Asset Allocation

Knights of Columbus Asset Advisors®

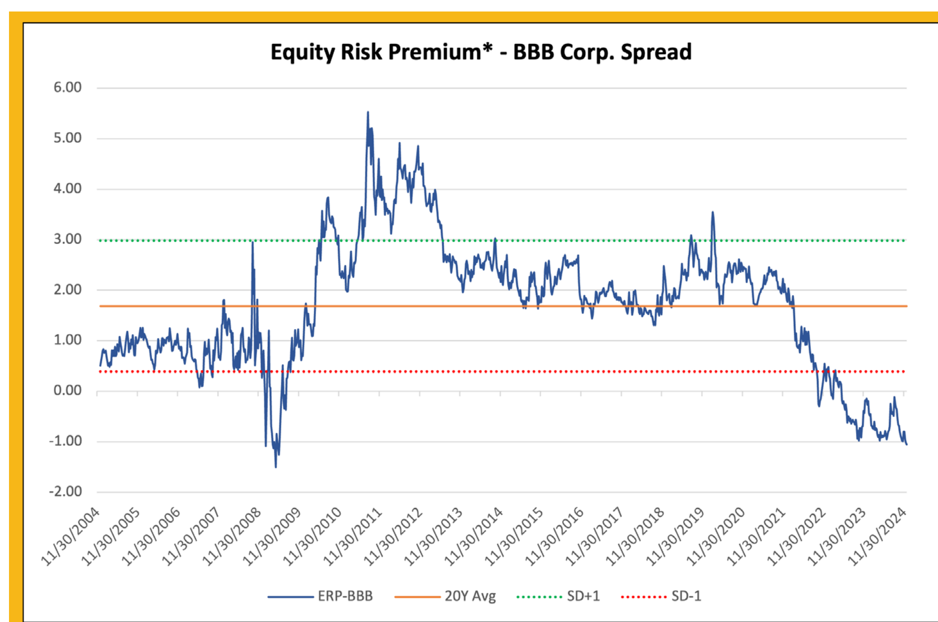
KoCAA's Asset Allocation Committee meets regularly throughout the year to evaluate current market and economic conditions, update risk and return expectations for various assets, and discuss the fiscal and monetary policy outlook.

The Committee has determined that it is appropriate to reduce exposure to equities, which were overweight relative to the midpoint of the target range, to at or slightly below the midpoint. We have implemented the change in our Diversified Model Portfolios effective January 2, 2025.

There are several reasons for the decision to reduce equity exposure, but the three primary drivers are:

1. While the long-term price trend remains constructive, the strong equity run over the past year has left the market extended from a short-to-intermediate perspective. On a price-only basis, the S&P 500 Index is up 46% since the October 27, 2023, low and is up 68% since the October 14, 2022, low. The 16% move from the August 5, 2024, low pushed the index 10% above its 200-day moving average, a level that has frequently been followed by declines, as was the case this past July. Further, equity market concentration is historically high, meaning fewer horses are pulling the cart. While Index earnings are widely forecast to rise +/- 10% in 2025, estimates are down 2% over the past six months and fewer stocks have rising estimates than falling estimates.

2. Equity valuations are expensive compared to historical averages, both on an absolute basis and more so relative to fixed income. The forward P/E Ratio on the S&P 500 is 2 standard deviations above its 20-year average. That does not mean it cannot expand further. But it does mean we have entered what we would call the high-risk zone, where accidents happen. At the recent high the S&P 500 Index was 27% above the December 31, 2021, weekly close (prior to the Russian invasion of Ukraine), yet earnings are expected to be only 15% higher in 2024 versus 2021. The Equity Risk Premium (index earnings yield less 10-year treasury yield) has been hovering near zero for much of 2024 and recently turned outright negative. The spread versus investment-grade corporate bonds, which are currently yielding more than 5%, has been negative for the better part of two years as interest rates trended higher. Based on current long-term expected returns for both asset classes, investors are not being sufficiently compensated for the added risk of holding equities versus bonds, in our view



3. With the new Trump administration taking over, there are many uncertainties. While we think we know the impact of some of the new administration's likely policies (lower taxes good, more, and higher tariffs bad), the market may be assuming a more benign backdrop for risk assets than will prove to be the case. Tariffs could be inflationary, which could exacerbate stubborn inflation that already looks to be troughing, pushing interest rates higher. While higher rates mean lower bond prices, equities could potentially fare worse given elevated valuations.

With the proceeds from a reduction in equities, we are increasing the allocation to Core Fixed Income to slightly overweight relative to the mid-point of its target range. Credit spreads are quite tight, but do not appear at great risk of substantial widening under the scenario we envision. Higher yields overall in the absence of a correction in equities would further increase the relative long-term attractiveness of bonds. This tactical shift represents a modest reduction in risk aimed at maintaining the expected long-term risk-adjusted return profile of our model portfolios.

For additional information, please contact your KoCAA representative, email Client_Services@kofc.org or call (203) 752-4502.

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