Archer
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BALANCED INVESTMENT MANAGEMENT

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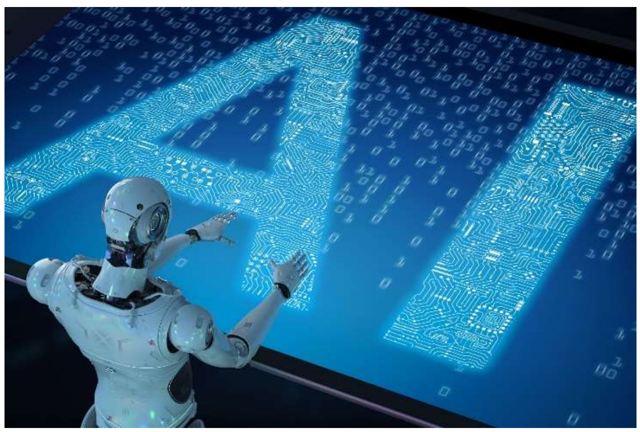
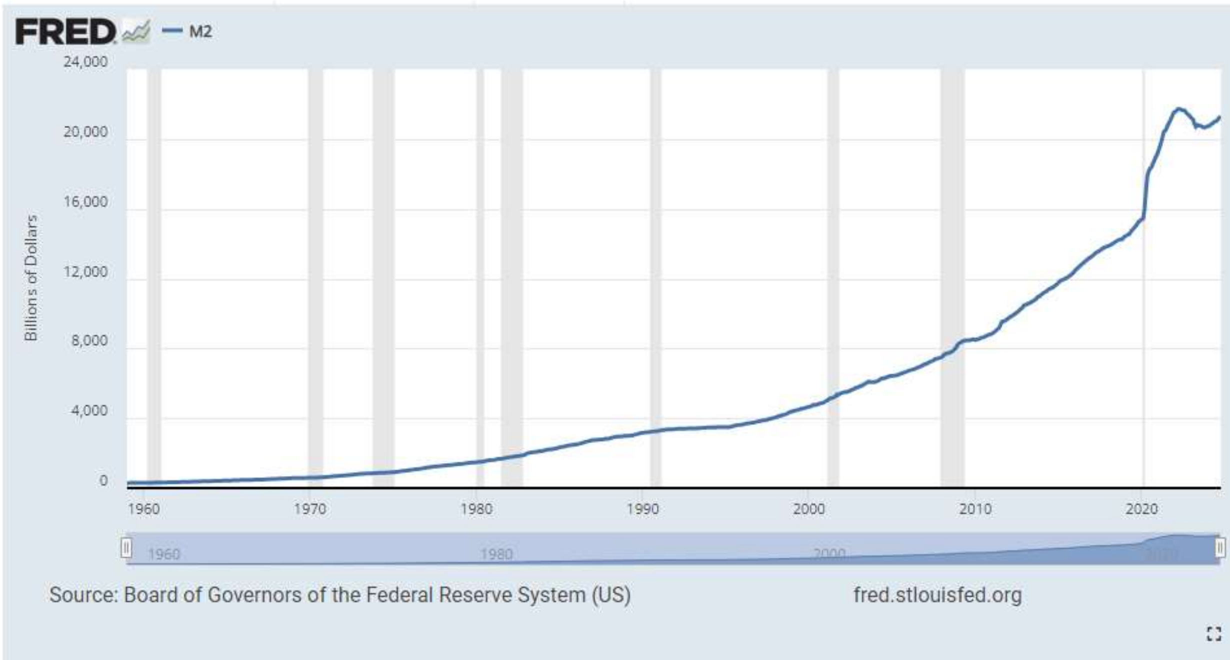
Archer 2025 Annual Outlook:



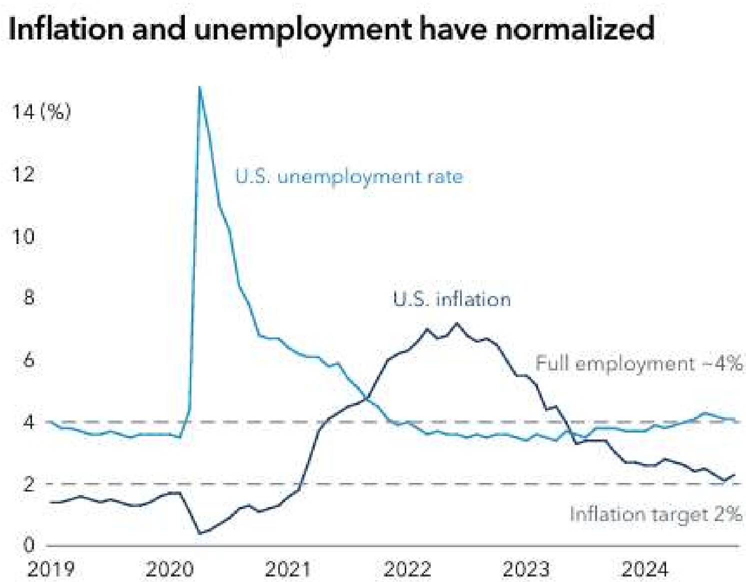
The election is finally over! We can now move on to what is expected of corporate profits and what we are likely to see from Washington. Further with Artificial Intelligence (AI) ramping up, how will it impact earnings, wages, and yes, even government spending.

Let’s start with Washington for a moment. You may be happy or disappointed with the election outcome, but as we have said in the past, do not focus on the moment, but what actually happens in Washington. What happens is nearly all the political theatre is just that theatre. Nearly all politicians own stocks, and they are the most self-serving of humans and want to increase their wealth. They will make decisions that have positive outcomes for the stock market and their bank accounts. If you own stocks and real assets you likely will have a good outcome. If you are not, it is likely inflation has hurt you over the last four years and may continue to do so. What could change? If we were to damper government spending, it would reduce the need for the Federal Reserve to print money. This alone would reduce inflation and help the lower-to-lower middle class. Conversely, the potential layoffs of government employees would put an initial strain on government resources and unemployment benefits as well as spending. The good news is unemployment is low by historical standards and there are other jobs these individuals could fill.



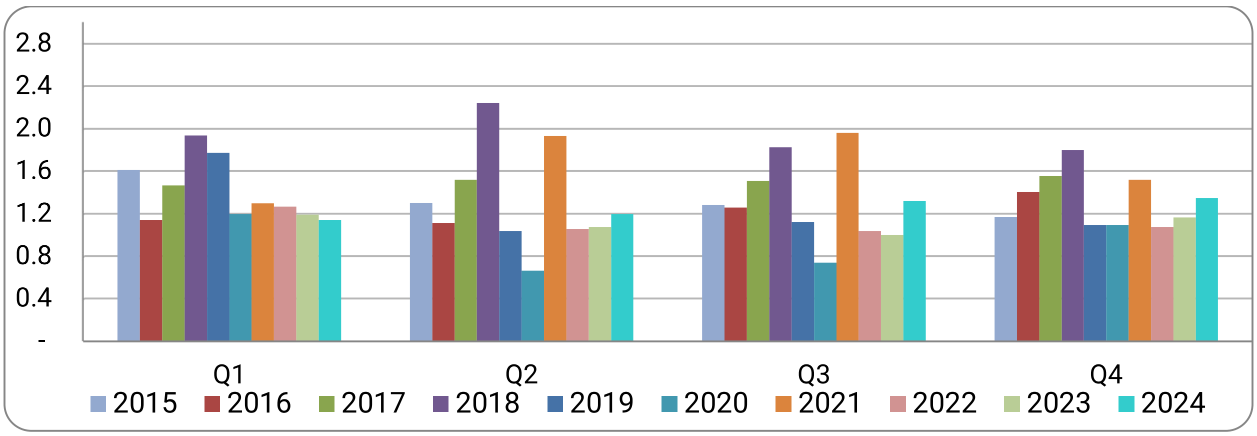
The chart above clearly shows why inflation was a problem and prices have risen. It also explains why inflation has declined recently. It is one of the simplest concepts: The more money the government spends that they don't have, we increase the M2 (think dollar bills). The less the government spends, the less dollars are in circulation and there are less dollars chasing the same amount of goods and services.

If the government decides they can live on less and we truly see reform out of Washington, it is likely inflation and cost of goods and services will subside or stay relatively quiet. This would contrast with what the government has shown to do in the past, print more money. The next chart shows that inflation and unemployment have normalized.



What it does not show is the government added 709,000 jobs in 2023 and nearly 300,000 jobs in 2022. With potential similar gains in 2024, there are similar opportunities to cut spending and have employees work in the private sector of our economy.

Let's examine 2025 and earnings of corporations that trade publicly. As we have noted in the past, if earnings increase, the stock market usually will follow. Earnings on publicly traded businesses appear to be extremely healthy and it appears those earnings will continue to grow throughout 2025. The chart below, which we often include, shows earnings in 2024 continue to be generally higher than they were in the same quarter the previous year. In the fourth quarter of 2024 we were running close to 1.34 to 1 which anything above 1.2 has historically been healthy for the stock market and the economy.



The earnings strength we see in these companies have become quite evident and the stock market has paid close attention as well. The stock market has moved significantly higher on the year with earnings growing and inflation in check currently. The stock market defined by the S&P 500 is up close to 28% as of December 26, 2024. We believe this return is on the expectation that earnings growth will continue to record numbers. The consensus earnings of the S&P 500 are expected to grow above double digits for 2025 to $268 according to FactSet and Capital IQ. This is slightly lower than what was expected in June of 2024 at $270. It is likely the profits will need to hit these levels for the stock market to sustain these lofty prices. From the next chart, which measures the valuation of the S&P 500, we can see we are trading at expensive levels.

Further, the earnings yield which currently is 3.24% (Earnings Yield = trailing 12-month earnings divided by index price) has averaged 4.69% over the last 20 years. Much of this is driven by the "Magnificent 7 stocks". (Apple, Amazon, Google, Meta, Microsoft, Nvidia, and Tesla)

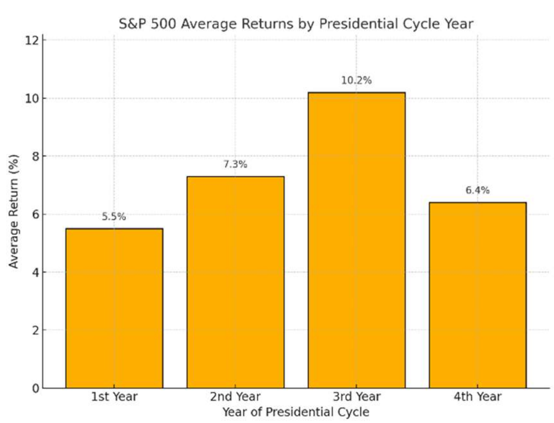
S&P 500 Index: Forward P/E ratio

Valuation measure	Description	Latest	30-year avg.*	Std. dev. over/under-valued
P/E	Forward P/E	21.45x	16.83x	1.41
CAPE	Shiller's P/E	36.95x	28.02x	1.46
Div. Yield	Dividend yield	1.34%	1.98%	1.82
P/B	Price to book	4.46x	3.18x	1.54
P/CF	Price to cash flow	16.50x	11.31x	2.19
EY Spread	EY minus Baa yield	-0.32%	0.68%	0.46

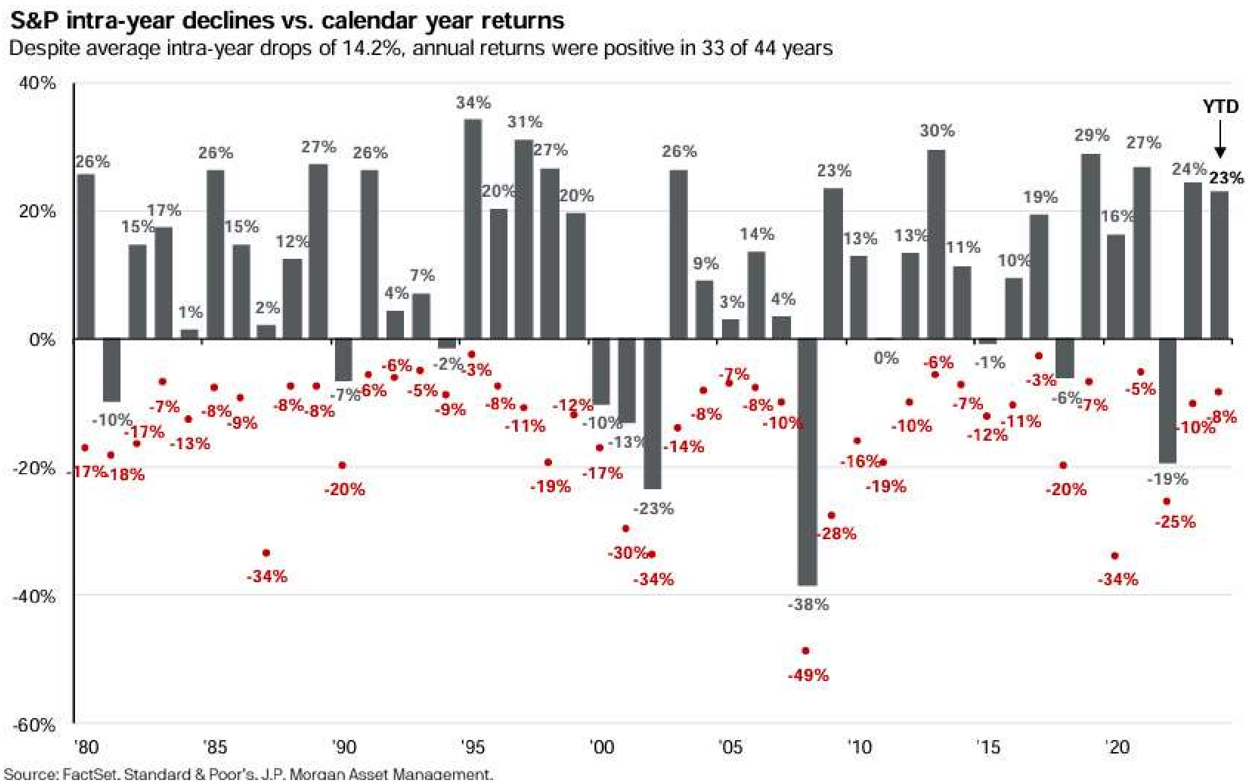
Source: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.

What appears to be driving this stock market is the impact of AI on companies. Some have said AI is currently in the initial stages of life similar to what Windows was on the Microsoft platform well over 25 years ago. If AI can help companies grow, develop, and use resources to be more efficient, which also may mean less employees, the profits will likely grow at a higher pace than what we have seen over the last decade. We are seeing companies like Google, Amazon, Meta, Microsoft, and others spending larger amounts of their operating cash flow to advance their high-tech companies and competitiveness. There is plenty of room for these employees to find jobs as job opportunities and openings still are still at elevated levels.

With the elevated levels of the S&P 500 and the expectations of continued growth in earnings, we believe the market may disappoint investors who have become accustomed to believing the market will move much higher every year. In fact, as the new President will take over it is good to remind people of the average returns each President has enjoyed during each of the Presidential election years back to 1945.



Lastly as we enter 2025, remember the stock market is made up of companies that do well, and some do not. The market, although over time it has moved higher has not been without declines and they are normal in the process of returns. One of the best charts to reinforce this is the intra-year declines we often see in years when the stock market has moved higher.



We will be diligent in watching earnings, inflation, employment, and the powers-to-be in Washington. We continue to like the prospects of the stock market over the long term. It is possible we will see volatility increase in the markets as a new administration takes over and headlines in the media try to impact people's emotions. Overall, the health of consumers and corporations continues to be strong and this is good for economy.

Regards,

The Archer Team