AMI INVESTMENT MANAGEMENT
Registered Investment Advisor

# Quarterly Investment Commentary

FOURTH QUARTER, DECEMBER 2024

The staff at AMI Investment Management would like to extend our warmest wishes to clients, friends, and their families for a happy and healthy New Year.  As AMI enters its 30th year of business, it serves as a fitting reminder that being entrusted with the management of client assets is a big responsibility—one we take seriously and strive to perform in a manner that justifies this trust.  It's been said that becoming an overnight success takes years of hard work and experience, but we also recognize that our business longevity is due to the loyalty of our clients.  In today's noisy world, having trustworthy and reliable guidance is essential when making investment decisions.  Our goal remains to serve as your trusted partner, helping to navigate the investment landscape with clarity, purpose, and confidence.  Thank you for your continued business, and we look forward to working with you in the New Year.

## Bizzaro World

Fans of the TV show *Seinfeld* might recall the season eight episode titled "Bizzaro Jerry".  In one of the subplots, Elaine falls in with a new group of friends who physically resemble Jerry, George, and Kramer but are completely opposite in terms of personality: they are polite, reliable, and empathetic.  As Elaine describes living in this pleasantly strange, alternate version of her normal word, Jerry draws the connection to the Superman universe's Bizzarro World.  A world where everything is the opposite of what it normally is. "Up is down, down is up.  He says 'hello' when he leaves, 'goodbye' when he arrives," Jerry explains.


*Elaine in the Bizzaro World.*

For much of the last two years it could be said that the economy and markets have operated in a pleasantly strange sort of bizzarro world.  The Fed's restrictive monetary policies, which began in 2022 and led to one of the fastest paces of interest rate increases in history, has helped to bring down the rate of inflation but has also given rise to some factors that contradict historic norms.  For those with an enquiring mind, or perhaps in need of a sleep aid, dusting-off any college macroeconomics textbook and flipping to the chapter on tightening money supply with higher interest rates might find the following summary:  businesses spend less which leads to lower economic growth, lower economic growth leads to higher unemployment, higher unemployment leads to lower consumer spending, lower spending negatively impacts corporate profits, and so on.  Generally, this type of environment is not considered the most fruitful for investors.

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In 2022, the market's response to the looming higher interest rate environment and the challenging road ahead was uncomfortable yet orderly. By the third quarter, U.S. stocks had declined by approximately 25%, while rapidly rising interest rates caused high quality bonds to fall by 10%. There were very few safe havens for investors to hide during this volatile period. The excesses, distortions, and speculation that had built up in the markets were being cleared—a process that generally takes time to totally unfold.

Then, in late 2022, when the outlook appeared bleak, investors abruptly shifted their views. The markets and U.S. economy have delivered a number of notable "Bizzaro" highlights since then:

**9/30/2022 - 12/31/2024**

- The S&P 500 stock index is up 70% while the NASDAQ index, which is heavily concentrated in technology stocks, is up 87%. Both benchmarks surpassed all-time highs this year.
- Corporate earnings were basically flat in 2023 from the prior year and are expected to grow around 9% this year. The consensus estimates are for 13% earnings growth for 2025.[1]
- The U.S. economy grew around 3% in 2023 and is expected to grow in the 2.5% range this year, roughly in-line with the 10-year average. Business investment and consumer spending have been the primary drivers of economic growth this year.
- The unemployment rate has risen slightly to just over 4%, up from a 50-year low of 3.4% in 2023. Although unemployment has trended higher, it's still below what's considered full employment[2] and well below the long-term average of around 6%.

If the markets and economy managed to function like this during a period of mostly restrictive monetary policies, what might it look like once lower interest rates kick in? More on this later.

# The Shift in Sentiment and What's Ahead

What triggered this change in sentiment in late 2022 and ignited the current bull market? During this period there were several factors that contributed to the market shift:

1) Inflation eased off its highs allowing the Fed to start contemplating rate cuts at some point in the not-so-distant future. (This didn't happen until September 2024.)

2) Lower interest rates would likely enable the economy to avoid a severe recession.

3) A small San Francisco-based company named OpenAI launched ChatGPT—which fueled the prospects for the current generative Artificial Intelligence (AI) boom.

Each contributed in its own way to the shift but given the profound run-up in large technology stocks, ChatGPT has likely carried the most weight. The Russell 1000 Growth index, which has significant exposure to many of the stocks viewed as AI beneficiaries, has nearly doubled since late 2022 compared to the average stock which is up around 42%.[3] Additionally, the growing concentration in the S&P 500 index's makeup has been well publicized. The top 3 largest companies (Apple, Microsoft, Nvidia) now make up a whopping 20% of the index while the top 7 companies, mostly tech related, now make up roughly 33% of the index and account for 25% of earnings.

[1] S&P 500 EPS 2022 were $222, $223 in 2023, and estimates are $242 for 2024 and $274 in 2025.
[2] Brookings estimates the full employment rate of unemployment at 4.4% in Q3
[3] Return for the Invesco S&P 500 Equal Weight Index from 9/30/22-12/31/24

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This disconnect between big tech and the rest of the market has been addressed in our past commentary, but should it be a cause for concern? It's a question that has two pretty straightforward but opposite answers.

- The rapid rise of large tech stocks is a symptom of speculative excess being pushed by irrational optimism, while most stocks outside of large tech are not participating.
- The stock market has rationally identified the firms that stand to benefit the most from this new technology and applied reasonable valuations based on future growth prospects.

At this point, there's no definitive answer and time will determine whether markets have acted sensibly or irrationally during this bull market phase. Our view is there are segments of the market where price appreciation has gotten way ahead of the underlying fundamentals, which should be a cause for concern for investors with significant exposure.

Spending on the AI "gold rush" over the past two years has been immense. The tech giants have spent tens of billions of dollars per quarter ($62 billion in Q3 alone) to beef up infrastructure and computing power to run AI systems. The outlays have largely been concentrated in the backbone foundation—including semiconductors (Nvidia) and cloud computing (Amazon, Microsoft, Google). Recently, many tech giants have announced new product launches, such as chat-optimized platforms (like ChatGPT), AI agents designed to complete tasks on your behalf, and even quant computing chips—because who doesn't need a chip that's smarter than an entire IT department. Given the enormous spending and investment, the bar has been set high for many of these products. From a shareholder's perspective, 2025 might be the year that the "rubber meets the road" for this innovation. These products will not only need to materialize but also demonstrate feasible value by enhancing productivity and increasing profits.

It's easy to imagine that in the coming year it will become clearer which AI ventures are winners and which are not —or distinguishing between those with profitable, practical applications from those with mere hopes and dreams.

"So, what does everyone think of XX81's suggestion for increased funding into AI research?"

# Evaluating the Terrain in 2025

As we've stated in the past, we shy away from the predictions game of setting year-end targets for stock prices or interest rates because it's largely a crapshoot—too many unpredictable events transpire for it to be a worthwhile exercise. Our preference when gauging return potential is to evaluate the terrain and identify hazards where possible. As we enter 2025, the pillars of the economy appear to be on solid footing. Inflation is still elevated but normalizing, the labor market appears healthy, corporate earnings are expected to grow, and sentiment is bullish. As noted earlier, the economy is expected to hum along while the Fed continues to lower interest rates. The election has come and gone without major disruption, and the levers of government seemed poised for growth.

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What gives us pause is that a very optimistic future has largely been priced into stocks already. In addition, the range of potential outcomes over the coming year has widened significantly. These outcomes span from scenarios where potential tariffs and trade wars reignite inflation forcing the Fed to raise rates, to ones where AI technology ushers in a new era of productivity and economic growth.

What we do know is speculative conduct has been on the rise for the better part of the last couple of years—almost as if the sell-off of 2022 never occurred. Some examples of this include equity valuations that are well above historical averages, the recent ascent of Bitcoin after its disastrous crash two years ago, or our federal budget deficits which are the largest in history. Even recent news headlines outside of the financial section illustrate some evidence of excesses.

- Elon Musk has become the richest person to walk the earth, surpassing Mansa Musa the ruler of the Mali Empire from 1312 to 1337.
- Juan Soto, a baseball player for the New York Mets, signed a 15-year, $765 million contract, the largest contract in the history of sports. He'll collect roughly $89,000 per at-bat next season by some estimates.
- A crypto currency entrepreneur paid $6.2 million for a piece of "artwork" consisting of a banana duct taped to a wall. The new owner immediately ate the banana.

These are all noteworthy observations but lousy tools for managing portfolios. Although excesses have built up and investor sentiment has become somewhat complacent, these episodes can go on for some time. From our viewpoint, the outlook is not dire, but we proceed with caution.

Corporate earnings will play a key role going forward and must continue to grow to justify current valuations. Our theme in the new year will be to maintain broad equity diversification—which includes owning stocks outside of the most popular names—owning high-quality bonds for income and diversification benefits, being mindful of the current risks, and periodic rebalancing of portfolios to align with client objectives.

In the meantime, let's enjoy the back-to-back years of strong portfolio returns and cheers to a prosperous 2025.

# AMI Update

We are pleased to announce that if you are an iPhone user, you can now download the **AMI Client Portal App** through the Apple App Store for free. Below you will see what the app looks like within the store. If you are an Android device owner, we hope to have the supported app available in the early New Year for download from the Google Play Store. We will continue to keep you posted on this being released.


Once the app is downloaded, to login into it you will use the same credentials you used to set up your portal, your email and password. If you have any questions or need assistance, please do not hesitate to contact any member of our team at 260-347-1281. We are here to help you make the most of this new option for viewing your AMI portal.