. The result is a surge in manufacturing-related construction, the largest on record, as companies build new warehouses, industrial facilities, and semiconductor plants. The artificial intelligence industry's emergence has provided another catalyst, as companies like Microsoft, Amazon, and Meta spend billions on data centers, information processing equipment like semiconductors, and energy production to meet growing power demand.

Economic growth is forecast to slow but remain solid next year, driven by the Trump administration's pro-growth policies. The new administration's policy agenda focuses on extending the 2017 tax cuts, reducing regulations across industries, and boosting domestic manufacturing through targeted incentives. These measures have the potential to stimulate capital expenditures, expand manufacturing capacity, and attract foreign investment to the U.S.

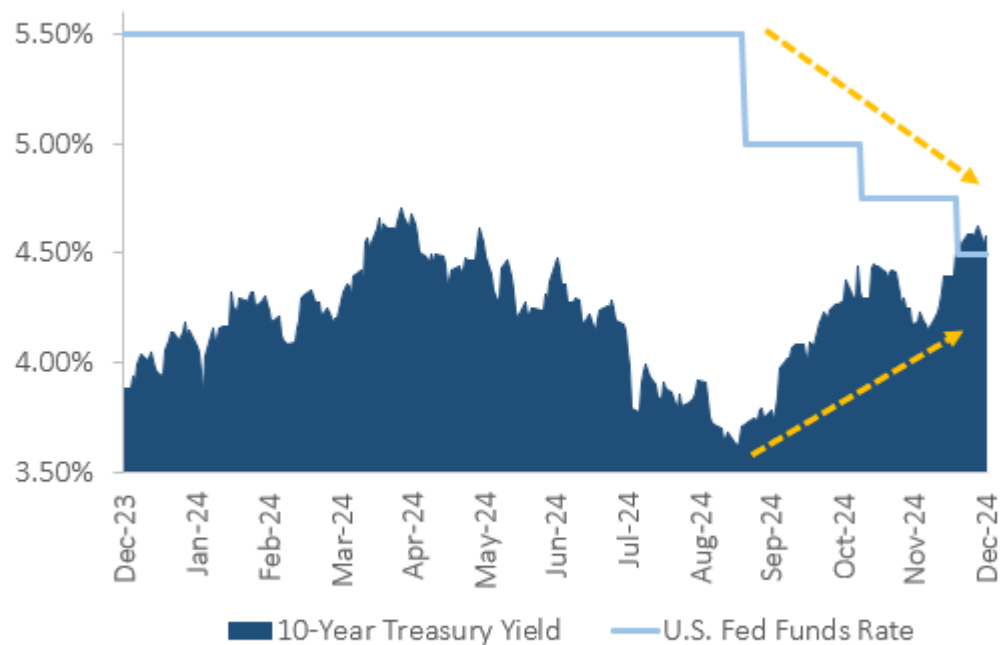
An Update on the Fed's Interest Rate - Cutting Cycle

The Fed continued its rate-cutting cycle in Q4, lowering interest rates by -0.25% at both the November and December meetings for a total of -0.50%. The two -0.25% rate cuts were well telegraphed by the Fed and widely expected, but the big development in Q4 was the changing

outlook for 2025. Despite the two rate cuts, Fed Chair Jerome Powell and other Fed presidents indicated they are not in a hurry to cut rates further. The change in tone follows the U.S. economy’s recent strength, which has caused the Fed to re-examine the need for additional rate cuts.

Recent economic strength has also led the market to re-evaluate its rate cut forecast. This dynamic can be seen in the bond market, where longer-maturity Treasury yields have risen sharply since the first rate cut in September. Figure 3 graphs the 10-year Treasury yield against the federal funds rate, which is the interest rate the Fed adjusts to set monetary policy. Since the first rate cut in September, the federal funds rate has decreased by -1.00%. While the Fed controls shorter-maturity interest rates, the market has more control over longer-maturity interest rates. Over the same period, the 10-year Treasury yield has had the opposite reaction: rising by nearly +1.00%.

FIGURE 3 – 10-Year Treasury Yield vs Federal Funds Rate



Source: U.S. Treasury, Federal Reserve. Latest available data as of 12/31/2024.

What caused Treasury yields to rise as the Fed cut interest rates? Two key data points contributed to the Fed’s decision to start cutting rates in September: falling inflation and rising unemployment. Inflation declined from 3.3% in July 2023 to 2.6% in August 2024, while unemployment rose from 3.5% to a high of 4.3%.

The two trends caused the Fed to shift its focus from lowering inflation to supporting the labor

market. However, since the Fed started cutting, the trends have reversed. Inflation progress has stalled since September, and unemployment has declined to 4.2%. Heading into 2025, the Fed and the market have similar rate cut expectations: approximately -0.50% in cuts for the entire year. The question is whether they are placing too much emphasis on recent trends and underestimating the need for rate cuts. As both the Fed and the market saw in 2024, forecasting Fed policy is difficult, especially this cycle.

Equity Market Recap - Stocks End the Year Higher

The stock market ended Q4 higher, but the path included periods of volatility. In October, the S&P 500 ended its five-month winning streak, with most of the equity market finishing slightly lower. The sluggishness occurred as Treasury yields rose after the Fed's first rate cut in September, suggesting the sharp rise in yields may have played a role in October's market action. However, stocks rebounded in subsequent months.

In November, the quick and decisive election outcome became a tailwind for stocks. Investor enthusiasm fueled the post-election rally, with stocks trading higher in anticipation of tax cuts, deregulation, and U.S.-focused trade policies aimed at benefiting U.S. companies. Small caps led the way during the broad market rally, with the Russell 2000 rising +11% in November to set a record high. Bank stocks were another popular post-election trade as investors priced in expectations for financial deregulation and strong economic growth. Industrial stocks saw broad-based strength in anticipation of the Trump administration's pro-growth policies and protectionist policies, which could spark an industrial renaissance in the U.S. By the end of November, the S&P 500's year-to-date return surpassed +26%, putting the index on track for consecutive gains of more than +20%.

In December, the market's excitement cooled, with the S&P 500 trading sideways and ending the month lower. Beneath the surface, a familiar trend from earlier in the year impacted returns, with smaller companies underperforming larger ones by a wide margin. The Russell 2000 Index was hit hardest, falling -8.4% and giving back most of its post-election gains. Value stocks also traded lower in December, with the Russell 1000 Value Index declining by -6.8%. In contrast, the Magnificent 7 stocks discussed earlier gained more than +5%.

Shifting focus to global markets, international stocks underperformed U.S. stocks in Q4. The MSCI Emerging Market Index returned -7.2%, while the MSCI EAFE Index of developed market stocks returned -8.3%. Both major international equity indices underperformed the S&P 500 by nearly -10% due to currency headwinds (i.e., a stronger U.S. dollar) and the outperformance of U.S. mega-caps.

Looking ahead to 2025 for international markets, the potential for tariffs under the Trump administration is creating significant uncertainty across several global regions.

Credit Market Recap - Bonds Trade Lower as Interest Rates Rise Throughout the Quarter

The sharp rise in Treasury yields weighed on bond returns in Q4. The biggest differentiator within the bond market was duration, or the sensitivity of a bond's price to interest rate movements. High-yield corporate bonds produced a total return of -0.1% due to their lower sensitivity to rising interest rates and higher absolute yields. In contrast, investment-grade bonds returned -4% as rising yields had a bigger impact on their longer maturities. Excluding interest received and only looking at price returns, an index of investment-grade corporate bonds posted its biggest quarterly loss since Q3 2022.

Full-year credit returns highlight the key themes that shaped the bond market throughout 2024. Higher-quality bonds like U.S. Treasuries, corporate investment-grade, and mortgage-backed securities underperformed as the market debated and ultimately lowered its rate-cut expectations. In contrast, lower-quality bonds outperformed as economic growth and corporate fundamentals remained solid. Corporate credit spreads, which measure the difference in yield between two bonds with a similar maturity but different credit quality, steadily tightened throughout the year. This provided a boost to lower-quality bonds in 2024 but has left credit spreads near their lowest levels in decades. For context, the U.S. high-yield corporate credit spread is near its lowest level since 2007, which means investors are receiving less yield in return for taking credit risk.

2025 Outlook - Key Themes to Watch

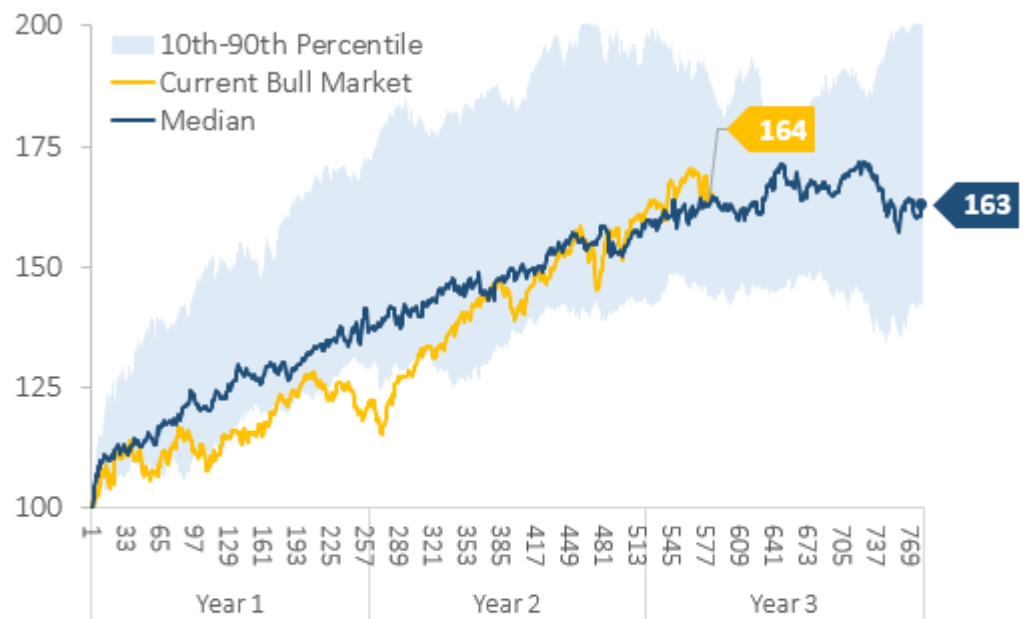
The S&P 500's steady climb in 2024 reflects the market's growing confidence. Investors are optimistic about the artificial intelligence industry's growth potential. The U.S. economy outperformed expectations, growing at an above-trend rate in three of the past four quarters despite high interest rates. The stock market rally intensified after the election in November, as investors focused on the incoming administration's policy agenda. Expectations for tax cuts, deregulation, and energy production are fueling hopes for stronger economic growth. The bond market echoes the equity market's confidence, and corporate high-yield credit spreads are near their lowest levels in over 15 years.

However, the equity market rally has made broad market indices like the S&P 500 more concentrated and more expensive. The question on many minds is whether the momentum can continue in 2025. The S&P 500 currently trades at nearly 22x times its next 12-month earnings estimate, a level not seen outside of periods like the late-1990s tech boom and the recent post-COVID recovery, when interest rates were near zero. Investors have shown a willingness to pay higher multiples, but with valuations now at extremes, earnings growth will likely play an important role in determining the stock market's path in 2025.

Figure 4 tracks the current bull market, which started in October 2022 and is now in its third year. The current bull market has performed in line with historical norms, but the chart shows

that returns often moderate as bull markets mature. This suggests that the market’s focus could shift to fundamentals and earnings as the next catalyst to push markets higher. 2025 is shaping up to be a year where companies will need to deliver on investors’ expectations to justify their high valuations.

FIGURE 4 – S&P 500 Returns During Bull Markets



Source: Standard & Poor’s. A bull market is defined as a +20% gain in the stock market off a recent market low. The “Current Bull Market” started in October 2022, and the “Median” includes all bull markets since the start of 1930. Analysis is based on price and does not reflect any management fees, transaction costs, or expenses. Past performance does not guarantee future results. Latest available data as of 12/31/2024.

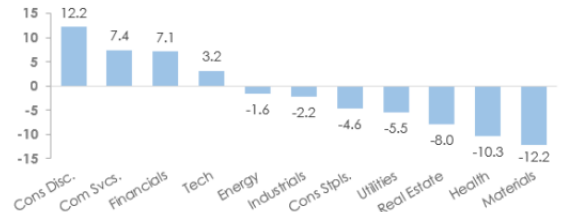
This Quarter in Numbers

FIGURE 5
U.S. Style Returns (4Q 2024 in %)

| | Value | Blend | Growth |
|-------|-------|-------|--------|
| Large | -1.9 | 2.5 | 7.1 |
| Mid | -1.8 | 0.7 | 8.2 |
| Small | -1.1 | 0.3 | 1.7 |

Data Reflects Most Recently Available As of 12/31/2024

FIGURE 6
U.S. Sector Returns (4Q 2024 in %)



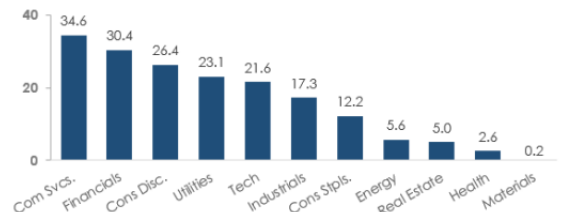
Data Reflects Most Recently Available As of 12/31/2024

FIGURE 7
U.S. Style Returns (2024 in %)

| | Value | Blend | Growth |
|-------|-------|-------|--------|
| Large | 14.1 | 24.8 | 33.1 |
| Mid | 12.9 | 15.2 | 21.8 |
| Small | 7.6 | 11.3 | 15.0 |

Data Reflects Most Recently Available As of 12/31/2024

FIGURE 8
U.S. Sector Returns (2024 in %)



Data Reflects Most Recently Available As of 12/31/2024

FIGURE 9
Market Data Center

| Stocks | 1 month | 3 months | 6 months | YTD | 1 year | 3 years | Dividend Yield | NTM P/E | P/B |
|---------------------|---------|----------|----------|-------|--------|---------|----------------|---------|-------|
| S&P 500 | -2.4% | 2.5% | 8.4% | 24.8% | 24.8% | 27.6% | 1.20% | 21.6x | 5.0x |
| Dow Jones | -5.2% | 0.9% | 9.7% | 14.7% | 14.7% | 22.6% | 1.60% | 19.5x | 5.4x |
| Russell 2000 | -8.4% | 0.3% | 9.6% | 11.3% | 11.3% | 2.8% | 1.15% | 24.2x | 1.0x |
| Russell 1000 Growth | 0.9% | 7.1% | 10.4% | 33.1% | 33.1% | 33.3% | 0.45% | 29.2x | 13.0x |
| Russell 1000 Value | -6.8% | -1.9% | 7.3% | 14.1% | 14.1% | 16.2% | 1.88% | 16.2x | 2.6x |
| M SCI EAFE | -2.9% | -8.3% | -2.1% | 3.6% | 3.6% | 4.3% | 3.24% | 13.7x | 1.8x |
| M SCI EM | -1.6% | -7.2% | -0.1% | 6.5% | 6.5% | -8.2% | 2.42% | 12.0x | 1.8x |
| NASDAQ 100 | 0.5% | 4.9% | 7.0% | 25.5% | 25.5% | 30.4% | 0.55% | 26.8x | 8.1x |

| Fixed Income | Yield | 1 month | 3 months | YTD | 1 year | 3 years |
|------------------|-------|---------|----------|------|--------|---------|
| U.S. Aggregate | 4.91% | -1.7% | -3.1% | 1.3% | 1.3% | -7.1% |
| U.S. Corporates | 5.31% | -2.7% | -4.0% | 0.8% | 0.8% | -9.8% |
| Municipal Bonds | 3.06% | -1.3% | -0.9% | 1.2% | 1.2% | -1.2% |
| High Yield Bonds | 7.27% | -0.8% | -0.1% | 7.7% | 7.7% | 5.4% |

| Key Rates | 12/31/2024 | 11/30/2024 | 9/30/2024 | 6/30/2024 | 12/31/2023 | 12/31/2021 |
|----------------------|------------|------------|-----------|-----------|------------|------------|
| 2-Year Treasury | 4.24% | 4.15% | 3.64% | 4.72% | 4.25% | 0.73% |
| 10-Year Treasury | 4.57% | 4.17% | 3.79% | 4.37% | 3.88% | 1.51% |
| 30-Year Treasury | 4.78% | 4.36% | 4.13% | 4.54% | 4.03% | 1.90% |
| 30 Yr Fixed Mortgage | 7.25% | 7.12% | 6.68% | 7.26% | 6.99% | 3.27% |
| Prime Rate | 7.50% | 7.75% | 8.00% | 8.50% | 8.50% | 3.25% |

| Commodities | Level | 1 month | YTD |
|-------------|-------|---------|--------|
| Oil (WTI) | 71.72 | 5.5% | -10.6% |
| Gasoline | 1.99 | 5.2% | -22.9% |
| Natural Gas | 3.10 | -7.9% | -24.5% |
| Propane | 0.78 | -3.4% | -0.1% |
| Ethanol | 1.47 | -5.8% | -33.2% |
| Gold | 2,641 | -1.5% | 44.6% |
| Silver | 29.24 | -6.0% | 21.6% |
| Copper | 4.05 | -0.9% | 6.3% |
| Steel | 709 | 1.3% | -4.7% |
| Corn | 4.59 | 5.9% | -32.4% |
| Soybeans | 10.08 | 1.9% | -32.6% |

Data Reflects Most Recently Available As of 12/31/2024

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The S&P 500 Index or Standard & Poor's 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S.

The Russell 2000 index measures the performance of approximately 2,000 small-cap US equities.

The MSCI EAFE Index is a stock market index that measures the performance of large- and mid-cap companies across 21 developed markets countries around the world. Canada and the USA are not included.

The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging

Markets (EM) countries.

The Nasdaq 100 Index is a stock index of the 100 largest companies by modified market capitalization trading on Nasdaq exchanges.

The Russell 1000 Growth index is an index that tracks large cap, growth stocks. This benchmark is important for investors that might tilt their investments towards large cap growth. Growth stocks, in comparison to value stocks, are considered companies with a more growth potential, and a higher risk profile.

The Russell 1000 Value index is an index that tracks large cap, value stocks. This benchmark is important for investors that might tilt their investments towards large cap value. Value stocks, in comparison to growth stocks, are considered companies with a stable cash flow, and more mature business model.

The CBOE VIX Index is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPX®) call and put options.

The Magnificent 7 is a group of major tech companies with stock growth that, on average, far outpaced the high-performing S&P 500® in recent years.

Coined in 2023, the group consists of Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla.

The Dow Jones Industrial Average, or simply the Dow, is a stock market index that indicates the value of 30 large, publicly owned companies based in the United States, and how they have traded in the stock market during various periods of time. These 30 companies are also included in the S&P 500 Index. The value of the Dow is not a weighted arithmetic mean and does not represent its component companies' market capitalization, but rather the sum of the price of one share of stock for each component company. The sum is corrected by a factor which changes whenever one of the component stocks has a stock split or stock dividend, so as to generate a consistent value for the index.

The Bloomberg US Aggregate Bond Index is used as a benchmark for investment grade bonds within the United States. This index is important as a benchmark for someone wanting to track their fixed income asset allocation.

The Bloomberg US Corporate Index covers performance for United States corporate bonds. This index serves as an important benchmark for portfolios that include exposure to investment grade corporate bonds.

The Bloomberg US Corporate High Yield Index covers performance for United States high yield corporate bonds. This index serves as an important benchmark for portfolios that include exposure to

riskier corporate bonds that might not necessarily be investment grade.

Treasuries, also known as Treasury securities, are debt obligations issued by the United States government. They are used to raise cash needed to fund government operations and help finance the federal deficit. Treasuries are backed by the full faith and credit of the US government, making them one of the safest investments. They are an important instrument in monetary policy, allowing central banks to control the money supply.

The Prime Rate is the interest rate that commercial banks charge their most creditworthy corporate customers. The prime rate is derived from the federal funds rate, usually using fed funds + 3 as the formula.