Market Commentary

December 31, 2024

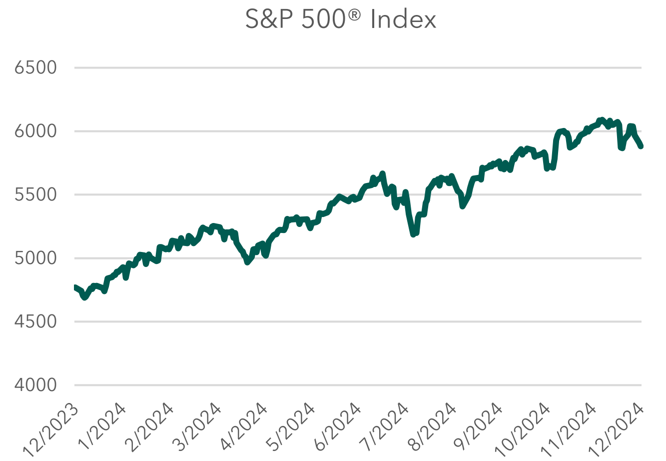
U.S. Equities Market

Party Like It's 1999

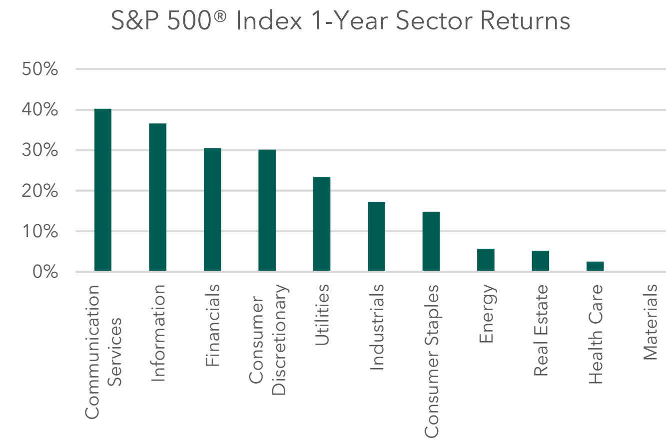
Equity markets, as measured by the S&P 500® Index, ended the year up 25%, putting together the two best consecutive years since 1997-1998. Markets were led by Technology stocks amid the fervor of Artificial Intelligence, particularly with regard to the Semiconductor industry as the buildout of datacenters and the pursuit of Generative AI fueled capital spending. Financial stocks performed well as the Federal Reserve ("Fed") began lowering interest rates in the hopes that the highest inflation in decades was coming down closer to its 2% target level. Consumer Discretionary stocks also had a strong year as the American consumer, while gainfully employed, continued the post-COVID spending splurge but at a more measured pace. All sectors in the S&P 500® Index were in positive territory though Materials and Energy stocks barely eked out gains. The global economy, particularly China, failed to keep pace with the United States. The Real Estate sector also failed to match the overall market as long-term interest rates remained stubbornly high and office occupancy rates remained stubbornly low. The trend of growth outperforming value, and large company stocks outperforming small, held true for most of the year as the big continue to get bigger and Technology companies swallow more of the overall economy.

Equity markets finished the fourth quarter on a strong note following the results of the Presidential election in hopes of a lighter regulatory regime and the renewal of tax cuts in 2025. Speculation in cryptocurrencies and in equities - and their options - thought to be in President-elect Trump's favor was reminiscent of Roaring Kitty, GameStop and other so-called meme stocks of just a few years ago. However, continued high fiscal deficits and sticky core inflation caused long-term interest rates to increase despite Fed actions. Thus far, equity markets have been impervious to these effects but increasing mortgage rates have caused the housing market to slow. While prices have held steady, existing home sales are plumbing the lows not seen since the Great Financial Crisis ("GFC") and new home builds are stuck far below the pace prior to the GFC despite the lack of housing in most parts of the country. Though consumer and corporate credit seems okay, there are signs of strain in auto lending and credit cards, particularly among lower-income consumers and households. This bears watching as we enter 2025.

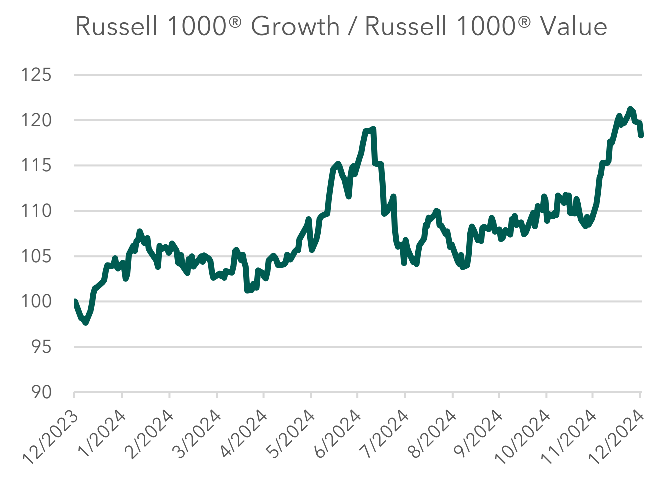
The U.S. remains best-positioned globally with energy independence, an entrepreneurial culture, and relatively self-sustaining consumer and job markets thanks to its strong services component. One wonders, though, how long it can go it alone, especially amid the largest geopolitical upheaval since the disintegration of the former Soviet Union in the 1990s. This New Year will see new leadership in the U.S., Germany, and, most likely, France and Canada, in addition to the recent changes in Japan and the United Kingdom. When Italy is the sole constant in the G-7, one may be forgiven to question stability in the world. Forza!



Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

U.S. Taxable Fixed Income Market

Are We There Yet?

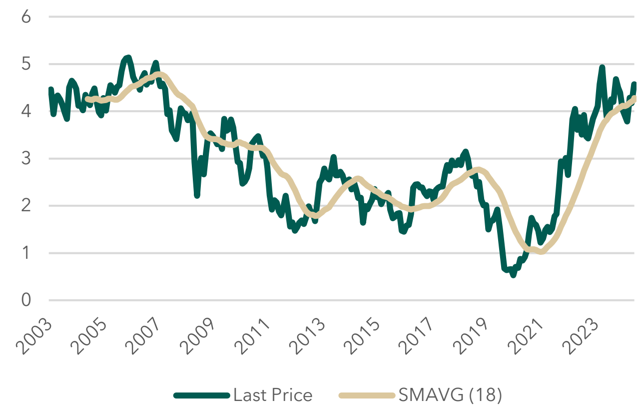
The Bloomberg Intermediate Government/Credit Index gained 3% in 2024, more than offsetting a 1.6% decline in the final quarter. The U.S. 10-Year Treasury yield climbed again in 2024, moving from 3.88% to 4.56%, marking the 4th consecutive year of rising long-term interest rates. Bond investors are now very familiar with the inverse relationship between yield and price, but 2024 is a perfect illustration how coupon income offsets the headwind of higher interest rates. The coupon income received in 2024 is largely the reason why intermediate bonds investors still earned a positive return despite higher interest rates.

2024 marked a divergence in the direction of interest rates, a rare but not unprecedented dynamic. Overnight rates fell from 5.33% to 4.33% as the Fed started cutting the Federal Funds Rate in September. The U.S. 2-Year yield was largely flat on the year, finishing at 4.25% and, as previously mentioned, the U.S. 10-Year Treasury yield rose. This is a reminder to investors that the Fed controls overnight rates, but many other factors impact long term rates - economic growth, inflation expectations, foreign currency, and global investor demand being key examples. In our view, the dispersion witnessed was driven from a combination of resilient US economic growth and slowing - but above target - inflation. Additionally, U.S. investors expected this Fed rate cutting cycle to be deeper than now appears likely.

The valuation of corporate bonds is measured by the difference in yield (spread) to a similar maturity U.S. Treasury security. Spreads are currently quite low (tight), presenting less relative opportunity for investors. Corporate leverage has been stable, profit margins robust, and interest expense flat, underscoring the positive fundamental outlook. We tend to be more constructive on corporate credit when spreads are wider, but understand the positive fundamental outlook explains why investors continue to allocate funds to the asset class. We look to reduce the risk of a credit allocation in a rich valuation environment through credit selection and portfolio construction.

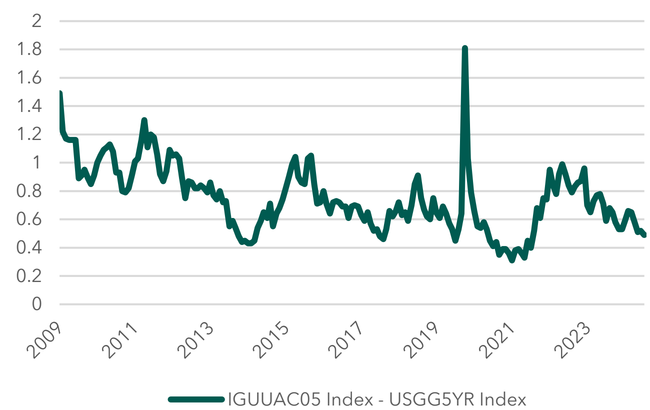
Are we there yet regarding the peak of long-term rates? We believe we are close, but acknowledge further upside is possible given solid U.S. economic growth, somewhat sticky inflation, large fiscal deficits, and additional uncertainty surrounding the policies of the new administration. Presently higher long-term rates have been a global theme over the past four years, suggesting we have experienced a global secular shift away from the zero/low-rate environment exiting the GFC (Great Financial Crisis.) An intermediate taxable portfolio has an approximate coupon rate of 4.5% entering 2025 and even if rates do in fact push higher again for a fifth consecutive year, investors have a considerable buffer to keep top of mind.

U.S. 10-Year Treasury Yield



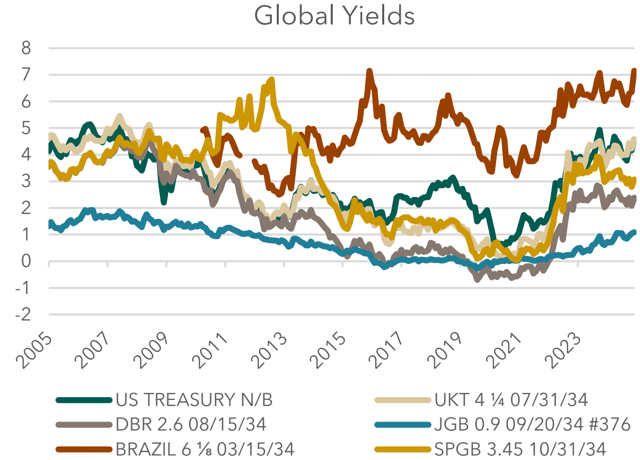
Source: Bloomberg

U.S. Corporate Credit Spreads



Source: Bloomberg

Global Yields



Source: Bloomberg

Market Commentary

December 31, 2024

U.S. Municipal Fixed Income Market

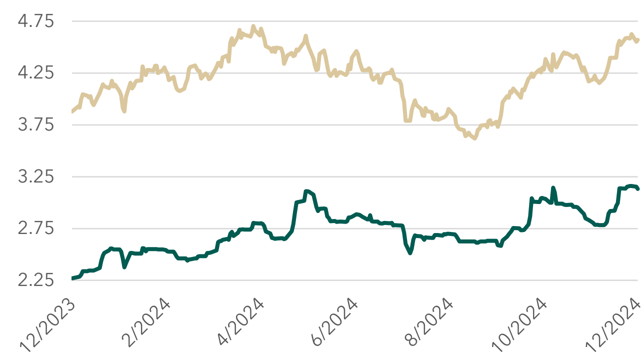
A Cooler Than Expected Quarter

The municipal market began the fourth quarter on solid footing after comfortably absorbing the significantly higher supply seen through the summer and fall, with July through October being one of the heaviest issuance periods on record. However, as the quarter progressed, uncertainty surrounding the upcoming Presidential election began to weigh on both taxable and tax-exempt investors. While the market seemed to find a general sense of direction following the outcome of the race, it was the final Fed meeting of the year that tipped the scale. Despite delivering an additional 25 basis point cut, Federal Open Market Committee forecasts showed less than anticipated easing in 2025, coupled with somewhat stickier inflation ahead, sending rate markets sharpy higher. This ultimately saw the 10-Year U.S. Treasury yield increase from 3.78% to 4.56% over the quarter and the Bloomberg 10-Year AAA Muni yield increase from 2.63% to 3.13%.

Despite higher yields, municipal credit was steady over the period with spreads generally unchanged within the investment grade universe. BBB to AAA municipal spreads have continued to remain within a tight 10 basis point range throughout much of the year, currently sitting at approximately 88 basis points, well below the 10-year average. While it could be hard to see further tightening from here, the fundamental backdrop for most municipal sectors remains reasonably sound heading into the New Year. 2024 saw a strong upgrade-to-downgrade ratio of approximately 4:1, and although pandemic era stimulus has been fully appropriated at this point, state and local issuers continue to benefit from healthy tax receipts and a better than anticipated economic environment this late into the cycle. It is still too early to forecast how the new administration's fiscal and public policy will ultimately impact the sector, but we believe they would be unlikely to derail the current credit landscape in the near-term.

Looking into early 2025, the technical backdrop for municipals appears more favorable. January and February should provide strong reinvestment capital to investors in the form of maturities and coupons, with estimates of nearly $75 billion available in those two months alone. This should help fuel demand for what will likely be another year of higher-than-average new issue supply, with estimates ranging from approximately $425-475 billion. One benefit of the late year rate volatility was moderate relief in Muni-to-Treasury ratios that had become relatively less attractive early in the quarter, reaching just 65% in the 10-year portion of the curve. As it stands now, we will enter Q1 closer to 70%, a level that is not only above the 12-month average but where investors view an entry into tax-exempts more favorably.

10-Year AAA Muni Yield vs
10-Year U.S. Treasury Yield



Source: Bloomberg

10-Year AAA Muni Yield as a % of 10-Year
U.S. Treasury Yield

Source: Bloomberg

BBB to AAA Municipal Spreads (bps)

Source: Bloomberg

Market Commentary

December 31, 2024

DAVIDSON
INVESTMENT ADVISORS

International Equities Market

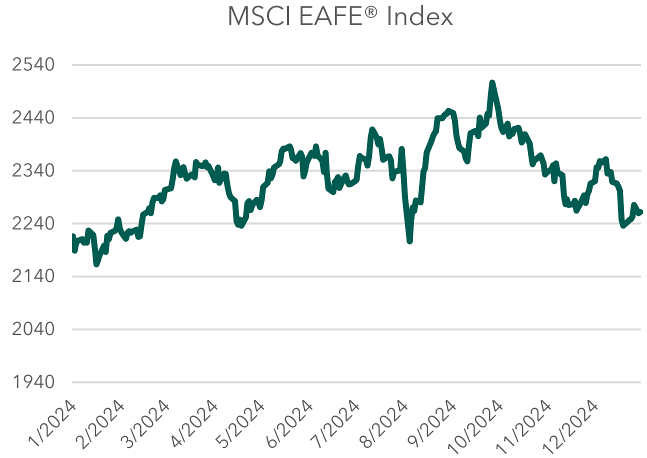
Strong Finish for the Dollar

Both the MSCI EAFE and MSCI Emerging Markets Indices finished down during a quarter where domestic equities posted positive performance. The MSCI EAFE Index was down 8.06% for the quarter but finished the year up 4.35%. The MSCI Emerging Markets Index was down 7.84% for the quarter and up 8.05% for the year. For both indices, the fourth quarter performance was the worst quarter not only for the year, but also for the past two years. The dollar was particularly strong – its strongest quarterly performance since the fourth quarter of 2016.

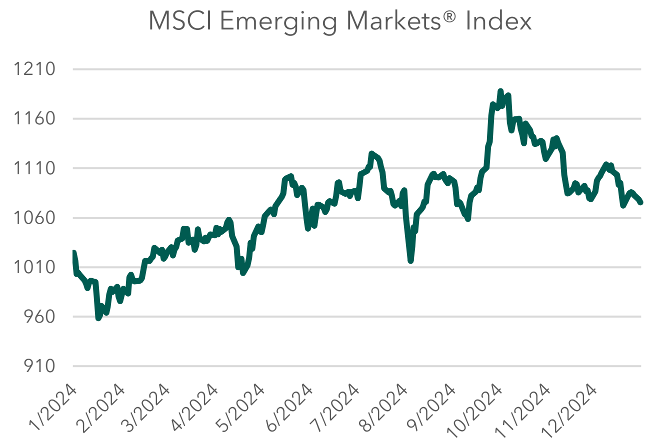
We surmise the dollar's strength was due to two reasons. The first was the reduction in market expectations in the number of interest rate cuts by the Fed over the next year. The second was the potential negative impacts to growth from higher tariffs. This expectation does not imply there will be no potential impact to U.S. growth – it just assumes the impact will be greater for our trading partners.

Reviewing earnings growth expectations for 2024, market forecasts for domestic and developed markets finished the year close to where they started. Consensus forecasts assumed at the beginning of the year S&P 500® earnings would grow 10% in 2024, which is close to today's estimate of 9.4%. For the EAFE Index, analysts expected relatively flat earnings growth, about 1%, versus today's estimate of 0%. Emerging market growth expectations were the only ones that proved too high. The market estimated profits would grow 18% and today those expectations have fallen to 11%. As for 2025, the market assumes S&P 500 profits will grow 12%; EAFE earnings will grow 3.9%; and Emerging Markets earnings will grow 13.5%. We will have to see what impact tariffs will have on those estimates as the year progresses.

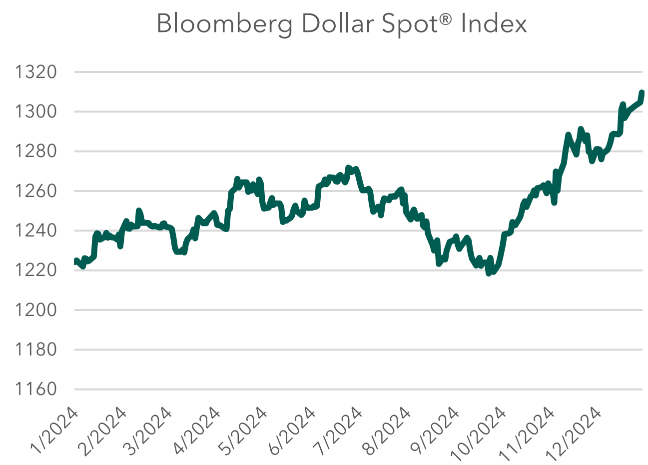
Like last year, valuations are lower for international equities versus domestic. Price to earnings ratios for both developed and emerging markets are near their historical averages. For domestic equities, valuations continued to increase during 2024 and are more than one standard deviation above their historical averages. For the valuation gap to narrow, growth expectations for international equities will have to improve or domestic expectations will have to deteriorate. Given current lackluster economic forecasts for international markets, that expectation appears unlikely.



Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

DAVIDSON INVESTMENT ADVISORS

Disclosures

Davidson Investment Advisors, Inc. is a SEC registered investment advisor. The opinions expressed herein are those of Davidson Investment Advisors and are subject to change.

The information contained in this presentation has been taken from trade and statistical services and other sources, which we believe to be reliable. We do not guarantee that this information is accurate or complete and it should not be relied upon as such.

This presentation is for informational and illustrative purposes only, and is not intended to meet the objectives or requirements of any specific individual or account. Past performance is not an indicator of future results. Indices provide a general source of information on how various market segments and types of investments have performed in the past. An investor should assess his/her own investment needs based on his/her own financial circumstances and investment objectives.

The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. Indices are not available for direct investment.

The S&P 500® Index is a gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

The Russell 1000® Growth Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

The Federal Funds Rate is the interest rate that banks charge each other to borrow money overnight. It is a key tool used by the Federal Reserve to control the money supply and influence economic activity.

The MSCI EAFE Index is broadly recognized as the pre-eminent benchmark for U.S. investors to measure international equity performance. It comprises the MSCI country indexes capturing large and mid-cap equities across developed markets in Europe, Australasia and the Far East, excluding the U.S. and Canada. Numerous exchange-traded funds are based on the MSCI EAFE Index, and the Chicago Mercantile Exchange, NYSE Liffe U.S. and the Bclear platform of Liffe are licensed to list futures contracts on this index as well.

The MSCI Emerging Markets Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Market countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The Bloomberg Dollar Spot Index tracks the performance of a basket of 10 leading global currencies versus the U.S. Dollar. It has a dynamically updated composition and represents a diverse set of currencies that are important from trade and liquidity perspectives.