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GENTER CAPITAL MANAGEMENT

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Introduction

When Donald Trump announced, in late 2022, that he was running again for President of the United States, he joined a small group of former American presidents who sought their old job. This group includes Martin Van Buren, Millard Fillmore, Ulysses S. Grant, Grover Cleveland, Theodore Roosevelt, and Herbert Hoover. Until Trump, only Cleveland, among the men listed above, won the Presidency back. First elected in 1884, Cleveland was our 22nd President and then our 24th.

In the aftermath of November's election, there has been a resurgence of interest in Grover Cleveland. He was a "Gold Democrat" from New York, holding together a rickety coalition of big city political machines, farmers, and "good government" types to become a formidable national candidate. He was well-regarded for his even-handedness. As President, to accommodate his rural constituency, he dialed down tariffs designed to protect American industry. He also resisted the "spoils system," following through on his commitment to allow lower-ranked civil servants to retain their office, regardless of party affiliation.

But the real test of his two Presidencies was the Long Depression, the economic slowdown lasting from 1873 to 1899. Cleveland's coalition would ultimately fall apart, as gold-backed dollars became untenable to most farmers. They saw silver, and inflation, as the best way to break the chains of their crushing debts.

In 1896, as his second term wound to its close, Grover Cleveland opted to stick with convention and not run for a third term. With him out of the picture, the "Silverites" took control of the Democratic party. "The Great Commoner," William Jennings Bryan, became its standard-bearer. In that election, which political historians regard as one of the most consequential in American history, Cleveland privately supported Bryan's opponent, William McKinley, who did become the 25th President.

Time will tell if the contest to become the 47th President is a consequential election on the order of 1896. But the 2024 election solved, as all elections solve, the important question of national priorities. Americans were presented with two paths, and one was chosen. To be sure, there are certain fundamentals to the American economy that even the federal government cannot mess up. Household consumption amounts to almost 70% of GDP. Government spending is another 20-25%, but it can drive growth (or the lack thereof) and inflation (or the lack thereof). After a couple years of quiescence due to divided government, government policy is back with a vengeance. A course has been set and it carries economic implications in its wake.

Review and Outlook

Throughout 2024, our view was that the year would divide into the ten months of pre-election and two months of post-election. Sure enough, in the immediate aftermath, the stock market—as measured by both the Dow Jones Industrial Average and the S&P 500—spiked significantly. On the fixed income side, corporate spreads compressed to year-long lows, moving to within a basis point of the tightest level for the entire 21st century.

By year-end, though, the stock market was up only slightly from Election Day. The risk landscape of 2024 may have changed from pre-election to post-election, but market performance did not. As the election receded into the distance and its set of uncertainties dissolved, another set of uncertainties inevitably emerged to take its place. Our baseline view is that these uncertainties should land on the side of business growth.

During 2024, inflation risks were highest in April, which led to a delay in the expected rate cuts from the Federal Reserve. The market, which had been expecting 150 basis points of cuts at the start of the year, scaled back its expectations. But by September, in the aftermath of the summer's weak employment prints, the Federal Reserve responded with its first rate cut since the COVID-19 crisis—a meaty, 50 basis point cut which helped alleviate growth scares. Two 25 basis point rate cuts would follow, in early November and mid-December, leading to 100 basis points in cuts for the year.

When will the Fed stop cutting rates? It depends on the evolving facts on the ground, of course, but also upon a fuzzy Fed concept called "R-Star" (R*). R* is that neutral rate where policy is neither accommodative, to fight downside risks like recession, nor restrictive, to fight upside risks like inflation. There is no strong consensus about R*. Extrapolating from the projections of Fed officials, where we subtract the 2% inflation target from their long-run estimates of the Fed Funds rate, it could be anything from 0.50% to 1.75%. In other words, if the inflation benchmark is 2.8%, as it is currently, then R* right now is anywhere from 3.30% (2.8% plus 0.50%) to 4.55% (2.8% plus 1.75%). At this time, the Fed's rate target at 4.25-4.50%, so we are already breaching the upper range of the Fed's R*.

We do not think that the Fed wants to go too deep into the neutral zone. Inflation is not entirely tamed, with inflation itself at 80 basis points above target, long-term inflation expectations creeping higher, and the prospect of additional inflationary pressures from tariffs, deportations, deficits, and stubbornly high "owners' equivalent rent." We think the Fed will remain vigilant to inflation risks, and look for only one cut this year, with the likelihood of zero cuts being roughly equal to the likelihood two cuts. We would note that both headline CPI and the target core PCE have ticked higher from the end of Q3, though they did make some progress over the entire year. Headline CPI, in particular, fell from 3.4% to 2.7%, while core PCE, which is the Fed's actual metric, declined from 3.04% to 2.82%. But other inflation indicators used by the Fed, such as the "Supercore" readings and the Atlanta Bank's "Sticky," remain above 3.5%.

To be sure, Fed Chair Jerome Powell and other Fed officials have been quite explicit that their risk assessment is now fully balanced, meaning that they are equally concerned about the downside risk of slowdown as the upside risk of inflation. They have spent the better part of a year walking their risk assessment towards that stance. Inflation is not the only thing the Fed thinks about; the unemployment rate is now at 4.2%, which is the Fed's long-run target. This is still an economically healthy level, and we think the current trend on employment is "sideways." If it turns "south," then we take the Fed at its word that it will act, but we do not expect that action will be required.

Over the past two years, and notwithstanding the dour forecasts, the economy has been exceptionally strong. We reckon that President Trump wants this to continue. Towards that end, we think fewer bills are smarter than attempting to piecemeal legislation through Congress. We agree with Mr. Trump that the likeliest way to enact reform is through singular legislation which includes everyone's pet issue, whether border security, energy policy, extending the tax cuts, or tariffs. While these efforts will require legislative action, we also think that President Trump, backed by a supportive Supreme Court, has significant latitude to unilaterally reduce the regulatory burden. We project 2% growth this year, which is lower than the past two years, but if there is significant deviation from this prediction, we think it is more likely to the upside.

It is always difficult to quantify the impact of politics on investments and the economy. Towards that end, our Director of Fixed Income, Alexander Hall, put together a model, building from the assumption that Trump intends to do as promised on the campaign trail. Alex's table below attempts to measure the near-term (less than a year) and longer-term (one to four year) economic impacts of policy. For instance, reducing government waste may have a negative near-term impact, as government retrenches, but the longer-term impact would be positive.

We think this is a useful and interesting way to map out the complex relationship between policy and the economy. The vertical axis contains the policy category, and the horizontal axis has the economic category:

Potential Impact of New Trump Administration Policy Goals

	Near-term (<1yr) Impact							
	Growth	Employ-ment	Inflation	Deficit	Interest Rates	Equity Valuati	Score	Net Effect
Deportation / Immigration	Neg	Neu	Vry Neg	Sltly Neg	Neg	Neg	-1.67	Neg
Taxes (reduce)	Pos	Sltly Pos	Neu	Vry Neg	Neg	Pos	0.00	Neu
Tariffs (increase)	Neu	Sltly Pos	Neg	Neu	Sltly Neg	Neu	-0.33	Sltly Neg
Energy (increase)	Sltly Pos	Sltly Pos	Sltly Pos	Sltly Pos	Sltly Pos	Sltly Pos	1.00	Sltly Pos
Defense Spending (reduce)	Neg	Sltly Neg	Sltly Pos	Sltly Pos	Pos	Neg	-0.17	Sltly Neg
Gov't Waste (reduce)	Sltly Neg	Neg	Pos	Neu	Pos	Sltly Neg	0.00	Neu
Gov't Regulations (reduce)	Pos	Sltly Pos	Pos	Sltly Pos	Neu	Pos	1.33	Pos
Health (improve)	Neg	Sltly Neg	Sltly Pos	Sltly Pos	Pos	Neg	-0.17	Sltly Neg
Score	-0.25	0.00	0.25	0.00	0.25	-0.25	0.00	
Net Effect	Neg	Neu	Pos	Neu	Pos	Neg		Neu
	Longer-term (1-4yrs) Impact							
	Growth	Employ-ment	Inflation	Deficit	Interest Rates	Equity Valuati	Score	Net Effect
Deportation / Immigration	Sltly Neg	Neu	Sltly Neg	Pos	Sltly Pos	Neg	-0.17	Sltly Neg
Taxes (reduce)	Pos	Sltly Pos	Sltly Neg	Sltly Neg	Sltly Neg	Pos	0.33	Sltly Pos
Tariffs (increase)	Neu	Pos	Sltly Neg	Neu	Neu	Sltly Neg	0.00	Neu
Energy (increase)	Sltly Pos	Neu	Neu	Sltly Pos	Neu	Sltly Pos	0.50	Sltly Pos
Defense Spending (reduce)	Sltly Neg	Sltly Neg	Sltly Pos	Pos	Pos	Neu	0.50	Sltly Pos
Gov't Waste (reduce)	Pos	Sltly Neg	Sltly Pos	Vry Pos	Sltly Pos	Neu	1.00	Sltly Pos
Gov't Regulations (reduce)	Vry Pos	Sltly Pos	Sltly Pos	Neu	Sltly Neg	Pos	1.00	Sltly Pos
Health (improve)	Sltly Neg	Neu	Sltly Neg	Vry Pos	Neu	Sltly Neg	0.00	Neu
Score	0.63	0.25	-0.13	1.25	0.25	0.13	0.40	
Net Effect	Pos	Pos	Neg	Pos	Pos	Pos		Pos

Running through the exercise, taking everything into consideration, we forecast a "neutral" impact from policy in the near term, and a "slightly positive" impact in the longer term. We use this grid, or any model, to clarify thinking, not determine it. Our investment discipline involves analyzing the evolving facts on the ground with a willingness to rethink our assumptions. We are setting this table up at GenterCapital.com, so please feel free to try it out for yourself.

At the end of it, President Trump's policy agenda is bold and ambitious. We think that he will try to achieve what he said he would achieve. Moreover, he is not a babe in the woods about the ways of Washington. Mr. Trump's agenda will no doubt meet with varying levels of success, but his proposed changes will have economic impacts, and therefore carry important consequences to investors.

Equity Report

Equities had another strong year, with the S&P 500 total return of 25.03%, closing at 5,881. The S&P 500 index reached its all-time high (6,099) on 12/6/24. For much of the year, the "Magnificent-7" stocks (AAPL, AMZN, GOOG, META, MSFT, NFLX and TSLA) drove outsized returns in the S&P. In contrast, the equal-weighted S&P was more muted, returning 11.05% for the year. While the market was quite narrow in the first half of the year, it did broaden mid-year. And animal spirits were reawakened, after the election, for a more business-friendly administration.

The economy once again proved to be more resilient than expected in 2024; GDP growth will probably be in the 2.8%-3.0% range. This was much stronger than most forecasts and consistent with the higher-than-expected 2.9% growth in 2023. Inflation also continued to trend in the right direction for much of the year.

The significant improvement over the past two years has helped put a bid under equities. Still, there are signs of elevated and sticky inflation on the Services side of the economy, which accounts for two-thirds of U.S. economic activity. As such, until inflation is squarely under control, we agree that the Fed will be wary about interest rate reductions. The equity market may be eager for the Fed to reload the punchbowl, but we think Fed officials will be more prudent, which also suggests that multiple expansion will be more challenging. We think investors will need to rely on underlying earnings growth and cash flow generation to drive returns.

Consumer sentiment has been improving as inflation pressures have eased and spending trends remain firm. There are still signs of stress among lower income households struggling with higher prices. While we are optimistic about the outlook for 2025, we are also vigilant about the health of the labor market and the potential of credit distress to impact economic activity. Economic and credit cycles are explained away, or even (conveniently) forgotten, during bull markets, but higher credit costs, rising delinquency rates, and shrinking excess savings—real issues for many families—should not be ignored.

In the meantime, a solid job market continues to provide a good tailwind for rising, albeit slowing, aggregate demand. This should translate into higher earnings as well. Unless and until employment stalls and turns negative, the broader economy historically avoids outright recession, and equities traditionally follow with higher earnings.

While headline returns for the equity market were strong, it was a "tale of two tapes." Investors continued to bid up valuations for mega-cap Growth. The Russell 1000 Growth Index returned 33.4%, compared to the Russell 1000 Value Index, which returned 14.4%. Since the prior market peak at the end of 2021, Growth has extended its multi-year outperformance. We would note that the relative outperformance is now at similar extremes to those experienced at the height of the Tech frenzy in 2000.

Despite a solid showing for the headline S&P 500 index, it was another year primarily driven by mega-cap stocks. While Technology and Artificial Intelligence (AI) driven businesses did very well, there were also big winners in Financials, Consumer Discretionary, Industrials and Communication Services. Some economically-sensitive corners of the market are still lukewarm on near-term prospects, as the manufacturing segment of the U.S. economy, entering its third year of a downturn, still struggles to recover.

Financials and Technology were two of the clear winners this year, with the sectors up 29% and 23% respectively. Financials came alive in the second half of 2024, as the growth outlook seemed to broaden and expectations for an extended business cycle took hold. Continued strong prospects for all things AI helped extend the multi-year run in the Technology sector. Like the wider market, though, there were industry segments within technology, like non-AI semiconductors, which struggled for much of the year.

Defensive and interest rate sensitive sectors like Healthcare and Consumer Staples were laggards, up only 10% and 2% respectively. While Healthcare earnings were largely as expected, the sector remained a convenient target for politicians of all stripes. We see the graying of America as a significant tailwind for Healthcare. Seniors have tremendous wealth and disposable income, which we would expect to be spent ensuring a longer and healthier life. Our expectation is that older consumers will shift more of their discretionary spending toward healthcare services, as that is where they will get the greatest value for their dollar.

Government is heavily involved in the healthcare system, of course, and its knee-jerk reaction is to blame businesses for making too much money. We have seen efforts to control prices and rising outlays for more than a decade, and each flare up of political outrage has ended with modest changes to the healthcare system which barely "bends the curve." The atmospherics create headline risk for the sector but also offer attractive entry valuations and above-average capital appreciation potential for long-term investors.

The most curious sector for us remains Energy, which also lagged the broader market. Commodity oil was volatile all year but ended the year essentially unchanged with inventory levels still 20% below pre-COVID stocks. There is concern about economic softness outside the United States as China struggles to stem its economic slowdown and Europe continues to trail behind. But despite the sluggishness in the world ex-America, and despite the push toward electric vehicles and all things "green," global energy consumption continues to rise.

While the equity market vacillated between Goldilocks and hard-landing concerns earlier in the year, Goldilocks pulled ahead convincingly when the Fed seemed to pivot to a more dovish tone. And despite what many viewed as a "hawkish cut" during its last meeting of the year, the economy is still running at full employment and only showing modest signs of slowing.

We are maintaining a more value-oriented view of the Equity market as we enter 2025 and continue to champion increased stock selectivity. We do see increasing signs of excessive risk-taking of the sort that occurs during the latter phases of a bull market. Investors need to pay close attention to valuations, as the market is once again at heady levels on the broad indexes. Moreover, there are no shortages of risks in the new year, which include potential trade wars, uncertain tax and fiscal policies, and ballooning government debt.

We continue to favor businesses and sectors with above-average cash generation that are selling below their long-term averages (such as Healthcare). We also believe that Energy offers good opportunities, with excellent free cash flow yields and much more disciplined leadership in terms of expanding capacity and prioritizing shareholders. And we remain constructive on Financials, which became inexpensive in 2023 and still represent, in our view, a good long-term value.

Our equity portfolios are well-positioned entering 2025, with a balance of inexpensive and high-yielding cash flow businesses along with industry leaders possessing above-average growth prospects. The common denominator of all our businesses remains strong balance sheets. These provide dry powder for companies to weather any storm and invest in new opportunities as they arise.

Fixed Income Report

In previous commentary, we asked whether the Federal Reserve would stick the "soft landing" or need to cut rates several times in the face of economic weakness. We are biased to the soft landing outcome, but with the impending changes on the fiscal side, it seems that the economic fate of our country is moving out of the hands of the monetary authority and into the hands of the second Trump administration. While the central bank still plays a decisive role, it is, if anything, in a tighter spot, as it must now navigate the "roughly equal balance of risks" through the disparate and consequential policies of the new sheriff in town.

On the taxable side, we removed our barbell orientation prior to Election Day. We also decided, with the election of Donald Trump, that prospective outcomes included solid growth, persistent inflation, and higher deficits, which warrants a reduction in portfolio duration. These changes to positioning have already been beneficial to portfolio performance, as the Treasury curve has shifted in a bear-steepening manner.

With credit spreads near twenty-year lows, we find limited relative value in corporate bonds. Since we see the prospect for increased volatility leading to wider spreads, we are positioning portfolios to be overweight credit on the short end of the curve, picking up extra yield, but without the price erosion that spread widening brings to securities with longer duration. Our current outlook supports the allocation to corporate bonds, as balance sheets are strong, and growth prospects remain solid.

Right now, the hard part is determining whether the bear steepener has largely played out. Our view is that it still has room to run, so we will maintain our current positioning. We expect much volatility, as the market's thinking, and our own thinking, on the likely impacts of President Trump's policies continue to evolve.

The Fed has done an excellent job managing a soft landing during the policy quiescence of the past couple of years, but fiscal disruptions are back and that complicates things from the standpoint of *rate* policy, leading to an important question: the shape of Trump/Fed relations.

Scott Bessent, the incoming Treasury Secretary, has said that there will be no effort to kick Chairman Jerome Powell from his post prior to the expiration of his term. If you ask us, this makes sense from *Trump's* perspective. We do not yet definitively know whether the overall tendency of the new administration's policies will be towards short-term pain or more conventionally inflationary. We do know that President Trump wants the debt ceiling raised and is irritated that he must deal with the issue. We also know that he is telling us not to expect grocery prices to come down, which, in the absence of a recession, is totally true. Having Powell around to absorb any heat from continuing inflation is not a bad thing from Mr. Trump's perspective. He can say, "fighting inflation is Powell's job," and he'd be right.

President Trump probably understands interest rates and monetary policy as well as any President in modern political history. He will not make a mistake like President Erdogan in Turkey, who argued a few years ago that lower rates *reduce* inflation. Since that time, Turkey has been rewarded with 60% annual inflation. President Trump does not want that outcome because inflation, as we saw in November, is electoral poison. While he also does not want the Fed to choke off growth, it seems like the torpor which characterized the long decade between the Great Financial Crash and the COVID-19 emergency has begun to lift.

The bottom line is that Mr. Trump has bigger fish to fry. There is not much upside for Trump to burn

political capital trying to rework the Federal Reserve. Why not just let the Fed be responsible for inflation, and demand support from the Fed if the soft landing turns hard? Powell and the Fed have a proven record of being responsive on both of those fronts.

Our view is that President Trump may grouse about Chairman Powell here and there, but as long as he can point his finger at the Fed for inflation, and as long as the Fed is ready to provide support if the economy goes the other way, Powell's tenure should not be an important issue to him until the first half of 2026. In that moment, Trump will have to decide what he wants from a Fed Chair, but until then, our guess is that we will not see any serious effort by the Trump administration to dislodge Powell.

With reference to the Fed, we expect to see quantitative tightening (QT) end in the first half of 2025. From the standpoint of reserve management, there are technical reasons to believe that the Fed will end the drawdown soon. However, we would note that, other than spillover from the money markets (and the Fed has shown its willingness again and again to throw everything including the kitchen sink at seizures in the financial system), balance sheet policy does not have an outsized influence on the real economy. Powell would no doubt like to have a balance sheet that is leaner and less cluttered with non-Treasury loans, but interest rate policy, not balance sheet operations, is the key to meeting core objectives like containing inflation, boosting growth, and normalizing the rate curve.

The story of 2024 in the tax-exempt market was the record-setting supply of municipal issuance. Despite rising benchmark AAA yields, state and local governments continued to tap the market throughout the entire year. According to *The Bond Buyer*, new issuance for 2024 was $539 billion, up 24% from 2023. The new issue market is an excellent source for alpha (extra yield) in the tax-exempt space, and we took full advantage of the wave of new supply, eclipsing our primary market purchases from prior years.

The process of curve normalization occurred in the muni space as well. After two full years of inversion—where short rates were substantially higher than those in the belly—the yield curve started to find its positive slope. Here is a table that shows the progress:

	12/31/23	12/31/24	BP Increase
1 Yr	2.59	2.97	38
2 Yr	2.50	2.82	32
3 Yr	2.35	2.83	48
4 Yr	2.27	2.86	59
5 Yr	2.22	2.90	68
7 Yr	2.19	3.00	81
10 Yr	2.27	3.13	86
15 Yr	2.88	3.38	50
20 Yr	3.14	3.64	50
25 Yr	3.33	3.79	46
30 Yr	3.40	3.87	47

The steepener in 2024 was most pronounced in the belly of the curve, which was the richest segment at the start of the year. As the curve continues to normalize, we expect to move more of the intermediate strategy out of our modified barbell and into the belly. Curve rolls will again become attractive. While the portfolio duration for our MQI product is in line with its benchmark index, our yield advantage, or "carry," speaks to our primary market focus, sector and credit selection, and trade execution.

To conclude, more growth and inflation should lead to higher rates and probably a steeper yield curve. We have seen that play out during 2024, as the inverted yield curve renormalized, and we expect it to continue in 2025. There's a strong inverse correlation between long-term bond yields and stock returns. While stock market fluctuations do not significantly impact bond yields, rising bond yields typically exert downward pressure on stock prices.

We expected to see the yield curve normalize as the Fed launched a cycle of rate cuts, and so it has. We think the benchmark 10 Year Treasury Note would ideally remain between 4% and 5%, but real-world variables, such as growth spikes or inflation spikes, could shoot the 10 Year over 5%. We do not think that laterally moving financial markets would impair the real economy. The real economy depends upon its underlying fundamentals, which we think are decent, and the wisdom of the new policies about to be unleashed, which fall in the "TBD" category, but about which we are, on balance, positive.

Conclusion

Elections have consequences, and in American democracy, when a major political party earns the "trifecta" (White House, Senate, and House of Representatives), one can only expect it to be taken for a spin. Indeed, one could argue that the problem with our system of divided power is that it inhibits us from discovering what works. Unless there is a trifecta, government is locked in stalemate, where issues fester and little gets resolved.

Since the Cold War ended, we have seen six trifectas: the Democrats in 1992 for two years, the Republicans in 2002 for four years, the Democrats in 2008 for two years, the Republicans in 2016 for two years, the Democrats in 2020 for two years, and now the Republicans in 2024. It used to be an article of faith that Americans like divided government, but that no longer seems to be the case. And while there are institutional constraints to what even a "trifecta" can achieve, there is also the plain reality that Americans think that "business as usual" has left them with the short stick. We think this majority opinion, like most majority opinions, trends toward truth.

In the meantime, all Americans, regardless of persuasion, might marvel at the majesty of our democracy. No, it is not majestic like the King of England, say, but in its own way, our 'government with the consent of the governed' has unadorned splendor. All these generations later, the American experiment in self-government endures.

We shall see if our latest version of self-government continues the pattern of a 50/50 nation, alternating back and forth between fractious camps, or if it can take us to a different place, with a new consensus and a durable majority. We have had those periods in our history: the aftermath of Grover Cleveland's presidency was one such period. It has been a long while, though, and it is a tall challenge. In the meantime, we look towards 2025 with interest and measured optimism.

Disclosure: For informational purposes only. Not a recommendation to buy or sell any security or class of security. Investing entails risk, including loss of principal. Past performance is no guarantee of future performance.