New Administration Poses Opportunities, Challenges

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Review of 4Q 2024

The S&P 500 rose 3.36%, bringing the year-to-date performance to 25.71%. Several major economic developments occurred during the fourth quarter, including an additional 0.50% in federal funds rate cuts and a decisive outcome in the November election, where Donald Trump and the Republican party gained control of the White House, Senate and the House of Representatives. The underlying strength of the U.S. economy continued to surprise to the upside, setting up an interesting backdrop for 2025. We expect the Trump administration to push forth its agenda against the Federal Open Market Committee (FOMC), which is keeping rates higher than expected to fight the renewed threat of inflation from Trump tax cuts and tariffs.

U.S. GDP Estimates

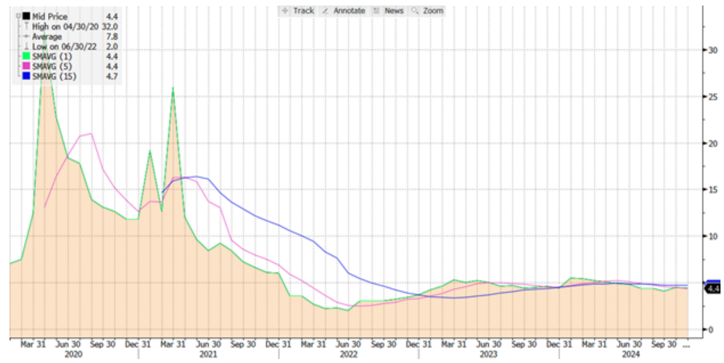
'23 Act.	'24E	1Q '25E	2Q '25E	3Q '25E	4Q '25E	'25E	'26E
2.9%	2.8%	2.0%	1.9%	2.2%	2.4%	2.6%	2.3%

Source: Pinnacle Financial Partners

Some of the surprising economic data included third quarter GDP, retail sales, CPI and PPI and the November jobs report. The resilience of the U.S. economy is a nice problem to have. Finally, the Personal Consumption Expenditures (PCE) readings were generally in line with estimates. Despite the hotter data, the FOMC cut the federal funds rate by a total of 1% in 2024. We believe that the FOMC has been aggressive enough in loosening financial conditions that it can slow the pace of upcoming rate cuts in 2025.

The election of Donald Trump as the 47th U.S. president will present both opportunities and challenges for investors. During Trump's first presidency he cut both corporate and individual tax rates, which was accretive to U.S GDP growth and capital investments. He also imposed tariffs through his "America First" program, angering many of our trading partners who retaliated with tariffs of their own, which increased the cost of many finished goods. He was successful in achieving a trade deal with Mexico and Canada, which lowered the price of goods. In his second term, Trump needs to use tariffs as the means to an end—to achieve new trade deals that benefit U.S. consumers and don't increase the price of finished goods. Many companies have increased their ordering and inventories of products they fear will be hit with tariffs once Trump takes office. In his first administration, Trump also supported deregulation, which was helpful for American businesses but does not contribute directly to additional GDP growth, and the benefits are difficult to calculate.

U.S. Personal Savings as a % of Disposable Income



Source: Bloomberg

U.S. Core PCE YOY

'23 Act.	'24E	1Q '25E	2Q '25E	3Q '25E	4Q '25E	'25E	'26E
2.8%	2.5%	2.5%	2.3%	2.3%	2.3%	2.3%	2.1%

Source: Pinnacle Financial Partners

Economic Outlook

Our outlook for 2025 is positive, but challenges remain. We believe that a broad economic slowdown is still underway—we expect U.S. GDP growth to slow by 0.2-0.3% in 2025. We have already seen the markets react to incoming President Trump's policies. In September, prior to the election, the 10-year Treasury had a yield of 3.60%; at year end, the yield had risen to 4.57%. This precipitous rise in long Treasury rates has been driven by a belief that all of Trump's policies are inflationary. The incoming president has said he intends to eliminate taxation on overtime and Social Security benefits. He also wants to lower the corporate tax rate to 15% from 21% and make permanent the personal income tax cuts he passed during his first term. The results of these actions would increase GDP growth, capital stocks and wages, but price levels will rise, which will be reflected in higher inflation and debt levels over time.

There has been a lot of discussion about a rising inflation expectation with Trump's economic plan and the potential for the FOMC to raise the federal funds rates as a response to a surge in inflation readings from Trump's agenda. We do not believe that this will occur; instead, we believe that the FOMC has already changed its dot-plot to address these concerns and will keep interest rates higher than many expected, which means it is willing to trade higher rates for lower GDP growth.

Economic Outlook

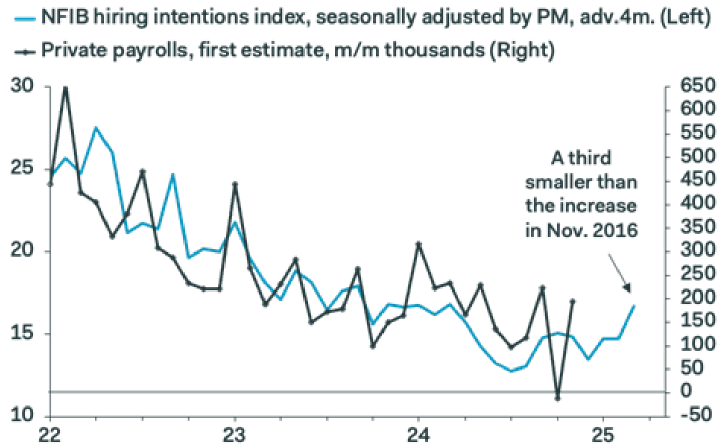
GDP	0.8%
GNP	-0.1%
Capital Stock	1.7%
Wages	0.8%
Full-Time Equivalent Employment	597,000
Baseline Debt-to-GDP Ratio, 2065	201.2%
Conventional Debt-to-GDP Ratio, 2065	223.1%
Dynamic Debt-to-GDP Ratio, 2065	217.0%

Source: Tax Foundation

We expect the Trump administration to have a challenging 2025 as it tries to work on its agenda against the restraints of the swelling deficits and two foreign proxy wars. We believe that the Trump administration needs to focus on stimulating the domestic economy, along with shoring up America's standing across the globe. The strength of the U.S. dollar has limited U.S. exports in recent years and hurt our competitiveness globally. We expect the negative trends put in place by the Biden administration to continue in the first half of 2025 and predict the second half of the year will have higher GDP growth and all the benefits of Trump's economic agenda.

We expect the "DOGE" initiative to be challenging—2.3 million government workers are paid roughly $250 billion per year. These civil servants, many of whom are unionized and have a long tenure, will be harder to get rid of than Elon Musk thinks. Musk believes that he and Vivek Ramaswamy can cut about $2 trillion out of total government spending of $6.75 trillion. That may sound good on paper, but any material cuts in government spending and employees will only weaken current GDP and cause the unemployment rate to rise further. While cuts to total government spending are helpful to the deficit, the tax cuts will offset any advantages realized.

NFIB Hiring Intentions



Source: Pantheon Economics

With the U.S. economy continuing to slow into 2025, we expect the unemployment rate to peak around 4.5% in the second quarter of 2025. While U.S. consumer spending surprised to the upside, there is growing evidence that this is not sustainable. Personal saving as a percentage of disposable income continues to decline from the pandemic highs; this, combined with a weakening jobs market, does not bode well. Consumers with higher income will get a bump in disposable income if the upcoming tax cuts take effect, but low earners continue to be under substantial stress. Businesses continue to lower their hiring expectations as the slowdown continues. We expect consumer confidence, which surprised to the upside in late 2024, to fall by early 2025.

U.S. home prices are up over 50% from 2019 and kept moving higher as higher interest rates have combined with a nationwide shortage of housing to keep inventory low. We do not see the 30-year mortgage rate falling into the 5% area until late 2026—at that point, demand destruction could limit any potential upside. Beside single-family home prices, automobile average purchase prices have risen 27% since 2019, and financed monthly payments are the highest on record. All of this, combined with a 25% rise in food prices since 2019, provide a pretty negative backdrop for U.S. consumer spending when compared to a 4% rise in incomes since 2019. It is not surprising that GDP growth estimates continue to flatten given the rise in price levels since the pandemic.

Unemployment Rate

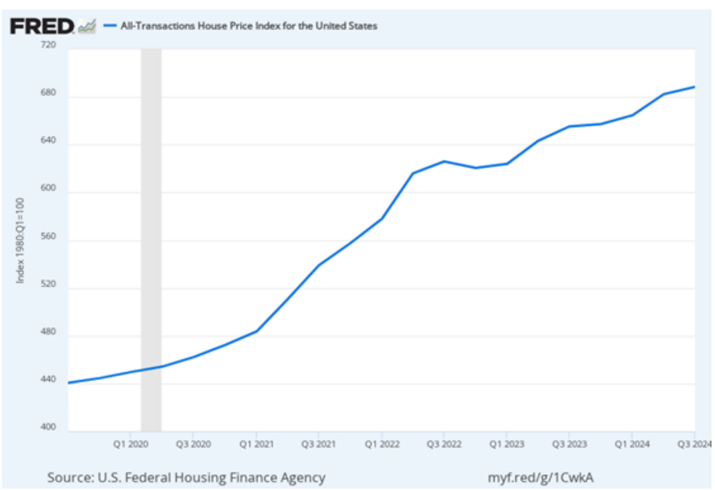
'24 Act.	1Q '25E	2Q '25E	3Q '25E	4Q '25E	'25E	'26E
3.6%	4.5%	4.5%	4.4%	4.4%	4.4%	4.4%

Source: Pinnacle Financial Partners

At the Dec. 18 FOMC meeting the group revised its rate cut dot-plot to show only 0.50% in rate cuts in 2025. It still sees terminal federal funds rates in the 3.25%-3.50% area by late 2026. This would imply that the federal funds rate would move down an additional 0.25%-0.75% in 2025, equating to a 6.75%-6.50% prime rate. We expect the FOMC to cut 0.25% in March, June and possibly September. The Treasury continues to issue record amounts of debt. As of Sept. 30 the total outstanding debt was $35.5 trillion, up $2.3 trillion since year end 2023.

Janet Yellen has continued to issue more short-term debt than longer term debt to try not to affect long rates. This strategy will increase issuance in 2025, which will create risk for Treasury auction participants. The precipitous rise in the 10-year Treasury yield is a result of a belief that the U.S. economy will perform better under Trump and a belief that U.S. Treasury issuance will continue to climb. Treasury auction participants continue to want higher term premiums to offset the risk of holding longer Treasury bonds. The positive news for Treasury investors is that U.S. GDP looks robust when compared to the anemic growth of the rest of the world. If U.S. GDP growth accelerates during the Trump presidency, the U.S. will avoid a fiscal crisis.

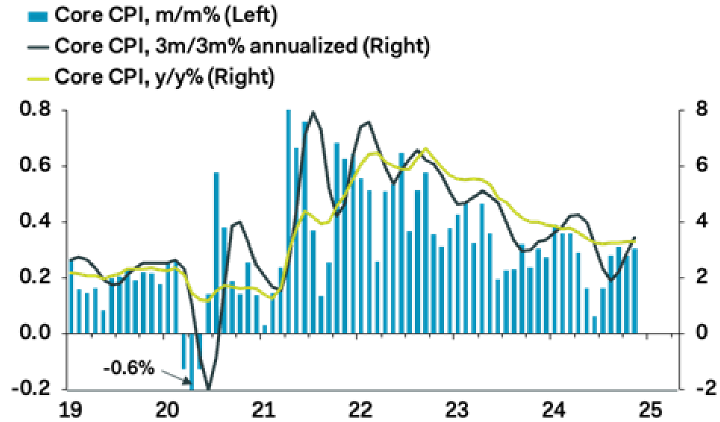
U.S. Home Price Index All-Transactions



Source: Pantheon Economics

In June the FOMC tapered its quantitative tightening sale from $95 billion a month to $60 billion a month. We had previously expected the FOMC to fully taper its purchases at the December 2024 or January 2025 meeting. Now that the FOMC has greatly reduced the number of federal funds cuts in 2025, we do not expect it to fully taper bond sales until the second half of the year. We believe the FOMC is

Core PCE Month to Month



Source: Pantheon Economics

in a wait-and-see mode, but any further weakening of economic results could force it to be more aggressive.

Portfolio Strategy

At quarter end the S&P 500 traded at 24.65x; the index is currently estimated to be trading at 21.63x 2024 earnings. Our 2025 S&P 500 earnings projection is $325, which is above the street's earnings of $317, but we still expect earnings to rise by 17% in 2025, which should provide a positive backdrop. Equity prices have had two years of strong performance—we expect 2025 to be a more normal year with equity prices rising 7-9%.

The best performing sectors for the quarter were: Consumer Discretionary, up 14.84%; Communications, up 8.44%; Information Technology, up 7.70%. The worst performing sectors for the quarter were: Energy, down 12.17%; Healthcare, down 9.85%; Real Estate, down 7.38%.

The best performing sectors year to date were: Communications, up 41.47%; Information Technology, up 33.87%; Consumer Discretionary, up 33.87%. The worst performing sectors year to date were: Materials, up 0.16%; Healthcare, up 0.80%; Energy, up 2.92%.

The S&P 500 sectors currently trading below the S&P 500 at the end of the fourth quarter were: Energy, 13.69x; Financials, 18.86x; and Consumer Staples, 21.48x. The most expensive sectors at the end of the second quarter were: Real Estate, 44.57x; Information Technology, 41.61x; and Consumer Discretionary, 31.98x.