MIDDLETON & COMPANY, INC.

Investment Update

January, 2025

2024 Fourth Quarter Update and 2025 Outlook

Review: The S&P 500 rally continued, with the index up 2.4% in Q4, bringing the full year return to 25.0%. The positive quarterly return was driven by a ~5% advance after the election that had partly faded by year end. The US dollar also saw a strong post-election rally, which contributed to the negative returns in international equities. Bond yields rose during the quarter, leading to negative returns in the US Aggregate Bond Index. The Federal Reserve continued to cut rates, but it revised its outlook for rate cuts in 2025 down to two from the previous estimate of four, which contributed to the move higher in bond yields.

	4Q24	3Q24	2Q24	1Q24	2024
S&P 500	2.4%	5.9%	4.3%	10.6%	25.0%
MSCI EAFE[1,2]	-8.1%	7.3%	-0.1%	5.8%	4.3%
MSCI Emerging Markets[2]	-7.8%	8.9%	5.4%	2.2%	8.1%
Bloomberg U.S. Aggregate Bond	-3.1%	5.2%	0.1%	-0.8%	1.3%
Bloomberg Municipal Bond	-1.2%	2.7%	0.0%	-0.4%	1.1%

[1]Europe, Australasia, Far East

[2]MSCI returns are in U.S. Dollars

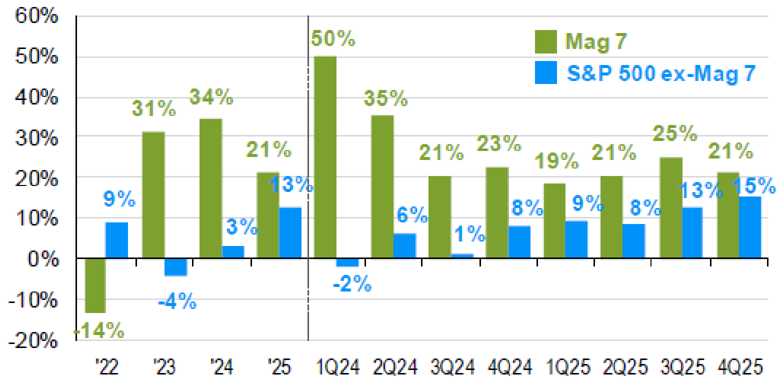
Another Strong Year for Returns. What Happens Next?

To think about potential 2025 returns, it is helpful to examine what has happened over the past two years. The so-called "Magnificent 7" or Mag 7 stocks* have been responsible for roughly 60% of the S&P 500 return since the end of 2022. As a group, they returned 162% in that time, compared to 58% for the S&P 500. Part of that stellar return was driven by earnings growth, which exceeded 30% in both 2023 and 2024. This can be seen on the chart on the next page, which shows earnings growth for the Mag 7 and the other 493 S&P 500 stocks. The other component of Mag 7 returns (slightly more than half), has been a recovery in valuation multiples from the low point reached at the end of the 2022 selloff. As the chart shows, earnings growth for these seven companies is expected to slow in 2025 (to "only" 21%). With decelerating earnings growth and seemingly full valuations, it seems unlikely to expect a repeat of the 2023-24 returns from the Mag 7 stocks, as a group, in 2025.

To be clear, we think most investors understand this. **The question is what the other 493 stocks in the S&P 500 can deliver**. As the chart

**Alphabet (GOOGL), Amazon (AMZN), Apple (AAPL), Meta (META), Microsoft (MSFT), NVIDIA (NVDA), Tesla (TSLA)* shows, consensus estimates assume these 493 stocks will see 13% earnings growth in 2025, a significant acceleration from the lackluster growth seen in 2023-24. While not impossible, this seems a bit optimistic, particularly in a year where economic growth is expected to decelerate. Disappointing earnings growth from this group would likely lead to declines in valuation multiples as well, dampening market returns in 2025.

S&P 500 Earnings Growth, 2022-25E



Source: J.P. Morgan Guide to the Markets, 12/31/2024; 4Q24 onwards represent consensus estimates

Outlook: US real GDP growth is expected to slow in 2025. The current consensus estimate for 2025 GDP growth is 2.1%, compared to an estimated 2.7% for 2024. That said, as has been the case for the last several years, there is significant uncertainty around the estimate which could drive the actual number higher or lower. This year, part of the uncertainty stems from potential implications of policies likely to be pursued by the incoming administration around deregulation, taxes, immigration, and trade. Absent detailed proposals, it is difficult to speculate on the net impact of these possible changes. However, it seems likely that any potential positive or negative economic surprises that result could flow through to corporate earnings growth and investor sentiment.

We continue to be cautious on overall international growth, as many key regions and countries face multiple economic headwinds, including a strong US dollar. Relatively strong US growth coupled with a higher for longer outlook for interest rates has sustained the US dollar over the past year, and potential tariff increases could add incremental support in 2025 as well.

Strategy: With a current Price-to-Earnings (P/E) ratio of 21.5x, the S&P 500 appears to be fully valued, particularly relative to Treasury yields. If the corporate tax rate is lowered, the resulting one-time boost to earnings would make the market multiple appear slightly less expensive. However, generally speaking, it seems that the market is pricing in a very optimistic economic scenario, which could prove to be difficult to achieve given the higher for longer interest rate outlook, softening job market, and geopolitical uncertainty. Therefore, we continue to view opportunities in higher quality stocks at reasonable valuations and higher quality bonds as attractive ways to improve the overall risk-reward of investment portfolios in the current market environment.