JANUARY 2025 EDITION
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“The smart way to keep people passive and obedient is to strictly limit the spectrum of acceptable opinion, but allow very lively debate within that spectrum”.—Noam Chomsky

THE WAY I SEE IT

By SERGIO SIMONE

I have been a fan of **“The Big Bang Theory”** television show since the first episode. I loved the intellectual backdrop in the comedy series. Often, one of the characters would reference a term I was unfamiliar with which would lead to me trying to understand it. In one particular episode the term **“Occam’s Razor”** was mentioned. One of the characters asked how something could have ended up in the trash can. Sheldon explained that the trash can could have materialized around the object but that Occam’s Razor would suggest that someone placed it there. Obvious, right?

I had never heard of Occam’s Razor at that time so looked it up. This principle suggests that when presented with competing hypotheses or explanations, the one that makes the fewest assumptions and is the simplest is usually the correct one. In other words, if all evidence points to a single conclusion, that conclusion is likely to be the correct one.

Occam’s Razor is often used in scientific and philosophical reasoning to eliminate unnecessary complexities and focus on the most straightforward explanation.

When doing economic forecasting, several key assumptions are typically made to create models and predictions. Some of the more popular ones include:

“Historical Trends”, where forecasters assume that past trends and patterns will continue into the future, using historical data as a basis for predictions.

“Market Efficiency”, that assumes markets are efficient and that prices reflect all available information.

“Rational Behavior”, assumes that individuals and businesses make rational decisions aimed at maximizing their utility or profit.

“No Major Shocks”, assumes that there will be no unexpected major shocks or disruptions, such as natural disasters, political upheavals, or sudden technological changes.

“Policy Continuity”, which assumes that government policies will remain consistent and predictable.

This leads me to the question: *“Can economic or market forecasting be done making the fewest assumptions and can I apply Occam’s Razor to making a forecast about the markets in 2025?”*

THE WAY I SEE IT

The principle of Occam’s Razor suggests that the simplest explanation, with the fewest assumptions, is often the best starting point. In economic forecasting, this means favoring models that are straightforward and avoid unnecessary complexity.

However, economic systems are inherently complex and influenced by numerous variables. While Occam's Razor can help streamline models and focus on key factors, it's important to balance simplicity with the need to capture the intricacies of economic behavior. Over-simplifying can lead to inaccurate forecasts, so it's crucial to find a balance that incorporates essential variables without overcomplicating the model.

Although Occam's Razor can be a useful guiding principle in economic forecasting, it should be applied thoughtfully to ensure that important factors are not overlooked. By applying the principle of Occam's Razor, which suggests that the simplest explanation is often the correct one, I can streamline my analysis and focus on key economic indicators like: GDP growth, unemployment rates, and inflation.

Here's my concise forecast for 2025 based on these indicators.

The global economy is expected to grow solidly in 2025, with varying rates across different regions. Goldman Sachs forecasts a 2.5% increase in the U.S. GDP, driven by strong consumer spending and a stable labor market. This growth rate, while slightly lower than in previous years, indicates a healthy economic environment with reduced recession fears. These feelings are likely to extend to consumers, the backbone of any economy. As inflation falls and incomes rise, consumers will begin to get more bang for their buck.

After two years of consecutive 20+% returns on the S&P 500, evidence indicates that 2025 will generate small double-digit gains. While not blockbuster gains it is a far cry better than earlier analysis indicating the stock market was expected to struggle in 2025.

The unemployment rate in the U.S. is expected to remain relatively stable, with a slight increase to around 4.3% by the end of 2025. This will be a welcome change from the roller coaster ride of the pandemic and post-pandemic eras.

Forecasters seem at odds in predicting the unemployment rate in 2025. Using the median forecast of experts surveyed by the Federal Reserve Bank of Philadelphia, I will use an expected unemployment rate of 4.3% for 2025. This is a very modest increase from 2024. This rate is not high by historical standards but falls in a range where I see no boom and no bust on the horizon. So, my forecast for 2025 is that I expect the market to mosey along more or less the same way it has been doing recently.

In Canada the picture is a little different. Influenced by slower economic growth and reduced immigration targets the unemployment rate is expected to climb to 6.8%. This will keep the Bank of Canada focused on easing. However, the weakening Canadian dollar, new government stimulus cheques sent to millions of Canadians and potential for igniting upward pressure on the housing market will be a major cause for concern for the Bank of Canada. For this reason, I will be reducing exposure to Canada in 2025.

Inflation is projected to continue its downward trend in 2025, although it will remain above the central bank targets in some regions. In the U.S., inflation is expected to moderate to around 2.5%, driven by easing supply chain disruptions and stable consumer demand.

However, progress seems to have slowed, and inflation remains above the Fed's annual goal of 2%. This has caused the Fed to scale back its expectations for interest rate cuts in 2025.

One of the factors that continues to keep inflation elevated is the proposals for new tariffs from President Donald Trump which could drive up prices.

By applying Occam's Razor to economic forecasting, we can focus on the most critical indicators – GDP growth, unemployment rates and inflation – to provide a clear and concise outlook for 2025. While uncertainties remain, the overall economic environment appears stable, with moderate growth, stable unemployment, and controlled inflation. These predictions offer some valuable insights into our decision-making as we navigate the complexities of the global economy in the coming year.

While market forecasting can be a valuable tool for investors and analysts, it is fraught with challenges and uncertainties. Predicting market movements involves analyzing a myriad of factors, including economic indicators, geopolitical events, and market sentiment. However, the inherent unpredictability of these variables means that even the most sophisticated models can be prone to errors. Overreliance on market forecasts can lead to misguided investment decisions, as unforeseen events or shifts in market dynamics can quickly render predictions obsolete.

Additionally, the psychological impact of market forecasting can lead to herd behavior, where investors collectively follow trends based on predictions, potentially exacerbating market volatility. Ultimately, while market forecasting can provide insights, it should be approached with caution and complemented by a diversified and long-term investment strategy. Happy Investing In 2025!

In the realm of financial planning, numbers and strategies often take center stage. However, an equally crucial yet sometimes overlooked aspect is the role of personal values. Integrating values into lifestyle financial planning can transform the way individuals and families manage their finances, leading to more fulfilling and sustainable financial outcomes.

Values-based planning is how lifestyle financial planning differentiates itself from traditional financial planning. The importance (or lack of) that we place on such things as friendship, career advancement, health & fitness, prestige, adventure, wealth, and security among others, will provide the foundation for the financial plan. Life planners see this as the superior form of financial planning because it is completely client centered. So, how does it work?

Values serve as a compass that guides financial decisions, ensuring they align with personal goals and life priorities. When financial plans are rooted in what truly matters to an individual, the outcomes are not only financially rewarding but also personally satisfying. For instance, someone who values education may prioritize saving in a registered education savings plan (RESP) while another who values adventure might allocate more of their budget to annual travel expenses.

Understanding your values allows for more intentional choices about spending, saving, and investing. This means directing resources towards what you genuinely care about. For example, if environmental sustainability is a core value, you might choose to invest in green technologies or companies with strong environmental practices.

Similarly, your spending habits can reflect your values by supporting businesses and causes that resonate with you. Understanding core values is particularly powerful when we model a situation in which an individual has a negative cash flow year or years. When that happens, we can reduce spending in areas that are perceived as “less valuable and put more effort into achieving specific “wants”. For example, in a negative cash flow year, if adventure is not as important as academics, it would be easier for an individual to skip a year of travel so that they can continue to save in an education savings plan. Alternatively, if travel is more important than social service, one could skip their annual charitable donation so that they can continue to travel.

Values act as intrinsic motivators, helping individuals stay committed to their financial plans. When financial goals are tied to deeply held values, there is a stronger emotional connection, making it easier to stick to the plan. This intrinsic motivation can be particularly powerful during challenging times, providing the necessary drive to stay on course.

For families, shared values can play a significant role in sustaining wealth across generations. A common set of values and shared mission can guide financial decisions. This collective vision helps ensure that wealth is managed responsibly and in a way that benefits future generations, preserving a family’s legacy.

The challenge with families is that not all members share the same core values. We see this frequently with couples. For example, often we’ll see a situation in which one spouse prefers adventure, and the other spouse puts more value on career advancement or keeping a daily routine. These variations can create an opposition not only in how shared finances could be used, but also in how a couple spends their time together.

A solution we use is to focus on a couple's aggregate core values. In other words, we isolate a couple's shared values and look for solutions that work for both spouses. Another effective measure we take is modeling both spouses' preferred scenario so that couples can see how each scenario impacts their overall plan.

Incorporating values into financial planning promotes a holistic approach and that is something that we at KPW Financial value very much. Values are the foundation upon which meaningful and effective lifestyle financial planning is built. By aligning financial decisions with personal values, individuals and families can achieve not only their financial goals but also a greater sense of fulfillment and purpose. Whether it's through intentional spending, motivated saving, or sustainable wealth management, values play a crucial role in shaping a financial future that truly reflects what matters most.

If you would like to know your own core values, I recommend filling out one of our values surveys. It's a simple survey that shouldn't take more than a few minutes to complete. If you'd like a copy of the survey please email ryan@kpwfinancial.com and I will send you a PDF, or print the Values chart on the following page, complete it and send it back to me at ryan@kpwfinancial.com.

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Values

Name: ____________________
(First Last)

	Not Important			Somewhat Important		Important		Quite Important			Very Important
	0	1	2	3	4	5	6	7	8	9	10
Academics To have high regard for scholastic pursuits	O	O	O	O	O	O	O	O	O	O	O
Achievement To accomplish my goals	O	O	O	O	O	O	O	O	O	O	O
Activity To be fully occupied at all times	O	O	O	O	O	O	O	O	O	O	O
Advancement To have the opportunity for career advancement	O	O	O	O	O	O	O	O	O	O	O
Adventure To do things in new and interesting ways	O	O	O	O	O	O	O	O	O	O	O
Enjoyment To enjoy life and have fun	O	O	O	O	O	O	O	O	O	O	O
Expertise To be a known authority in a field	O	O	O	O	O	O	O	O	O	O	O
Family To contribute to family members	O	O	O	O	O	O	O	O	O	O	O
Friendship To have close companionship	O	O	O	O	O	O	O	O	O	O	O
Health To be healthy and lead a healthy lifestyle	O	O	O	O	O	O	O	O	O	O	O
Independence To be able to work or be alone and free from constraints	O	O	O	O	O	O	O	O	O	O	O
Location To be able to live anywhere	O	O	O	O	O	O	O	O	O	O	O
Power To have influence over my future	O	O	O	O	O	O	O	O	O	O	O
Prestige To obtain recognition and status	O	O	O	O	O	O	O	O	O	O	O
Routine To have a set daily schedule	O	O	O	O	O	O	O	O	O	O	O
Security To minimize adverse changes in my life	O	O	O	O	O	O	O	O	O	O	O
Self-Development To be the best that I can be	O	O	O	O	O	O	O	O	O	O	O
Self-Realization To realize the full potential of my skills and abilities	O	O	O	O	O	O	O	O	O	O	O
Social Service To serve others	O	O	O	O	O	O	O	O	O	O	O
Wealth To be able to afford opportunities	O	O	O	O	O	O	O	O	O	O	O

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Divorce is an emotionally and financially complex event that affects thousands of Canadians each year. While the reasons for divorce can vary widely, one factor consistently emerges as a leading cause: financial stress.

Money problems are often described as the *"silent"* killer of relationships. Unlike more overt issues such as infidelity or lack of communication, financial stress often builds gradually, creating a foundation of tension that can eventually overwhelm a marriage.

Financial disagreements touch on deeply personal values, such as trust, security, and priorities. When couples cannot find common ground on these matters, the strain can lead to conflict and, ultimately, divorce.

As a financial planner, I have seen firsthand how money-related issues can strain relationships to the breaking point. As a financial divorce specialist, I have worked closely with individuals and couples navigating the complexities of separation, and one recurring theme often emerges: financial stress is a leading contributor to marital breakdown. The proof is in the pudding; studies consistently show that financial stress is one of the top contributors to marital discord in Canada. Understanding how financial challenges contribute to marital breakdown is crucial for couples seeking to safeguard their relationship and build a more secure future together.

Money is more than just a medium of exchange; it is deeply tied to personal values, security, and self-worth. Disagreements over spending habits, saving priorities, or debt management can create tension and lead to resentment in a marriage. When couples face financial hardship, whether due to mounting debt, job loss, or differing financial goals, the stress often spills into other areas of their relationship.

Miscommunication and unresolved arguments about money can erode trust and intimacy, making it difficult for couples to work together as a team. There are a multitude of financial challenges that lead to divorce. Unmanageable debt, particularly when one partner feels burdened by the other's financial choices, can lead to feelings of frustration and inequality. Whether it stems from credit cards, loans, or unexpected expenses, debt can lead to arguments over responsibility and repayment priorities.

Similarly, differing spending habits, such as one partner being a spender while the other is a saver, can create resentment and feelings of incompatibility and make it challenging to agree on financial goals. Significant differences in income levels can create power imbalances or feelings of inadequacy in a relationship. Keeping financial secrets, such as hidden debt or undisclosed spending, can break trust and fuel conflict.

When couples fail to align their financial goals, such as saving for a home, retirement, or children's education, it can lead to misunderstandings and frustration. Over time, these unresolved differences may become insurmountable.

Major life events, such as job loss, medical emergencies, or market downturns, can create unexpected financial strain. Without a plan in place, these challenges often amplify existing tensions.

While financial stress is a significant contributor to divorce, proactive financial planning can help couples navigate these challenges and strengthen their relationship.

Some strategies include open communication, joint budgeting, debt management, future planning, and seeking professional guidance. Encouraging honest conversations about money helps couples align their financial priorities and expectations.

Creating and maintaining a shared budget fosters collaboration and ensures both partners have a clear understanding of their financial situation. Developing a plan to tackle debt together can alleviate stress and build trust. Setting long-term goals, such as saving for a home or retirement, helps couples focus on shared aspirations rather than immediate financial struggles. Working with a financial planner provides couples with objective advice and tailored solutions to manage their finances effectively.

While money is often labeled as the root of marital strife, it is ultimately how couples handle financial challenges that determines the strength of their relationship.

By fostering open communication, establishing shared goals, and seeking professional support, couples can transform financial stress into an opportunity for growth and partnership. Both partners should be involved in financial decisions, ensuring that each understands the household’s financial situation.

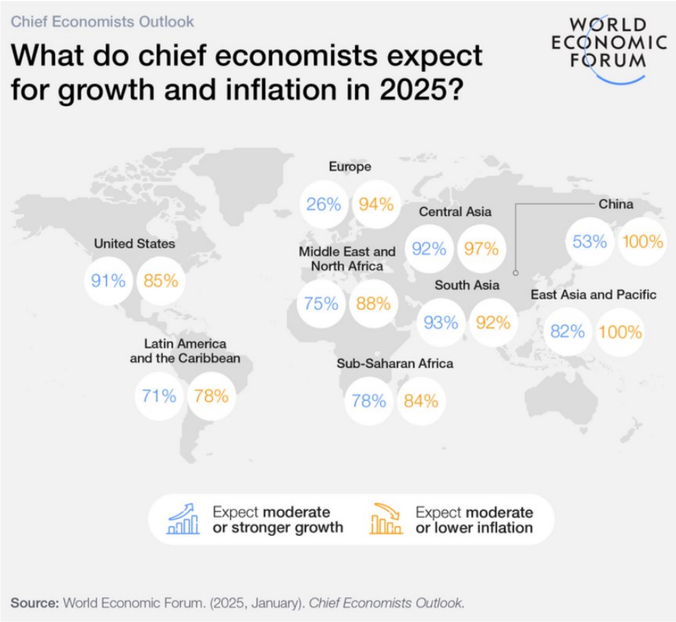
As a financial planner and financial divorce specialist, I have witnessed the transformative power of a well-thought-out financial strategy, not just for individual wealth, but for the health of relationships. By addressing financial issues proactively, couples can build a stronger foundation for both their finances and their marriage, ensuring a brighter future together. All this said, I encourage couples to prioritize financial transparency and collaboration, not just to avoid divorce, but to build a stronger partnership, as my mission remains to help clients find clarity, security, and confidence in their financial future.

CHIEF ECONOMISTS OUTLOOK

JANUARY 2025

The January 2025 Chief Economists Outlook explores key trends in the global economy, including the latest outlook for growth, inflation, monetary and fiscal policy. It discusses the impact of US policy on the global economy, investigates fragmentation trends and discusses the turbulent outlook for global trade. This series of reports draws on the individual and collective perspectives of a group of leading chief economists through consultations with the World Economic Forum's Chief Economists Community and a regular Chief Economists Survey.

The January 2025 edition of the Chief Economists Outlook reveals a global economy under considerable strain. While inflation is easing in most regions, uncertainty remains elevated and regional growth disparities shape an overall subdued outlook. US policy is expected to have a significant impact on the global economy in the years ahead, inducing a long-term shift to its trajectory. The Chief Economists Outlook also reveals intensifying pressures on the world's economic interconnectedness with fragmentation trends expected to accelerate in goods and services trade, labour mobility, technology and data and to a lesser degree in finance. Although global trade remains resilient, tensions are expected to intensify both between major powers and more widely.



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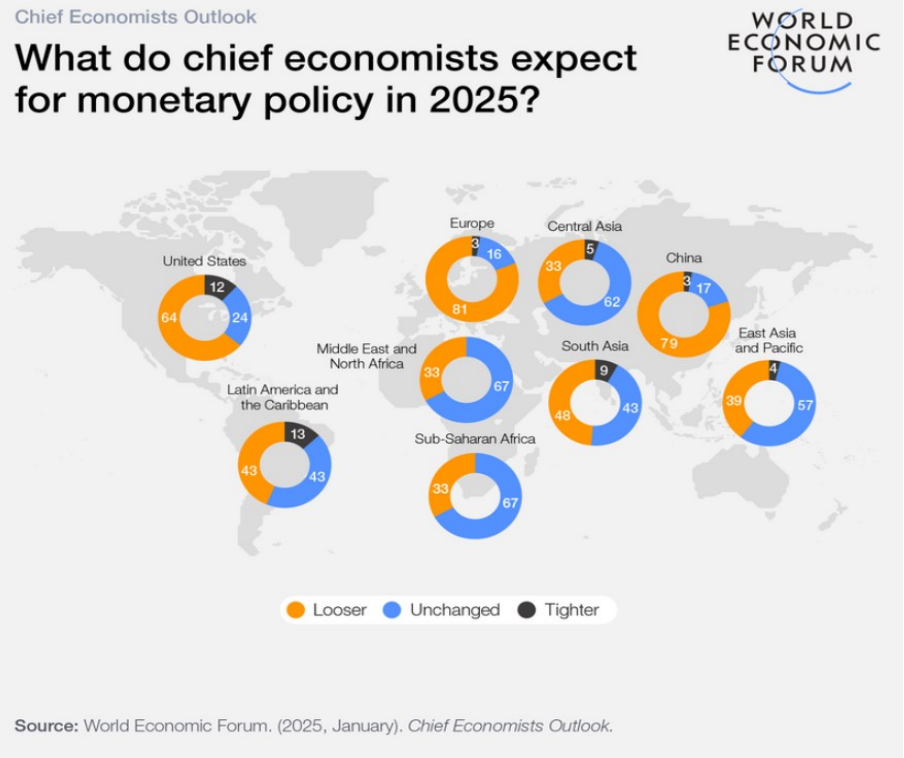

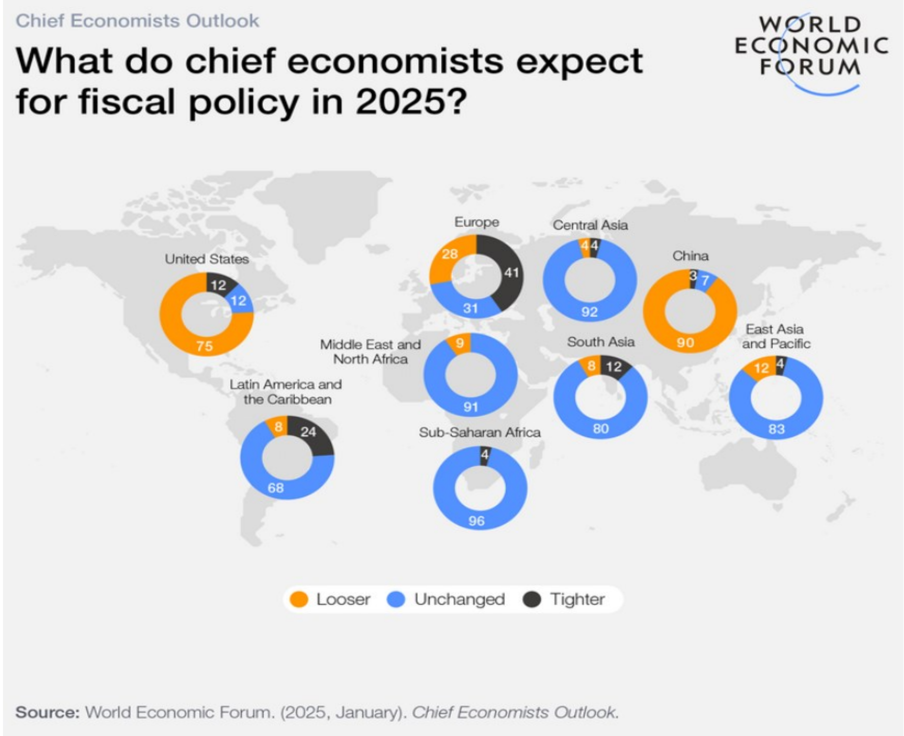

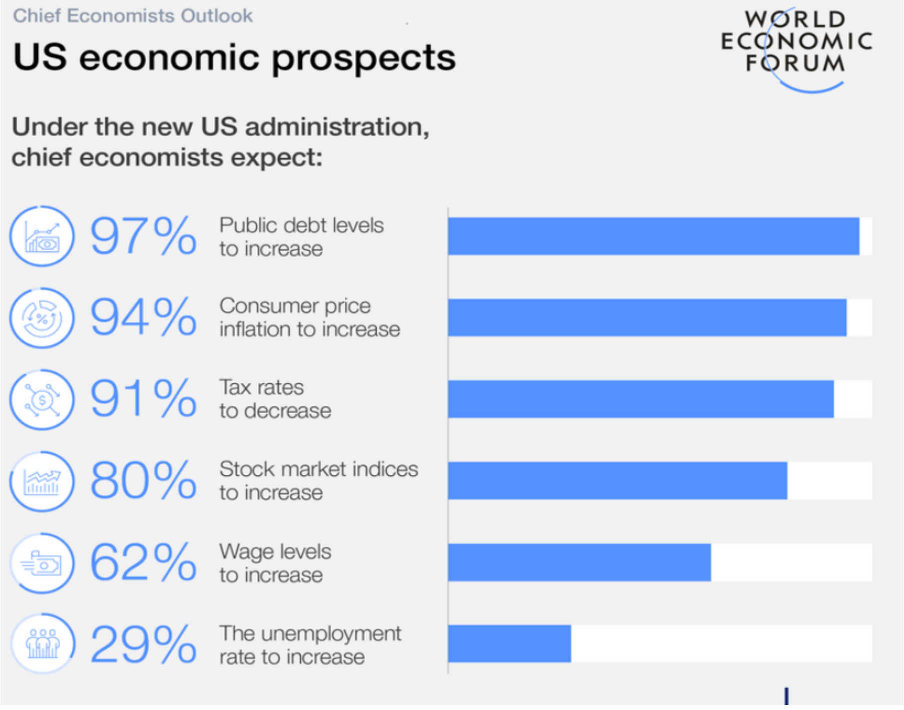

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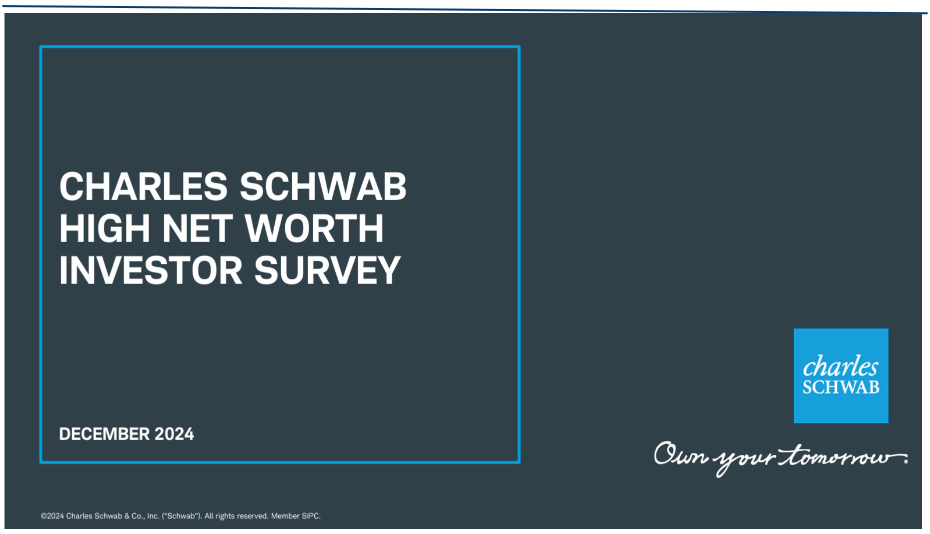

Methodology

This is an online study conducted for Charles Schwab by Logica Research. Logica Research is neither affiliated with, nor employed by, Charles Schwab & Co., Inc.

The online study was conducted from August 8th to September 2nd, 2024.

1,005 wealthy Americans with $1M+ in investable assets

- 900 high net worth investors with $1M+ in investable assets
- 105 ultra high net worth investors with $10M+ in investable assets

Generational definitions

- Millennials: Ages 27-42
- Gen X: Ages 43-58
- Boomers: Ages 59-76

Q. Do you expect to gift, donate, or pass on any of the following either during your lifetime or after you pass?

On Average, wealthy Americans intend to pass on $4.1 million in value.

Q. For each of the following what is the approximate value of what you expect to gift, donate, or pass on? (Base: Those who plan to gift, donate, or pass on money/assets = 970)

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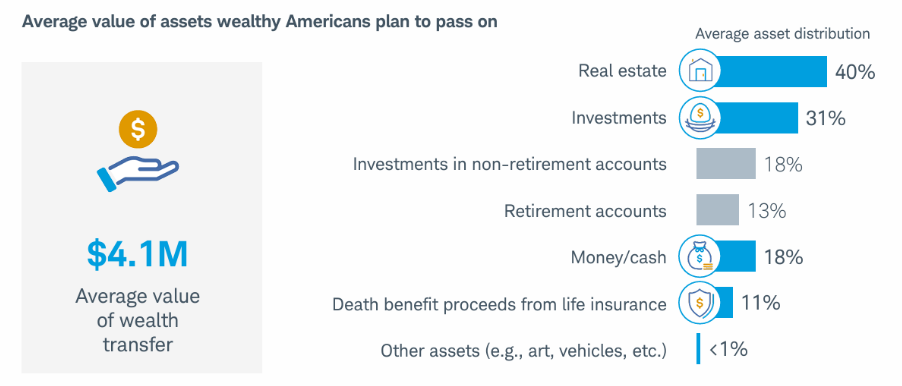


Highest value assets transferred will be in the form of real estate and investments.

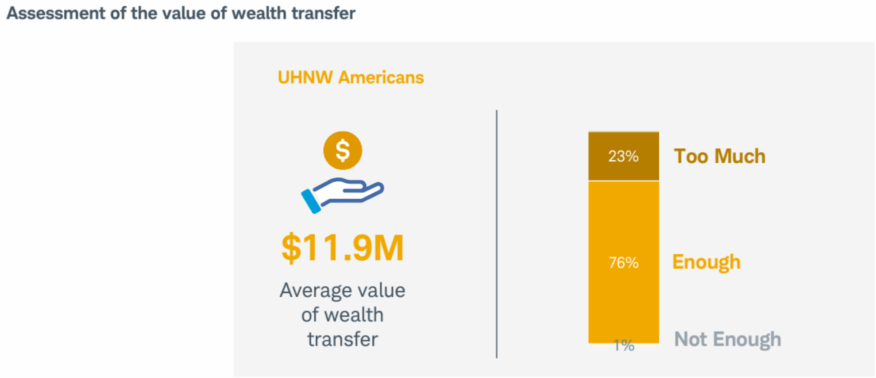
Q. For each of the following, what is the approximate value of what you expect to gift, donate, or pass on?

Average value of assets wealthy Americans plan to pass on

		Millennials	Gen X	Boomers
Average value of wealth transfer	**$4.1M**	**$4.7M**	**$4.8M**	**$3.1M**
Real estate	**$1.6M**	$2.2M	$2.5M	$750,000
Investments	**$1.3M**	$770,000	$780,000	$1.6M
Investments in non-retirement accounts	$720,000	$400,000	$560,000	$800,000
Retirement accounts	$530,000	$380,000	$220,000	$780,000
Money/cash	**$740,000**	$1.0M	$830,000	$550,000
Death benefit proceeds from life insurance	**$440,000**	$670,000	$710,000	$170,000

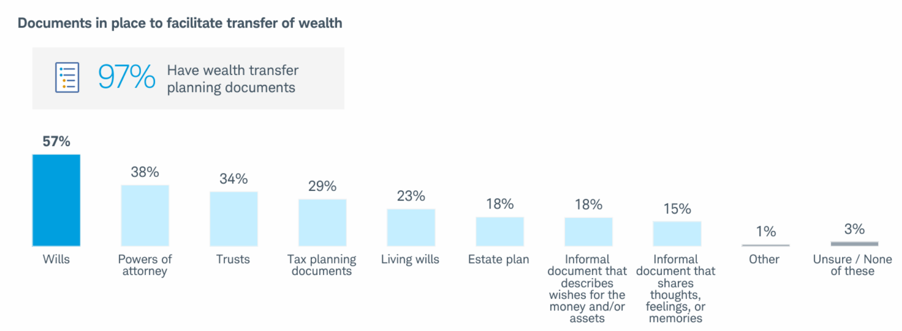
On average, UHNW Americans plan to transfer nearly $12 million in value and close to a quarter worry they are passing on too much wealth.

Q. For each of the following, what is the approximate value of what you expect to gift, donate, or pass on?



Most wealthy Americans have documents in place to facilitate their wealth transfer, but only one in five have an estate plan.

Q. What documents do you currently have in place to help with the transfer of your money and/or assets?



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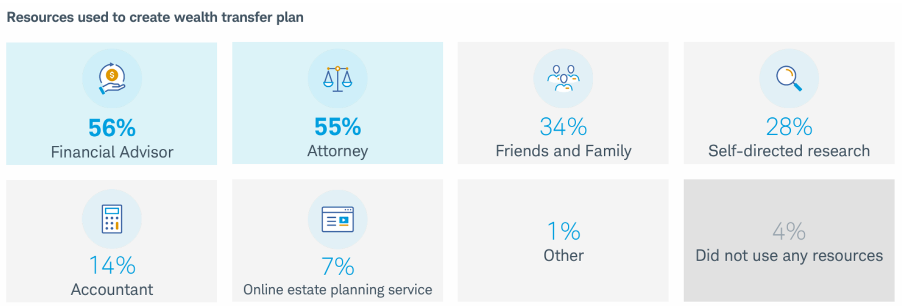
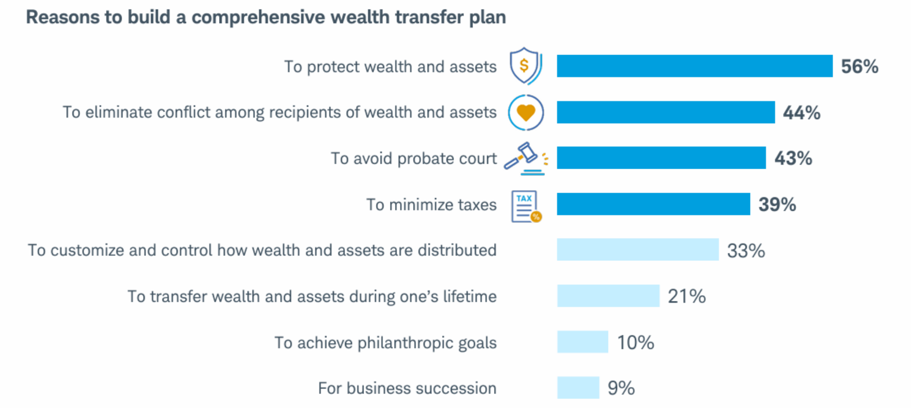
More than half of wealthy Americans work with financial advisors or attorneys to help with wealth transfer planning.

Q. Which of the following resources did you use when creating your plan to pass on money and/or assets?



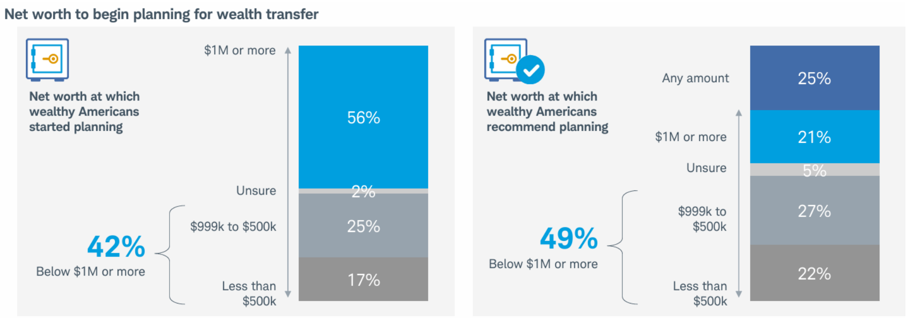
Wealthy Americans say the top reasons to create a formal wealth transfer plan are to protect assts, eliminate conflicts, avoid probate court, and minimize taxes.

Q. Which of the following are reasons why someone should build a comprehensive plan, such as an estate plan, to pass on money and/or assets?



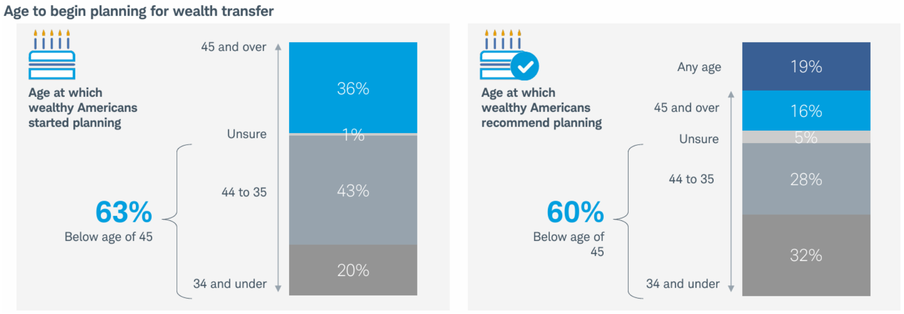
Over half of wealth Americans started planning their wealth transfer at a net worth of $1 million or more, although nearly half agree that planning should begin before that.

Q. What level of money and assets, or net worth, should someone have inorder to start planning passing on their money and/or assets?



Most wealth Americans began planning their wealth transfer before the age of 45 and recommend others do the same.

Q. How old does someone need to be in order to create a plan to pass on money and/or assets?



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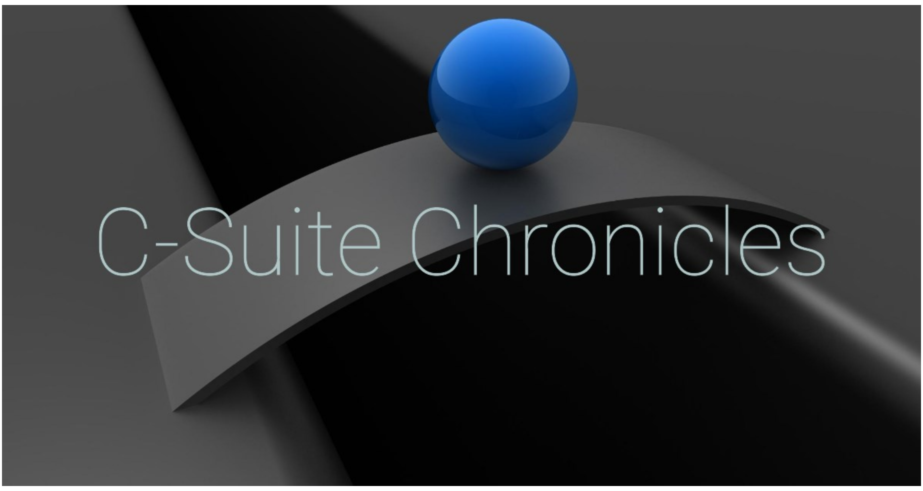


Protecting a small business in case you get sick or disabled is crucial for ensuring its continuity. Here are some steps you can take:

1. Disability Insurance:

Consider getting disability insurance specifically designed for business owners. This type of insurance can provide a monthly income to help cover business expenses if you become unable to work due to illness or injury.

2. Business Continuity Plan:

Develop a business continuity plan that outlines how your business will operate in your absence. This plan should include details on who will take over your responsibilities, how key tasks will be managed, and any necessary legal or financial arrangements.

3. Power of Attorney:

Appoint a trusted individual with power of attorney to make decisions on your behalf if you become incapacitated. This person can handle financial matters, sign documents, and manage other critical aspects of your business.

4. Key Person Insurance:

Consider key person insurance, which provides financial support to the business if a key individual (such as yourself) becomes disabled or passes away. This can help cover expenses and ensure the business continues to operate smoothly.

5. Succession Planning:

Create a succession plan that identifies potential successors and outlines the process for transitioning leadership. This can help ensure a smooth transition and minimize disruptions to the business.

6. Emergency Fund:

Build an emergency fund to cover business expenses during unexpected events. This fund can provide a financial cushion and help keep the business running while you recover.

7. Legal and Financial Advice:

Consult with legal and financial advisors to ensure all necessary documents and plans are in place. They can help you navigate the complexities of protecting your business and provide tailored advice based on your specific situation.

Taking these steps can help safeguard your business and provide peace of mind, knowing that it will continue to thrive even if you face health challenges.

HIGH HOPES OR HOLLOW HYPE? A 2025 REALITY CHECK

By Kevin Flanagan, Jeff Weniger
January 8, 2025

Let’s put a finger on the market’s pulse.

Economically, the closest thing to a tough year for the U.S. recently was 2022. While the market has largely moved past that year’s recession debate, it’s worth noting that the traditional definition that persisted for all our careers—two consecutive quarters of negative GDP growth—did occur in the first half of 2022.

The Philly Fed’s “Anxious Index” surveys economists on whether the next quarter will see negative GDP growth. At the height of worry in 2022, 47% said yes; now it’s just 15%. Historical patterns are encouraging. We looked at seven instances when economic sentiment flipped from high anxiety to low (Q4/1970, Q3/1975, Q1/1983, Q2/1992, Q2/2002, Q4/2009, and Q1/2021). Each occurred as a recession was ending or had just ended, and in all cases, the S&P 500 had gains over the following 12 months. For context, historical data show that if you were to select any random four-quarter period for the S&P 500 since 1968, there is roughly a 21% chance your selected window of time witnessed a loss. If the next year mirrors the prior observations, investors have black ink in store for 2025.

However, caution is warranted; according to the latest BofA Global Fund Manager Survey, several contrarian signals have emerged. A net 14% of respondents were underweight cash in December, the lowest level since the question was introduced in 2001, and cash allocations fell to 3.9%, matching the last notable low in June 2021. Additionally, investment professionals’ overweight position in U.S. equities relative to Europe has reached a 12-year high. That leaves room for a contrarian rally in European equities that could catch many off guard, including us (our model portfolios are underweight the region).

Despite the perception of euphoria around U.S. stocks, other surveys paint a mixed picture. The American Association of Individual Investors finds 38% of respondents are bullish vs. 34% bearish—a modest 4% gap that sits in the 42nd percentile of historical readings since 1987. Similarly, the Investors Intelligence poll of newsletter writers shows 54% are bullish, down from 63% post-Thanksgiving. Bears are scarce at 18%, with a 36-point bull-bear gap that, while seemingly high, sits in the 84th percentile historically—still around the broad middle of the sentiment curve.

One emerging consensus should have some more holes poked in it: the belief that tariffs and deportations are necessarily inflationary. Tell it to the market. Energy and Basic Materials—two sectors often tied to inflation expectations—have remained flat over the past year, even as the S&P 500 delivered a 23% total return. Higher import prices and wages might dominate headlines but think about other effects of potential population decline: fewer occupied apartments, a de-clog at the emergency room, fewer drivers wearing and tearing the roads, and so on.

For stock market sentiment, we saved the most concerning sentiment indicator for last: The Conference Board’s December survey found an unprecedented level of public optimism. Respondents expecting the market to rise in the next 12 months outnumber those expecting stagnation or decline by 12.8 percentage points, shattering the previous record of 2.0% set in January 2018. Uncharted waters like these demand a sturdy ship—and ignoring downside protection in 2025 may be a risk no prudent investor can afford to take. History has shown that markets at euphoric peaks can reverse sharply, so make sure your portfolio is equipped with life rafts.

AGF Insights and Market Perspectives

Market Quote: A New Year in Financial Markets Begins

Stephen Duench, CFA®
Portfolio Manager
AGF Investments

OH CANADA

If there was such a thing as an Investor's Almanac, it might include a section on the so-called Santa Claus Rally and why the lack of one this past holiday season might be worrisome to investors. Yet, historically, a much more important and accurate indicator of what's in store for equity markets has been how the start to a calendar year often dictates the performance of them over the next 12 months. And while the first few trading days in January have indeed been volatile, investors may end up being thankful that many of the most prominent global stock indexes – at least outside of Asia – have so far delivered positive returns year-to-date.

In many instances, moreover, it's been the index laggards of the past two years that are leading the way higher. This includes the S&P/TSX Composite Index in Canada, which may surprise many given the litany of negative headlines at play, most of which are mainly associated with the incoming U.S. administration's tariff (and economic takeover!) threats, as well as political drama related to Prime Minister Trudeau's recent announcement that he will step down once a new leader of the Liberal Pary of Canada is chosen sometime in the next few weeks.

Of course, whether this outperformance is sustainable remains to be seen, but Canada's equity market is supported by relatively attractive valuations, steady fundamentals and the potential to surprise further to the upside if foreign buyers are willing to overlook near-term political risks in anticipation of a more pro-growth regime change north of the border.

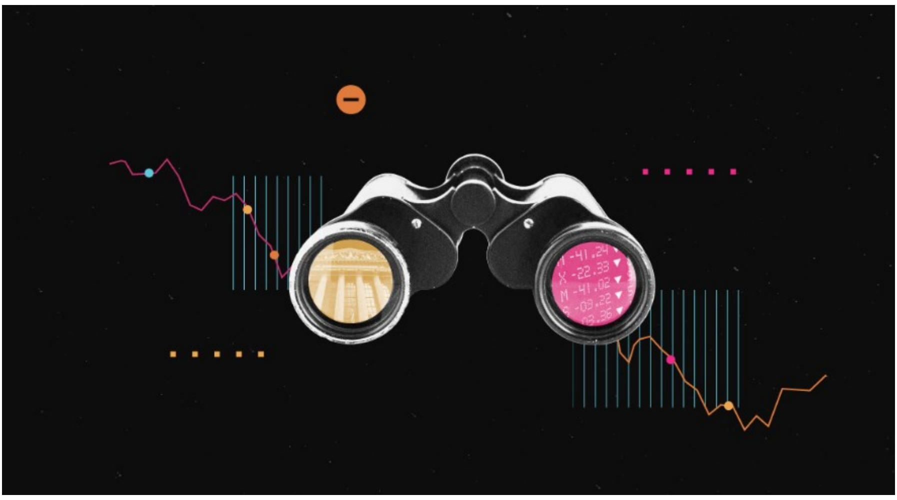
NO HO HO HO

John Christofilos
Chief Trading Officer
AGF Investments

There was no Santa Claus rally to end 2024 but that's usually not the "be all and end all" when it comes to seasonal signals of what lies ahead in 2025. Still, global equity markets are off to an uncertain start because of profit taking, pension fund selling and interest rate volatility, all of which have triggered larger-than-normal moves in several stock indexes and many individual names. Given that January is usually a higher-volatility month, we expect this current trend to continue for the next few weeks.

2025 US MARKET OUTLOOK: MARKETS ARE PRICED TO PERFECTION, BUT WILL IT LAST?

David Sekera, CFA



As we enter 2025, the tailwinds we identified last year that propelled the market higher in 2024 are receding. The rate of monetary policy easing is slowing, inflation has become sticky, long-term interest rates have swung upward, and the US economy is slowing. Even more importantly from a sentiment standpoint, spending on artificial intelligence hardware is shifting to increasing at a decreasing rate as opposed to increasing at an increasing rate. According to Brian Colello, Morningstar's equity strategist for the technology sector, "spending on AI graphic processor units and hardware is less likely to provide anywhere near the massive positive surprises we saw in 2024 as this fast-moving megatrend is better understood."

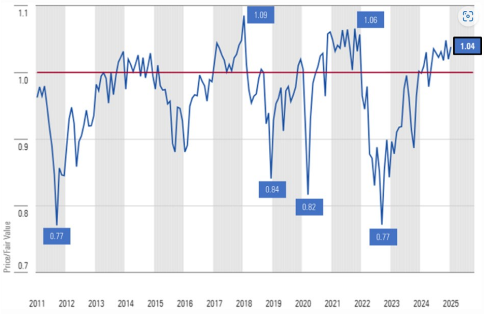
The next test for the markets is beginning as companies start to report earnings. We are not as concerned about fourth quarter earnings as economic growth appears to have remained healthy, but we are concerned that management teams may look to lower the bar on the market's expectations for earnings growth in 2025 as the rate of economic growth is poised to slow.

In our view, the bigger wild card in the first quarter will be what President Donald Trump may or may not do regarding his assertions to implement new tariffs on imports. The questions on everyone's minds are just how much of this tariff talk is campaign trail rhetoric? How soon will these tariffs be implemented? How big will they be? What countries and products will be taxed? And just as importantly, what countries and products may be excluded?

US Market Valuation Bumping Up Against the High End of Fairly Valued

Based on a composite of our intrinsic valuations of the more than 700 stocks we cover that trade on US exchanges, as of Jan. 6, 2025, we calculated that the US equity market was trading at a price/fair value estimate of 1.04. This represents a 4% premium to our fair value estimates. While this might not sound like much of a premium, since the end of 2010 the market has traded at this premium level or higher less than 10% of the time.

At this point, we think investors should remain at a market weight position according to their allocation target based on their risk profiles. However, with the market trading at the high end of our fairly valued range, we are becoming progressively cautious, and positioning is increasingly important.



With Stocks Fairly Valued, How Should Investors Position Themselves in 2024?

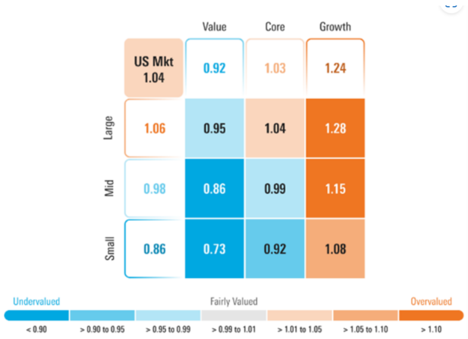
Based on our valuations, we expect little price appreciation at the market index level until earnings catch up to valuations—which isn't likely to occur until the second half of the year. In such an environment, undervalued value stocks, especially those that pay relatively high dividends, look especially attractive to us.

Based on our valuations, by market capitalization, we advocate for investors to:

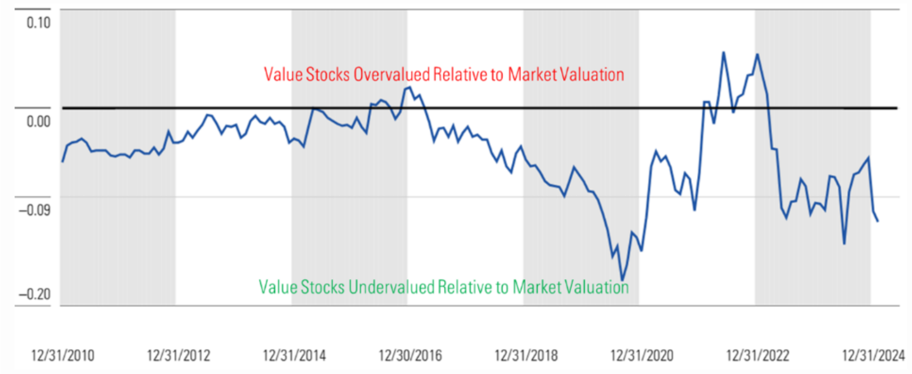
• Overweight: Small-cap stocks, which trade at a 14% discount to fair value.
• Market weight: Mid-cap stocks, which trade at a 2% discount to fair value.
• Underweight: Large-cap stocks, which trade at a 6% premium. The last time large -cap stocks traded at a higher premium was in 2018, right before the market corrected later in the year.

Based on the Morningstar Style Box, we advocate for investors to

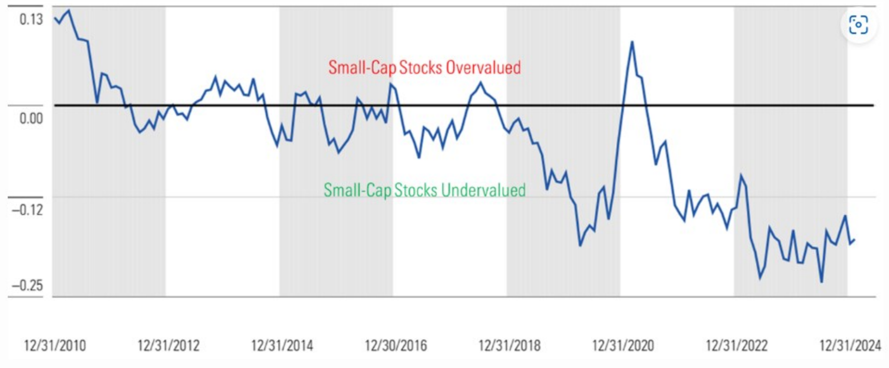
• Overweight: Value stocks, which trade at an 8% discount to fair value.
• Market weight: Core stocks, which trade at a 3% premium to fair value.
• Underweight: Growth stocks, which trade at a 24% premium to fair value.



Since 2010, growth stocks have traded at this much of a premium or higher less than 10% of the time. The most recent example occurred in early 2021, right before the disruptive technology bubble popped. While investors should maintain some exposure to growth stocks in their portfolio, we think now is a good time to lock in some profits and underweight the growth category in order to overweight value stocks, which remain at an attractive discount to our valuations and remain market weight core stocks.



By market cap, small-cap stocks remain attractive on both an absolute valuation basis and relative to the broad market.



Notable Changes in Sector Valuations and Outlooks

The divergence across sector performance, in conjunction with our valuation changes over the course of the year, has had a wide range of effects.

For example, communications was the most undervalued sector coming into 2024, yet it is now only 5% undervalued, making it the fifth most undervalued. Real estate was the second most undervalued and following a sluggish 2024 is now the most undervalued.

Utilities was one of the more undervalued sectors coming into the year. In 2024, the sector rose almost 27% as utilities became a second derivative play on AI growth, as AI requires multiple times more electricity than traditional semiconductors. As such, it is now one of the more overvalued sectors.

The financial-services sector was trading at a few percent discount to fair value, but as the Fed cut interest rates and the yield curve normalized, the sector skyrocketed more than 31%. As the second most overvalued sector we see a lot of opportunities to sell and lock in profits, as we think the market is overestimating the improvement in net interest margins over the long term.

Technology was trading at a premium to fair value coming into the year. It remains at a 7% premium even after incorporating a number of very large valuation increases across the sector over the year. Similarly, the industrials sector started the year at a premium and remains at a 5% premium today.

Consumer cyclical started the year at a slight premium, but following Tesla's TSLA meteoric rise after the US presidential election, the sector is now the most overvalued at a 19% premium. The increase in Tesla accounts for almost 40% of the entire sector's return.

Stocks in the energy and healthcare sectors significantly lagged the broad market. With so much focus on AI over the year, we think the market is overlooking a lot of value in these two sectors as both remain at discounts of 10% and 8%, respectively.

Last, the basic materials sector was the only one to register a loss last year, but we think the market is overly pessimistic about its long-term outlook. We see a significant number of undervalued opportunities as the sector trades at a 7% discount to our fair values.

Cyclical		Sensitive		Defensive	
Basic Materials	0.93	Communication Services	0.95	Consumer Defensive	1.08
Consumer Cyclical	1.19	Energy	0.90	Healthcare	0.92
Financial Services	1.10	Industrials	1.05	Utilities	1.07
Real Estate	0.89	Technology	1.07		

Undervalued			Fairly Valued			Overvalued
< 0.90	> 0.90 to 0.95	> 0.95 to 0.99	> 0.99 to 1.01	> 1.01 to 1.05	> 1.05 to 1.10	> 1.10

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Titans of Tomorrow: Quantum Computing and Robotics on the Brink of Revolution

Christopher Gannatti, CFA
Global Head of Research

In January 2025, Jensen Huang, CEO of NVIDIA, sparked a heated debate when he stated, "Quantum computing is a revolutionary technology, but we're still at least 15 years away from seeing its full potential in practical applications."1 This remark was met with a strong response from Alan Baratz, CEO of D-Wave, who countered, "Quantum computing is already here, delivering value to industries today. The future isn't as far off as people think."2 These contrasting viewpoints underscore the dynamic and evolving narratives around quantum computing and its rival technology, robotics.

In 2025, two titans of technology stand at the forefront of innovation: quantum computing and robotics. Each offers a vision of a future transformed, where the impossible becomes achievable and industries are redefined. But as we journey through this pivotal moment, a question arises: which of these marvels will shape our world more profoundly, and which will deliver the financial rewards investors seek?

The Promise of a Quantum Leap

Imagine a computer so powerful it could solve problems that today's fastest supercomputers would take millennia to compute. Quantum computing, with its ethereal qubits, defies classical logic, harnessing the strange and wondrous rules of quantum mechanics. Unlike traditional bits, qubits can exist in multiple states simultaneously, enabling computations at speeds that seem almost magical. This power, though still in its infancy, holds the potential to unlock new realms of discovery.

December 2024 also marked a historic announcement by Alphabet, which unveiled its breakthrough Willow chip. This quantum processor boasts an exponential improvement in error correction, addressing one of the field's most significant barriers. Willow's ability to reduce computational errors dramatically accelerates the path toward practical quantum computing.3 Markets reacted with enthusiasm, with Alphabet's stock surging and other quantum-focused companies seeing increased investor interest. This milestone re-energized discussions about quantum computing's potential to deliver real-world impact sooner than expected.

While much of quantum computing's promise lies in the future, there are tangible breakthroughs today. One such example is quantum-safe encryption. In 2024, the National Institute of Standards and Technology (NIST) released its first set of standards for post-quantum cryptography, providing protocols to safeguard digital communications against potential quantum threats.4 This stands in contrast to the broader aspirations for quantum applications, such as accelerating drug discovery or transforming artificial intelligence—visions that remain several years away.

Picture a pharmaceutical scientist, struggling with the complexity of molecular interactions. Today, simulating these interactions takes immense resources and time, but a quantum computer could map these processes with precision, accelerating the development of life-saving drugs. Companies like IBM and Google, through their IBM Quantum and Google Quantum AI projects, are already making strides in pushing the boundaries of this technology. IBM's roadmap envisions systems with over 4,000 qubits by 2025, a leap that could pave the way for commercial breakthroughs.5

The financial world is equally captivated. Goldman Sachs has invested heavily in quantum algorithms to optimize trading strategies, while startups like Rigetti Computing are exploring new avenues in quantum cloud computing. The quantum computing market, projected to reach $450 billion by 2040, represents a long-term goldmine for those willing to invest early.6

Yet, this frontier comes with immense challenges. Building these machines requires mastering qubits' delicate dance, shielding them from environmental noise that disrupts their harmony. Scalability and error correction loom as monumental hurdles, while the cost of development remains a barrier that confines access to elite institutions. Success is uncertain, but the rewards could be world changing.

The Robotic Revolution in Action

Meanwhile, robotics is no longer a dream of tomorrow; it is the reality of today. Step into a modern factory, and you will see robots tirelessly assembling products with speed and precision unmatched by human hands. These robots, often purpose-built for specific tasks, dominate logistics depots and warehouses. Autonomous mobile robots, akin to advanced Roombas, scurry about, moving goods efficiently within Amazon warehouses and beyond. Their precision, reliability and cost-effectiveness have revolutionized supply chain operations.

Amazon's acquisition of Covariant highlights the transformative role of robotics in logistics.7 Covariant's AI-driven robotic systems specialize in intelligent picking and sorting, combining cutting-edge perception algorithms with real-world adaptability. This partnership enables Amazon to handle a broader range of inventory with unmatched accuracy, cementing its dominance in e-commerce and logistics innovation.

Yet, much of the public's fascination with robotics centers on humanoid robots, which aim to replicate human dexterity and adaptability. Companies like Boston Dynamics have showcased incredible feats of engineering, with robots like Atlas performing acrobatics and complex maneuvers. However, these humanoid robots, while impressive, remain prototypes or specialized tools in research and niche applications. Their widespread adoption is hindered by high costs, technical challenges in achieving human-like versatility and a lack of immediate practical use cases compared to their task-specific counterparts.

In parallel, Toyota Research and Development is advancing robotics with an innovative approach centered on diffusion and large behavioral models.8 By leveraging these models, Toyota's robots are learning from vast datasets of human behaviors, enabling them to adapt to dynamic environments and perform complex tasks with greater autonomy. This approach could pave the way for robots that not only mimic human actions but also anticipate needs and solve problems proactively.

The contrast between these two types of robots highlights the dual pathways robotics is following: practical deployment for immediate industrial impact and aspirational innovation that pushes the boundaries of what machines can achieve. Logistics giants like Amazon rely on the former, while researchers and visionaries continue to advance the latter, driven by the dream of creating machines that seamlessly integrate into human environments.

The robotics market is flourishing, with a projected value exceeding $200 billion by 2030.9 The near-term returns are clear: increased productivity, reduced operational downtime and enhanced safety. However, questions of job displacement and ethical boundaries accompany the proliferation of machines into every corner of society. Addressing these challenges is critical as robotics continues to reshape industries.

A Converging Vision

While these technologies seem to occupy different realms, their trajectories intersect in fascinating ways. Quantum computing could supercharge the AI algorithms that power advanced robotics, making them smarter, more adaptable and capable of solving problems on the fly. Robotics, in turn, provides the physical agents that could bring quantum-derived solutions into the tangible world. Imagine a quantum-powered robotic system that optimizes global logistics or a humanoid robot capable of human-like reasoning thanks to quantum-enhanced artificial intelligence.

The timelines, however, diverge. Robotics, with its maturity and proven applications, is already reshaping industries. The return on investment is clear and immediate for companies adopting robotic solutions. In contrast, quantum computing's journey is more protracted. Its breakthroughs promise a seismic shift, but the rewards lie further on the horizon, contingent on overcoming formidable scientific and engineering challenges.

What Lies Ahead?

As we navigate the future, one truth emerges: the story of quantum computing and robotics is not one of competition but of complementarity. Robotics is the present—an accelerating force driving efficiency, safety and innovation. Quantum computing is the promise—a glimpse into a world where computational boundaries dissolve, revealing solutions once thought unattainable.

For investors, the choice between these technologies hinges on vision and patience. Those seeking near-term gains may gravitate toward robotics, with its clear trajectory and immediate impact. For those willing to venture into the unknown, quantum computing offers the allure of long-term transformation and exponential growth.

In the end, these technologies together form the dual engines of progress, propelling humanity toward a future where imagination meets reality. The journey is just beginning, and the next chapter promises to be even more extraordinary.

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