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Chartwell Current Outlook and Investment Strategy

Macroeconomic Update

The prevailing economic narrative in the beginning of 2024 was that high inflation in prior years, combined with exhausted post-COVID consumer savings balances, would drive lower consumer spending. This, in tandem with weaker manufacturing activity, would meaningfully slow economic growth as the year progressed. It did not happen. The Atlanta Federal Reserve's GDPNow™ (Federal Reserve Bank of Atlanta, Center for Quantitative Research) estimates healthy annualized fourth quarter GDP growth of 2.7%, as of January 9, 2024. While the manufacturing sector remains weak, the services sector is picking up the slack, leading to a relatively healthy jobs market. The manufacturing sector was in contractionary territory for the entire fourth quarter with the Institute for Supply Management Manufacturing index (December 2024 Manufacturing ISM® Report On Business®) for December registering 49.3. By contrast, continued strength in consumer spending drove the Services index (December 2024 Services ISM® Report On Business®) to 54.1 in December. In total, the economy added 511,000 jobs in the fourth quarter, down from the 531,000 added in the third quarter, but still a very strong result.

There is a fair amount of uncertainty over the future growth trajectory given the change in administration in late January as there are policy proposals that could have material impacts on our medium-term outlook. There is also some uncertainty over the future path of interest rates as some indicators of inflationary pressure are flashing warning signs. That said, economic fundamentals are reasonably strong, and we do not expect significant change in the near-term.

Asset Class Returns

As of 12.31.2024

	QTD	YTD
Equities		
Large Cap	**2.4%**	**25.0%**
Large Cap Growth	**7.1%**	**33.4%**
Large Cap Value	**-2.0%**	**14.4%**
Small Cap	**0.3%**	**11.5%**
Small Cap Growth	**1.7%**	**15.2%**
Small Cap Value	**-1.1%**	**8.1%**
Fixed Income	**-3.0%**	**2.1%**
Treasury Inflation Protected Securities	**-2.9%**	**1.8%**
High Yield	**0.2%**	**8.2%**
Cash	**1.2%**	**5.3%**

**Large Cap, Large Cap Growth, Large Cap Value, Small Cap, Small Cap Growth, Small Cap Value, Fixed Income, Fixed Income – Inflation Protected, High Yield and Cash refer to: S&P 500, Russell 1000 Growth, Russell 1000 Value, Russell 2000, Russell 2000 Growth, Russell 2000 Value, Bloomberg US Aggregate, Bloomberg US Treasury Inflation Notes, Bloomberg US Agg Corporate High Yield, and Bloomberg US T-Bills, respectively.*

Equity Market Update and Outlook

The equity markets closed out a solid year with the S&P 500 rising 2.4% in the fourth quarter, bringing the annual gain to 25.0%. Combined with last year's 26.3% rise, the cumulative gain for the past two years was an impressive 58.0%. Several key drivers contributed to the market's performance, including economic resilience, moderating inflation, Federal Reserve interest rate cuts, and the ongoing build-out of artificial intelligence (AI). The "Magnificent Seven" led the market rise, accounting for more than half of the S&P 500's return. These companies surged ahead as they are believed to benefit significantly from AI advancements. Gains in these mega cap tech stocks pushed the large-cap growth benchmark, the Russell 1000 Growth index, to a 33.4% gain for the year. Other areas of the market also experienced positive returns, although not to the same extent. Despite a strong year for Financials with the sector jumping 31.8%, the Russell 1000 Value index which has a heavy exposure to Financials, rose by just 14.4%. Small-cap stocks also had a good year, with the Russell 2000 index of smaller companies rising by 11.5%, although this was still far behind the increases seen in the large-cap benchmarks.

We believe equity markets can continue to advance in 2025 despite two years of solid gains and healthy market valuations. Our positive view is underpinned by a long-standing strategy of being generally optimistic when the economy is in good shape and more conservative when a downturn appears imminent. Currently, economic trends are solid as noted in the earlier section with the Federal Reserve easing and the potential for lower taxes and regulation. One area of particular concern is housing, which directly or indirectly accounts for perhaps 15% of the economy and remains sluggish as supply remains constrained with homeowners loathe to move and give up a sub 4% mortgage. In our opinion, the sector needs lower mortgage rates before home sales will be able to strengthen meaningfully.

Holdings are subject to change. A full listing of portfolio holdings is available upon request.

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Fixed Income Market Update and Outlook

The fourth quarter of 2024 presented significant challenges for bond investors. Concerns about persistent inflation and a more cautious approach to rate cuts by the Federal Reserve led to rising yields and falling prices for most bonds. Additionally, there was rising apprehension regarding the government's financial circumstances due to recent debt ceiling controversies, rising deficits, and higher interest payments. As such, interest rates across various maturities experienced upward pressure and the Bloomberg US Aggregate, a broad-based index that measures U.S. investment-grade, fixed-rate taxable bonds, declined by 3% during the quarter. Despite an increase in inflation expectations, inflation-protected bonds only managed to achieve slightly better returns than the broader averages due to their longer maturities. This high exposure to rate increases negatively impacted the segment. Meanwhile, high-yield bonds remained in positive territory for the quarter, gaining 8.2% for the year. Lower-rated bonds outperformed their higher-rated counterparts as investors grew more comfortable with credit risk, leading to tighter spreads against Treasuries. Throughout the year, investors came to believe that the economy would remain resilient and bought high yield bonds.

Looking ahead, as of early January, the yield to maturity for the bond market, as measured by the Bloomberg US Aggregate index, stood at approximately 4.54%. As we have previously noted, the current yield is often the best estimate of future returns for fixed income, with a 0.94 correlation between starting yields and total returns over the subsequent five years, according to research from investment bank Morgan Stanley. The bond portfolio should provide a source of stability for clients should the economy weaken more than anticipated or if inflation re-accelerates, negatively impacting the value of equity portfolios.

Definitions

Bloomberg US Aggregate Bond Index or the Agg, is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. Investors frequently use the index as a stand-in for measuring the performance of the US bond market.
Bloomberg US Corporate Index Average Option-Adjusted Spread (OAS) are the calculated spreads between a computed OAS index of all bonds in a given rating category and a spot Treasury curve. An OAS index is constructed using each constituent bond's OAS, weighted by market capitalization. The Corporate Master OAS uses an index of bonds that are considered investment grade (those rated BBB or better).
Dow Jones Industrial Average is the DJIA or "The Dow" is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.
The Nasdaq Composite Index is the market capitalization-weighted index of more than 2,500 common equities listed on the Nasdaq stock exchange.
Russell 1000 Growth Index measures the performance of the US large-cap companies whose earnings are expected to grow at an above-average rate relative to the market. It is a subset of the Russell 1000 Index. To refl ect the growth style characteristics, the index selects the companies that exhibit growth characteristics, i.e. higher price-to-book ratios and higher forecasted growth. Like other growth indexes, the index is largely biased toward the Information Technology sector which represents more than 40% of the index.
Russell 2000 Growth Index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small-cap stocks.
Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.
Russell 1000 Value Index measures the performance of the large-cap value segment of the US equity universe. It includes the Russell 1000 companies with lower price-to-book ratios and lower expected growth values.
S&P 500® Index: (registered trademark of The McGraw-Hill Companies, Inc.) is an unmanaged index of 500 common stocks primarily traded on the New York Stock Exchange, weighted by market capitalization. Index performance includes the reinvestment of dividends and capital gains.
Bloomberg US Treasury Inflation-Protected Securities (TIPS) Index is a market value weighted index that tracks the performance of inflation-protected securities issued by the US Treasury. It's a rules-based, benchmark index that doesn't have a defined investment objective, incur fees or expenses, or is actively managed.

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