STEARNS
FINANCIAL GROUP

Sailing in Uncharted Investment Waters in 2025

TRUMPONOMICS, THE MUSK X FACTOR AND GEOPOLITICAL WILDCARDS

presented by **Dennis Stearns, CFP®**

AAII Local Chapters
Research Triangle Chapter
January 25, 2025

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Dennis Stearns – Senior Wealth Advisor – Dennis is a CFP® professional and is nationally recognized for investment strategy and scenario analysis.

He is the author of several books including ***CEO Road Rules*** ("Must read" – Daniel Jorndt, former CEO, Walgreens), ***Fourth Quarter Fumbles*** ("Prepare now for your future!" Mitch Anthony, *New Retirementality)* and ***Fourth Quarter Champions*** *(Regular* and *Business Edition)*. His newest book, ***Ninja Entrepreneurs***, includes Top Ninja ideas from 120 business owner interviews ("An essential owner's guide" – Doug Tatum, four-time National Business Book Award winner for *No Man's Land*).

Dennis is regularly quoted in major publications including the *Wall Street Journal*, *NY Times*, *Kiplinger Finance*, *TheStreet.com*, *Financial Planning* magazine and the peer-reviewed *Journal of Financial Planning*.

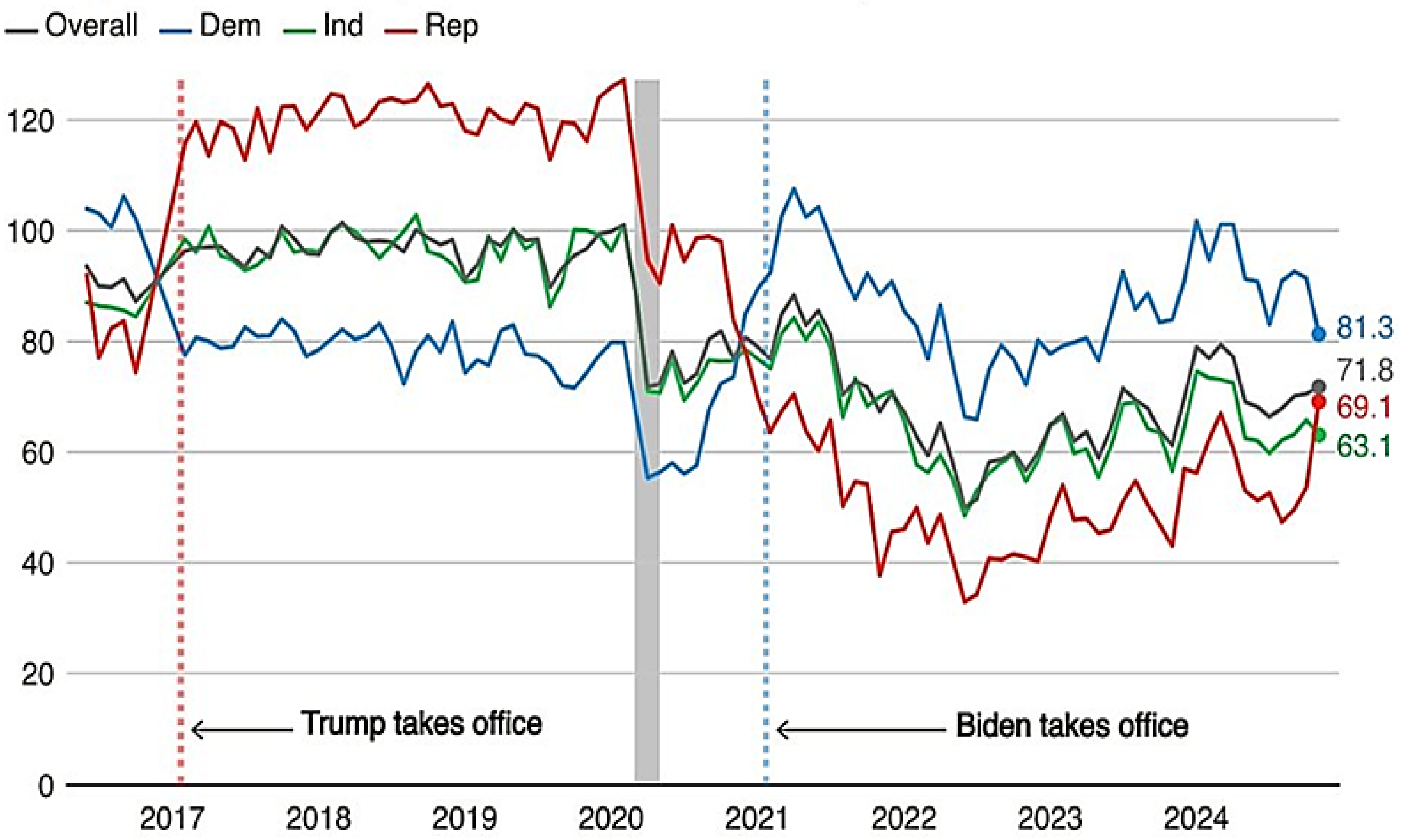
Dennis has advanced training in investment planning, financial planning, business planning and estate planning. Business awards include Most Admired CEO (*Triad Business Journal*), RIA Citywire Most Innovative Firms, Inc. 5000 and TBJ Fast 50.

Stearns Financial Group (SFG) is a $2.3 billion Wealth Management and Business Planning practice with offices in Greensboro and Chapel Hill, NC and clients around the U.S. SFG has been called one of the leading scenario planning firms by the Financial Planning Association. More info at www.StearnsFinancial.com.

agenda

U.S. Consumer Sentiment by Party Affiliation

U.S. consumer sentiment now largely reflects partisanship, and almost on cue, Republicans' assessments of the economy turned sharply higher right after Donald Trump prevailed in the Nov. 5 presidential election, while Democrats views notably soured.



Note: Gray bar is recession; survey was not conducted from November 2016 through January 2017.
Source: Reuters, University of Michigan Surveys of Consumers as of 11/8/2024. Measures consumer sentiment by party identification.

The Good, The Bad and The Wildcards for 2025

The Good

Strong profit margins

Resilient economy

Deregulation

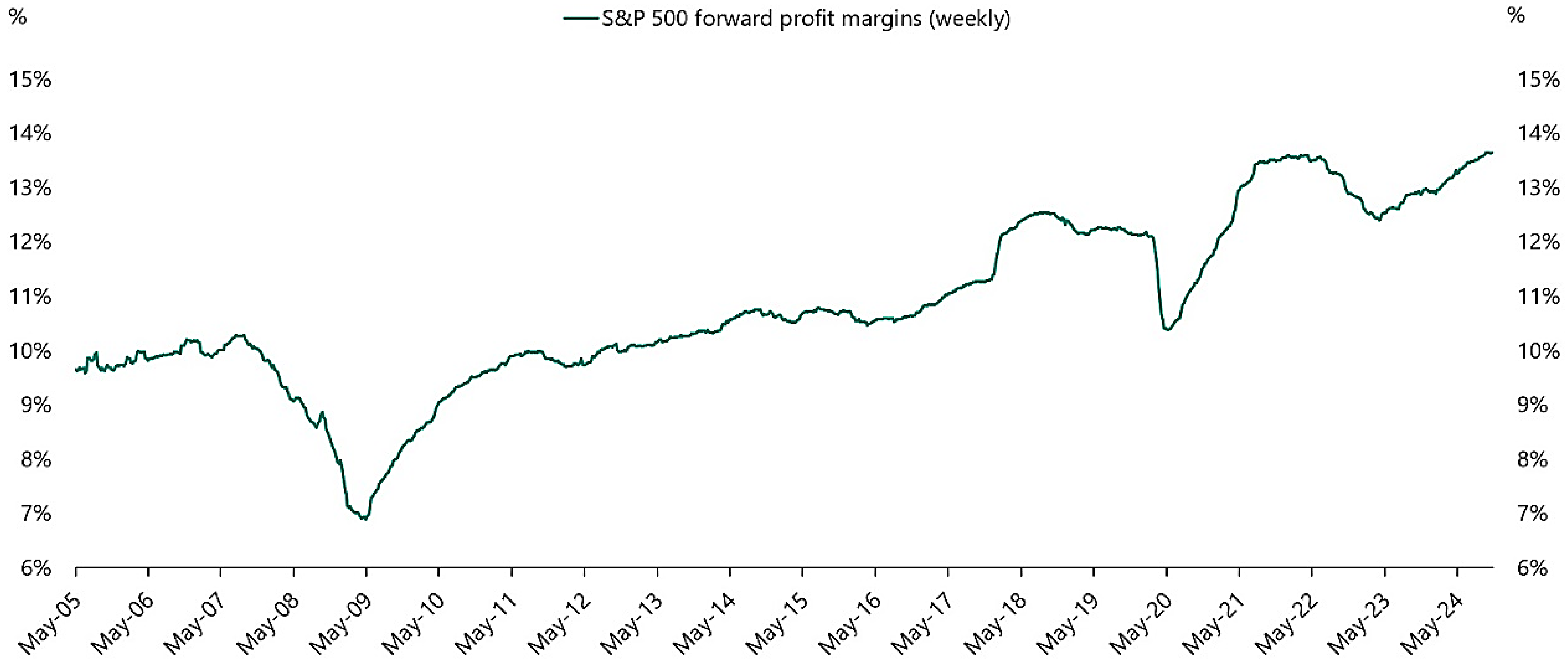
Potential decrease in corporate tax rate

Productivity gains continue

Less tight labor market

Good News – Profit Margins Remain Healthy

S&P 500 weekly forward profit margins at record-high levels

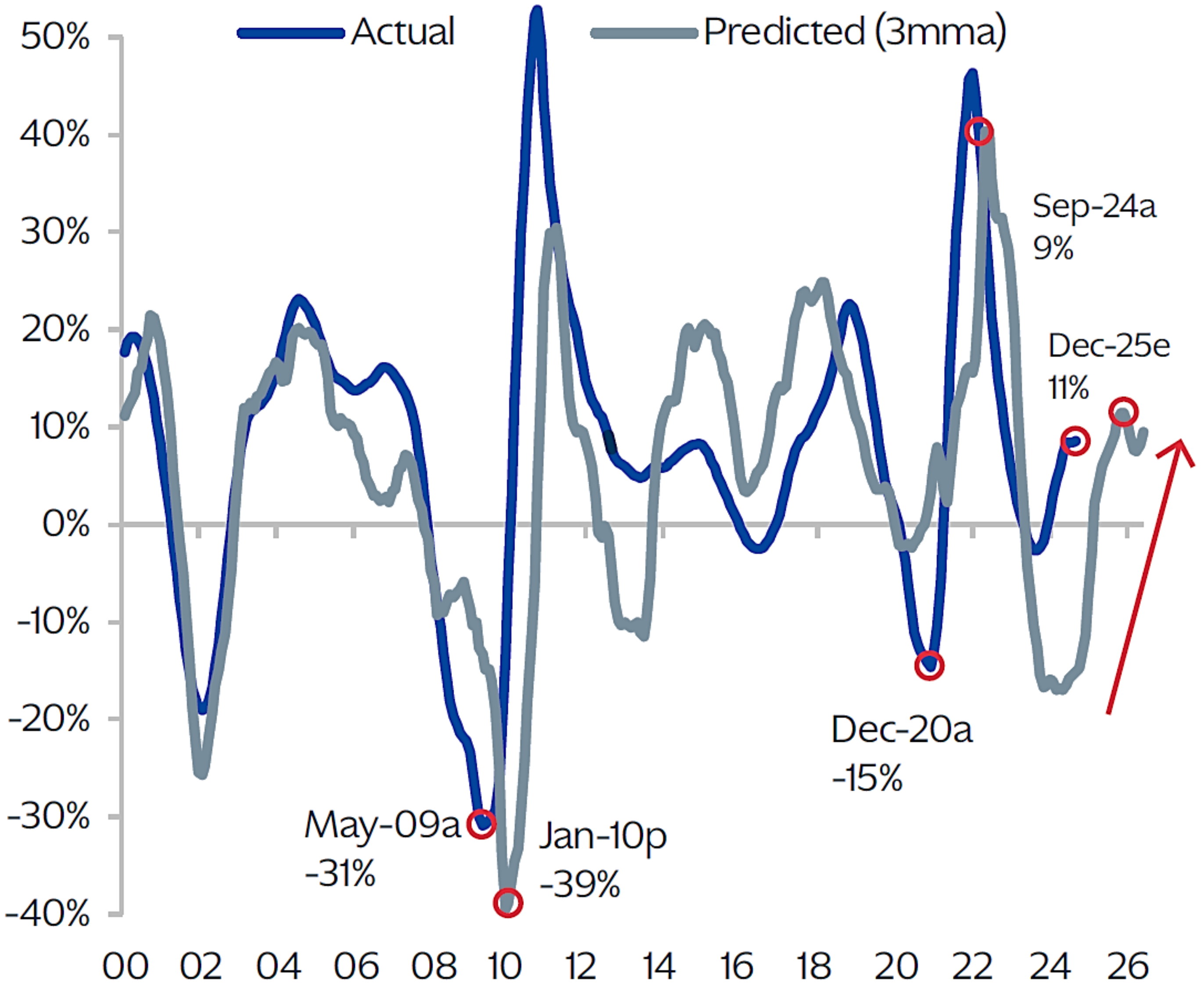


Note: The 12 months forward profit margins are calculated by using the weighted average of 1FY (current year estimate) and 2FY (next year estimate) to smooth out fiscal year transitions.
Source: Bloomberg, Apollo Chief Economist. As of 11/9/2024.

S&P 500 EPS Growth

12-Month Leading Indicator

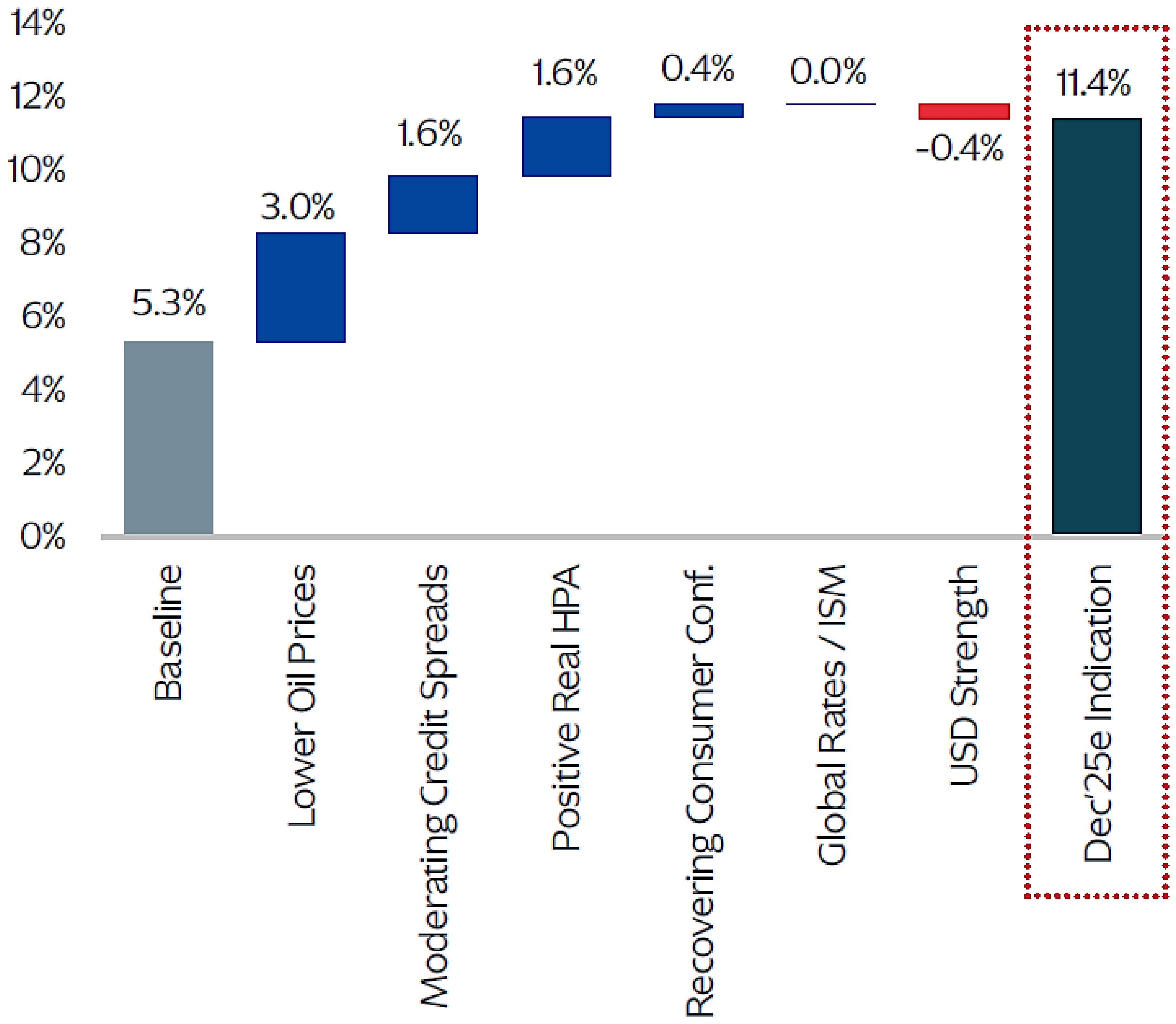
Earnings Growth Leading Indicator Inflects Higher Over Coming Quarter…



This S&P 500 Earnings Growth Leading Indicator ('EGLI') is a combination of seven macro inputs that may have significant explanatory power regarding the S&P 500 EPS growth outlook. Source: KKR *Insights* volume 14.6 Global Macro Trends, December 2024, National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro and Asset Allocation analysis. Data as of December 10, 2024.

Contributions to Dec-25e S&P 500 EPS Growth Forecast

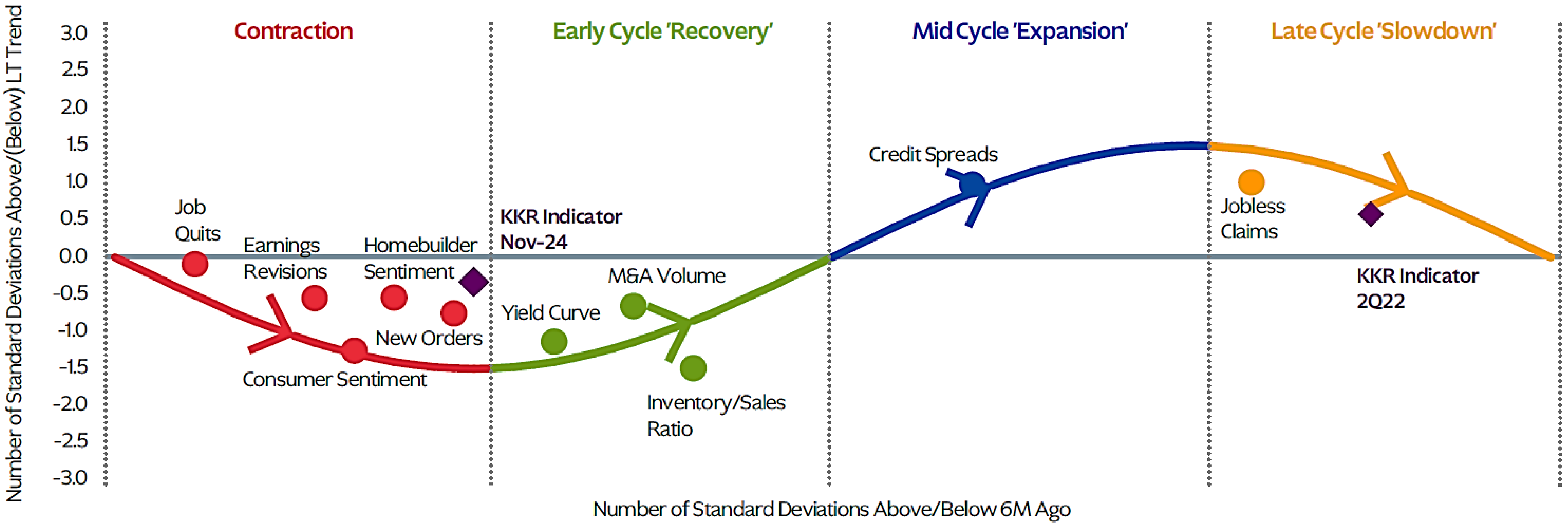
…powered by fading headwinds from Central Bank tightening and elevated commodity prices.



This S&P 500 Earnings Growth Leading Indicator ('EGLI') is a combination of seven macro inputs that may have significant explanatory power regarding the S&P 500 EPS growth outlook. Source: KKR *Insights* volume 14.6 Global Macro Trends, December 2024, National Association of Realtors, ISM, Conference Board, Bloomberg, KKR Global Macro and Asset Allocation analysis. Data as of December 10, 2024.

KKR GMAA Proprietary Cycle Indicator

The 10 subcomponents of this cycle indicator are unusually asynchronous and spread across all four phases of the business cycle.



Source: KKR *Insights* volume 14.6 Global Macro Trends, December 2024, Bloomberg, KKR Global Macro and Asset Allocation analysis. Data as of November 30, 2024.

U.S. Labor Productivity Growth, %

We believe stronger labor productivity is the 'secret sauce' to extending the business cycle as well as partially offsetting higher deficits.

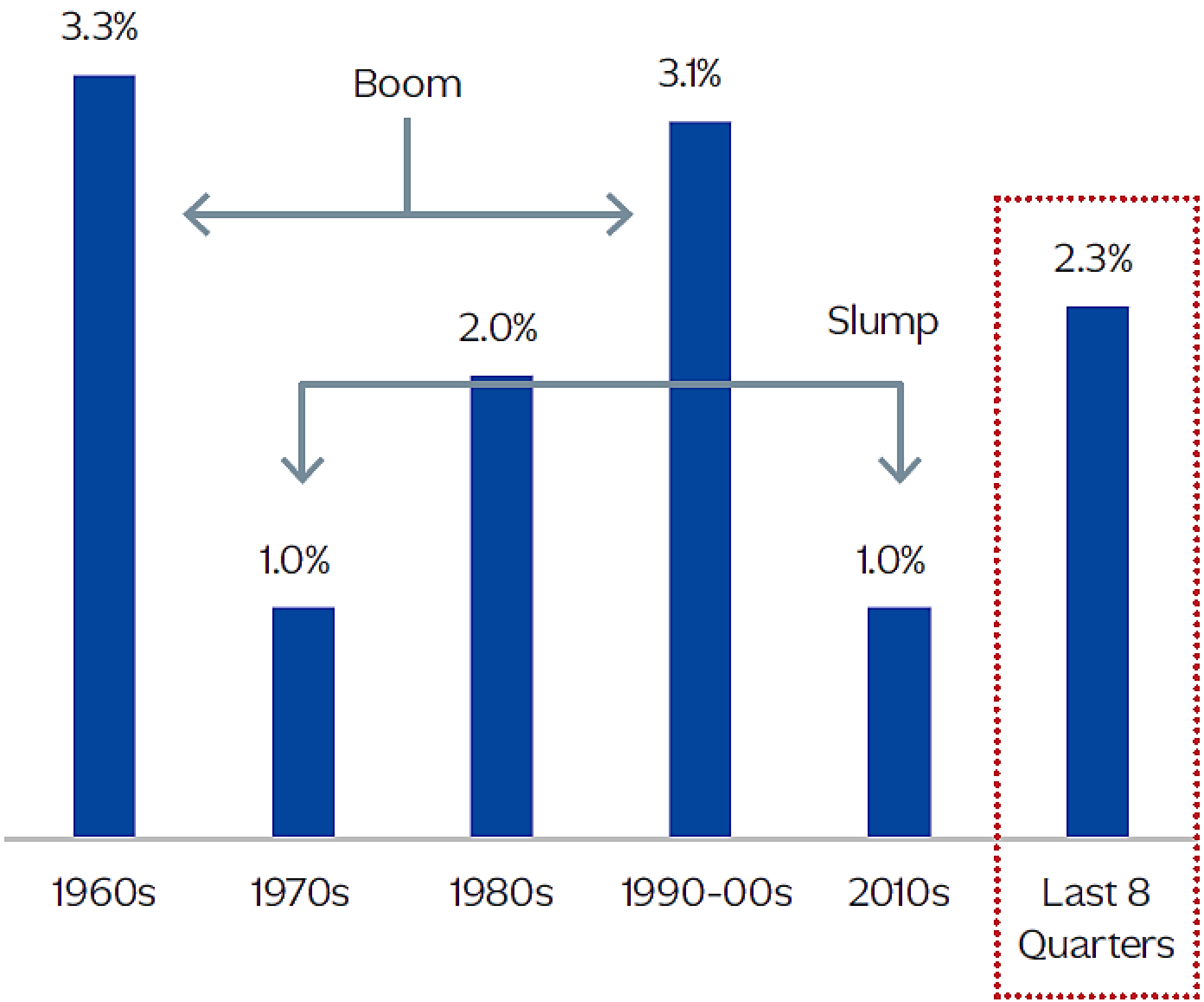
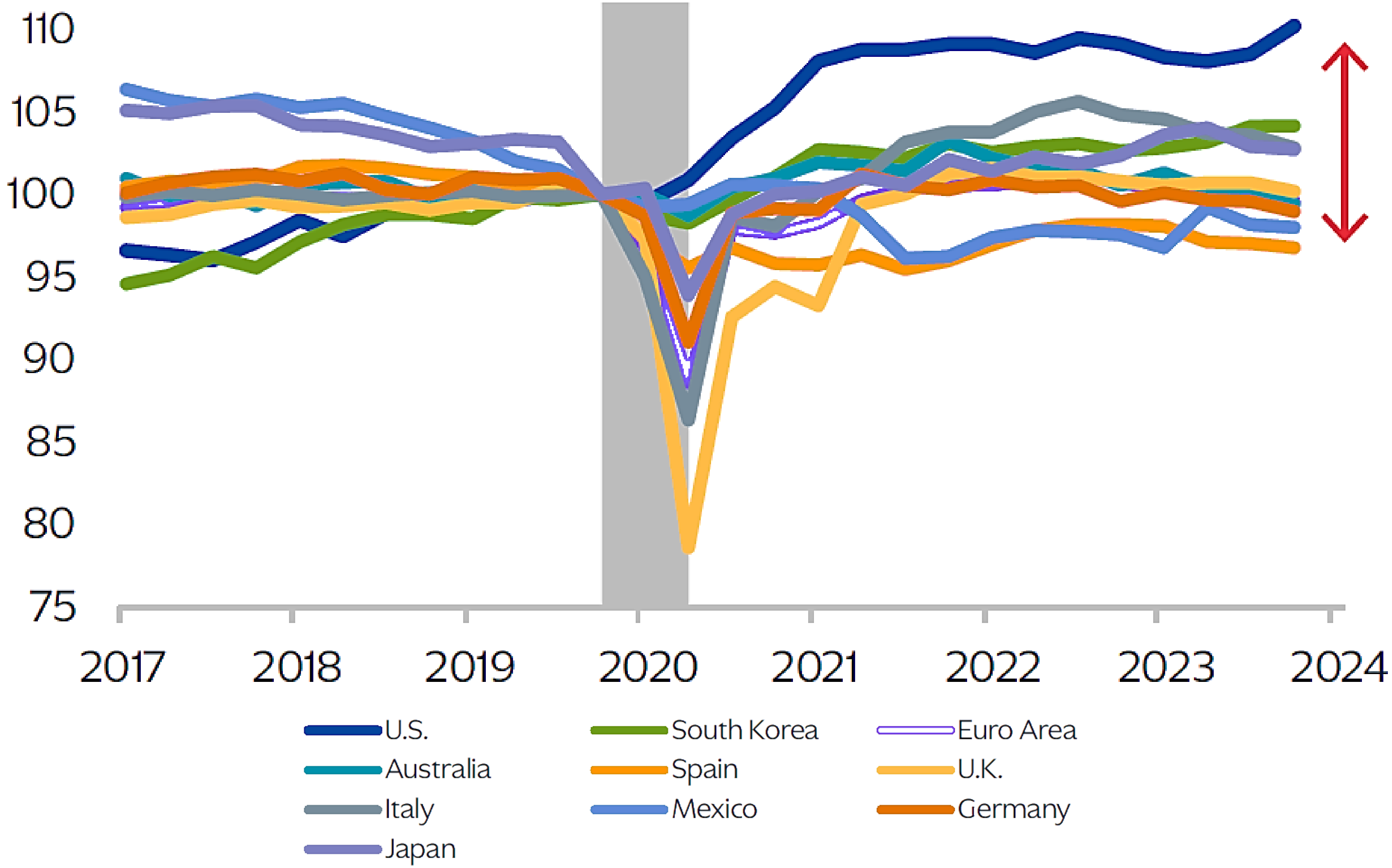


Chart refers to real output/hours worked. 1960s refer to 1959-68; 1970s refer to 1973-79; 1980s refer to 1980-88; 1990-00s refer to 1995-05; 2010s refer to 2010-19.
Source: KKR *Insights* volume 14.6 Global Macro Trends, December 2024, Bloomberg, Federal Reserve Bank of San Francisco. Data as of September 30, 2024.

Productivity Across Major Economies

Output per worker, 4Q19 = 100

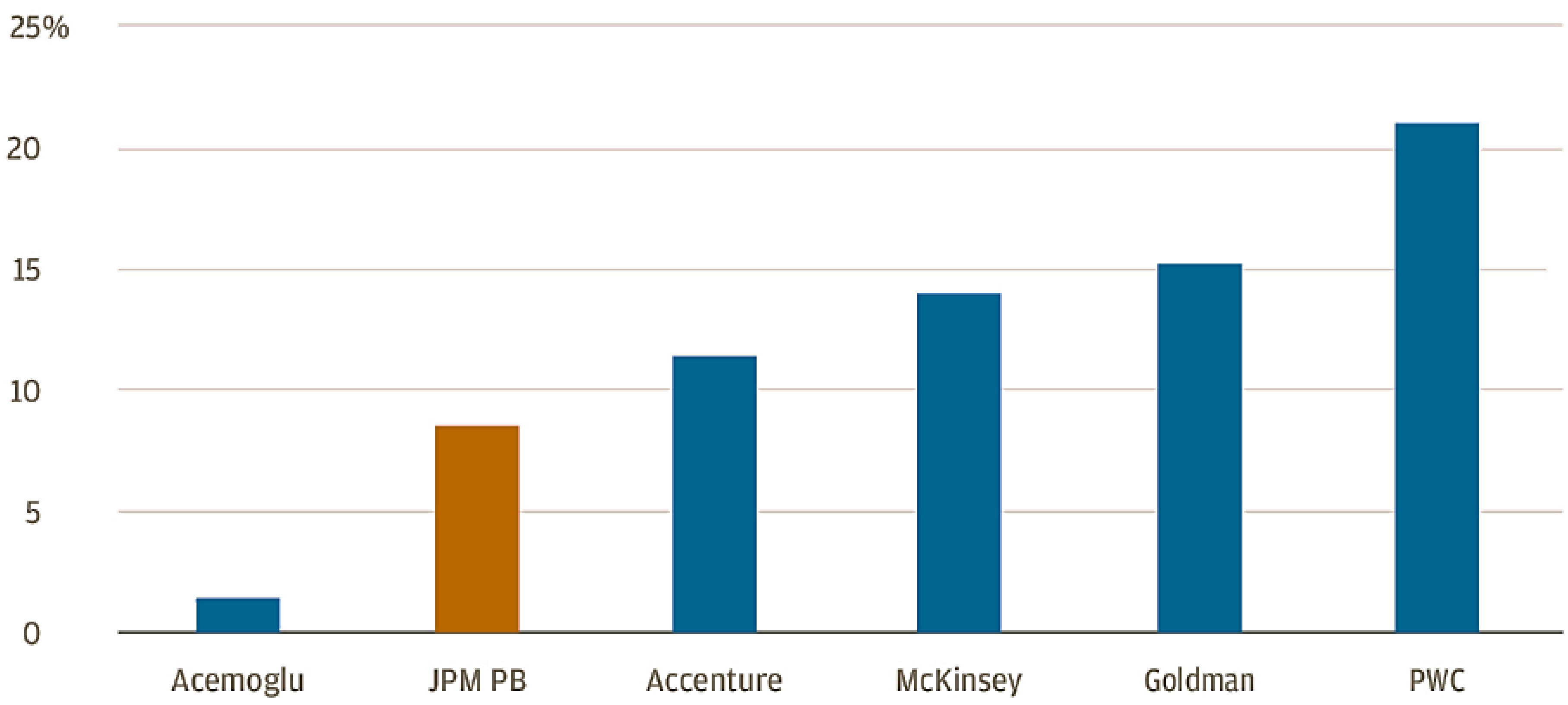
U.S. productivity is significantly outpacing the rest of the world since COVID-19.



Source: KKR *Insights* volume 14.6 Global Macro Trends, December 2024, Bloomberg, U.S. Bureau of Economic Affairs, EY Parthenon, KKR Global Macro and Asset Allocation analysis. Data as of September 30, 2024.

Productivity Gains Ahead

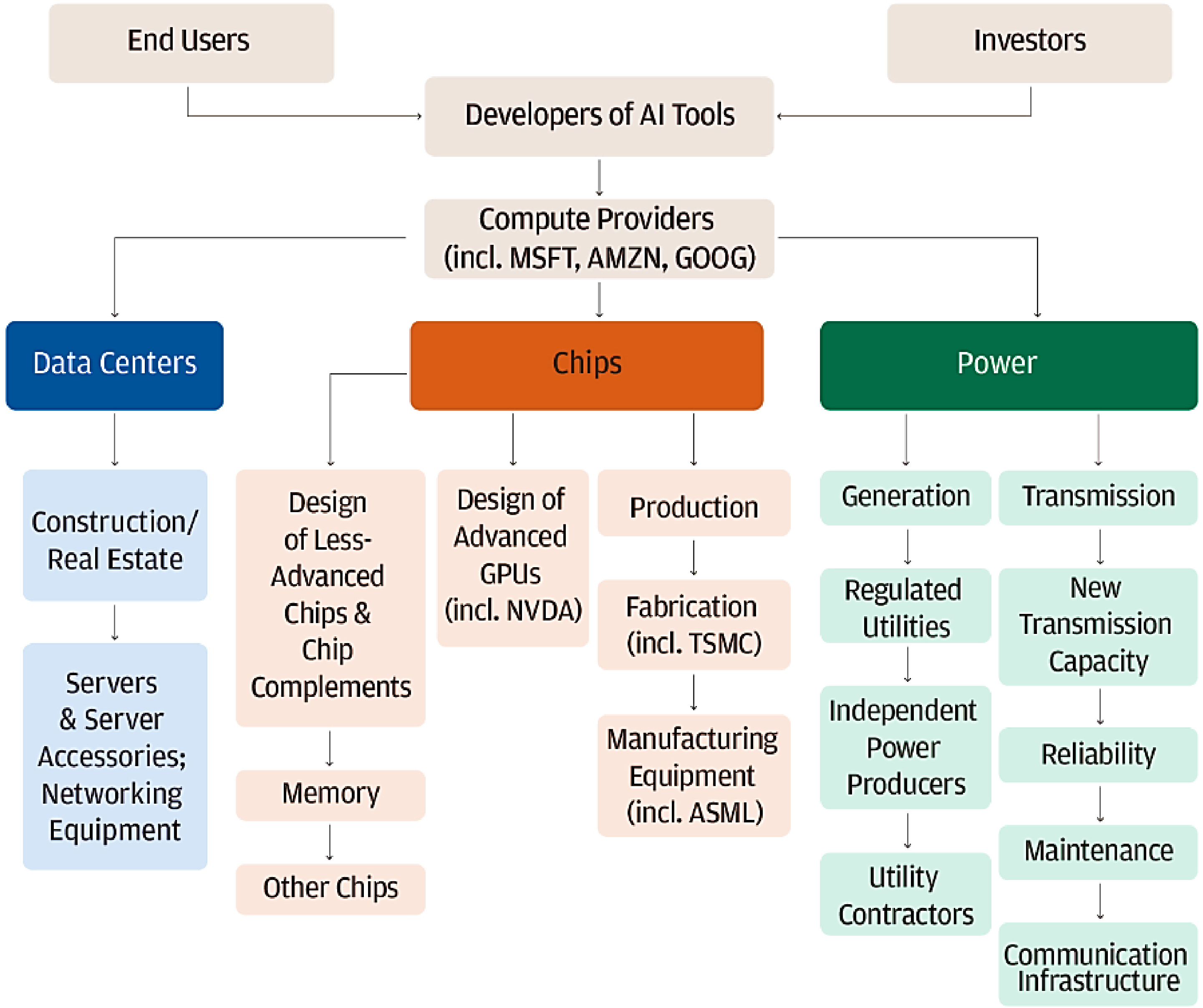
Economists Make Varied Estimates of How AI Will Impact Growth Over the Next Decade



Source: JP Morgan, Acemoglu, JPM PB, Accenture, McKinsey, Goldman, PWC. Data as of June 2024.

Productivity Gains Ahead

The AI Infrastructure Buildout Mapped Out



Source: JP Morgan, Bridgewater. Data as of May 20, 2024.

What Areas of Infrastructure Are Attractive?

1. Growth Cycle Capital Expenditures (CAPEX): The expansion of data centers and the onshoring of manufacturing are creating new electricity demand.

2. Replacement Cycle CAPEX: The shift toward renewable and/or more efficient traditional energy is driving the replacement of existing coal assets.

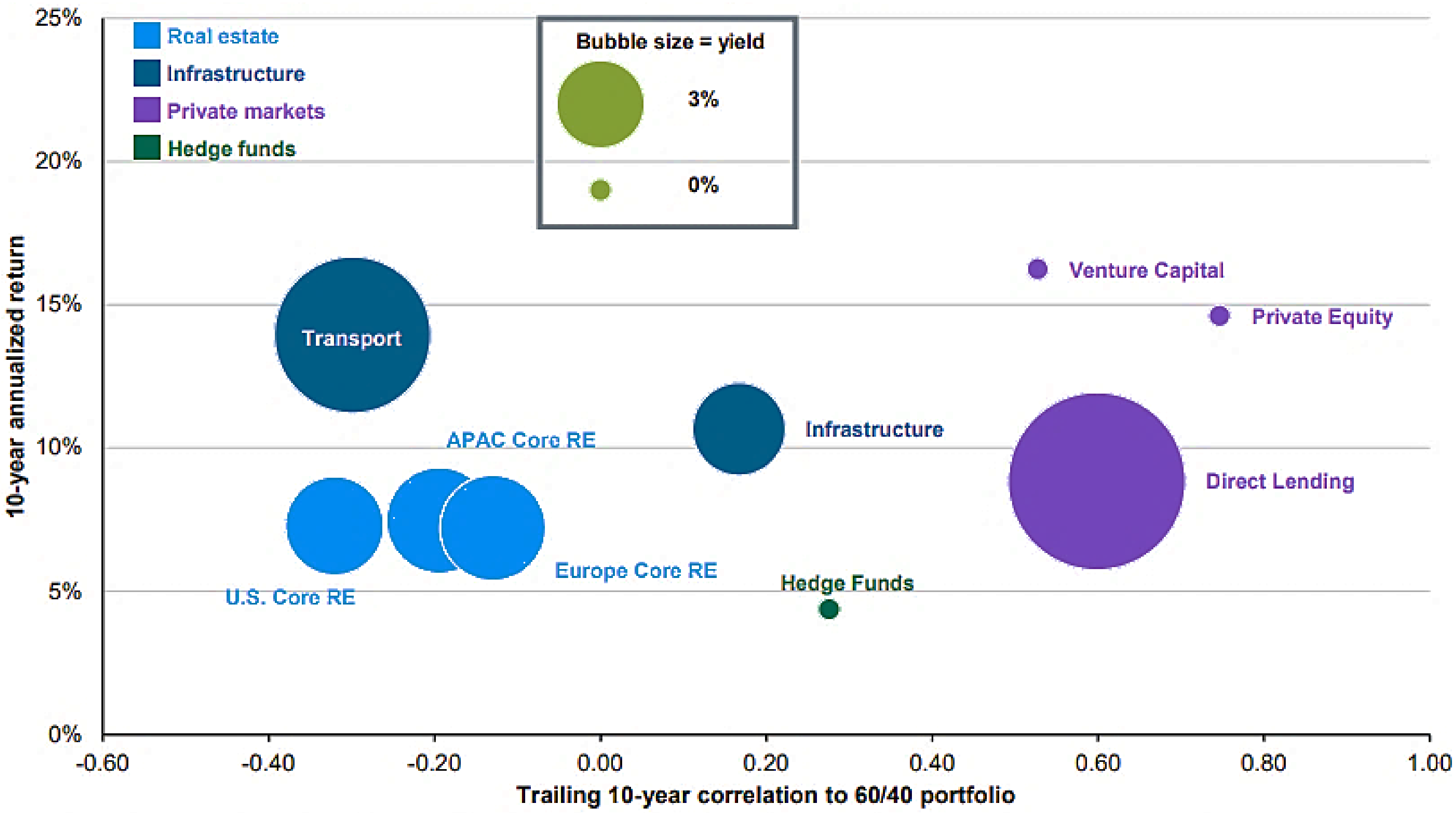
3. According to recent estimates from Boston Consulting Group*, global power demand is set to quadruple from 2020 to 2040 compared to the previous 20-year period.

4. Traditional Real Assets such as timber, farmland and toll roads, natural gas infrastructure.

*Versus, NextEra Energy & Boston Consulting Group as of 9/30/24

Private Alternatives: Correlations, Returns and Yields

10-year correlations and
10-year annualized total returns, quarterly, 2014-2023



Source: Burgiss, Cliffwater, Gilberto-Levy, HFRI, MSCI, NCREIF, FactSet, J.P. Morgan Asset Management. Correlations are based on quarterly returns over the past 10 years through 2023. A 60/40 portfolio is comprised of 60% stocks and 40% bonds. Stocks are represented by the S&P 500 Total Return Index. Bonds are represented by the Bloomberg U.S. Aggregate Total Return Incex. Ten-Year annualized returns are calculated from 2014 to 2023. J.P. Morgan Asset Management *Guide to Alternatives, Guide to the Markets - U.S.* Data are as of September 16, 2024.

Jobs, Jobs, Jobs

» The U.S. Jobs Market is still pretty good.

» **"Pink Slips Push Many Managers to Rethink Careers."** Rightsizing in corporate America – *WSJ*, 12/31/2024

» **"Factories in U.S. are Struggling to Fill Jobs."** Worker shortages persist in certain areas – *WSJ*, 12/31/2024

» Advice to all workers as TI Revolution shifts job priorities – **Be Indispensable and Sharpen Your Ax.**

The Bad

Stretched valuations
(22 F-PE vs 16X at beginning of Trump ver1)

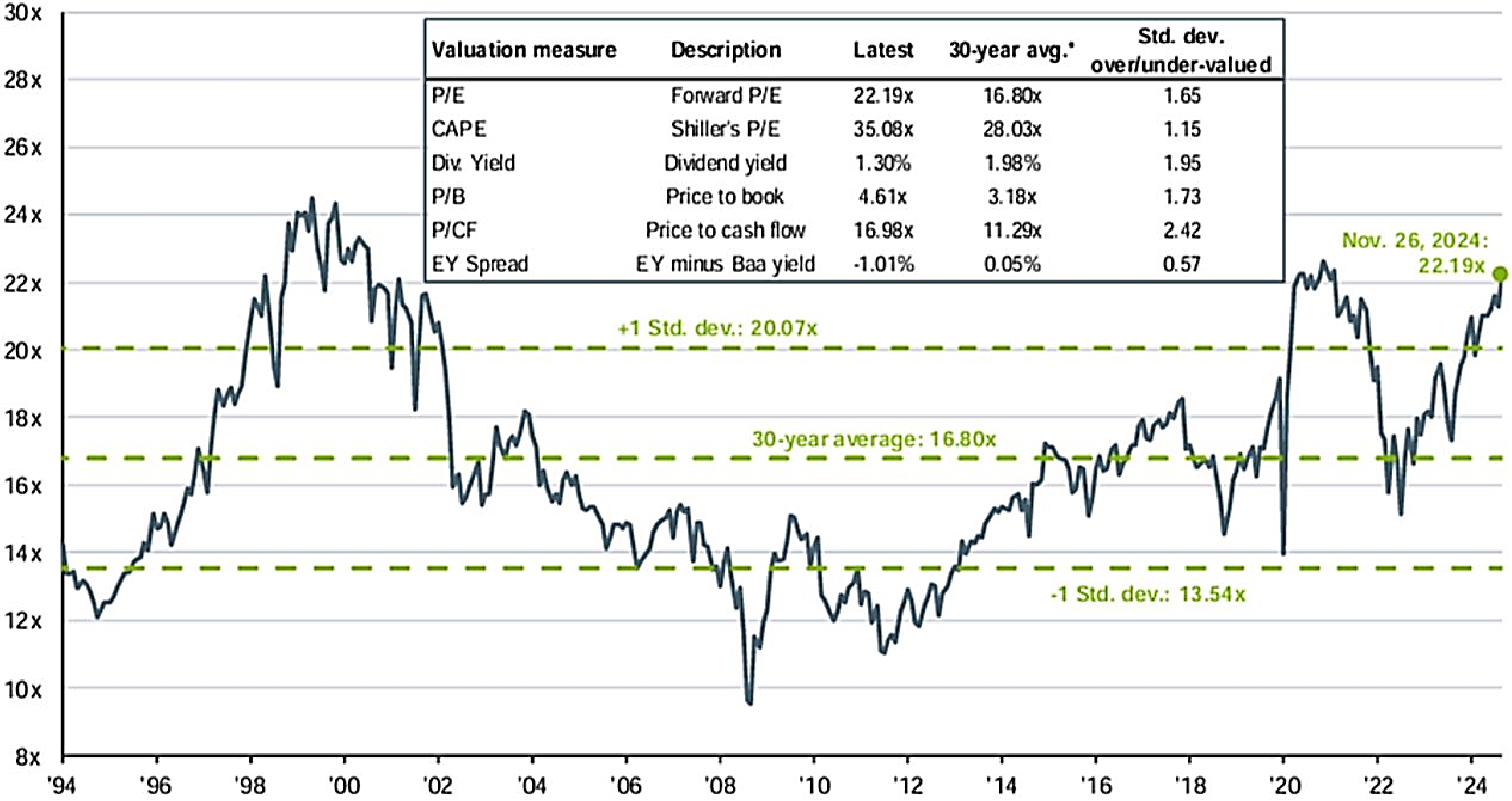
Ultra-low equity risk premium

Tariff headwinds (Trump ver1 levels or higher?)

Inflation pressures

Fed slowing interest rate cuts

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	22.19x	16.80x	1.65
CAPE	Shiller's P/E	35.08x	28.03x	1.15
Div. Yield	Dividend yield	1.30%	1.98%	1.95
P/B	Price to book	4.61x	3.18x	1.73
P/CF	Price to cash flow	16.98x	11.29x	2.42
EY Spread	EY minus Baa yield	-1.01%	0.05%	0.57

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

Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since March 1994 and by FactSet since January 2022. Average P/E and standard deviations are calculated using 30 years of history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Price-to-book ratio is the price divided by book value per share. Price-to-cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 30 years for each measure. *Averages and standard deviations for dividend yield and P/CF are since November 1995 due to data availability. *Guide to the Markets – U.S.* Data are as of November 26, 2024.

Market Valuations Priced for Perfection

Challenging to Justify Higher Market Levels Using Historical Heuristics

Implied S&P 500 Fair Value Worksheet: Average S&P TTM P/E by 10 Year Treasury Tranche (1953-2023)

10 Year Treasury Tranche		0-2%	2-4%	4-6%	6-8%	8-10%	10-12%	> 12%
Avg Tranche P/E		21.1x	16.9x	19.5x	16.3x	12.5x	10.6x	8.8x
Estimates		**Fair Value**						
Average EPS Decline in Recession: **-31.6%***	$165.84	3,499	2,799	3,241	2,699	2,065	1,752	1,457
Median EPS Decline in Recession: **-22.0%***	$181.46	3,829	3,063	3,546	2,953	2,260	1,917	1,594
Trailing 12 Mos (2Q'24)	$232.64	4,909	3,927	4,546	3,786	2,897	2,457	2,044
Strategas CY'24	$240.75	5,080	4,063	4,704	3,918	2,998	2,543	2,115
Consensus CY'24	$242.46	5,116	4,092	4,738	3,946	3,019	2,561	2,130
Strategas CY'25	$264.75	5,586	4,469	5,173	4,309	3,297	2,797	2,326
Consensus CY'25	$278.95	5,886	4,708	5,451	4,540	3,474	2,947	2,451

*Recession-related peak-to-trough earnings decline estimates based on trailing 12 Mos EPS as of 2Q'24. Source: Strategas, Investment Strategy Report, 8/26/24.

10-15 Year Asset Return Projections

	COMPOUND % RETURN PER YEAR		
	HISTORICAL 20-YEAR ANNUALIZED RETURN	ASSUMED 10-15 YEAR ANNUALIZED RETURN	PORTFOLIO WEIGHT
US EQUITIES	10.7	3.2	30
OTHER DEVELOPED MARKET EQUITIES	7.4	5.1	15
EM EQUITIES	9.3	4.8	5
10-YEAR US TREASURIES	2.7	4.5	20
CORPORATE BONDS*	4.6	5.4	10
ALTERNATIVES**	10.1	8.6	20
TOTAL PORTFOLIO***	7.8	5.1	
US INFLATION	2.0	2.5	
TOTAL PORTFOLIO REAL RETURN	**5.8**	**2.6**	

***Based on market cap-weighted average of investment grade and high-yield returns.
***Based on an equally-weighted average of hedge funds, global direct real estate, global REITs, private equity, venture capital, farmland, and timberland. U.S. direct real estate historical returns shown.
***Based on portfolio weights shown in final column.
Source: The Bank Credit Analyst, "Outlook 2025: Walking a Tightrope" – 11/25/24.

Goldman Sachs "Lost Decade" vs. Yardeni/JPM Forecasts

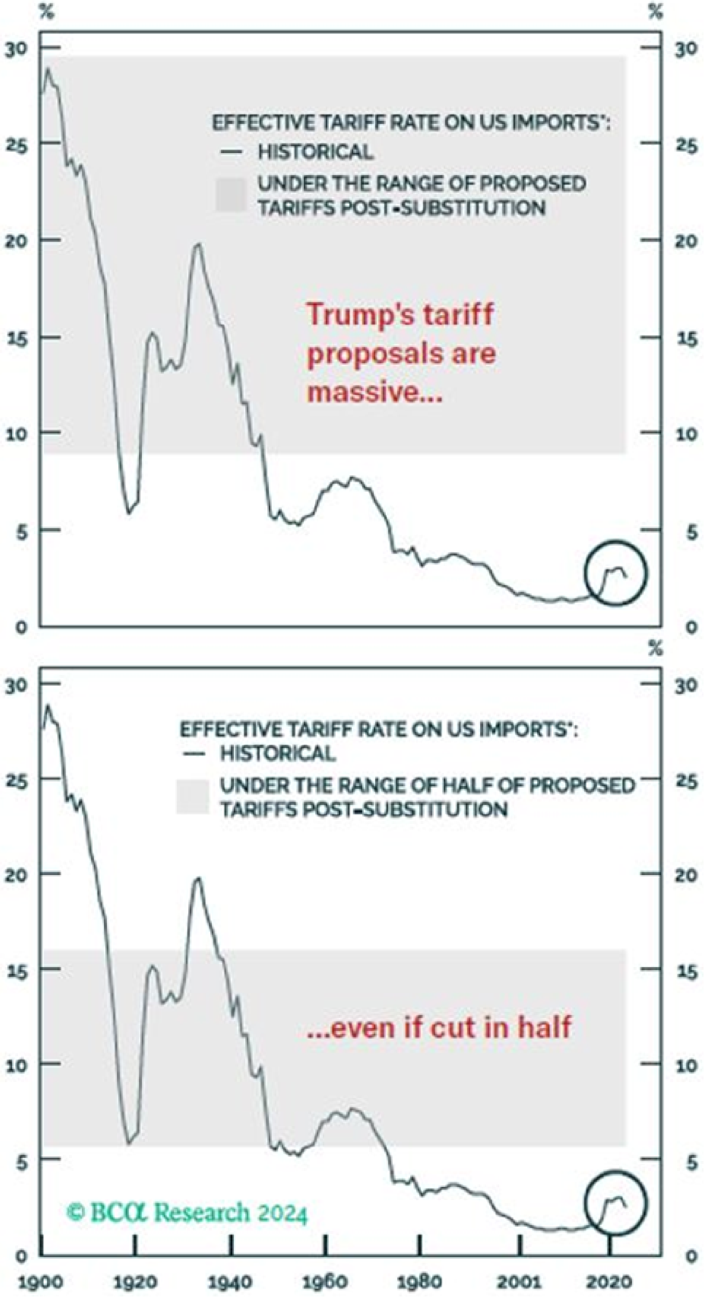
1. Goldman Sachs issued a "Lost Decade" forecast last fall for the S&P 500. 3% expected return and 3% average inflation[1].
2. At the same time, they believe the Good factors could create another 10%+ upward move in 2025[2].
3. Yardeni and JPM research factor in more tailwinds from productivity gains. Their projected stock returns are 6-10% annualized[3].
4. We've been here before – when valuations are stretched and "priced to perfection," small and large events can create significant stock volatility.
5. If you have large stock holdings with a low cost basis, run scenarios to see if hedging techniques may be helpful.

1. Goldman Sachs research report, 10/21/2024
2. *Lost Decade Ahead?*, Yardeni & Wallerstein, 10/22/2024
3. *Don't Abandon Stocks for Now*, J.P. Morgan in *Barrons* 10/24/25

The First Trade War was Negative for Risky Asset Prices

*Source: Caldara, Dario, Matteo (Acoviello, Patrick Molligo, Andrea Prestipino, Andrea Raffo (2019), The Economic Effects of Trade Policy Uncertainty, Journal of Monetary Economics (Nov. 2019).
**Source: Institute for Supply Management.
Note: Shaded for NBER-Designated U.S. Recessions. Research 2024
Source: The Bank Credit Analyst, “Outlook 2025: Walking a Tightrope” – 11/25/24.

Even Half of Trump’s Proposed Tariffs Would Go Well Beyond the First Trade War

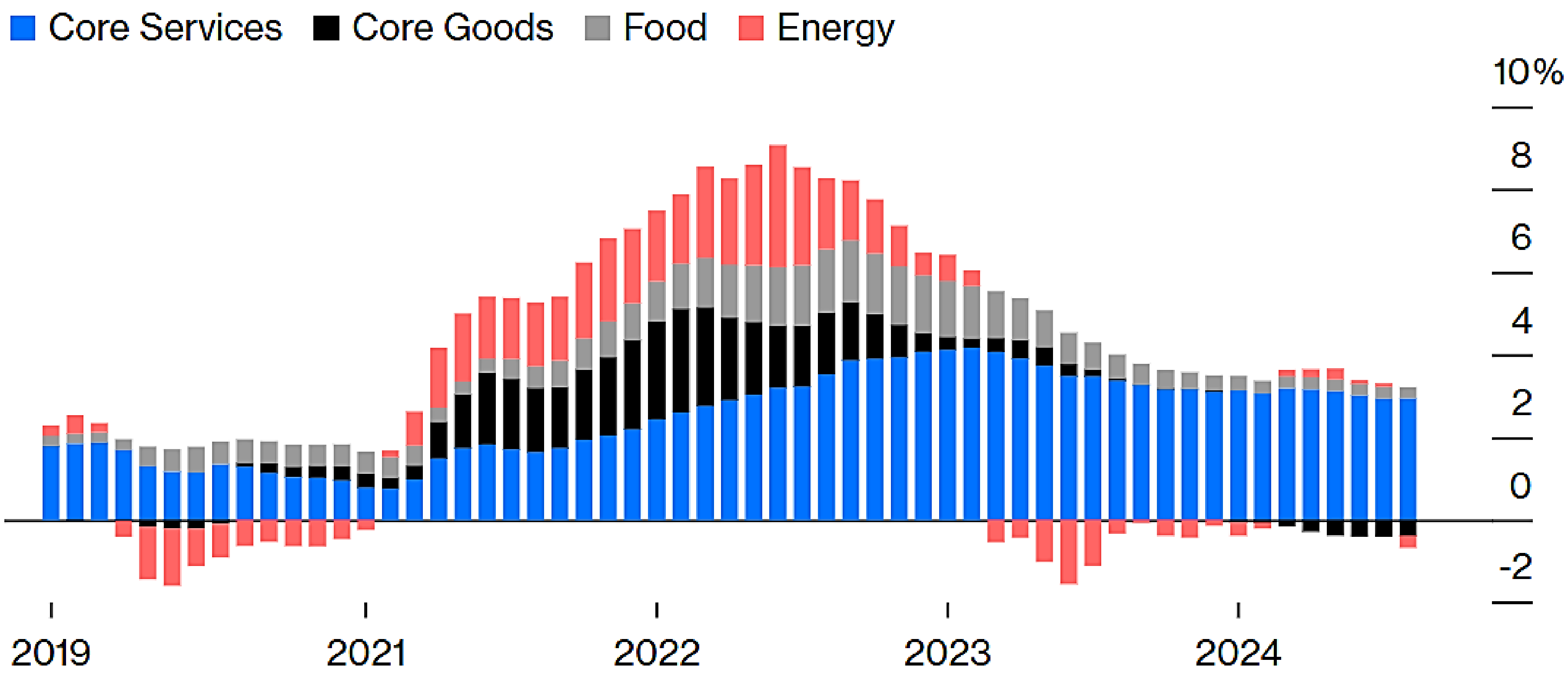


*Source: Yale University.
Source: The Bank Credit Analyst, “Outlook 2025: Walking a Tightrope” – 11/25/24.

Inflation Outlook

The Changing Face of an Inflation Scare

Once driven by goods and energy, ongoing inflation is all about services.

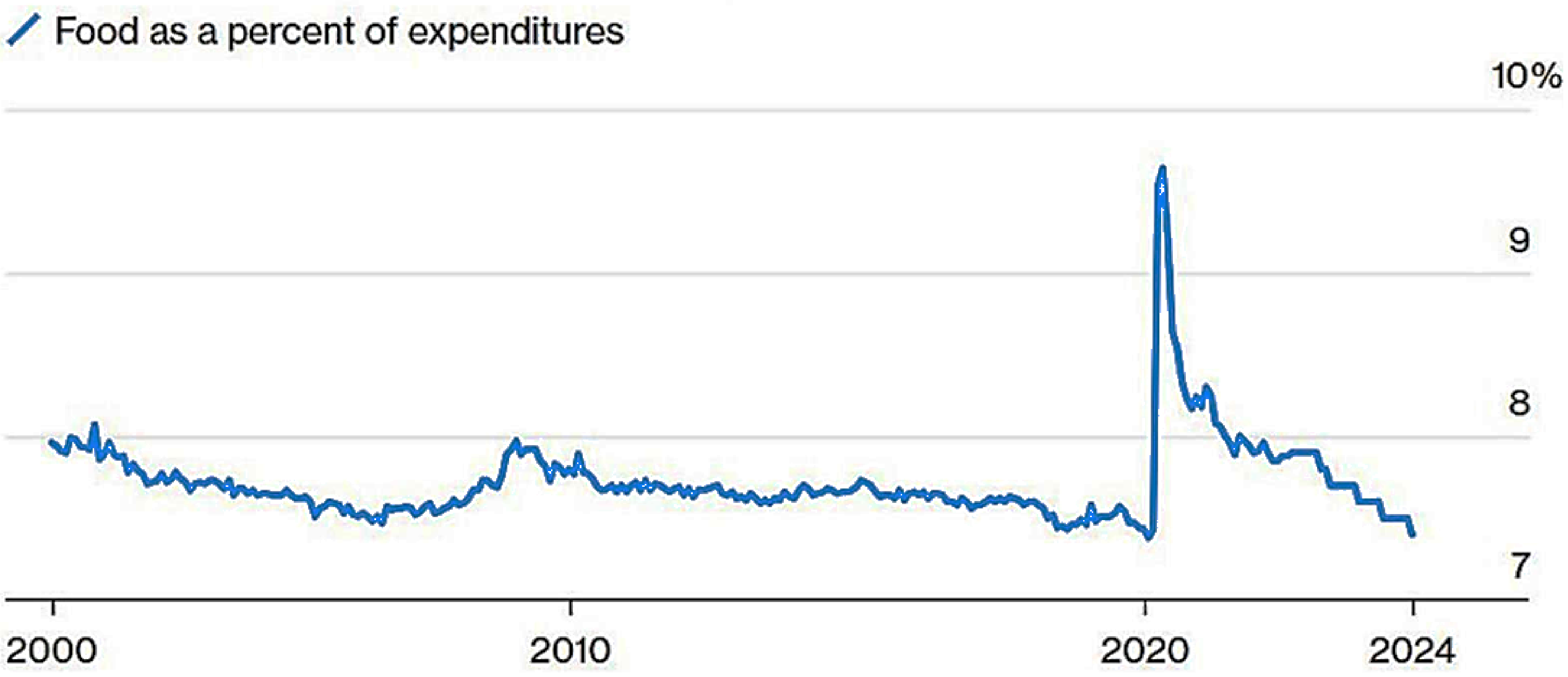


Source: Bloomberg Economic Analysis, Bloomberg Opinion, 9/12/24.

Current Inflation Reality Check

Back to Normal

Americans are now spending the same percentage of expenditures on food as they did before the pandemic.



Source: Bureau of Economic Analysis, Bloomberg. As of October 28, 2024.

Current Inflation Reality Check

Trump says it will be 'hard' to bring down grocery prices, pins hopes on lower energy costs and better supply chains.

Time magazine interview,
December 2024

What Could Cause an Inflation Resurgence?

- **Poor economic policy** – two potentially inflationary policies are Severe Immigration Restrictions (incl HB-1 visas) and Major Tariffs for China and Mexico.
- **Supply chain snarls** – world geopolitical hot spots could cause many goods and services to once again have greater costs. Energy supply-demand is balanced but fragile.
- **Housing supply remains below needed levels** – rent costs may again start rising.
- **Re-Shoring** – moving supply chains closer to the consumer (as is happening) is inherently inflationary.

Fed Chairman Powell:

"We need to take our time with future rate cuts, not rush, and make a very careful assessment, but only when we've actually seen what the [Trump administration] policies are and how they've been implemented," *Powell said of the Trump plans.*

"We're just not at that stage."

Source: Federal Reserve Meeting, December 18, 2024.

The Wildcards

Musk X Factor

Three Geopolitical Scenarios

Department of Government Efficiency (DOGE)

1. Musk and Ramaswamy are recruiting experts (including many silicon valley billionaires) to provide “technical advice” on cost cutting and efficiency through tech productivity tools.

2. The stated goal has been $2T in federal budget cuts from a $6T starting point.

3. They recently said $1T in cuts may be more realistic.

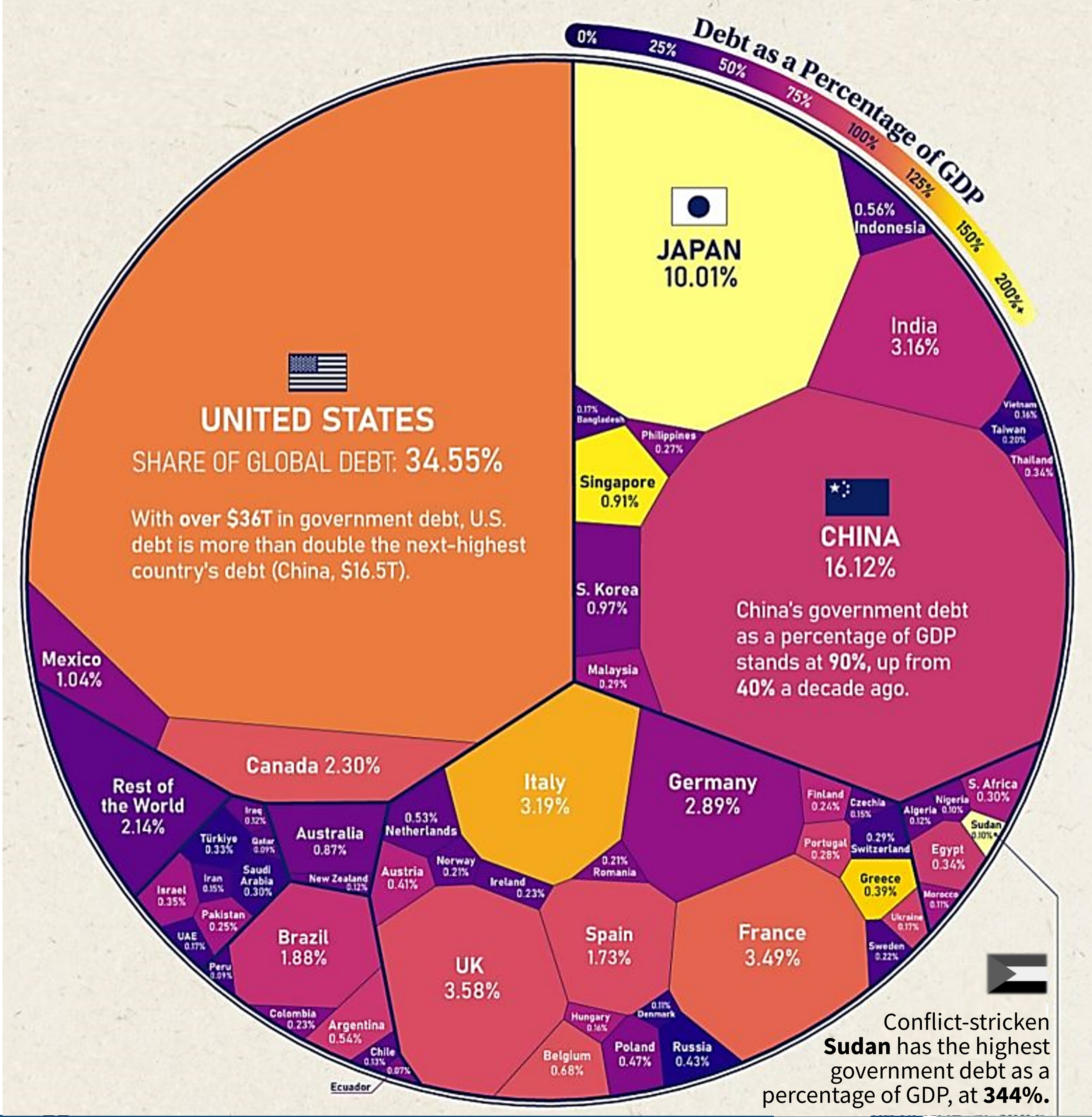
4. Modest risk that Musk’s campaign promise (expect hard times ahead – temporarily) will be fulfilled.

A World of Debt

Share of Global Debt by Country

Global government debt has increased by **$42.4 trillion** since 2015, when it was **$59.7 trillion.**

Total Global Government Debt: $102.1T



Source: IMF World Economic Outlook October 2024.

Federal Debt and Deficits

- » Federal debt has surged since the money printing interventions in the Great Recession of 2008/09. However, so has the economy – **always consider debt as a % of the economy**.
- » Federal debt costs have risen as interest rates have increased – one third being refinanced this coming year at lower rates.
- » Foreign holdings of treasuries has declined steadily in recent years to approximately 22%.
- » Projected federal debt interest costs have reached 18%, above the 14% “yellow line” considered more risky. This will settle back.

Sources: SFG, Penn Budget Model, 4/19/24

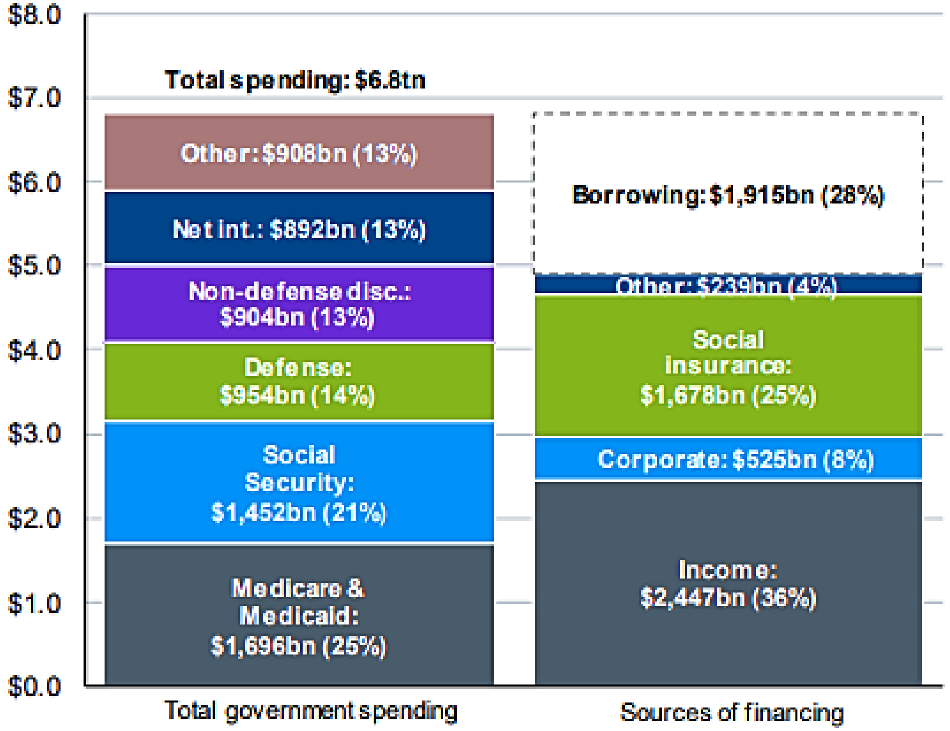
Penn Wharton Principles Based Illustrative Reforms, 12/4/2024

Federal Finances

Including 2017 Tax Act Extension

The 2024 federal budget

USD trillions

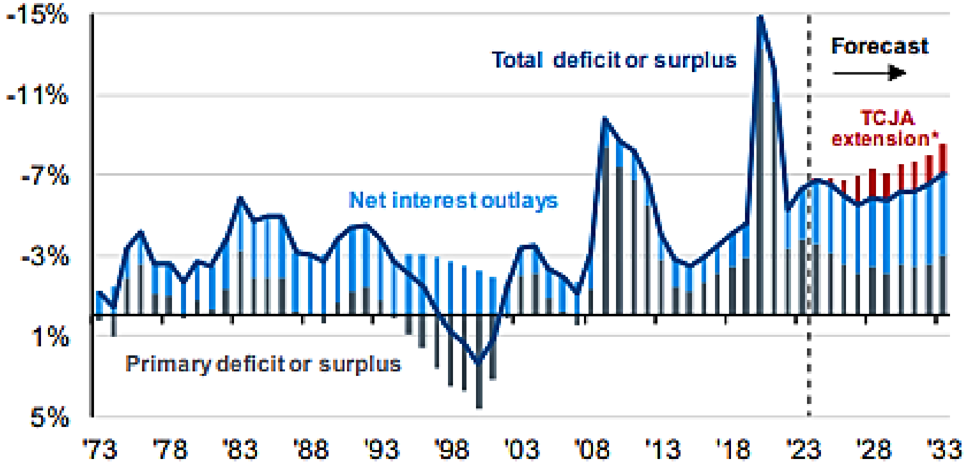


CBO's Baseline economic assumptions

	2024	'25-'26	'27-'28	'29-'34
Real GDP growth	2.9%	2.0%	1.7%	1.8%
10-year Treasury	4.5%	4.0%	3.6%	4.0%
Headline inflation (CPI)	3.2%	2.4%	2.2%	2.2%
Unemployment	3.8%	4.0%	4.3%	4.5%

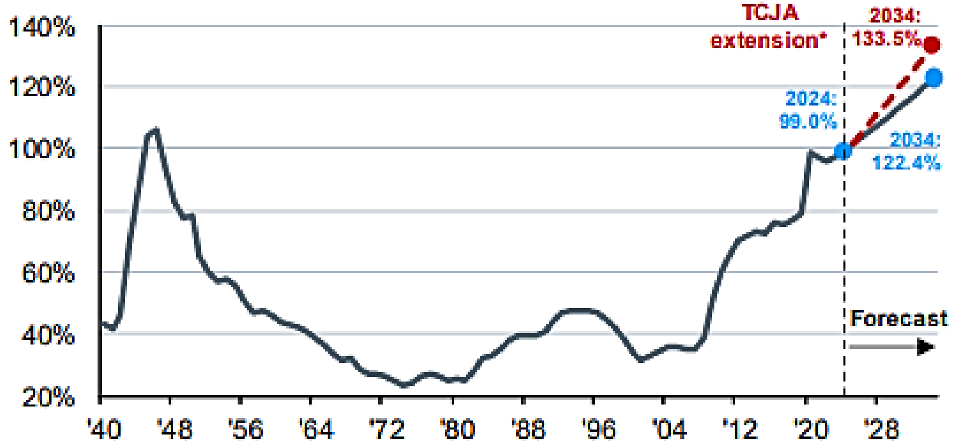
Federal deficit and net interest outlays

% of GDP, 1973-2034, CBO Baseline Forecast



Federal net debt (accumulated deficits)

% of GDP, 1940-2034, CBO Baseline Forecast, end of fiscal year



Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department. Estimates are from the Congressional Budget Office (CBO) June 2024. An Update to the Budget Outlook 2024 to 2034. "Other" spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Years shown are fiscal years. *Adjusted by JPMAM to include estimates from the CBO May 2024 report "Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues" on the extension of TCJA provisions. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.
Guide to the Markets – U.S. Data are as of September 16, 2024.

Federal Debt and Deficits

When will Federal Debt “crowding out” begin to have a major impact?

- The Penn Wharton Budget model estimates financial markets cannot sustain more than the next 20 years of accumulated deficits projected under current U.S. fiscal policy.
- PWB model is the best-case scenario. Stress testing suggests that severe market impact could occur in as little as seven years if interest rates rose and stayed elevated, or severe recessions depleted federal revenues, or the U.S. dollar lost its pre-eminent reserve currency status.

Why would China step up plans to invade Taiwan?

- They need advanced AI chips to save their economy.
- China sees Taiwan’s manufacturing capabilities moving to the U.S. over the next five years.
- President Xi - “be ready by 2027.”

U.S. officials estimate that some 90% of semiconductors and 70% of machine tools used by Russian military industries currently come from China.

Source: *Wall Street Journal* – December 13, 2024 – *"Has World War III Already Begun?"* by Yaroslav Trofimov

"We have collectively perhaps underestimated the magnitude of this emerging axis and the strategic impact it's having on us all," *warned* ***Andrew Shearer, Australia's chief of national intelligence,*** *in remarks at the Halifax International Security Forum in Canada last month.*

"We fell into the trap of looking at each component in isolation, and not seeing the linkages between them and the deep connectivity between one theater and another…We haven't adjusted our mindset and taken on board the scale of their strategic ambitions."

Source: *Wall Street Journal* – December 13, 2024 – *"Has World War III Already Begun?"* by Yaroslav Trofimov

“There is a certain transactional symbiosis among the emerging axis, particularly China and Russia, where each fulfills the needs of the other.”

said ***U.S. Navy Admiral Samuel Paparo,***
the commander of the Indo-Pacific command.

“To think that we will be able to drive a wedge between them is a fantasy.”

Source: *Wall Street Journal* – December 13, 2024 – *“Has World War III Already Begun?”* by Yaroslav Trofimov

SFG's Take

1. Risks are elevated in many areas.
2. Uncertainty level = High.
3. Opportunities abound.
4. Given lower projected returns in the next decade from a traditional portfolio, adding in non-correlated assets with secular tailwinds is prudent.
5. Consider hedging strategies in high value/low basis stocks.
6. Staying disciplined between your "core" assets and "explore" assets can help you balance your offense and defense.

SFG's Advice for Today's Uncharted Waters

1. Determine how much you need for financial independence and divide assets between "Core" and "Explore."
2. Rebalance "Core" to neutral targets aggressively.
3. Retirees – don't stretch risk levels in Core.
4. Explore funds – balance Techno-Industrial Revolution assets with small caps and niche assets.
5. For retirees, consider two years of living expenses in cash (money market funds or limited duration bonds).
6. Be prepared to pivot and adapt in today's environment.

Questions?

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