KOCAA Investment Roundtable: Year-End 2024

TRUMP WORLD 2.0 –

Heading into 2025, we have clarity on some issues, but several unknowns remain. The U.S. election was a major theme in 2024 and focused on not only who would win but whether there would be issues surrounding the election itself. Mercifully, for both the markets and the country, results were clear early in the morning on Wednesday, Nov. 6, and there were no lawsuits or accusations of election interference.

In the immediate period following the election, equities continued to perform well as investors moved to position portfolios to benefit from expected policies coming out of the new Trump administration. Interest rates were quite volatile, however, as budget and inflationary concerns battled with brighter growth expectations.

Geopolitically, some believed the markets to be pricing in concerns that China might move against Taiwan, predicated by regional dynamics and perceptions of China's view on U.S. leadership. Speaking with a geopolitical strategist revealed two interesting takes.

The world had come to think that Chinese and Russian-made weapons were on par with U.S.-built munitions. Yet, the under-armed Ukrainians enjoyed far more accuracy with western weapons, exposing Russian and Chinese-built weaponry as still inferior. The strategist further explained that the Chinese population is tired of their country's Zero Covid policy and, in the aftermath of China's one-child policy, President Xi would struggle to garner popular support to send their sole child into battle for a small island highly fortified with western military technology.

Regarding the Middle East conflagration, despite loud saber-rattling by Iran, Israel dismantled both Hamas' and Hezbollah's fighting ability in short order, further highlighting the superiority of western military capabilities. Moreover, Israel destroyed the four Russian-built surface-to-air missile batteries protecting Iranian airspace in two attacks, thus leaving Iran fully exposed to an air attack.

Things have subsequently quieted down on that front. Ultimately, Israel will have to address the humanitarian crisis in Palestine and significant rebuilding will be required. A lasting peace in the region may or may not be possible, but, with Trump in the White House, we expect further de-escalation in the region.

FED TRYING TO THREAD THE NEEDLE –

Back home, the inflation battle has returned to the front lines as the Fed's 2% target remains elusive. U.S. CPI declined to a low of 2.4% in September 2024 (from 9.1% in June 2022). The Fed then made a dovish pivot, cutting rates by 50 basis points at its September meeting and another 25 basis points in November, reflecting a view that inflation would continue to fall and allow them to turn their attention to ensuring that the employment market stayed strong.

However, inflation has accelerated by 30 basis points since September, and the 10-year Treasury moved back over 4.5%. In December, the Fed lowered the Federal Funds rate by an additional 25 basis points but signaled only two rate cuts in 2025, wary of the potential for a second wave of inflation. Further complicating the Fed's challenge is the enormous increase in U.S. government debt since Covid hit, which now stands at over 120% of nominal GDP with annual interest payments north of $1 trillion. The last figure exceeds the total U.S. defense budget.

Upcoming releases of data will help the Fed decipher whether they have done enough to tame inflation. The most recent release of data showed a slight deceleration in income and personal spending. Further, the PCE Index (the Fed's preferred inflation gauge) showed slight deceleration. As the U.S. economy is 70% driven by consumer spending, the health of the consumer is a significant factor in aggregate economic activity. The direction and composition of key income and price data in early 2025 will determine the Fed's focus on supporting employment versus fighting inflation.

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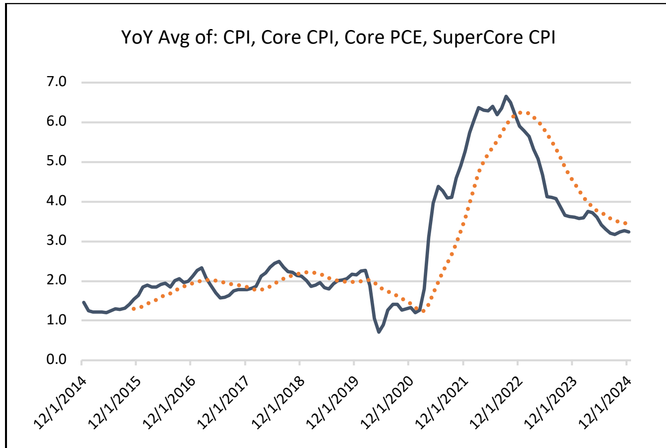
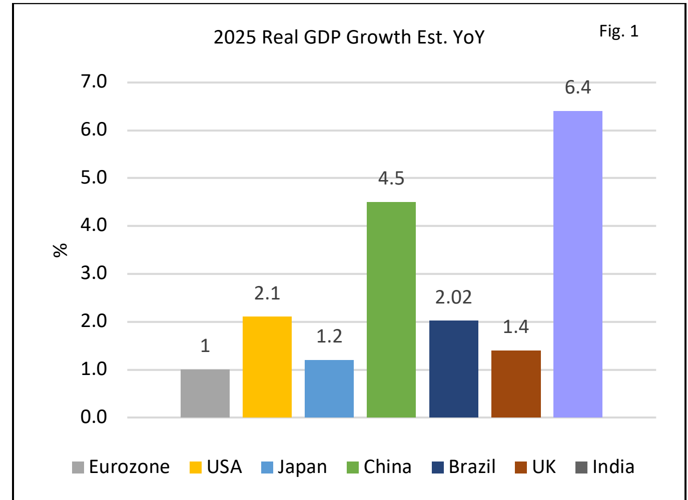




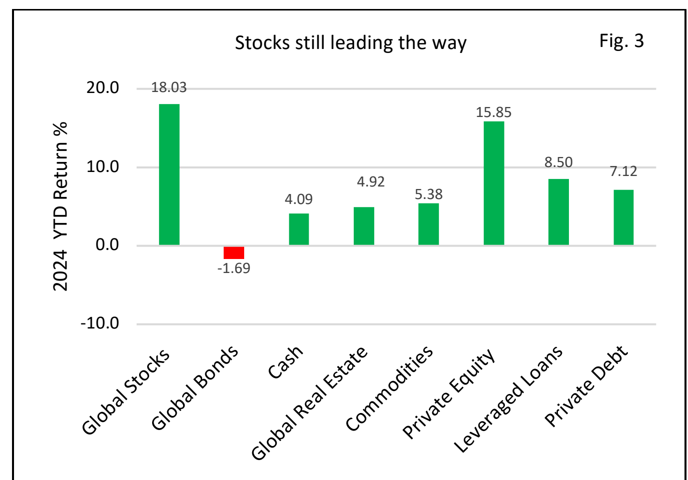
ECONOMY –

As frequently happens, consensus expectations for economic growth in 2024 missed the mark, with forecasts of a global slowdown. U.S. GDP growth is likely to come in at 2.3% (vs. 1.3% expected at the start of the year). In fact, most major global regions, except for Japan, are currently expected to finish the year with higher GDP growth than forecast at the start of 2024. For 2025, global GDP growth is again forecast to slow modestly from the 2024 pace, though Trump's tariff proposals remain a wildcard.

With the U.S. presidential election cycle in full swing, the Bureau of Labor Statistics cranked out "better-than-expected" employment numbers nearly every month, showing a surprisingly robust jobs market supporting solid consumer spending that generally topped expectations. However, there was a persistent and widening gap between the Non-Farm Payrolls figures (# of jobs) and the Household Employment Survey (# of employed).

While the details and methodologies are beyond the scope of this discussion, in August 2024 the BLS revised away over 800,000 jobs that it previously reported were created between April 2023 and March 2024. Furthermore, the BLS reported a total of 2.2 million new Non-Farm Payroll (NFP) jobs in the 2024 calendar year, while the Household Survey showed an increase in employment of 540,000 people. It seems unlikely that each newly employed person in 2024 held four jobs. We suspect that additional downward revisions to NFP are forthcoming.

MARKETS –



Nonetheless, despite still-elevated inflation, real wages have grown solidly over the past 12 months. Consumer spending appears to be holding up as 2025 kicks off, though those at the lower end of the income scale have likely maxed out their ability to tap credit.

Global publicly traded stocks continued atop the leaderboard in 20024, dominated by U.S. large cap growth stocks. Most assets enjoyed solid returns, the exceptions being bonds, industrial REITS, oil and a few industrial and agricultural commodities. Gold (+27.2%) built on its gains from 2023, as global central banks continued to accumulate reserves, and Silver (+21.46%) also glittered. Bitcoin, which began trading in ETF form on organized exchanges, more than doubled, topping $100,000. Leveraged Loans and

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Private Debt remain in demand, although investment grade corporate bonds currently yielding above 5% may offer competition on a risk-adjusted basis due to greater liquidity.

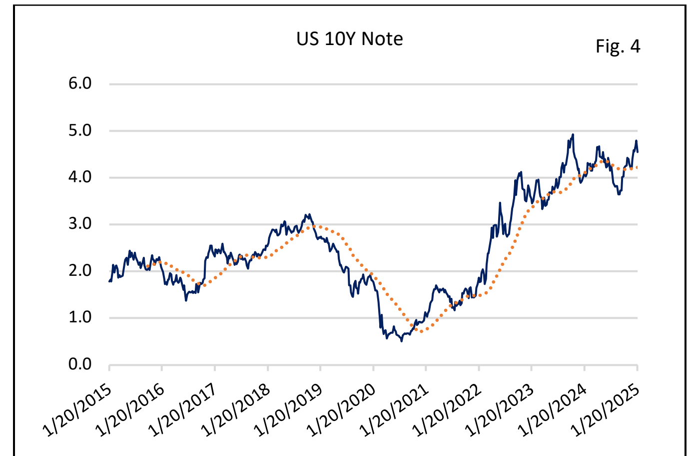
Global risk assets spent the majority of the fourth quarter digesting the re-election of Donald Trump as U.S. president and trying to ascertain the likely policy implications. The new administration's foreign policy goals seem clear — "peace through strength" — and there is also a strong Monrovian streak, with Trump talking about a Greenland deal and retaking the Panama Canal, however realistic either may be. On balance, the market's generally positive assessment regarding domestic economic initiatives is likely on target. But the devil is always in the details, and we expect a few surprises that could alter investors' current assessment.

FIXED INCOME – GOV'T

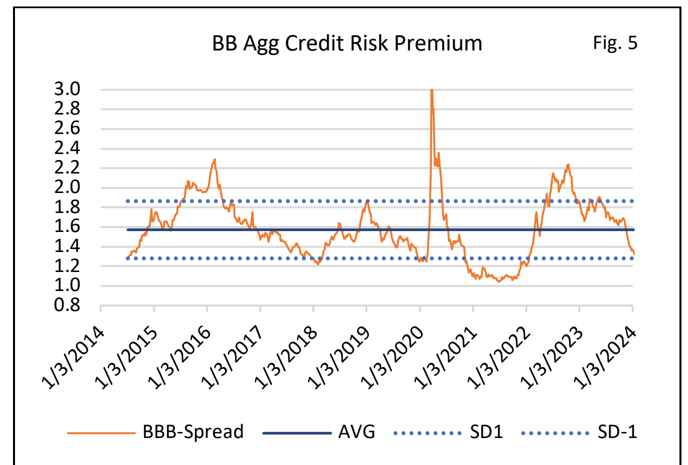
While headline ten-year U.S. Treasury rates were little changed over the last six months of 2024, that understates both the volatility seen during the half year as well as the significant transformation in the shape of the yield curve. As we discussed in the 1st Half Review, the curve steepened in anticipation of the Federal Reserve beginning to ease. After they started the cycle with a surprising 50bp inaugural cut in September, the long end was initially buffeted by global market volatility as well as a string of disappointing economic news.

In the fourth quarter, however, the long end reversed and sold off appreciably. Ten-year yields surged past 4.70% in the first few trading days of the new year, driven by speculation over the impact of likely Trump administration policies as well as data indicating a resilient, or even strengthening, American economy. We remain concerned that the Federal Reserve has lost touch with the trajectory of inflation as well as the economic reality on the ground and may again be looking in the rearview mirror. Governors are now vacillating between hawkish and dovish with each individual economic data point. We hope that Americans are not in for a repeat of the second half of the 1970s.

Despite the swing in political power in Washington, we do not expect that the aggressive deficit spending will ease any time soon, putting pressure on markets to support the debt issuance, as well as continuing to stimulate economic growth. We think the yields available in fixed income are attractive but would not lean heavy into duration until the outlook for the deficit and growth becomes clearer.



FIXED INCOME – CREDIT



After a brief Japanese yen-induced panic in early August, investment grade credit spreads resumed their steady grind tighter for the remainder of the year. Insatiable investor demand for yield and strong corporate balance sheets remains supportive for this dynamic to continue. While investment grade corporate bond yields of 5%-plus should remain tempting, we believe other segments of the market may offer a more attractive risk/reward proposition and thus maintain a neutral position in corporate credit.

A significant portion of overall income return is generated via the U.S. Treasury basis rate. Spreads are very tight in the weaker end of the credit quality spectrum, which also carries

the most beta to any economic shock or geopolitical crisis. Investment grade agency mortgages, senior tranches of CMOs and asset-backed exposure to prime borrowers represent an attractive opportunity set. We believe that the spreads available here, relative to historical levels, provide a reasonable space to clip coupons while minimizing risk.

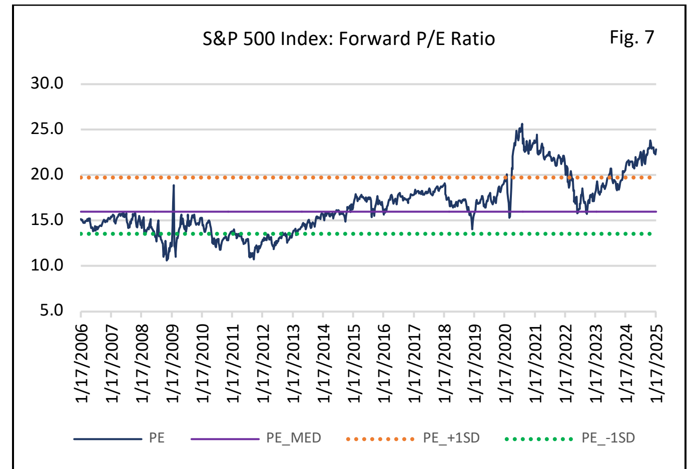
The beginning of 2025 should bring a fair amount of volatility, though it should also introduce some clarity into the direction and scale of the Trump administration's economic agenda. We believe that the risks are tilted towards a reacceleration in growth and an associated lift in inflation. Should this occur, the Fed would be forced to pause the easing cycle and at least seriously consider a pivot to an adjustment hike. The latter would force investors to re-evaluate the current narrative of a sanguine outlook for financial markets and spur increased volatility.

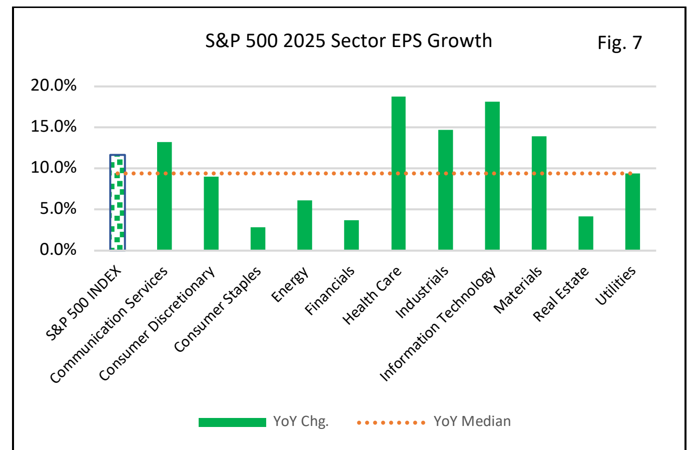
EQUITIES – US

In 2024, for the second consecutive year, the S&P 500 Index produced a total return of at least 25%. Moreover, it was the third time in four years with a 25% or greater return and the fourth time in the last six years gaining 25% or more. To say that it has been a good time to invest in large cap U.S. equities would be an understatement. Large cap growth stocks did even better, led by the "Magnificent 7" index of Technology and Communication stocks, which soared 67.34%. Small Caps, International and Value benchmarks, while positive on an absolute basis, all significantly trailed the large cap indices in 2024.

While large cap stock dominated benchmark returns, there was some broadening out as the year progressed. The Russell 2000 Index of small cap stocks outperformed the S&P 500 in the second half of the year (9.63% vs 8.42%) and nearly matched the 10.49% total return of the large cap Russell 1000 Growth Index. Despite the impressive second half return of the Magnificent 7 (+22.18%), Tesla (+104.08%) was the only name to outperform the index. Although AI continued to dominate the headlines, Nvidia only gained 8.72% in the second half, while Microsoft posted an outright decline of -5.34%.

The concentrated nature of the market, with a handful of Mega cap names driving benchmark returns, has been a concern for some time. Encouragingly, the top 10 stocks by weight in the S&P 500 Index contributed just 51% of the benchmark total return in the second half compared to 71% in the first half of 2024.





Some of the broadening in participation in the second half may have reflected optimism about the outcome of the U.S. presidential election and the potential for a more friendly policy environment for small business. It could also be that investors simply chose to book some gains in Mega cap growth stocks, redeploying sales proceeds into neglected stocks that lagged much of the year. A more likely driver, however, is that the relative earnings growth outlook began to shift in favor of smaller cap stocks and other areas of the market with accelerating earnings growth.

It remains the case that large cap stocks are historically expensive, with the market PE Ratio over the last 20 years exceeding current levels only in 2020-2021. This makes stocks showing with decelerating forward growth

vulnerable. While Technology and Communications Services are again expected to grow at a faster pace than the S&P 500 Index's aggregate 11.7% pace in 2025, the cyclical Industrial and Materials sectors are also forecast to outpace benchmark earnings growth, while Health Care has the highest expected sector growth rate. More significantly, the Energy, Financials and Industrials sectors have the strongest estimate revision momentum, while Technology and Communications Services have the weakest.

Regardless of the specific reason(s), we are optimistic that rotation in favor of the "Forgotten 493" stocks in the S&P 500 will continue in 2025. This should help buoy equity markets during a potentially disruptive transition period if investors substantially reallocate away from over-owned, over-bought and potentially over-hyped stocks.

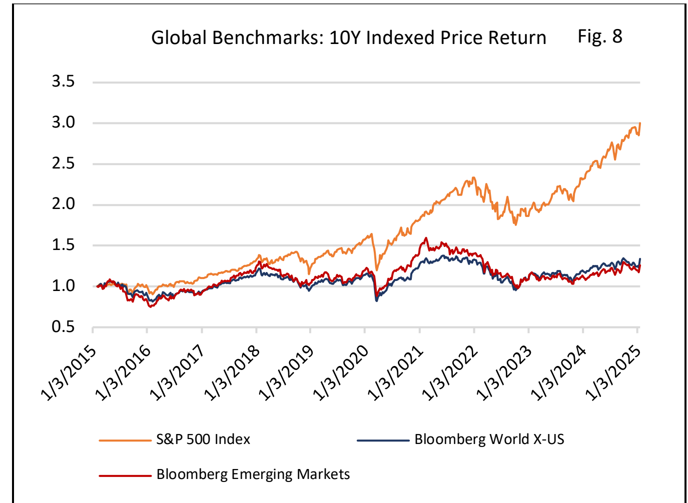
EQUITIES – INTERNATIONAL

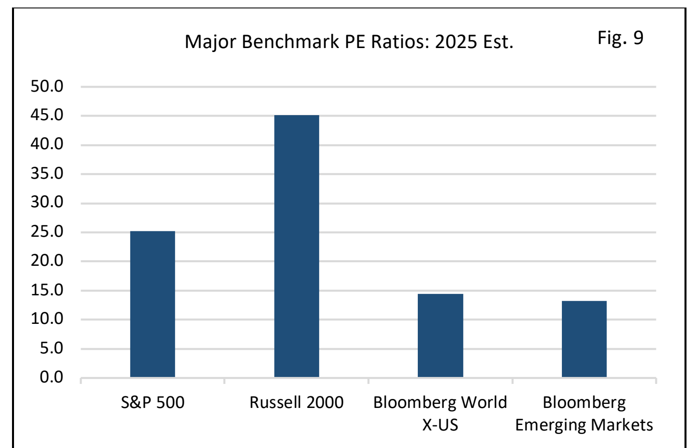
International equities experienced a volatile second half of the year. The Bloomberg World Ex-US Index finished the second half of the year only 53 basis points higher than the first half, finishing with a total return of 6.39% for 2024. Foreign markets faced significant swings related to currency movements, geopolitical risks and economic news. For the full year, non-U.S. Developed Markets returned 19.32%, well ahead of Emerging Markets (EM) at 8.07% in USD terms.

From a sector perspective, Financials (+18.5%), Information Technology (+14.1%) and Communication Services (+13.2%) drove the ex-U.S. benchmark in 2024, while Materials (-12.0%), Consumer Staples (-7.5%) and Energy (-3.9%) were laggards.

Emerging Markets Asia (+12.2%), Canada (+12.2%) and the United Kingdom (+10.7%) were the top performing regions in the benchmark, while Latin America (-24.6%) was a significant laggard and Europe ex-UK (+1.0%) also underperformed.

Canada was led by the Information Technology sector, primarily due to Shopify, as well as Financials. EMEA* was driven by the United Arab Emirates local market, with Real Estate the top-performing sector. Emerging market equities faced some country-specific hurdles during the year yet were up 18.3% through Oct. 2, topping the performance of developed markets. A sharp fourth quarter rally in the U.S. dollar erased much of the YTD gain.





In August, Japan's Nikkei 225 index recorded its most significant decline in index points, dropping 12.4% in a single day but rebounding in subsequent sessions. This was caused by rising Japanese interest rates sparking fears of an unwinding of the "Carry-Trade." In simple terms, the Japanese Carry-Trade involved borrowing money at very low rates (near 0%) in a weak currency (Japanese yen), converting into a stronger currency and investing in assets with higher return potential (i.e. U.S. bonds and stocks). The rise in Japanese interest rates caused the yen to appreciate, prompting investors to sell U.S. assets and repay yen-denominated loans, while also making Japanese bond returns relatively more competitive with equities.

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International markets were also shaken in September due to a rebound in China on stimulus news, while South Korea faced political instability. Social and political unrest in the Eurozone, particularly in France and Germany, continued to build in 2024 with elections upcoming in both countries over the next 24 months. Additionally, currencies heavily affected EM performance, particularly in Latin America, with the Brazilian real decreasing by 20% and the Mexican peso decreasing by -18% against the U.S. dollar.

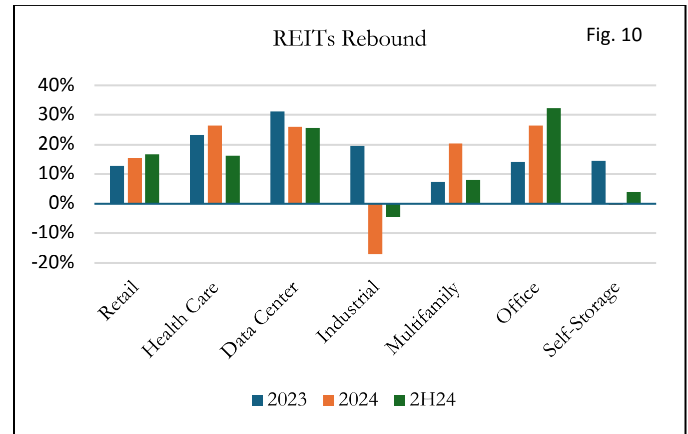
Amazingly, going back to the financial crisis in 2008, the Bloomberg World Ex-US Index has underperformed the S&P 500 Index in 13 of 17 years, including 10 of the last 12. In 2025, international markets will remain challenged. China faces volatility due to higher U.S. tariffs, growth concerns and potential debt deflation, while other emerging markets, such as Brazil, face multiple headwinds including currency.

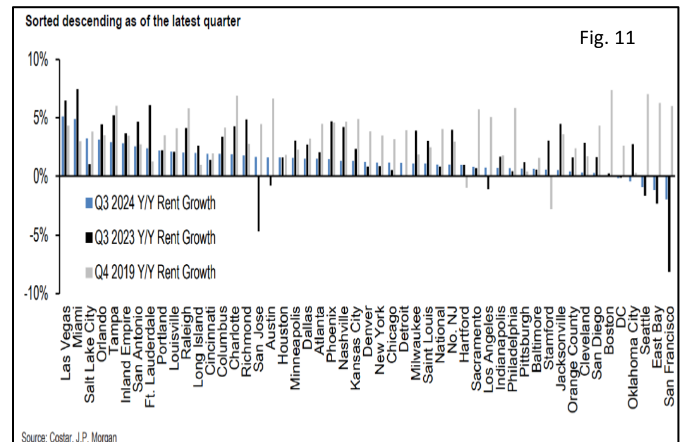
REAL ESTATE

After a weak start for 2024, REITs rallied during the second half of the year. Sentiment in the sector was boosted by the Fed's shift toward a rate-cutting cycle, which was expected to lower cap rates, mitigate rising costs of refinancing and boost transaction volumes. Although valuation pulled back in December, as the Fed shifted toward a more hawkish tone with fewer rate cuts expected for 2025, the real estate sector still booked a gain for the year. Industrial REITs remained weak for 2H24, while the Office segment saw a marked shift in investor sentiment and was the best performing subsector. Data Center, Health Care and Retail REITs also saw stellar equity performance.

Despite the generally positive performance across asset types, there were pockets of weakness such as the Industrial assets. Self-Storage renormalized from the high demand in the post-pandemic period, and lower move-in rates are a headwind for revenue growth. A potential rebound for Self-Storage in 2025 hinges on housing demand. In addition, Office segment fundamentals remained weak despite a stronger investor sentiment.

Office occupancy continued to weaken to the low 86% range compared to over 87% a year ago. Occupancy remains far below the low 90% range set just prior to the pandemic and the mid-87% range set during the GFC. Leasing volume has been up to the 400mm sq ft per quarter range in 2024, driven by strong growth in the NYC region, but is still more than 50% below pre-pandemic range. Around a third of office tenants are still on pre-Covid leases, and renewals could create further headwinds on occupancy.





Market consensus, however, is expecting to see occupancy trough in 2025-26. Overall, there remains a bifurcation between the high-quality buildings that are close to full occupancy and the commodity offices that are struggling.

Office transaction volume remains very low, though there are signs of improving activity in NYC and Austin. Anecdotally, brokers are indicating cautious optimism for improvement in 2025, but interested buyers still lack the liquidity in terms of available debt and equity capital for potential deals. Muted transaction volume suggests that full re-pricing in the office market has not materialized.

There are few major markets reporting rent growth above 3%. Five out of 50 major markets are still seeing negative growth, including Washington, D.C.; Oklahoma City;

Seattle; East Bay and San Francisco. Bay Area offices remain weak with recovery elusive. West Coast watchers are expecting a gradual rebound in the Bay Area driven by an AI-related venture capital boom. We are from Missouri on that. Industrial REITs saw weak performance due to the combination of new supply and softer demand that dampened market rents, while new starts are still muted. Nonetheless, leasing spreads remain positive, and coupled with rent escalators on existing leases, the subsector still generated 6.7% same-store net operating income growth in 2024. In 2025, we fear that lower asking rents in the market may reduce leasing urgency. In addition, domestic economic policy uncertainty and the threat of rising tariffs could further temper investor sentiment in the new year.

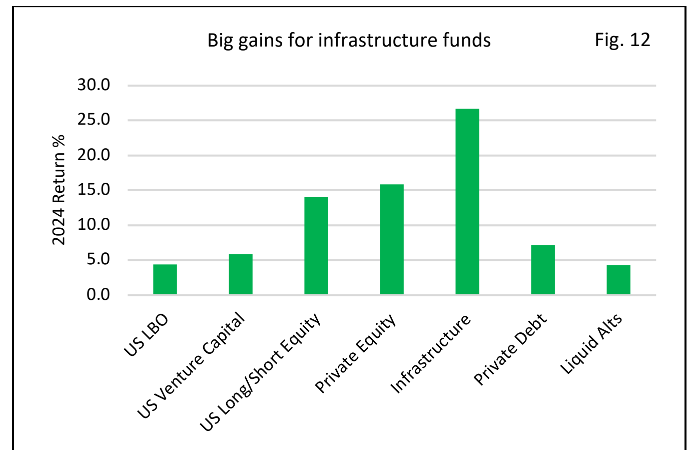
ALTERNATIVE ASSETS

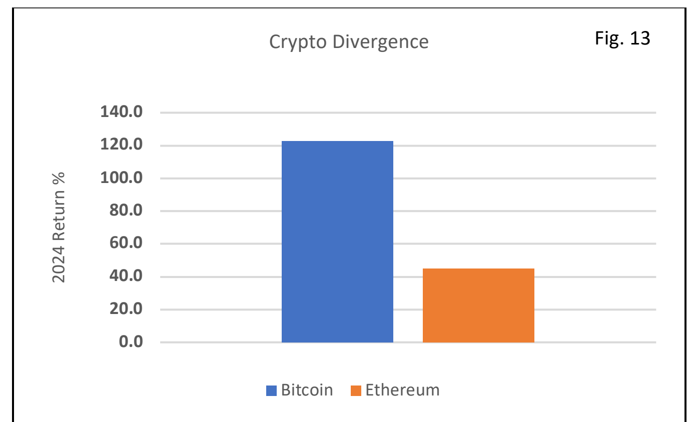
It was a year of both challenges and opportunity for "Alts" in 2024. As economic uncertainties persisted, investors in private equity, private credit and other alternative asset classes have been navigating a complex environment.

Regardless of one's views of the merits of cryptocurrencies as investment assets, 2024 was the year that they went mainstream, when ETF's for both Bitcoin and Ethereum began trading on U.S. exchanges. Bitcoin, particularly, is increasingly seen as a viable asset for speculation and diversification purposes by institutional investors.

Private credit was a standout performer in 2024, with investors increasingly turning to this asset class as a stabilizing force during turbulent market conditions. As traditional banks have pulled back from lending, particularly in riskier sectors, private credit providers have stepped in to fill the gap, offering attractive yields in a higher interest rate environment. Deal flow was particularly robust in the middle-market segment.

With central banks maintaining elevated interest rates for most of 2024, private credit strategies focused on senior secured loans benefited from higher spreads and improved credit quality. While many institutional investors leaned into private credit, there's a growing emphasis on risk management, particularly in distressed sectors. The market has become more selective, with credit managers focusing on less cyclical, higher-quality borrowers. Private equity (PE) faced a mixed year in 2024. The market showed resilience in certain sectors, particularly technology,





healthcare, and sustainable infrastructure. On the other hand, higher borrowing costs and uncertainty over macroeconomic conditions weighed on deal-making activity, especially in leveraged buyouts (LBOs).

M&A activity in the large-cap segment down-shifted in 2024 with debt financing more expensive. However, deal flow in the middle market remained relatively steady, driven by both strategic buyers and private equity firms with dry powder

looking to deploy capital. As financing became more difficult, private equity firms leaned more heavily on operational improvements rather than financial engineering to drive value creation in portfolio companies.

Exit opportunities in 2024 were tempered by volatility in public markets, although secondary buyouts and strategic sales provided viable alternatives to IPOs, where activity remained muted compared to pre-pandemic levels.

Turning to 2025, the alternative investment landscape is likely to remain dynamic but cautious. Interest rates are expected to stay elevated for most of the year, influencing both credit conditions and deal-making activity. However, opportunities exist in more niche markets like clean energy infrastructure, distressed debt and specific technology sectors like AI and cybersecurity.

While market volatility may persist in the early part of 2025, alternative investments, particularly those with a focus on resilience, operational efficiency and sustainable growth, are likely to provide attractive returns and strategic diversification for long-term investors.

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SOURCE DATA

Exhibit	Source
Figure 1	Bloomberg, KOCAA
Figure 2	Bloomberg, KOCAA
Figure 3	Research Affilates (RA), Bloomberg

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Figure 4	Bloomberg, KOCAA
Figure 5	Bloomberg, KOCAA
Figure 6	Bloomberg, KOCAA
Figure 7	Bloomberg, KOCAA
Figure 8	Bloomberg, KOCAA
Figure 9	Bloomberg, KOCAA
Figure 10	Bloomberg, KOCAA
Figure 11	Costar, J.P. Morgan
Figure 12	Research Affiliates (RA), Bloomberg
Figure 13	Bloomberg, KOCAA

Figures 3, 10, 12, 13 Return Data

Asset Class/Segment	Index
Global Stocks	MSCI ACWI
Global Bonds	Barclays Global Agg USD
Cash	US 3M T-Bill
Global Real Estate	S&P Global REIT USD Index
Commodities	Bloomberg Commodity Index
Private Equity	Equally Weighted returns for NB Private Equity Partners, Harborvest Global Private Equity Ltd, Solactive Private Equity Select Index, FTSE Private Equity Buyout Index
Leveraged Loans	Markit iBOXX Liquid Leveraged loans
Private Debt	Indxx Private Credit Index
Office	FTSE NAREIT Office Sub Sector Total Return
Hotels	FTSE NAREIT Lodging/Resort Property Sub Sector Total Return
Commercial Mortgage	FTSE NAREIT Mortgage Commercial Financing Sub Sector Total Return
Retail	FTSE NAREIT Retail Property Sub Sector Total Return
Industrial	FTSE NAREIT Sub Sector Industrial Total Return
Data Center	FTSE NAREIT Sub Sector Sata Centers Total Return
Self-Storage	FTSE NAREIT Self Storage Property Sector Total Return
Health Care	FTSE NAREIT Health Care Property Sector Total Return
US LBO	RA: US LBO Simulation
US Venture Capital	RA: US VC Simulation
US Long/Short Equity	Bloomberg Equity Long/Short Hedge Fund Index
Infrastructure	Alerian MLP Index
Private Equity	Equally Weighted returns for NB Private Equity Partners, Harborvest Global Private Equity Ltd, Solactive Private Equity Select Index, FTSE Private Equity Buyout Index
Private Debt	Indxx Private Credit Index
Liquid Alts	Wilshire Liquid Alternative TR Index

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Bitcoin	Bloomberg Bitcoin Index
Ethereum	Bloomberg Ethereum Index

*Europe, Middle East, Africa