

“Getting  
Comfortable Being  
Uncomfortable;  
Welcome Aboard  
the Chaos Train.”

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During 2024, stocks and short-duration bonds were up strongly as economic growth was better than initially expected, inflation weakened, and the Federal Reserve lowered interest rates. The S&P 500 was up 2% in the fourth quarter, and bonds were down slightly. There were two major market moving events in Q4. First, Donald Trump was elected President, with Republicans gaining a slim majority in Congress. The stock market initially rallied strongly as investors assumed benefits from pro-business deregulation, animal spirits, and the extension of tax cuts. Second, the Federal Reserve announced that the interest rate cutting cycle might slow due to concerns of renewed inflation stemming from expected tariffs and other changes in government policies. Bond yields rose, and the stock market gave back most of the initial Trump Bump. As we enter 2025, we are “getting comfortable being uncomfortable,” as this year will likely be filled with uncertainty and volatility stemming from unpredictable government policy. This is what we refer to as the “Chaos Train.” After two years of very strong stock market returns and high valuations, we felt it prudent to become more cautious given our expectations of high uncertainty. Our goal is to both protect and grow your capital over the long term. We reduced risk exposure in early January, increasing your cash position from 10% to 15%. We expect to redeploy this capital back into stocks either opportunistically or when we feel more confident about the future path. The real rate of return on bonds continues to be near historic highs, and we are taking advantage of this situation for our balanced accounts.



## Getting Comfortable Being Uncomfortable; Welcome Aboard the Chaos Train

Trump was elected President of the United States, and the Republicans won a slim majority in Congress. This resulted in renewed optimism and concern for investors.

The renewed optimism comes from expectations that certain restrictions, regulatory constraints, and negative business sentiments will be lifted and that more growth will be ignited in the US. Regardless of one's political persuasion, from a business standpoint, there was pressure on various parts of the economy in the last four years, particularly in mergers & acquisitions, regulation, and excessive rulemaking for the banking industry. The loosening of that atmosphere should increase animal spirits for investment over the next few years. For example, look at the utility industry. It takes, on average, 17 years to plan and build a transmission power line in this country. Most of that time involves doing various studies and overcoming regulatory hurdles. For the United States to continue to be a leader in Artificial Intelligence, a significant increase in electric power will be required. The regulatory environment will need to become more supportive to make this happen quickly. As the saying goes, "It's not the way to run a railroad."

The markets are excited about this pro-business stance, and it is a primary reason why we saw stock market strength immediately following the election. In addition, employment and income statistics have been strong, house prices stable, and benefits from recent government infrastructure programs are just beginning. As many may remember, Trump has historically monitored his approval rating by whether the stock market goes up or down. This may moderate some of the potential "wild" ideas he proposes on the chaos train.

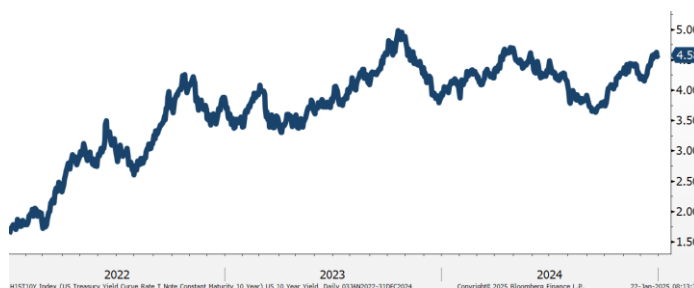
Investors and taxpayers also hope a Republican-controlled Congress will extend the 2019 tax cuts. This would significantly benefit many taxpayers, especially those in the highest tax brackets.

On the flip side, there is also renewed concern about the potential for inflation to increase because of tariffs and changes to immigration and other policies.

President Trump has been threatening tariffs since he was elected. We expect the threat of tariffs to cause many political issues and potential retaliation. In addition, if history rhymes, the 1930s provide a cautionary tale of how tariffs can negatively impact domestic economic growth and create inflation. Changes in immigration policy also have the potential to increase wage inflation by reducing the workforce.

Because both tariff and immigration changes have the potential to be inflationary, longer-dated interest rates rose in Q4. This surprised many investors who had been counting on interest rates falling. Chart 1 shows that the 10-year US Treasury is now 4.6%, a level that historically can begin to pressure stock market returns.

Chart 1  
The Yield on the 10-Year US Treasury Rose in Q4  
Value in percent



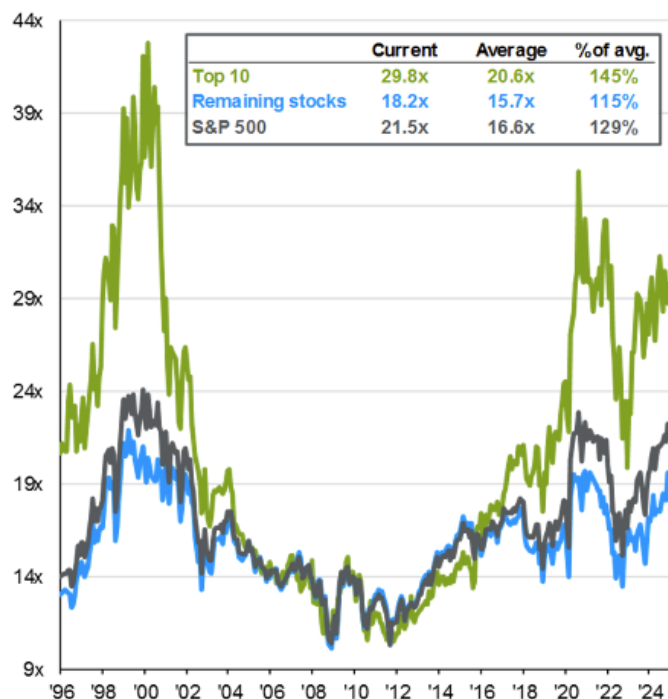
Source: Bloomberg

Higher rates can pressure stock valuation multiples, especially for technology stocks. We experienced this in both 2018 and then again in 2022. Multiple contractions can be painful for equity investing, particularly when starting from such lofty levels. Chart 2 shows the price-to-earnings ratio on the S&P 500 and

the S&P 500 equal weight index. Valuations have been rising significantly over the past two years, especially for the top 10 stocks in the S&P 500.

Chart 2

P/E Ratio of the Top 10 and Remaining Stocks in the S&P 500  
Next 12 months, 1996 - Present



Source: JPMorgan Asset Management

We are also concerned about stock concentration risk. The weight of the top 10 stocks in the S&P 500 is currently 39%, significantly higher than the levels in 1999. Less diversification can create more volatility in the Index should one of the top 10 underperform.

Chart 3

Weight of the Top 10 Stocks in the S&P 500  
% of Market Capitalization of the S&P 500



Source: JPMorgan Asset Management

Higher interest rates, high stock market valuations, and the largest companies' concentration risk have made us more cautious. In early January 2025, we raised another 5% in cash in our stock portfolios as we expect the markets to remain volatile. Currently, our stock portfolios hold about 15% in cash. Given valuations, we can afford to be patient and watch to see how things play out. With rates potentially higher for longer, that time is on our side.

## Mixed Messages in the Economy

While overall economic growth in 2024 and in Q4 were generally very good, there are continued distortions.

In the 4th quarter, manufacturing continued its 9-month slide of weakness in orders while the service sector continued its strength. Areas of weakness were energy, autos, parts of electronics, semiconductors, as well as the housing complex. This weakness has been partially offset by strong growth in aerospace and electrification. Although expectations and inquiries have picked up substantially since the election, real orders have yet to materialize. A few weeks ago, one of our private equity clients said, "Managements are very optimistic again, but where are the firm orders?"



## 2024 Stock Portfolio Performance

During 2024, we focused on several investment themes: aerospace, electrification, clean and dirty energy, security, artificial intelligence (AI), defense, healthcare, and infrastructure. In our risk management process, we diversify our investments and focus on valuation. In our opinion, the S&P 500 is no longer well diversified and doesn't focus on valuation. Over time, we believe our strategy should provide a better risk-adjusted return vs. the S&P 500.

## Focus on Secular Growth Themes for

Given our expectation of market volatility in 2025, we are more heavily focusing on our investment themes, where we are confident of demand irrespective of market volatility.

### Electrification

Given the growth in AI, electricity demand is growing significantly. We own several stocks in our portfolio that benefit from this theme, as well as pipeline companies and natural gas stocks, which stand to benefit. Most of these companies were star performers in 2024, and we expect strong future growth in 2025 and beyond.

The push for additional power has led to the revitalization of nuclear power. Nuclear has a low environmental impact, provides massive power production, and is constantly on. On the flip side, nuclear is very expensive to build and still carries the perception of safety concerns. Our expectation of nuclear resurgence is one reason we bought a position in the country's largest nuclear producer. We also own an energy play which, in addition to having some nuclear capability and traditional gas power plants, also has a large solar and wind power generating capacity.

While the latter is currently out of favor for the moment, the combination should be powerful longer term.

We are currently exploring a potential investment in small modular reactors (SMRs). Bill Gates and many other very successful investors are focusing on this area, and there are encouraging signs. At the earliest, we expect to see SMRs producing power by 2035.

### Energy

We still have confidence in the growing demand for energy in all its forms. Natural gas has been a great performer in the last few quarters. We have two recent additions to the portfolio that benefit from natural gas. The natural gas theme also benefits other companies in your portfolio, though in a less direct way. Finally, select pipeline companies that we own stand to benefit. We expect traditional oil companies to benefit from their huge free cash flows and strong total shareholder returns (dividends and share repurchase). Our international oil and gas services investment has not yet met our expectations.

### Artificial Intelligence and Quantum Computing

The United States is seeing a resurgence in new technology: artificial intelligence, driverless cars, space, and quantum computing. We live in exciting times and are reminded why the US is a superpower. We are moving at a rapid pace, much like the internet era of the 1990s, and it is a great time for this country, our economy, and our productivity.

Along with AI, we are hearing about the growth in quantum computing. Regarding your investment portfolio, we have several shots on goal through our some of our investments. Quantum computers will take us to yet another "next level", but it will take time. I recently read a book by Michio Kaku titled Quantum Supremacy. It's an easy read and very informative of

where Quantum computing will take us. We expect it will be the next wave after AI.

### Healthcare

During 2024, your portfolios were overweight healthcare. As we look toward 2025, we still believe healthcare is a great long-term investment. A strong healthcare system is important for the country; valuations are near historical lows, and dividend yields are high. We are intrigued by potential merger and acquisition activity and improvement in MedTech companies. We added a pharmaceutical company in the fourth quarter because we believe the renewed focus on their business should become a catalyst. There are several other idiosyncratic healthcare plays represented in the portfolio.

### Alternatives in Bourgeon Portfolios

As we continue to explore investment opportunities, we have begun selectively allocating to the private markets, where appropriate, and after thorough due diligence.

Over the last five years, significant changes in the alternatives landscape have made it more accessible to individual investors, lowering traditional barriers and opening new growth potential. We believe that private markets (equity, infrastructure, credit, real estate, secondaries) present a compelling opportunity to diversify your portfolio further, particularly if the M&A market improves under the new administration.

As always, we remain committed to guiding you through these opportunities. If you'd like to discuss how alternatives could fit into your investment strategy, please don't hesitate to contact us.

### Fourth Quarter Model Portfolio

Our model portfolios all achieved strong absolute returns for the full year. The fourth quarter was a tale of

two stories where US equities generally posted positive returns, but investors with exposure to global equities, fixed income, or certain US sectors had difficulty. International developed and emerging markets each trailed the S&P 500 by roughly 10%. The strong rise in interest rates throughout the quarter caused broad fixed income to post negative returns. Higher rates also hurt real estate investments, with the sector trading down for the period. With certain exceptions, US equities had a volatile quarter but ultimately enjoyed a "Trump bump" and rose for the period.

Our model portfolios are built to provide broad diversification across regions and market capitalizations. We continue to believe in the principle of spreading our bets across various asset classes and geographies.

In recent years, US equity outperformance and the exceptionalism of the US economy have been truly extraordinary and outperformed international markets. Our model portfolios significantly overweight US equities, but in totality, they are not meant to be solely representative of the returns of the S&P 500. We will continue to manage global exposures to participate in what works best while remembering that circumstances can change quickly, and asset classes fall in and out of favor all the time.

### Volatility is High Even in the Bond

The volatility in the bond markets during 2024 was dramatic, with yields moving both up and down swiftly and with impact. We continue to slowly lengthen duration when reinvesting maturing bonds, taking advantage of real yields at close to 2%, the highest levels since 2006. The spreads between corporate bonds and US Treasuries are quite low. This is either an endorsement of the economy's strength or a warning about US debt levels. We have added more US Treasuries to our bond portfolio.