Bitterroot
CAPITAL ADVISORS

CAPITAL MARKETS REVIEW

2024
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All public market data are as of 01/10/2025 unless indicated otherwise.

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EXECUTIVE SUMMARY

Capital Markets

Equity Markets

Global equities, as measured by the ACWI Index in USD, declined 1.0% in Q4 and increased 17.5% during CY 2024. In Q4, US large-cap stocks (+2.3%) sharply outperformed international developed and emerging market equities (both down 8.0%). For CY 2024, US large-cap stocks likewise dominated (+24.5%) international developed (+3.8%) and emerging market (+7.5%) equities.

For both periods, US equity outperformance was driven by stronger corporate earnings and economic activity and greater exposure to technology and internet themes which benefitted from AI spending. In Q4, US equities also benefitted from shifts in investor sentiment following the 2024 US presidential election (Trump policies perceived as more favorable for US companies), and from currency fluctuations as the USD strengthened materially vs. other currencies, especially in Q4.

Government Bonds and Investment Grade Credit

U.S. government and investment-grade corporate bonds declined in Q4 as bond yields rose sharply. The Barclays US Aggregate Index declined 3.1% for the quarter and appreciated 1.3% for CY 2024.

During Q4, U.S. Treasury yields increased by 70 to 80 basis points across the maturities curve, reflecting a combination of stronger than expected economic data, stalling in the disinflation trajectory, and perceptions regarding potential effects of Trump policies with regards to taxes, immigration, and tariffs.

High-Yield Bonds & Leveraged Loans

US High-yield bonds were relatively flat during Q4 and +8.2% in CY 2024. In Q4, high-yield bond coupon income was offset by declines in prices associated with rising rates. For CY 2024, bonds benefitted from high coupon income and compressing spreads, which were partially offset by rising base rates. High yield bond spreads at 280bps are well lower than historical averages (420bps) and those experienced under recessionary conditions (600bps-800bps).

US leveraged loans appreciated by 2.2% during Q4 and 9.1% in CY 2024. For both periods, leveraged loans benefitted from high coupon income (driven by high base rates) and stable prices. With base rates having declined by 100 basis points over the past four months and a further 50 basis points reduction expected by year-end 2025, leveraged loan coupon income will decrease moving forward and lower returns are expected for 2025 and in future years.

CAPITAL MARKETS (CONTINUED)

Hedge Funds

Hedge funds posted flat performance in Q4 and were up 5.3% for 2024. In 2024, most strategies post positive performance with long-short equity strategies (+7.5%) and convertible arbitrage (+6.8%) delivering the strongest relative performance, while merger arbitrage (-1.8%) underperformed with a difficult regulatory environment for mergers contributing to weaker performance.

Private Equity

Private equity returns rose 3.1% in Q3 and are up 5.9% YTD following a 9.3% gain in 2023. With Q4 data pending due to reporting lags, low-single-digit returns are expected.

Returns in 2024 have lagged public equities, largely due to lower exposure to AI and tech sectors. Additionally, PE managers have been reluctant to mark-up asset valuations during a period of still low exit activity. Q4 deal activity approximated $185bln, slightly below values seen in Q2 and Q3. Entry valuations have remained stable around 12.5x EBITDA (above 2023 trough levels and below the 14x 2021 peaks) while leverage has remained in the low 5x Debt / EBITDA range or roughly 45% of deal value.

Encouragingly, the exit environment has continued to improve from trough levels, with Q4 exit value reaching $126bln, the highest level since Q4 2021 and 60% higher than Q4 2023.

Private Credit

Private Credit (measured by the Cliffwater Direct Lending Index) was up 2.8% during Q3 2024. Early indications suggest approximately roughly similar returns for Q3. While the outlook remains positive, returns will decline as interest rates fall. Unlevered yields approximate 10% at base rates of 4.3%. Although current credit quality remains solid, the percentage of loans in non-accrual is rising, indicating potential defaults or markdowns in legacy portfolios. Competition is intensifying among private credit lenders, but conditions remain reasonably favourable in the middle market, where spread compression has been less severe.

Private Real Estate

The private real estate market saw a slight rebound in Q3 2024 (latest data available), with the NCREIF Index up 0.8%, marking the first positive quarterly performance over the last six quarters. Signs of stabilization are emerging, as cap rates level off and transaction volumes increase. Operating fundamentals vary by property type: industrial and multi-family rents are flat despite strong demand, while office continues to be pressured with historically high vacancy rates. It remains to be seen what effect the recent rise in long-term interest rates may have on cap-rates and transaction volumes.

CAPITAL MARKETS (CONTINUED)

Outlook & Portfolio Positioning

Although 2024 saw strong returns across risk assets, we expect that 2025 could bring increased volatility. US economic and immigration policy (and knock-on effects across the globe) is highly uncertain as the Trump administration returns to the White House. Non-US economic growth remained relatively low in 2024 and potential US policies such as enactment of further tariffs could strain nascent recoveries. Geopolitical risks are heightened, although there is some optimism regarding potential settlements or de-escalations in those crises. With U.S. equity valuations appearing stretched, the potential outcomes for the next 6-12 months are broader than usual, especially for public equities.

We are incorporating these views into our portfolio positioning by:

Extending Duration
Adding Treasury bonds with intermediate maturities (5-10 years), especially with 5-10 year U.S. Treasury yields ranging between 4.5% and 4.7%.

Focusing on Private Investments
Continuing to allocate to new private investment strategies, with a particular emphasis on private equity secondaries and private credit, which offer compelling risk-adjusted return potential in the current environment.

EXECUTIVE SUMMARY

Strategic Asset Allocation View (7-years)

Our 7-year forecasts consider several factors that will shape the mid-term investment landscape.

Asset Class: Strategic Outlook (7-year timeframe)		
	Expected Annual Return	Relative Attractiveness*
	0% ———— 20%	Negative – Neutral – Positive
Equities		
US Large Cap (S&P 500)		
US Small Cap (Russell 2000)		
MSCI Europe		
Japan Topix		
MSCI Emerging Markets		
Fixed Income		
US Treasuries		
US Corp Investment Grade		
US Corp High Yield		
US Corp Levered Loans		
Alternatives, Private Equity, & Real Estate		
Real Estate (Private) - Unlevered		
Alternatives (Hedge Funds)		
Private Credit (New Funds)		
Private Equity (New Funds)		

Note *: The attractiveness of each asset class (as depicted by the positioning of the sliders) is based upon risk-adjusted returns when considering expected returns, volatility, and liquidity. Thus, US Treasuries with mid-single digit returns are shown as quite attractive given a low-risk profile whereas public equities are only rated modestly attractive despite their higher expected return as equities have much greater volatility.

STRATEGIC ASSET ALLOCATION VIEW (CONTINUED)

Macroeconomic & Market Factors

Interest Rates Outlook

We anticipate that interest rates will decline from current levels over the forecast period, but they are unlikely to return to the ultra-low levels experienced from 2009 to 2021.

Corporate Profit Margins

Margins (especially in the US) will be affected by opposing forces. Onshoring and reduced labor flexibility may exert downward pressure, while AI adoption could significantly boost productivity and expand profit margins, particularly in the U.S. Trump policies with regards to tariffs and immigration are also wildcards and may constrain margins as well.

Geopolitical Risks

Heightened geopolitical uncertainty—stemming from the U.S.-China relationship, conflicts in the Middle East, and the potential for other military tensions—will likely influence market volatility and investment strategies.

Equity Market Outlook

Expected Returns

With valuations having significantly increased over the last 18 months, we forecast mid-single digit nominal pre-tax annual equity returns (6.0%-8.0%) over the next seven years.

U.S. vs. International Markets

While U.S. stocks are expected to outperform international equities, we anticipate a greater convergence in returns due to elevated U.S. valuations. International markets are generally aligned with historical averages, making them potentially more attractive from a relative valuation perspective.

Growth vs. Value Stocks

Quality and growth stocks are expected to continue outperforming value stocks, though at a slower pace compared to the past seven years. For U.S. equities, earnings growth and dividends are likely to be the primary drivers of returns, rather than multiple expansion.

Potential Wildcards

The adoption pace of generative AI could significantly impact U.S. tech sectors, potentially leading to above-trend revenue growth and margin expansion. Conversely, should AI capex spend decline from extremely robust current levels or revenue monetization from AI prove lower than expected, several US large-cap technology stocks may experience muted stock performance. Given their high concentration in the index, S&P 500 performance may be heavily influenced by the performance of a select number of stocks.

STRATEGIC ASSET ALLOCATION VIEW (CONTINUED)

Fixed Income Outlook

Attractive Base Yields
"Safe" fixed income remains appealing, with base yields across the curve above 4.3% for maturities between 2 and 10 years. U.S. 10-Year Treasuries currently yield 4.76%, well higher than the 3.6% lows seen in September. We expect yields to remain within a 3.5% to 5.0% range in the near term, with potential retrenchment from current levels more likely than a sustained surge above 5.0%.

Expected Returns
We project close to mid-single digit returns for U.S. government debt and investment-grade bonds over the 7-year horizon. On a risk-adjusted pre-tax basis, the return potential for safe fixed income remains attractive compared to equities.

Credit Market Outlook

Riskier Credit Assets
High-yield bonds are yielding 7.4%, while leveraged loans offer 8.7% yields. Expected returns for these assets are in the range of 6.0%-6.5%. The high base yields make these options appealing for generating current income.

Spread Considerations
Current high-yield spreads (285 bps) are below historical averages and far below recessionary levels (600-800 bps). If a recession occurs, spreads may widen, negatively impacting near-term prices, but high starting yields could cushion total returns.

Comparative Attractiveness
Despite tighter spreads, risky credit remains attractive relative to equities on a pre-tax basis, though it is less compelling compared to safe government bonds.

Alternative Investment Outlook

Private Market Strategies
We expect private equity and private credit to deliver higher returns relative to public markets over a multi-year period. Private equity secondaries, specialty finance, and asset-backed credit remain appealing areas for new investments given their potential for superior returns and diversification benefits.

Macroeconomic Conditions & Key Issues

Macroeconomic Conditions

Shorter-term View: Key Issues & Scenarios

MACROECONOMIC CONDITIONS & KEY ISSUES

Macroeconomic Conditions

United States

The U.S. economy remains fundamentally strong and decoupled vs. the rest of the world. However, policy uncertainty remains high with a wide range of potential implications.

Real GDP grew at an annualized rate of 3.1% in Q3 2024, following 2.3% annualized growth during the first half of 2024. The Q3 expansion was primarily driven by gains in consumer spending, federal government spending, and exports.

Consumer spending remains healthy, with monthly sales increases averaging 0.6% during Q4. The consumer savings rate has remained stable at 4.4% over the past several months but is down from 5.5% at the beginning of 2024.

However, not all economic indicators are positive. Credit card and auto loan delinquencies have been steadily rising over recent quarters, especially among lower-income households.

The labor market remains well-balanced and has rebounded over the last several months from its summer slowdown. Certain measures such as initial jobless claims and continuing claims remain low, and wage growth has moderated to approximately 3.9% annually. However, job market dynamics appear more balanced, with job openings down to 8.3 million from the 12.7 million peak in 2022. Additionally, quit rates have returned to pre-pandemic levels. While firings remain very low, new hirings have fallen off considerably.

Inflation has remained relatively stable with the core PCE averaging 0.2% monthly increases over the past six months. The data has been choppy with September and October monthly inflation increases of 0.25% each followed by a 0.11% increase in November. While the data can be volatile, long term consumer inflation expectations recently surged to 3.3% in January 2025, the highest levels since 2008. Consumers may be factoring in potential impacts from certain proposed Trump policies such as tariffs and deportations.

The Federal Reserve has enacted three rate cuts of 100bps in aggregate since September 2004. However, Fed commentary has become more hawkish over the past month and market participants are currently forecasting two additional cuts of 50bps in aggregate during 2025 versus previously forecasting 100bps in aggregate through four cuts.

MACROECONOMIC CONDITIONS (CONTINUED)

Canada

Canada's economic growth has been relatively modest year-to-date. Growth should improve in 2025 subject to uncertainties regarding US trade policy.

Real GDP increased by 1.0% annualized in Q3, slightly lower than expected. Consumer spending, government expenditures, and residential investment increased, but business investment plunged by 11%. Per capita growth declined for the sixth consecutive quarter.

Encouragingly, monthly GDP growth increased by 0.3% in October with the goods sector registering its best growth since January 2023 while services growth moderated from Q3 levels.

The labor market remains under pressure with the unemployment recently reaching record highs as rapid population growth outpaces job creation. Inflation has decreased significantly, with core inflation near 2.0% year-over-year (YoY).

The Bank of Canada increased the magnitude of interest rate cuts and cut by 50bps at both the September and December 2024 meetings. During 2024, the BOC reduced interest rates by 175bps, bringing the benchmark rate to 3.25% by year-end. Economists are forecasting 100bps of additional easing over the next 12-18 months as growth remains uneven. Lower interest rates should boost consumption and business investment.

The housing market has shown improvement over the past several months with new governmental policies likely serving as tailwinds. November 2024 marked the fourth consecutive month of that Canadian home sales rose and the market is recovering more swiftly than expected.

Uncertainty regarding US tariff policy towards Canada remains high heading into 2025. If Trump enacts proposed tariffs, Canadian exports will likely decline and Canada will likely experience lower growth in 2025 and 2026.

MACROECONOMIC CONDITIONS (CONTINUED)

Europe

Europe's economy has modestly rebounded in 2024, following stagnation in 2023.

Real GDP grew by 0.4% Q/Q in Q3 and has grown 1.2% YOY through Q3. Growth has been robust in Spain, moderate in France and Italy, and slightly negative in Germany. However, growth has appeared to slow during the final quarter.

Consumers are relatively more optimistic than businesses, driven by rising real incomes and high savings, which have bolstered sentiment. There is cautious optimism for accelerating growth due to factors such as the waning energy crisis, strong employment levels, substantial consumer savings, and the likelihood of continued interest rate cuts amid slowing inflation.

The Services PMI has been positive for several months following a lull in the second half of 2023.

However, manufacturing remains weak, with PMI surveys still below the 50 threshold, indicating stagnation. If China announces significant additional stimulus measures in March 2025, orders should likely increase for European manufacturers, given China's significant import demand for European goods. On the flip side, US tariff policy remains a major wildcard for European manufacturers.

The European Central Bank (ECB) cut rates for the fourth time in December, and further reductions are anticipated as economic growth has stagnated at low levels and inflation continues to trend downward. Headline inflation has averaged 2.2% YOY over the past three months and core CPI has remained stable at 2.7% YoY.

Political instability remains high with significant governmental changes occurring in France and Germany.

MACROECONOMIC CONDITIONS (CONTINUED)

China

China's economic continues to muddle along with mixed indicators.

Q3 GDP grew 4.6% YOY bringing YTD growth to 4.8% or slightly below China's 5.0% target. On a QOQ basis, the economy grew by 0.9%, lower than the average growth over the past five years. The slowdown was caused by weak domestic demand and low capacity utilization although exports remained strong and grew by 6% YOY.

China's economy has shown some recovery following a slate of stimulus measures introduced from late September, with manufacturing and services PMI indexes rebounding.

However, retail sales in November missed expectations and consumer inflation fell to the lowest level in five months. The property sector remains challenged despite measures aimed at stabilizing demand.

To revive growth, Chinese authorities will issue a record 3 trillion yuan ($411 billion) in special Treasury bonds next year. Additionally, the government will likely unveil more aggressive fiscal stimulus at its annual parliament meeting in March 2025.

Significant fiscal support will be necessary to drive growth in the face of still weak domestic consumption (lower household income and wealth driven by declining home prices), significant overcapacity leading to declining industrial profits and producer deflation, and a potential slowdown in exports if tensions surrounding world trade increase. Potential US and to a lesser extent European tariffs coupled with China's response to such tariffs remain major wildcards for 2025.

MACROECONOMIC CONDITIONS & KEY ISSUES

Shorter-term View: Key Issues

Below, we visit vital issues that will affect markets over the next 12-24 months.

Issue #1: US Policy Under the Trump Administration

Policy uncertainty is set to increase markedly over the next few years.

Trump has outlined a policy agenda that has some elements that are market-friendly and others that may be unfavorable for equity markets.

His likely focus on de-regulation (fewer regulations and less red tape), extension of the current tax provisions (otherwise set to expire at the end of 2025), potential additional corporate tax cuts, and easier M&A environment are all pro-growth in nature and should be favorably received by investors.

However, Trump has also proposed substantially increasing tariffs which would likely reduce growth globally and cause significant uncertainty with regards to capital expenditures and business sentiment. Additionally, he has also proposed significantly increasing deportations and lowering immigration into the US, which may lead to increased inflation over a mid-term time frame.

The application of policy under the Trump administration is unpredictable and also unlikely to occur in a linear fashion. As such, equity markets may face fits and starts as policy plans are announced and begin to be applied.

SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue #2: Inflation Trajectory

The US disinflation process is showing signs of stalling, and the Fed has reduced its 2025 rate cut expectations.

While inflation is down markedly from its 2021 peaks, the "last mile" towards the Fed's 2% annual target has been difficult to achieve. Recent inflation data has shown uneven progress towards the 2% goal, although Fed officials remain confident the price pressures will continue to ease. Core CPI has remained around 3.3% YOY for the last several months although the Core PCE (fed's preferred inflation gauge) is lower at 2.7% YOY. Recent monthly data has been bumpy. Services inflation has declined but remains higher than normal at 4.5% YOY. Goods inflation ticked back up to 2.0% YOY in November although hurricane related disruptions may distort recent monthly data. In January, consumer inflation expectations for both the next one year and next ten years ticked up after months of relative stability.

Remarkably, the US has achieved a significant slowdown in inflation while achieving strong economic growth and limited increases in the unemployment rate. The still-strong economy and stable labor market coupled with stalling disinflation has led to expectations for reduced Fed rate cuts in 2025 (markets now project two cuts of 50bps in aggregate versus prior expectations for four cuts of 100bps in aggregate). Trump's policies are considered potentially inflationary although the application and timing are significant wildcards.

Outside of the US, inflation continues to recede in Europe, Canada, and many other developed markets. Growth remains much slower than the US in those economies. As such, it is likely that rates in Europe and Canada decline at a faster pace and to lower ultimate levels than in the US.

SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue #3: Economic Growth

US economic growth significantly surpassed expectations in 2024 while other economies generally experienced muted growth. Markets are generally expecting much of the same for 2025, with US policy and its global ramifications a large wildcard.

US GDP growth has exceeded expectations and has grown 2.6% YOY through Q3. The economy has gained momentum over the past two quarters with Q2 and Q3 GDP growth at 3.0% annualized or better. Q4 GDP is projected to increase by 2.3% according to latest Fed models. Most economists are forecasting another year of above-trend 2.0%+ GDP growth for the US driven by continued strong consumer demand, AI-related spend, and pro-growth Trump policy initiatives such as less regulations.

The US labor market remains resilient, with unemployment at 4.3%, up from a low of 3.4%. On the one hand, firings remain very low. However, new hiring has also slowed considerably.

Spending among upper-middle-class and wealthy consumers remains strong, while lower-income households face rising credit card and auto loan delinquencies.

In Europe, the economic recovery has been muted and uneven. The outlook for 2025 remains uncertain. On the one hand, lower interest rates coupled with high employment and consumer savings should lead to faster growth. On the other hand, manufacturing remains very weak (PMIs consistently under 50) and Germany's economic growth is still near 0%. German and French governmental instability has also increased the risks to downside growth. Geopolitical risks are mixed as well. On the one hand, an end to the Ukraine / Russia conflict seems more likely with Trump in office (a cessation of the conflict would improve sentiment in Europe significantly). However, the US tariff policy and the effects across Europe from its application are likely negatives, although ultimate magnitude and timing is highly uncertain.

SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue #4: Corporate Earnings

US corporate earnings are robust. However, analysts are forecasting faster growth in 2025, and initial forecasts may prove optimistic.

S&P 500 earnings grew 9% YoY in Q3, with growth extending beyond the "Magnificent Seven" tech firms.

Analysts forecast 12.0% earnings growth for Q4 2024 and are currently forecasting 15% earnings growth for 2025. Analysts tend to be optimistic regarding future earnings and generally reduce their forecasts closer to earnings releases. In 2025, analysts are projecting a convergence in terms of Magnificent Seven earnings growth and the rest of the S&P 500.

At first glance, this seems reasonable as AI and broader technology demand remains strong, manufacturing appears to be stabilizing or showing greens shoots of improvement, consumer spending remains robust, and higher for longer interest rates should be benefit financial sector firms.

However, significant uncertainties remain especially around Trump policies with regards to tariffs and to a lesser extent immigration. It is an open question as to whether the positive aspects of Trump policy (less regulation and lower corporate taxes) will outweigh the negative aspects (taxes and deportation).

SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue #5: AI Adoption

AI drove 2024 S&P 500 performance. While demand appears strong heading into 2025, it is difficult to predict the level of spend and demand in future years.

Sectors such as semiconductors and technology hardware have significantly benefited from AI-related spending.

While the near-term outlook for AI hardware is strong, sustainability beyond 2025 is uncertain. Some companies have strengthened their competitive positions through AI leadership (e.g., Apple, Microsoft, Alphabet), despite limited current impact on financial results.

The main beneficiaries thus far include semiconductor firms (Nvidia, Micron, Broadcom) and cloud companies (Amazon, Meta, Google). In the last quarter of 2024, software companies associated with AI also delivered significant jumps in stock performance. The utility sector has also benefitted from the surge in AI demand as demand for power is forecast to grow meaningfully relative to the generally flat demand witnessed over the past decade.

Upcoming earnings reports will be closely watched for signs of sustained demand, cost pressures, and shifts in competition.

Issue #6: China Government Policy

China's economy muddled through 2024 with several structural challenges. However, the government recently announced stimulus measures that may restore consumer confidence and drive improved growth, with further measures likely to be announced in March 2025.

The property sector remains weak, with ongoing declines in new home prices and consumer spending.

In response, the government has announced significant stimulus measures, including lower borrowing rates, property incentives, and efforts to stabilize equity markets through a stock stabilization fund and share buyback incentives.

Chinese equities surged 40% over three weeks through early October on optimism about the stimulus, but momentum faded as policy details fell short of expectations. As such, further large-scale fiscal measures are needed to boost domestic consumption and stabilize the property development sector. Analysts expect the government to announce much larger fiscal stimulus measures during China's annual political summit in March 2025.

SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Issue #7: Geopolitical Risks

Militarily, geopolitical risks seem to have stabilized with improved prospect for some sort of resolution. However, the risk of escalation in potential trade wars.

The conflicts in the Middle East seem to have to stabilized with a ceasefire between Israel and Hezbollah and increasing momentum towards a ceasefire in the Israel – Gaza war. The recent regime change in Syria represents a future unknown.

The Russia-Ukraine war appears to be in a stalemate. However, with Trump entering the White House, a resolution appears more likely than it did under the Biden administration.

Thus far, oil prices have remained stable due to muted global demand amid weak European and Chinese economies and rising U.S. supply. However, a sustained increase in oil prices could reignite inflation and raise the risk of a global recession.

As discussed previously, changes in global trade policy and tariffs are the largest wildcards over the next few years.

MACROECONOMIC CONDITIONS & KEY ISSUES

Shorter-term View: Scenarios

We envision multiple potential trajectories for equity returns over the next twelve months, with the S&P 500 positioned at 5,827 as of January 10, 2025.

Scenario A: Optimistic Case

The optimistic scenario assumes strong economic growth with continued progress towards lower inflation.

In this case, we assume that a) Trump's policies towards deregulation and lower taxes are announced first and lead to improved investor and business sentiment, b) inflation continues its gradual trajectory downwards towards 2.0% and the Fed cuts by 50bps-75bps in 2025, c) ex US global growth increases modestly as rate cuts spur demand in Europe and China stimulus bolsters domestic demand, and d) Trump tariff and deportation policies are less aggressive than feared and are phased in over multiple years.

Rate Cuts and Economic Growth

Continued easing in interest rates supports healthy consumer spending, modest wage growth, and improved profit margins as companies continue to manage costs effectively.

Earnings Outlook

AI demand remains robust and the Magnificent Seven continue to generate strong earnings growth which is accompanied by improving earnings growth across the broader market.

S&P 500 earnings could grow from $242 in 2024, to $275-$285 in 2025, and $310-$325 in 2026, with equity multiples holding at 21x-23x forward earnings.

Market Implications

Under these conditions, the S&P 500 may reach 6,600-7,400 by YE 2025, delivering a total return of 15%-28% from current levels.

SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Scenario B: Base Case

The base case projects slowing growth but no recession, with the Fed continuing gradual rate cuts.

The Fed cuts by 75bps-100bps in 2025, followed by an additional 50bps cuts in 2026 as core inflation continues to slow.

Economic and Employment Trends
Consumer spending is projected to slow without substantial declines, unemployment modestly rises, and GDP growth stays between 1.75%-2.25%.

Earnings Outlook
AI demand remains relatively strong. Magnificent Seven earnings growth cools from torrid 2023 levels while broader market earnings growth continues to improve.

S&P 500 earnings rise from $242 in 2024 to $265-$275 in 2025, and $290-$305 in 2026, with equity multiples at 19.5x-21.5x forward earnings, resulting in an S&P 500 index level between 5,750 and 6,450 and a total return of 0.0% to 12.0%.

Scenario C: Pessimistic Case

The pessimistic scenario anticipates a deeper economic slowdown, possibly leading to a recession.

Economic deterioration accelerates due to depleted consumer savings, triggering layoffs, or external factors like European recession or resurgent inflation that could prompt new Fed rate hikes.   Trump implements tariff policies that leads to slowdown in business investment and global growth.

Recession and Market Decline
The recession would be more profound, with S&P 500 earnings declining in 2025 and into 2026, before beginning to recovery.

Market Implications
The S&P 500 could drop by 20% within 12 months as expectations adjust, but a quicker Fed pivot to easing may trigger a strong market rebound.

SHORTER-TERM VIEW: KEY ISSUES (CONTINUED)

Given the level of policy uncertainty and the rich valuations with high embedded expectations facing US markets, all three scenarios are possible for the S&P 500 in 2025. While base and upside scenarios appear more plausible than the downside case, markets are increasingly pricing in a landscape characterized by robust earnings growth while interest rates remain higher for longer.

Supporting Factors

The U.S. consumer remains generally healthy, with unemployment still at historically low levels, strong AI-related demand, and solid corporate earnings growth. Additionally, easing cycles by the Fed and other central banks provide a favorable macroeconomic backdrop. The Trump administration is likely to have a pro-business, pro-economic growth mindset.

Caution Advised

Despite these positive dynamics, the significant increase in US equity valuations over the past 18 months, coupled with ongoing macroeconomic and geopolitical risks, suggests caution. Policy uncertainty with regards to tariffs remains very high and the trajectory for continued progress on lowered inflation remains murky. We recommend avoiding substantial new equity allocations at current levels.

Longer-term Outlook

7-year expected returns for equities are in the range of 6.0%-8.0%, which is lower than historical averages, reflecting elevated valuations, especially in US markets. There is potential for heightened volatility over the forecast period.

Capital Markets Review

Equity Markets: Performance & Valuation

Fixed Income Markets: Performance & Valuation

Alternatives and Private Investments

Actionable Investment Opportunities

CAPITAL MARKETS REVIEW

Equity Markets: Performance

Global equity markets, as tracked by the MSCI ACWI Index, declined 6.7% in Q4, but appreciated strongly by 17.5% in CY 2024.

Equity Indices - Performance

	% Return	Total Returns (%) - USD		Annualized Returns (as of 1/10/25)			
	YTD 1/10/25	Dec-24 Qtr	CY 2024	1Y	3Y	5Y	7Y
US Large Cap (S&P 500)	-0.9%	2.3%	24.5%	23.0%	8.8%	13.5%	12.7%
US Small Cap (Russell 2000)	-1.8%	0.3%	11.5%	12.7%	1.8%	7.1%	6.3%
MSCI EAFE	-0.8%	-8.0%	3.8%	4.3%	1.8%	4.5%	3.6%
MSCI Emerging Markets	-1.7%	-8.1%	7.5%	9.4%	-2.5%	1.0%	0.7%
MSCI ACWI	-0.9%	-1.0%	17.5%	17.1%	5.8%	9.7%	8.6%
S&P 500 - Equal Weight	-1.1%	-2.0%	12.4%	11.8%	3.8%	9.8%	9.3%
MSCI ACWI - Equal Weight	-2.0%	-6.7%	5.4%	5.9%	-1.9%	2.7%	2.2%
US Style Factors							
MSCI US Quality	-0.6%	-0.7%	23.6%	21.8%	10.3%	14.5%	14.7%
Russell 1000 Growth	-0.8%	7.0%	33.1%	31.3%	11.7%	17.9%	17.0%
Russell 1000 Value	-0.8%	-2.1%	13.7%	13.1%	4.4%	7.8%	7.2%

Regional & Style-Factor Performance

During Q4, US large-cap equities (+2.3%) substantially outperformed international developed and emerging markets (both down roughly 8%). US large stocks were buoyed by a) US exceptionalism with much stronger US economic growth relative to other regions, b) significantly higher exposure to technology sectors and AI themes, and c) investor perceptions regarding potential geographic winners and losers under the incoming Trump administration.

International markets' performance in USD was also hurt by significant currency depreciation vs. the dollar in Q4.

On a full-year basis, U.S. large-cap equities (S&P 500) appreciated by 24.5%, again substantially outperforming international developed (+3.8%) and emerging markets (+7.5%). The factors described above all contributed to the full-year US outperformance and were most prevalent in Q4.

Globally, growth stocks outperformed value stocks in both Q4 (+2.6% vs. -2.5%) and CY 2024 (24.2% vs. 13.3%).

EQUITY MARKETS: PERFORMANCE (CONTINUED)

Growth stock outperformance was pronounced in the US (+33.1% vs. +13.7% in 2024) whereas value modestly outperformed growth internationally (+6.1% vs. +5.0% for CY 2024). For CY 2024, high-quality stocks performed well in the US at +23.5%, but poorly internationally at -0.7%.

Globally during Q4, the financials (+10.7%), industrials (+10.2%), and consumer discretionary (+9.4%) sectors were top performers, while energy (-2.2%) and technology (+1.1%) lagged. For full year 2024, the technology and communication services sectors (both +31.6%) and financial sector (+24.3%) sectors delivered the best results while materials, energy, healthcare, and consumer staples underperformed (-8.1%, +1.7%, +1.1% and +4.1% respectively)

U.S. Equities

In Q4, the Magnificent Seven resumed its pattern of substantially outperforming the rest of the S&P 500. The market-cap weighted S&P 500 was up 2.3% during Q4 while the S&P 500 Equal Weight Index was down 2.3%.

The Magnificent Seven delivered far greater earnings growth than the rest of the S&P 500 during 2024. However, earnings growth improved for the rest of the S&P 500 over the course of the year and was positive YOY for the past three quarters.

During Q4, consumer discretionary (+14.3% largely driven by Tesla's 54.4% rise) and communications services (+8.9%) sectors performed best, while materials (-12.2%), healthcare (-10.3%) and consumer staples (-3.4%) performed worst. In 2024, technology, communication services, and financials performed best (+36.7%, +40.2%, and +30.5% respectively) while materials, healthcare, and energy (-0.4%, +2.6%, and 5.2% respectively) performed worst.

For CY 2024, the primary drivers of equity gains have still been several large-cap technology and technology-related companies (NVIDIA, Meta, Apple, Tesla) with significant exposure to AI-driven growth (as was the case in 2023). The Magnificent Seven accounted for over half of the S&P 500's YTD gains, with NVIDIA alone contributing 26% of the index's returns.

On an equal-weighted basis, the S&P 500 was up 12.4% YTD, trailing the market-cap weighted index by 12.1%, one of the largest differentials in history, and echoing a similar trend from 2023. This performance disparity was heavily driven by the performance of the Magnificent Seven which were up 10.0% in Q4 and 48.5% for full-year 2024 on a weighted basis.

In Q4 and for CY 2024, small caps lagged large caps by 2% and 13% respectively. Their lagging performance has been due to lower exposure to AI themes, higher interest costs from greater leverage, and potential concerns regarding economic slowdowns. Given large-caps' high valuations on an absolute and relative basis, small caps may be well-positioned to outperform if a scenario that includes rate cuts, better-

EQUITY MARKETS: PERFORMANCE (CONTINUED)

than-expected economic growth, tax cuts, and limited impact from tariffs materializes.

International Developed Market Equities

The MSCI EAFE Index sharply declined by 8.0% in Q4 and appreciated by 3.5% YTD. In Q4, slow economic growth in Europe coupled with increasing political instability in France and Germany, low corporate earnings growth, unfavorable currency transaction, and investor concerns regarding prospective increased tariffs under the Trump administration all contributed to weak performance. In CY 2024, many of the same factors mentioned above coupled with much lower exposure to AI themes also impacted performance.

European equities were down 9.8% in Q4 and +1.5% in CY 2024 in USD and -3.3% and +8.8% for those periods in local currency. Within Europe in CY 2024, financials and industrial sectors had strong performance in local currency while materials, consumer staples, and energy had modestly negative performance.

Japan equities were down 3.5% in Q4 and +8.6% in CY 2024 in USD and 5.9% and +20.7% for those periods in local currency. Yen fluctuations affected underlying corporate earnings and stock price performance in USD. In local currency, Japanese equities appreciation was supported by solid earnings growth (helped by Yen weakness as significant corporate revenue is derived outside of Japan while most costs are incurred in Yen), and by structural reforms.

Emerging Markets

Emerging market equities declined 8.1% in Q4 (-4.2% in local currency) and climbed 7.5% YTD (+13.2% in local currency). Korean and India equities were the largest detractors for Q4. CY 2024 performance was driven by Taiwanese stocks with high exposure to semiconductors and Chinese stocks which rallied during the second half of the year following announcements of government stimulus measures.

Outlook - Style Factors

For mid-to-long-term investors, we favor modestly overweighting US stocks relative to the MSCI ACWI Index. US large cap equities have greater exposure to secular growth themes, have higher revenue growth, better profitability and higher returns on capital. These factors should lend themselves to faster earnings growth, which is generally the largest contributor to long-term stock price performance. In addition, the US has better corporate governance and a more shareholder-oriented (as opposed to total stakeholder) culture relative to international markets. We would suggest a greater overweight should valuations contract from current rich levels.

For mid-term investors, we also continue to favor high-quality companies with strong business models, superior revenue growth, and attractive returns on capital.

EQUITY MARKETS: PERFORMANCE (CONTINUED)

While these companies may face short-term underperformance following recent gains, particularly in technology and communication services, their long-term outlook remains compelling.

Over shorter time horizons, cyclical stocks such as value stocks and small caps could outperform as they benefit more directly from interest rate reductions and pro-growth economic policy (either under the Trump administration in the US or via meaningful China Stimulus).

Also, over shorter-time horizons (12-18 months), international stocks may outperform US stocks. US stocks are richly valued and have already priced in potential benefits from pro-growth Trump policies while largely overlooking potential negative implications with regards to other policies such as tariffs and immigration. On the flip side, international stocks are more reasonably valued relative to history, and their recent performance seems to embed significant investor pessimism surrounding potential negative effects to growth from potential Trump policies and other geopolitical concerns.

In a nutshell, we would characterize equity markets as follows:

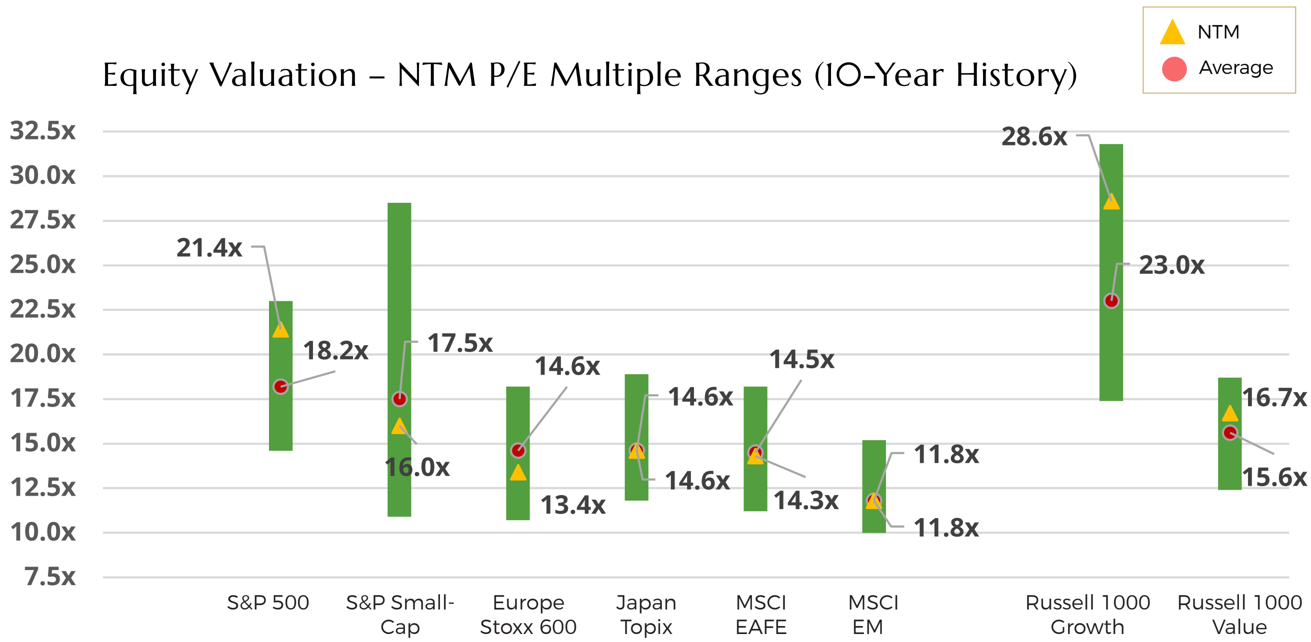
- **Large-cap US Equities:** strong fundamentals, rich valuations, and high expectations
- **International Equities:** weak fundamentals, reasonable valuations, and low expectations.

While it is certainly possible the US meaningfully outperforms international markets in 2025, slight disappointments relative to lofty US market expectations could lead to 15%-20% selloffs in US markets whereas modest outperformance vs. low expectations could lead to short-term appreciation in international markets.

CAPITAL MARKETS REVIEW

Equity Markets: Valuation

U.S. equity markets are trading at elevated valuations relative to historical norms and government bonds. However, there are important nuances in the S&P 500's valuation dynamics.



S&P 500 Valuation

The market-cap-weighted S&P 500 Index currently trades at 21.4x next-twelve-months (NTM) P/E, which appears expensive compared to historical averages. In contrast, the equal-weighted S&P 500 trades at 16.9x NTM P/E, a level closer to historical norms. This disparity highlights the concentration of market performance in a narrow group of large-cap stocks, particularly within the technology and communications sectors, which together account for 45% of the index.

While the S&P 500's valuation appears elevated, it is partly a reflection of the index's changing composition, which has shifted towards higher-quality companies with robust growth prospects, secular tailwinds, and a consistent record of attractive earnings growth.

Growth and Quality Stocks

U.S. growth and quality stocks, particularly in technology and communications, are valued at a premium relative to historical averages.

EQUITY MARKETS: VALUATION (CONTINUED)

Over the past 24 months, operating fundamentals in these sectors have been strong, with accelerating revenue growth and controlled costs driving outsized earnings gains. However, comparisons will become more challenging in 2025 and earnings growth rates should normalize at lower but still healthy levels.

Thus far, investors have largely overlooked rising AI-related spending in operating expenses and capital investments at many large-cap tech companies (Microsoft, Meta, Google). If AI revenue monetization does not meet expectations in 2025, these companies could face stock price pullbacks. Additionally, AI semiconductor bellwethers (Nvidia and Broadcom) have benefitted tremendously from AI-related data center semiconductor spend. While demand in 2025 remains robust, any indication of slowing data center spend will likely result in sharply negative stock performance for these companies.

Value Stocks

In contrast, U.S. value stocks—including sectors such as healthcare, energy, financials, and consumer staples—are generally considered to be fairly valued to modestly expensive relative to historical norms.

Financials, especially banks, have reported better-than-expected fundamentals. They may benefit from Trump pro-growth and lower regulation policies. Additionally, higher-for-longer interest rates coupled with a better M&A environment may serve as additional tailwinds.
Outside of certain companies exposed to blockbuster weight-loss drugs, healthcare companies have experienced challenging fundamentals while adjusting to the post-pandemic environment. Utilization has been higher than expected post pandemic for insurers and hospitals while demand was pulled forward during the pandemic for life sciences and pharma companies. However, on a relative basis, healthcare sector valuations are now much cheaper versus the broader S&P 500, leaving the sector well positioned to outperform should fundamentals inflect and beat lowered expectations.

Energy prices remain subdued due to weaker-than-expected global demand and rising supply. However, energy demand could increase if economic growth accelerates in the West due to interest rate cuts, and if Chinese demand picks up following stimulus measures. On the other hand, rising U.S. energy supply and signs of weakening supply discipline within the OPEC+ alliance could limit the upside. Energy prices have recently climbed due to colder weather in Western countries and increased sanctions applied towards Russia and potentially other countries.

EQUITY MARKETS: VALUATION (CONTINUED)

International Markets

International developed market valuations are more in line with historical averages. On the one hand, economic growth is weaker across international developed markets with lower corporate earnings growth projected over the next few years. Additionally, these economies and underlying companies will likely fare worse if Trump's enacts his proposed tariffs. On the other hand, investor sentiment already reflects these fears and expectations are low. If US trade policy is more benign than feared and / or China stimulus is large than expected, international markets could rally meaningfully over the short-term.

Equity Valuations Relative to Bonds

The valuation of U.S. large-cap equities appears especially high when compared to government bonds. The S&P 500 is trading at 21.4x consensus NTM earnings. This valuation equates to a 4.7% earnings yield whereas historically, the earnings yield (the inverse of the P/E ratio) has averaged 200-300 basis points (bps) above the yield on 10-year Treasuries.

With 10-year Treasuries currently yielding 4.7%, a 13.0x-15.0x forward P/E multiple would be considered "fair" based on historical relationships. However, many investors do not anticipate 10-year Treasury yields remaining at 4.7% for an extended period.

Alternatively, for equities to sustainably trade at these valuations, investors would need to believe in structurally higher earnings growth going forward over the mid-term, which is very possible given the changing sector composition of the S&P 500, particularly with the prominence of technology stocks benefiting from sustainable secular growth trends.

If the 10-year yield were to retreat to 3.75%, a more reasonable fair valuation would be in the range of 15.5x-17.5x forward EPS. It is important to note, however, that the traditional relationship between equity valuations and bond yields may not hold given the changing composition of the S&P 500 (higher quality companies with better secular growth prospects).

CAPITAL MARKETS REVIEW

Fixed Income Markets: Performance

Safe fixed income assets, including government bonds and investment-grade corporate bonds, declined in Q4, driven primarily by rising bond yields.

Fixed Income Indices – Characteristics and Performance in USD

	% Ret YTD 1/10/25	% Ret Dec-24 Qtr.	% Ret Full-year 2024	Annualized % Returns As of 1/10/25 1Y	3Y	5Y	7Y	Duration (yrs)
US Treasury	-0.9%	-3.0%	0.5%	0.6%	-2.6%	-1.0%	0.6%	5.8
US Corp. IG	-1.1%	-3.1%	2.1%	2.0%	-2.0%	0.0%	1.7%	6.8
US Corp HY	0.0%	0.2%	8.2%	8.7%	3.3%	4.1%	4.6%	3.1
US Corp Lev. Loans	0.3%	2.3%	9.0%	8.9%	7.0%	5.8%	5.5%	NA
Barclays US Aggregate	-1.0%	-3.1%	1.3%	1.2%	-2.2%	-0.6%	0.9%	6.1
Barclays Canada Agg. *	-1.5%	0.0%	4.0%	3.7%	-0.3%	0.3%	1.6%	7.3

** Barclays Canada Aggregate Index returns in CAD*

Drivers of Bond Yield Increases

The increase in bond yields were fueled by better-than-expected economic data coupled with uneven inflation data in September and October. While the Fed continued cutting rates as forecasted through the rest of 2024, it shifted its expectations in 2025 towards fewer rate cuts with lower magnitude (2 cuts of 50bps in aggregate vs. 4 cuts and 100bps in aggregate).

Additionally, bond market investors began to price in potential pro-growth and possibly inflationary effects associated with prospective Trump policies after the US presidential election.

- Short-term bond yields (2-year maturities) rose by 60 bps, while longer-term yields (10-year maturities) increased by 80 bps during Q4. Bond yields have risen by another 10bps since the beginning of 2025.

High-Yield Bonds & Leveraged Loans

Both high-yield bonds and leveraged loans delivered positive performance in Q4 and performed well in CY 2024.

- High-yield bonds benefited from high coupon rates and tightening credit spreads. Lower-quality, riskier high-yield bonds significantly outperformed higher-quality bonds as economic growth and corporate earnings proved more resilient than anticipated.

FIXED INCOME MARKETS: PERFORMANCE (CONTINUED)

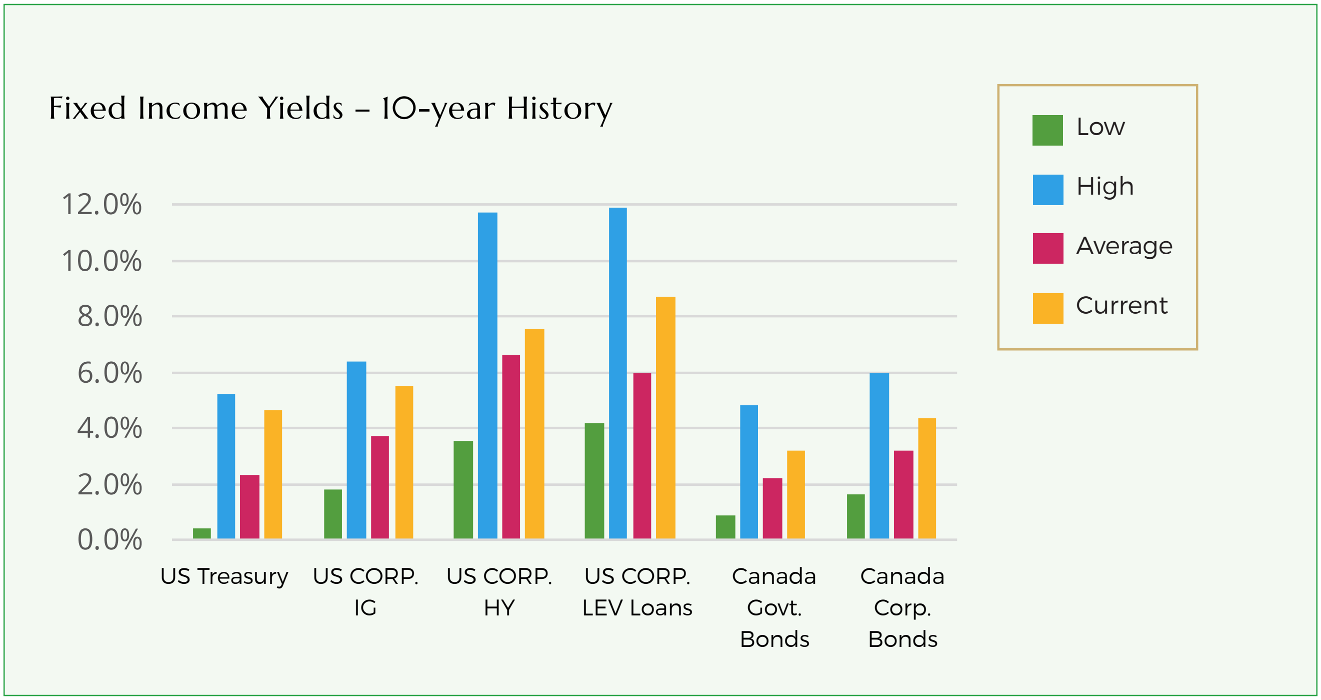
- CCC-rated bonds, the lowest-quality category, increased by 2.5% in Q4, outperforming BB-rated (-0.5%) and B-rated bonds (+0.3%). In CY 2024, CCC-rated bonds appreciated by 18.2%, well ahead of the gains seen in BB-rated (+6.3%) and B-rated bonds (+7.6%).

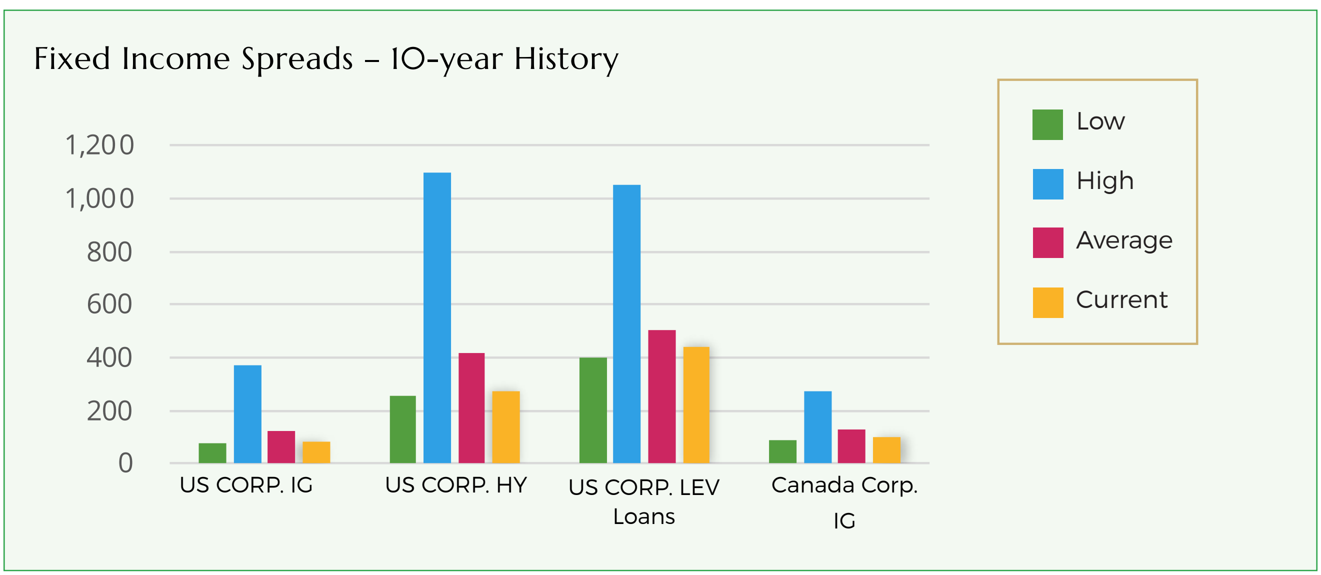
- Leveraged loans, which are floating-rate instruments, have benefited from high coupon rates driven by elevated SOFR base rates combined with stable credit spreads. However, the base rate has declined from 5.3% to 4.3% following the Fed's rate cuts over the past several months, and further declines are expected over the next 12-18 months. As a result, leveraged loan returns are likely to decrease moving forward.

CAPITAL MARKETS REVIEW

Fixed Income Markets: Valuation

Safe fixed-income yields, including government and investment-grade corporate bonds, continue to offer attractive returns in the current environment.





FIXED INCOME MARKETS: VALUATION (CONTINUED)

High Current Yield Landscape

As of January 10, 2025, U.S. Treasuries are yielding approximately 4.38% for 2-year maturities, 4.57% for 5-year maturities, and 4.76% for 10-year maturities. U.S. corporate investment-grade bonds are yielding around 5.52%, with the risk of default considered very low.

Tight Spread Premiums

Both investment-grade (IG) and high-yield (HY) bond spreads remain tight, supported by strong corporate earnings performance despite the elevated interest rate environment. Currently, IG spreads are at 80 basis points (bps), while HY spreads are at 274 bps, both well below their 10-year averages of 125 bps and 425 bps, respectively.

Historically, spreads have widened significantly during recessions, reaching approximately 200 bps for investment-grade bonds and 800 bps for high-yield bonds. However, the quality of the high-yield index is stronger today than in past downturns. Given the high base rates, it is unlikely that spreads will expand to previous recessionary levels, even if economic activity slows substantially.

Competitive Dynamics in Lending

The lending landscape has become more competitive, especially for large corporate borrowers, while conditions remain more favorable for middle-market lenders.

Large Corporate Borrowers
These companies continue to enjoy ample credit availability from banks and large private lenders. After a period of reduced activity from late 2022 to mid-2023, large banks have returned to the leveraged loan market, leading to a 125-150 bps contraction in new issuance spreads. However, this increased activity has resulted in weaker covenant packages.

Middle-Market Borrowers
Lower-middle-market and middle-market companies face more significant challenges in accessing capital. With regional banks pulling back from lending, spreads for these borrowers have narrowed less significantly (by only 75-100 bps) compared to larger corporate borrowers, reflecting the ongoing constraints in this segment.

CAPITAL MARKETS REVIEW

Alternatives and Private Investments

Hedge Funds

Hedge funds delivered flat performance in Q4 and were up 5.3% for 2024. In 2024, most strategies post positive performance with long-short equity strategies (+7.5%) and convertible arbitrage (+6.8%) delivering the strongest relative performance, while merger arbitrage (-1.8%) underperformed with a difficult regulatory environment for mergers contributing to weaker performance.

Commerical Real Estate

The NCREIF Index for commercial real estate increased by 0.8% in Q3 2024, marking the first quarter of positive performance in two years. According to Green Street, a weighted index of commercial real estate values appreciated by 5% in CY 2024. However, Greenstreet expects that further price recovery may stall given the increase in interest rates over the past few months. Cap rates appear to have leveled off and have peaked for most property types.

Data from the RCA Commercial Property Index highlights variation across different property sectors:

- **Industrial:** Prices are flat thus far in Q4 through November and are up 4.0% 4.0% YTD.
- **Apartments:** Prices declined 0.6% thus far in Q4 and are down 5.1% YTD.
- **Office**: Prices are flat thus far in Q4 and down 2.7% YTD, with central business districts experiencing larger declines compared to suburban offices.

Operating fundamentals across property types show significant divergence:

- **Office**: Vacancy rates have climbed above 20% for the first time but appear to be bottoming.
- **Apartments:** Demand remains strong, with high absorption, but an increase in new supply is limiting rent growth.
- **Industrial:** Vacancy rates have risen to 6.5%, up from a low of 3.7%, but still below pre-pandemic averages. Despite strong demand, increased supply has resulted in flat rents on a quarter-over-quarter basis.

Private Equity

Private equity deal and exit activity is rebounding from previously depressed levels. State Street reports that U.S. private equity delivered a 5.7% return YTD through Q3 2024 (latest data available). Preliminary estimates indicate low single-digit returns for Q4 2024, bringing estimated CY 2024 gains to high-single-digit levels. Private equity lagged S&P 500 equity market performance in 2023 and 2024 due to lower exposure to mega-cap technology stocks which largely drove the S&P 500 market appreciation. Additionally, private equity managers remain cautious about marking up asset values amid low exit volumes.

ALTERNATIVES AND PRIVATE INVESTMENTS (CONTINUED)

Deal Activity

- In Q4 2024, U.S. PE buyout deal activity reached $187 billion, up 10% YOY but down from the $200mm+ levels seen in Q2 and Q3 earlier this year. In 2024, deal activity increased by 19% to $840bln from $708mm in 2023. During 2024, both platform LBO and acquisition add-on deal activity expanded.
- Deal valuations have stabilized around 12.5x EBITDA in recent quarters following a trough of 11.2x in 2023 and 13.7x at the peak in 2021. Tier 1 assets continue to command high valuations, while prices for lower-quality assets have declined by 20%-30% from peaks, if they come to market at all.

Leverage and Exits

- New deal Debt/EBITDA multiples have remained stable at roughly 5.0x debt / EBITDA in 2024, down from 5.9x in 2022, with debt/total capital at 45%, below both 2022 levels (51%) and the 10-year average (55%).
- Exit activity continues to improve with Q4 exit values reaching $126bln, a 65% increase vs. Q4 2023. In CY 2024, exit values of $416bln increased by 50% YOY, but remain well below the $840bln 2021 peak. General partners are selectively bringing their better assets to market for exits via sales or IPOs.
- Given still low exit values compared to 2020-2021 and increasing fund maturity walls, we anticipate increased secondary market activity as firms seek liquidity.

Venture Capital

Venture capital (VC) performance appears to have bottomed but remains uneven. According to State Street, U.S. VC returned 4.0% YTD through Q3 (latest data available). Deal activity increased in 2024 to $209bln from $162bln in 2023. These levels are in line with pre-pandemic activity but significantly lower than the 2021 peak of $355bln.

AI Companies Lead Investment Focus

AI-related startups continue to attract substantial investment, with high valuations seen in seed and Series A funding rounds. AI deals increased to $97bln or 46% of venture deal value from $56bln or 23% deal share in 2023. Signs of valuation froth are emerging with regards to AI venture deals. Outside of the AI sector, investor terms for new deals have become more favorable compared to the 2020-2021 period.

Exit activity remains weak, with distribution rates at an annualized 5.5% of NAV, the lowest level since the Global Financial Crisis. However, recent VC IPOs have shown better performance in the public markets than those launched in 2022-2023, suggesting a potential turning point in 2025.

CAPITAL MARKETS REVIEW

Actionable Investment Opportunities

US Government Bonds

The recent swift increase in US Treasury bond yields has resulted in attractive entry points to add duration to fixed income portfolios. 5-year and 10-year Treasury bonds are yielding 4.57% and 4.76% respectively as of January 10, 2025, up 70bps-80bps from September 2024 lows.

- At the levels, bonds provide attractive coupons if held to maturity and also provide potential for capital appreciation should bond yields decline due to recessionary conditions or faster than expected declines in inflation.

Private Equity

The secondary market for private equity remains robust, with strong activity in both LP-led transactions and GP-led deals. As buyer and seller expectations converge, the quality of LP portfolios and GP continuation vehicles offered via secondaries continues to improve, making this an appealing segment for discerning investors.

- **LP-Led Secondaries:** Volume has surged as exit activity remains low and several PE fund vintages from 2007-2011 approach maturity walls. Despite the exit environment forecasted to improve in 2025, this trend is expected to continue as overall secondary market transaction volume represents only 2% of private equity NAV.
- **GP-Led Continuation Vehicles:** The market for GP-led transactions continues to expand, particularly for transactions involving high-quality assets. The supply-demand dynamic is also favorable with significantly greater demand from GPs to effect transactions vs. LP demand for investment (LP's can be choosier in terms of deals).

Private Credit

Private credit offers compelling potential returns, ranging from low double-digits to mid-teens, through a variety of specialty finance and structured credit solutions.

- **Specialty Finance:** There is increasing interest in niche opportunities such as consumer credit card portfolio purchases, forward flow agreements (i.e., "lending to lenders"), and bank credit risk transfers. These transactions are providing attractive yields as banks seek to reduce regulatory capital charges.
- **Flexible Junior Capital:** Demand is rising for flexible junior capital, which involves structuring payment terms with a mix of cash and PIK interest. These solutions offer mid-teens IRRs and can negotiate stronger financial and maintenance covenants, providing additional downside protection.

ACTIONABLE INVESTMENT OPPORTUNITIES (CONTINUED)

- **Asset-Backed Credit Solutions:** There is a growing appetite for asset-backed lending, where companies pledge high-quality collateral—such as receivables, inventory, and certain fixed assets—to secure liquidity. This trend reflects a shift towards collateralized lending in a more cautious credit environment.
- **NAV Financing and Liquidity Solutions for PE Firms:** There is increasing demand for NAV financing and other bespoke lending solutions tailored to private equity firms seeking to generate liquidity from their portfolios. These financing options can unlock capital without necessitating an asset sale.

Interestingly, while credit spreads for publicly traded corporate and high-yield debt remain tight, private credit funds report robust pipelines, suggesting significant divergence in borrower access to credit. This creates opportunities for private lenders to step in where traditional financing may be constrained.

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