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Navigating 2025: Economic Strength, Market Volatility, and Investment Trends

The outlook for the U.S. economy, bond market, and stock market in 2025 presents a complex interplay of growth expectations, interest rates, and market dynamics. As we delve into each sector, it becomes evident that while optimism prevails, there are underlying challenges that could influence outcomes.

U.S. Economic Outlook

The U.S. economy is projected to exhibit a moderate growth trajectory in 2025, with

estimates suggesting a GDP increase between 2.0% and 2.5%. Goldman Sachs anticipates a 2.5% growth rate, surpassing the consensus forecast of 1.9% among economists.

The economy has shown resilience, with inflation slowly, if not haltingly, trending back toward the Federal Reserve's target of 2%, and a labor market that remains robust despite some occasional signs of cooling.

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- We expect the yield curve to steepen, with one or two Fed cuts bringing short-term rates to about 4.0% by the end of 2025.
- Inflation is likely to remain a thorn in everyone's side and is unlikely to reach the Fed's stated 2% target in 2025.
- As 2025 sets up to be a year for consequential economic and policy changes, we continue to migrate credit quality higher, on the whole, while selectively identifying higher-yielding opportunities.

Targeting the sweet spot for duration

In a quarter full of important

economic data releases and an active Fed cutting cycle, the most significant event was the conclusion of the 2024 federal election cycle. Trump's victory and a Republican sweep of both houses of Congress imply major policy changes in 2025. Those repeatedly broadcast during the campaign include slashing federal expenses, cutting taxes, implementing additional tariffs, undertaking mass deportations, and reducing regulatory burdens—especially on energy producers. All of these factors could significantly impact economic activity.

How successfully President Trump can implement his

agenda will be a critical determinant of the ultimate economic impact. Many bolder proposals are likely opening negotiating positions to frame the administration's goals. There will be resistance to most of the proposed policies, and many will likely get bogged down in legal battles. In reality, there are still many unknowns.

At the same time, we expect the Fed to slow the pace of cuts in 2025. The yield curve should continue steepening as policy eases toward the Fed's presumed neutral rate. We still expect the Fed will lower rates

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Vice President,
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John Saf
contributes 25
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investment industry experience. Prior to joining Calamos in 2017, he served as a managing director and portfolio manager at Oppenheimer Investment Management (2006-2017). In this role, he was responsible for nearly \$1 billion in assets, including insurance portfolios. In addition to being a CFA charterholder and Certified Public Accountant (inactive), John is a Fellow in the Life Management Institute.



one to two more times, with rates around 4.0% at the end of 2025.

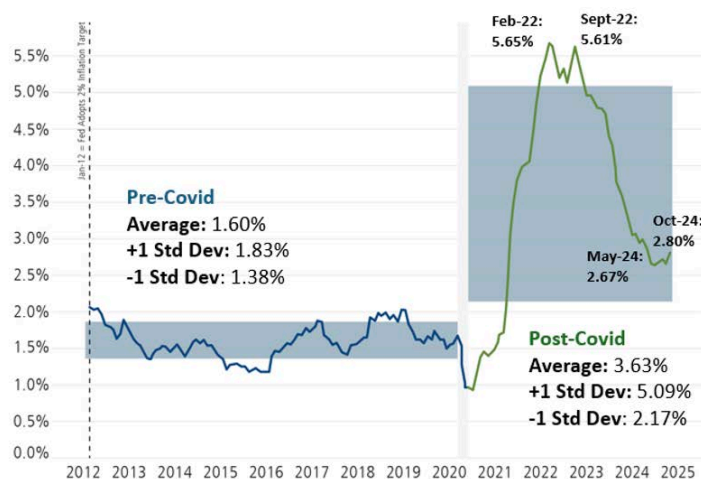
Inflation will likely be a thorn in everyone's side—the Fed, the administration, and consumers alike. Year-over-year measures are already reaccelerating, and unless an unexpected recession develops, our team sees inflation settling back into a range around 3%, well above its 2% symmetrical target.

Given our inflation concerns, persistent interest rate volatility, a higher-than-expected terminal Fed funds rate, and the market's growing unease at the size of persistent US deficits (reflected in a higher term premia), our view is that long-maturity Treasury rates will be stickier at high levels with the yield of the 10-year Treasury closing 2025 in a range of 4.75 – 5.25%. As such, we favor the

front end of the curve. Fed cuts could generate positive price returns in short-duration strategies, while the long-end dynamics could result in flat-to-slightly negative price returns on strategies with intermediate-to-longer durations.

The consumer is still partying like it's 1999, although consumption is far from evenly distributed with high earners driving most of the improvement in retail sales. Given the increasing stress on low-income consumers, we see GDP growth decelerating to trend by year-end. That should lead credit spreads in the investment-grade and high-yield markets modestly wider from the cycle tights. Even so, our team believes that with a starting yield above 7% and fairly sturdy fundamentals, the high-yield market is likely to deliver mid-single-digit positive returns for 2025.

INFLATION: STICKIER THAN ANYONE WOULD LIKE—AND ON THE RISE AGAIN



Past performance is no guarantee of future results. Source: Bianco.

Intermediate Treasury Yields Move 75 to 100 bps Higher Across the Curve

Intermediate Treasury yields increased sharply across the intermediate curve after the 50 bps Fed funds cut on September 18. In the previous 10 cycles, the 10-year note yield declined by an average of 103 basis points. This is the first occurrence where the 10-year note yield moved materially higher over the past 40 years covering 11 cutting cycles.

Intermediate Credit option-adjusted spreads (OAS) tightened

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2 bps during the quarter with A-rated corporates tightening from 65 bps to 61 bps and BBB-rated corporate OAS tightening from 99 bps to 86 bps.

4Q24 and 2024 Sector Performance
Intermediate Corporates outperformed duration-matched Treasuries by 60

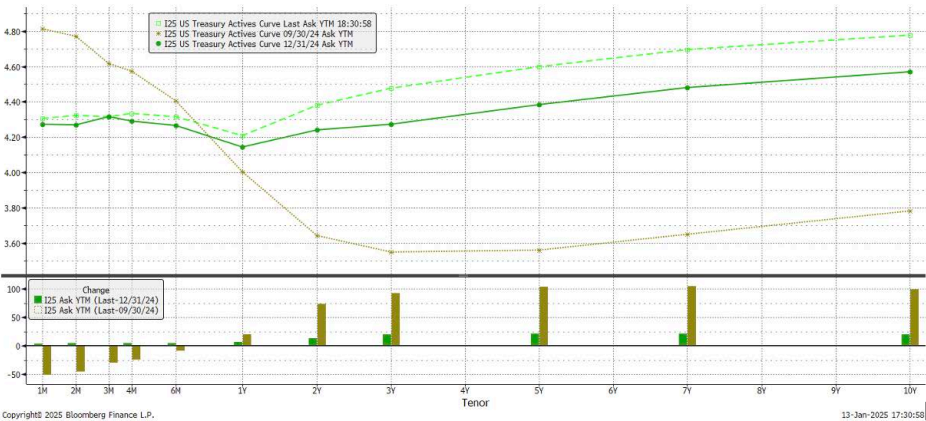
basis points during the quarter due to their yield advantage, positive convexity and modest spread tightening. Intermediate Agencies and Structured Securities underperformed duration-matched Treasuries by 3 and 10 basis points respectively during the quarter. For the year, Intermediate Corporates, Structured Securities and Agencies outperformed duration-matched Treasuries by 210, 53 and 33 basis points respectively.

Intermediate Taxable Munis performed well again and finished 2024 in second place only 30 bps behind Intermediate Corporate sector total return. The yield-to-worst (YTW) of the Bloomberg Intermediate U.S. Aggregate Index increased from 4.13% to 4.81% during the quarter.

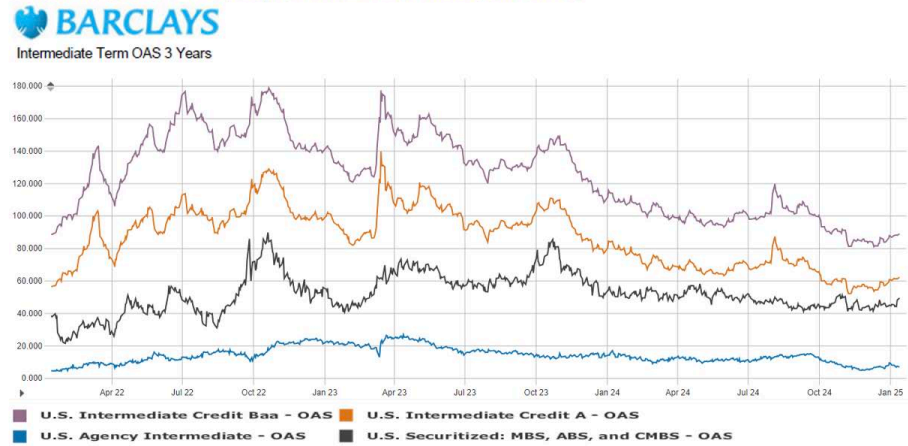
Investment Strategy – Maintain Quality Bias and Modest Duration Overweight
We have been quite vocal about our view that the 10-year Treasury yield has returned to pre-GFC range (3.50% to 5.25%) and is not likely to return to post-GFC Zero Interest Rate Policy (ZIRP) range. This view underpinned our belief that intermediate yields were unlikely to drop enough to trigger materially higher mortgage refinancings and prepayments. We expressed this view across portfolios by actively increasing

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TREASURY YIELD CURVE MOVEMENT DURING 4Q24 AND QUARTER-TO-DATE



OPTION-ADJUSTED SPREADS (OAS) FOR INTERMEDIATE INDEX COMPONENTS



Past performance is no guarantee of future results. Source: Barclays Live - Chart.

INTERMEDIATE AGGREGATE INDEX PERFORMANCE BY ASSET CLASS (EXCESS RETURN VS. TREASURIES)

	1Q24	1Q24	2Q24	2Q24	3Q24	3Q24	4Q24	4Q24	YTD	YTD
	Total	Excess	Total	Excess	Total	Excess	Total	Excess	Total	Excess
Return	Return	Return	Return	Return	Return	Return	Return	Return	Return	Return
U.S. Treasury: Intermediate	(0.36)	-	0.58	-	3.97	-	(1.70)	-	2.42	-
US Aggregate: Government-Related Interm	(0.07)	0.14	0.71	0.08	3.91	0.14	(1.55)	(0.03)	2.95	0.33
Intermediate Corporate	0.26	0.70	0.74	0.24	4.66	0.56	(1.40)	0.60	4.22	2.10
U.S. Securitized: MBS, ABS, and CMBS	(0.91)	(0.04)	0.12	(0.07)	5.44	0.73	(3.01)	(0.10)	1.46	0.53
Bloomberg Interm U.S. Aggregate	(0.42)	0.13	0.46	0.03	4.60	0.36	(2.07)	0.09	2.47	0.61
Bloomberg Tax-exempt Muni 1-10yr Blend	(0.37)	N/A	(0.40)	N/A	2.67	N/A	(0.95)	N/A	0.91	N/A
Bloomberg Municipal Intermediate Taxable	0.66	N/A	0.53	N/A	4.35	N/A	(1.61)	N/A	3.90	N/A

Past performance does not guarantee or indicate future results. Current performance may be lower or higher than the performance quoted.

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<p>already overweight allocations of municipal housing bonds issued by state housing finance agencies secured by single-family mortgages in lieu of holding 15 or 30-year maturity Mortgage-backed Securities (MBS) directly. The call protection and fixed maturities of our state municipal housing bonds improved portfolio convexity versus performance benchmarks. This convexity and additional yield advantage contributed to notable outperformance across portfolios in 2024. We will maintain this tactical overweight until economic expectations and/or capital markets indicate</p>	<p>a change is warranted.</p> <p>Due to our highly credit quality and yield standards for new purchases, we were unable to extend portfolio duration past applicable benchmark indices by year-end. We are intensifying efforts to add duration as the 10-year Treasury yield approaches 5% to match or slightly exceed benchmark duration, but will adjust to economic trend shifts, especially in consumer and producer price expectations.</p> <p>Our investment philosophy is rooted in being adequately</p>	<p>compensated for the risks we are taking. Even though credit spreads can trade in tight ranges for years, it is prudent to use expensive markets as a low-cost opportunity to migrate to higher overall credit quality. The team has been actively doing so across strategies for multiple quarters, investing in secured structures when possible. However, we maintain meaningful exposures to acceptable credit risks identified through our research-driven process. <input type="checkbox"/></p>
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Navigating 2025: Economic Strength, Market Volatility, and Investment Trends

<p>Several factors contribute to this optimistic outlook:</p> <ul style="list-style-type: none">• Consumer Resilience: Strong real income growth and healthy balance sheets are expected to support consumer spending.• Fiscal Policy: Government policies under the incoming administration may encourage private and public investment, further bolstering economic activity.• Structural Improvements: Enhancements in productivity and potential growth rates are seen as supportive of higher policy rates and stable economic conditions. <p>However, uncertainties loom, particularly regarding potential</p>	<p>policy shifts and their implications for inflation, which has recently trended slightly higher, and growth. Analysts warn that while the economy is poised for growth, risks related to geopolitical tensions and domestic policies could introduce volatility.</p> <p>U.S. Bond Market Outlook</p> <p>The bond market faces a challenging environment in 2025, primarily due to the impending maturity of approximately \$3 trillion in U.S. debt, much of which consists of short-term securities.</p> <p>This situation raises concerns about how the market will absorb this significant issuance amid ongoing budget deficits projected to remain around \$2</p>	<p>trillion annually.</p> <p>Key considerations include:</p> <ul style="list-style-type: none">• Interest Rate Dynamics: The Federal Reserve is expected to lower interest rates to a range of 3.75% to 4%, which could create a more favorable environment for bond prices as yields decline. Declining rates should continue to provide a tailwind to investment-grade intermediate term bond portfolios, typical of our P&C insurance clients.• Longer term: US Interest rates are expected to come down more slowly than predicted at this time in early 2024 and/or to remain higher for longer. Even if <p><i>Continued on page 5</i></p>
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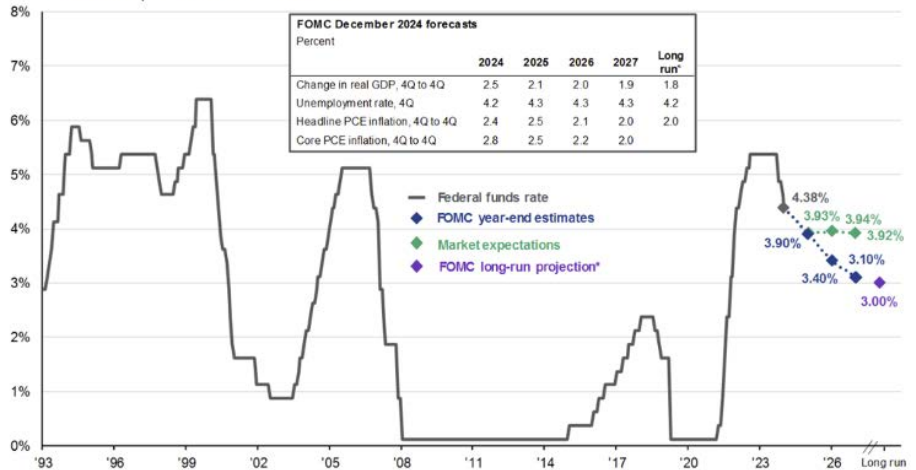
rates continue to trend toward the Fed Target, there are no expectations for a return to the near zero interest rates environment that dominated for many years post “great recession”.

However, any unexpected inflationary pressures could complicate this outlook.

- **Market Volatility:** The bond market has experienced fluctuations due to varying expectations about economic growth and inflation. Analysts suggest that while there may be opportunities for higher returns in fixed income, investors should remain cautious about duration (interest rate risk) and credit risk as they navigate these uncertainties.
- **Yield Curve:** The curve continues to reshape towards a normalized upward sloping curve

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



Source: JP Morgan

- **Yield Predictions:** Forecasts indicate that 10-year Treasury yields could hover around 4.5%, depending on economic conditions throughout the year. Overall, while there are opportunities for fixed-income investors, the bond market is expected to remain volatile as it adjusts to evolving economic conditions.

U.S. Stock Market Outlook

Notwithstanding a 5-year period during which the US stock market has traded historically “rich” by P/E measurements, the stock market outlook for 2025 is characterized by continued optimism. Analysts' consensus predicts an average increase of around 10% for the S&P 500 index.

Following two consecutive years of substantial gains (approximately 24% each year), Wall Street anticipates that corporate earnings will benefit from a stable economy and declining interest rates. Factors influencing this positive sentiment include:

- **Earnings Growth:** Consensus corporate earnings are projected to rise by about 11%, driven by moderate economic expansion and improved

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U.S. Treasury yield curve



Source: JP Morgan

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revenue generation across sectors. JP Morgan provides a slightly more optimistic estimate of 14%: see the chart below.

- **Sector Performance:** Analysts expect small-cap and mid-cap stocks to perform well as lower interest rates enhance their attractiveness compared to larger firms. Additionally, advancements in artificial intelligence may help narrow performance gaps between leading tech companies (the "Magnificent Seven") and other sectors.
- **Market Volatility Risks:** Despite the optimistic forecasts, analysts caution

S&P 500 Index: Forward P/E ratio



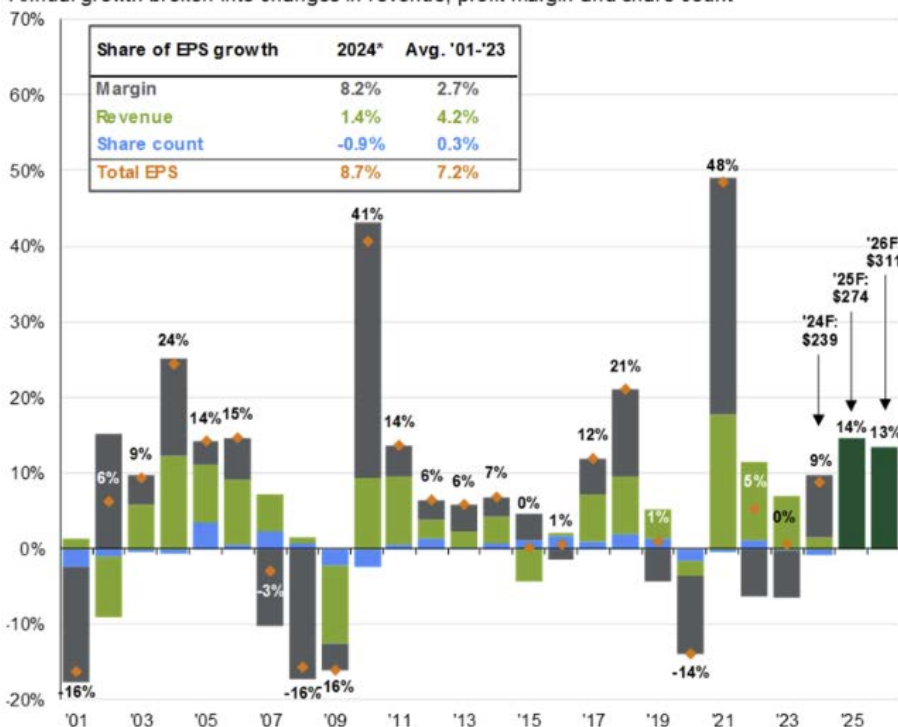
Source: JP Morgan

that geopolitical tensions and domestic policy shifts under the new administration could introduce volatility into the markets. In summary,

while the stock market is poised for another year of gains supported by strong economic fundamentals, investors should remain vigilant regarding potential disruptions stemming from political changes.

S&P 500 year-over-year pro forma EPS growth

Annual growth broken into changes in revenue, profit margin and share count



Source: JP Morgan

CapVisor Summary

The outlook for the U.S. economy, bond market, and stock market in 2025 reflects a blend of optimism tempered by caution. Economic growth is expected to remain robust yet moderate, supported by favorable consumer dynamics and fiscal policies. Meanwhile, the bond market grapples with significant debt maturities amidst an uneven declining interest rate cycle, presenting both challenges and opportunities for investors. Overall, Insurers reserve portfolios should continue to post real returns higher than

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they have experienced for many years - see upcoming article on our LinkedIn page. Lastly, the stock market appears set for continued growth; however, external factors such as geopolitical risks may inject

volatility into an otherwise positive landscape. As we move through 2025, stakeholders across these sectors will need to navigate these complexities with strategic foresight. □

Is 2025 Going to Rhyme with 2000?



Sean is a Partner and Portfolio Manager at NBW Capital, having over 30 years of investment professional

experience. His primary areas of coverage are Energy, Financials and the Health Care sectors. Sean joined NBW Capital in 2021. Previously, he worked at The Boston Company as a Senior Managing Director and played a leadership role managing several different equity strategies.

Market Outlook

After back-to-back years of over 20% return for the S&P 500 Index, a question arises about the outlook for 2025. With a lot of dynamics at play, such as the move back to a Trump administration and fewer forecasted rate cuts, we will lay out some of our thoughts. On top of our mind is whether 2025 will rhyme with the year 2000. Of concern is the market sector concentration,

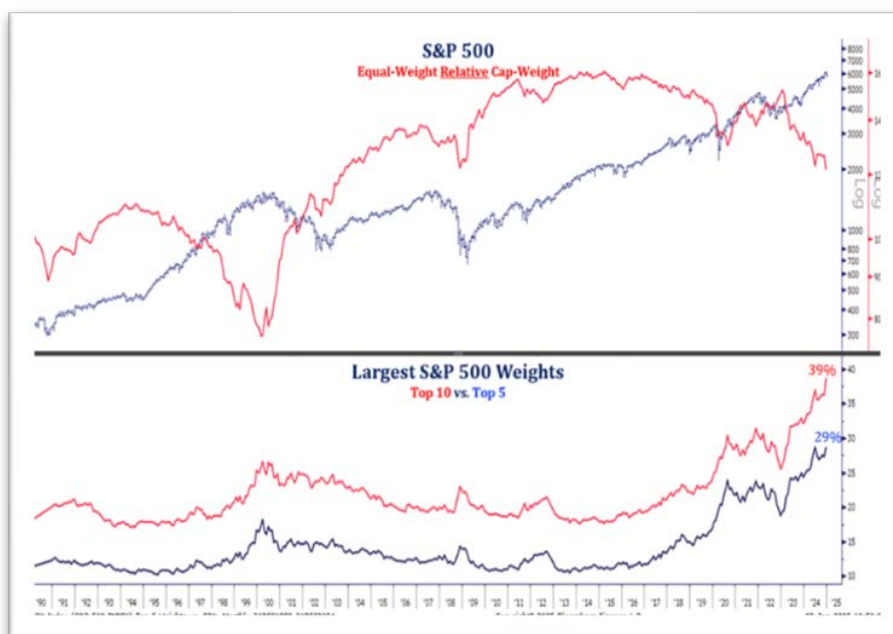
which is approaching dot-com era levels. However, an important lesson learned from that period is there were still opportunities to make money in the market.

Trying to Learn from History

There are a lot of similarities between the year 2000 and 2025. There was and is a two-tier market in both periods. In 2000, it was the internet bubble. Now in 2025, there is a lot of enthusiasm around artificial intelligence (AI). While valuations are not as extreme as the dot-com bubble, the AI bubble is more extreme in terms of market concentration. Specifically, as seen in the chart to the left, the top ten weights in the S&P 500 now represent 39% of the Index and the top five are 29%, with nearly all focused on technology and AI.

Both years were also characterized by moderately growing economies with supportive earnings growth and

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Source: Strategas

Is 2025 Going to Rhyme with 2000?

benign financial conditions. A new Republican administration was assuming the presidency with a pro-growth agenda highlighted by tax cuts. In 2000, 10-year yields on government securities were around 4% and as we enter 2025, CPI (ex food and energy) is running at an unalarming rate of about 3%.

The Bursting of the Internet Bubble

In March 2000, the dot-com bubble began to burst. Interestingly, the burst came with no overt catalyzing event or any news to speak of. It was only much later that we learned that internet data traffic had been overestimated by Wall Street in part because of the grossly overstated data traffic being released by WorldCom, the operator of a large fiber optic data transmission network. We now have concerns that the tens of billions of dollars going into AI data center Capital Expenditure (CapEx) may not generate a

U.S. 10-Year Treasury Rate and CPI (ex Food & Energy)

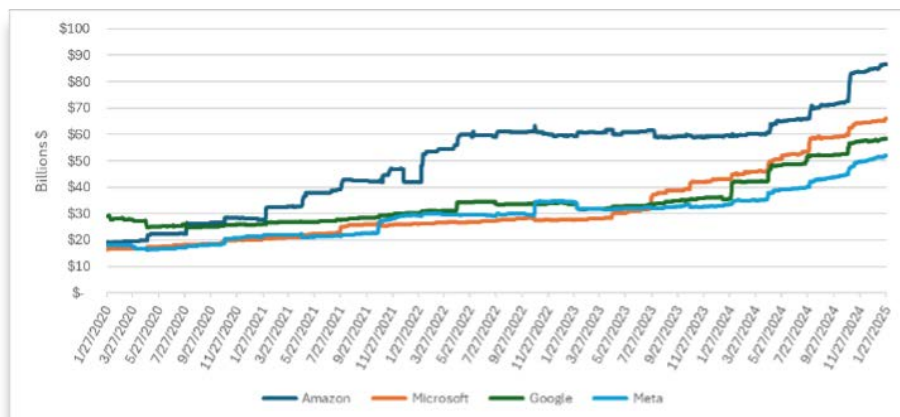


Source: Bloomberg

near term return. While it may be profitable over 20 years, the revenue opportunity over the next five years is questionable. While AI will certainly be a powerful tool and is evolving rapidly, we know of no “killer application” that can drive revenues and profits so far that justifies the rapid, massive investments in the space.

As highlighted in the chart below, Capital Expenditure (CapEx) budgets for the four main players building out AI data centers have doubled or tripled in recent years. A fear of missing out has created an environment where we question whether costs are properly being factored into the equation, or more specifically the ultimate return on investment.

Capital Expenditure for Major Data Center Vendors



Source: Bloomberg

How Much Risk is There in the Mega-cap Stocks of Today

Is the past a prologue to the future? The bursting of the dot-com bubble occurred over roughly a three-year period (i.e. 2000 through 2002). During that time, the S&P 500's cumulative total return was negative 37.65%. The heavy weights in the Index, which had previously outperformed but

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Is 2025 Going to Rhyme with 2000?

were at extreme valuations, fared the worst. The broader market went down less, with the equal-weighted S&P 500 down 15.32%. Certain parts of the market that were previously ignored, like

small-cap value, did very well and were up 23.57% during this time period.

Today, valuations are not quite

as extreme as 2000.

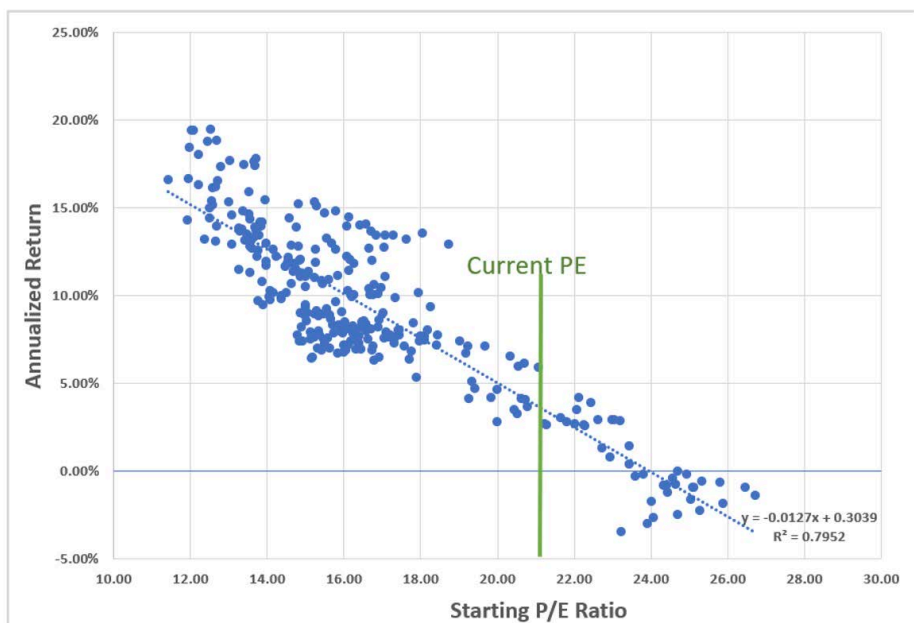
Highlighted in the chart to the left, the Price to Earnings ratio for the S&P 500 peaked at nearly 26 times earnings in late 1999 and again in early 2000. With the current valuation at 21.66 times earnings, caution is warranted. Especially in those mega-cap stocks trading above the average. It is worth highlighting though, that the large index names today are of higher quality than some that existed during the dot-com bubble. All have dominant market positions, high margins and true revenue, earnings and cash flows. This was not the case for some of the companies in the dot-com era.

S&P 500 Price to Earnings Multiple



Source: Bloomberg

Starting P/E versus next 10-year annualized return (1990 - 2024)



Source: Bloomberg

What Does Current Valuation Mean for Future Returns?

Within financial markets, we are always looking for good predictors of future return. Whether at the market level or the individual stock level, a lot of value can be gained by identifying factors that have been predictive and then analyzing whether they will continue to be predictive. Perhaps one of the strongest correlations is between the starting valuation when you buy into the market and what is your next ten year total return.

The chart to the left highlights this correlation, where each dot represents a starting month going back to 1990. The bottom axis is the starting

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Is 2025 Going to Rhyme with 2000?

Price to Earnings Multiple and the left axis is the next ten year total return. The far right of the chart, where valuations were 24-26 times earnings would represent buying into the market at the peak of the dot-com bubble, in which case it took more than ten years to recoup your investment.

Highlighted is the current valuation for the market cap-weighted S&P 500, which is 21.66 times earnings. From this level, we are cautioning our clients that future returns for the cap-weighted index will likely be more modest than the strong returns over the past couple years. Based upon this analysis, it would suggest mid-single digit total returns. However, we also highlight

that the equally-weighted S&P 500 is trading at a more reasonable valuation of 17.03 times earnings, which would suggest some opportunity for close to 10% return on the average stock.

Conclusion

Only time will tell the market return for the next several years. However, for some of us that experienced the dot-com bubble, we see some striking similarities in the current market. In particular, the enthusiasm around a new technology that didn't have a well-defined revenue opportunity. As well as a race to invest in technology before

knowing the return on that investment. In addition, the combination of high valuations and the concentration of the index in a handful of names adds risk to the market. But, by broadening the lens beyond the Magnificent 7 stocks (Apple, Amazon, Alphabet, Meta, Microsoft, Tesla, NVIDIA), there is still value to be found in the other 493 stocks in the index. We believe this will set up an environment where active management will outperform the S&P 500 for several years similar to what we saw in 2000. □

Upcoming Events

The CapVisor team is attending ReConnect 2025 in the Cayman Islands from April 10-11. We look forward to connecting with you!

Carl Terzer is speaking at the NCCIA Annual Conference in Charlotte, NC from May 14-17. More details will be available

soon on CapVisor's LinkedIn page.

Connect with CapVisor on LinkedIn. We share interesting investment information, research, and announcements.



Carl E. Terzer
Principal & Editor in Chief
CapVisor Associates, LLC

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