



2024 Market Review and 2025 Preview

2024 Market Review

Stocks performed much better in 2024 than many investors imagined they would at the start of the year. The S&P 500 rose +25%, setting a major milestone by surpassing the 6,000 level for the first time in history.

During the year, the S&P 500 recorded 57 record highs. Going back to World War II, there have only been 4 other times when the S&P 500 recorded more than 50 all-time highs in a single year: 1995 (77), 2021 (70), 1964 (65) and 2017 (62).

At DSG Capital Advisors, we believe five themes worked together in 2024 to propel U.S. stock prices to all-time highs. These five themes included: (1) Artificial Intelligence build out, (2) Federal Reserve interest rate cuts, (3) U.S. elections, (4) Strong consumers, and (5) Corporate earnings growth.

We also identified six themes we believe will be the key drivers of market performance in 2025. These six themes include: (1) U.S. debt levels, (2) New Administration policies, (3) Federal Reserve and interest rates, (4) Inflation, (5) AI transition from “build out” to “implementation”, and (6) Corporate earnings growth.

Our 2024 Market Review and 2025 Preview examines how each of these themes contributed to financial market performance in 2024 and provides our thinking on how they could impact financial markets in 2025.

Before delving into the key themes that influenced the markets, we first review the performance of various 2024 asset returns. For additional context, we also included the performance of these same assets over the past six years.

Large-cap U.S. growth stocks led the way in 2024, driving the Russell 1000 Growth +33% and Nasdaq +26%. The bellwether U.S. stock index, the S&P 500 Index, increased +25%. The more value-oriented Dow Jones returned +15%, while mid-cap stocks returned +14% and small-cap stocks returned +9%. International stocks rose modestly with MSCI World ex-U.S. +5%.

U.S. Bonds provided modest returns in 2024 with the U.S. Aggregate Bond index rising just +1%. Gold had a strong year, increasing +27%, while other commodities were basically flat.

Bitcoin was in a league of its own, returning +115%.

Investment Class	Investment Style	2024	2023	2022	2021	2020	2019	2018
Stocks	US Large Cap - S&P 500	25%	26%	-18%	29%	18%	31%	-4%
	US Large Cap - Nasdaq	26%	55%	-32%	28%	49%	39%	0%
	US Large Cap - Dow Jones	15%	16%	-7%	21%	10%	25%	-3%
	US Mid Cap - S&P 400	14%	16%	-13%	25%	14%	26%	-11%
	US Small Cap - S&P 600	9%	16%	-16%	27%	11%	23%	-8%
	US Growth - Russell 1000 Growth	33%	43%	-29%	28%	38%	36%	-2%
	US Growth - Russell 1000 Value	14%	11%	-8%	25%	3%	27%	-8%
	Emerging Markets - MSCI EM	7%	10%	-20%	-3%	18%	18%	-15%
	Global Markets - MSCI World	5%	16%	-16%	8%	11%	22%	-14%
Bonds	US Aggregate Bonds	1%	6%	-13%	-2%	8%	9%	0%
	Investment Grade Corporate Bonds	-3%	5%	-20%	-4%	8%	13%	-7%
	High Yield Corporate Bonds	2%	5%	-15%	0%	-1%	8%	-7%
Alternatives	Commodities	0%	-13%	14%	27%	-4%	5%	-13%
	Gold	27%	13%	-1%	-4%	25%	18%	-2%
	Bitcoin	115%	156%	-64%	58%	302%	92%	-73%

Source: Bloomberg (12/31/2024)

Sector performance in 2024 varied widely, but overall returns were impressive. On the high end of the performance spectrum were the technology focused and economically sensitive sectors: Communications +40%, Technology +37%, Financials +31% and Consumer Discretionary +30%.

In the middle of the pack were Utilities +23%, Industrials +17% and Consumer Staples +15%. Although we would classify each of these sectors' performance as robust compared to their historical averages, they underperformed the S&P 500 index in 2024.

Energy +6%, Real Estate 5%, Healthcare 3% and Materials 0%, all significantly underperformed the S&P 500 index.

Sector	2024	2023	2022	2021	2020	2019	2018
Communications	40%	56%	-40%	22%	24%	33%	-13%
Technology	37%	58%	-28%	35%	44%	50%	0%
Financials	31%	12%	-11%	35%	-2%	32%	-13%
Consumer Discretionary	30%	42%	-37%	24%	33%	28%	1%
S&P 500	25%	26%	-18%	29%	18%	31%	-4%
Utilities	23%	-7%	2%	18%	0%	26%	4%
Industrials	17%	18%	-5%	21%	11%	29%	-13%
Consumer Staples	15%	1%	-1%	19%	11%	28%	-8%
Energy	6%	-1%	66%	55%	-34%	12%	-18%
Real Estate	5%	12%	-26%	46%	-2%	29%	-2%
Healthcare	3%	2%	-2%	26%	13%	21%	6%
Materials	0%	13%	-12%	27%	21%	25%	-15%

Source: Bloomberg (12/31/2024)

Given the outsized returns in 2024, many investors were focused on elevated stock valuations. As shown in the chart below, the S&P 500 Index ended 2024 with a forward P/E ratio of 21.7x, more than one standard deviation above the historic averages and significantly above the 30-year average of roughly 17x.



As discussed in section 5 below, with 2024 S&P 500 corporate earnings growth of just +7.4%, most of the S&P 500's +25% return was derived from multiple expansion rather than earnings growth. As we have witnessed throughout history, elevated stock prices eventually need earnings growth to maintain those valuations. Put simply, high stock multiples without earnings growth are not sustainable over the long term.

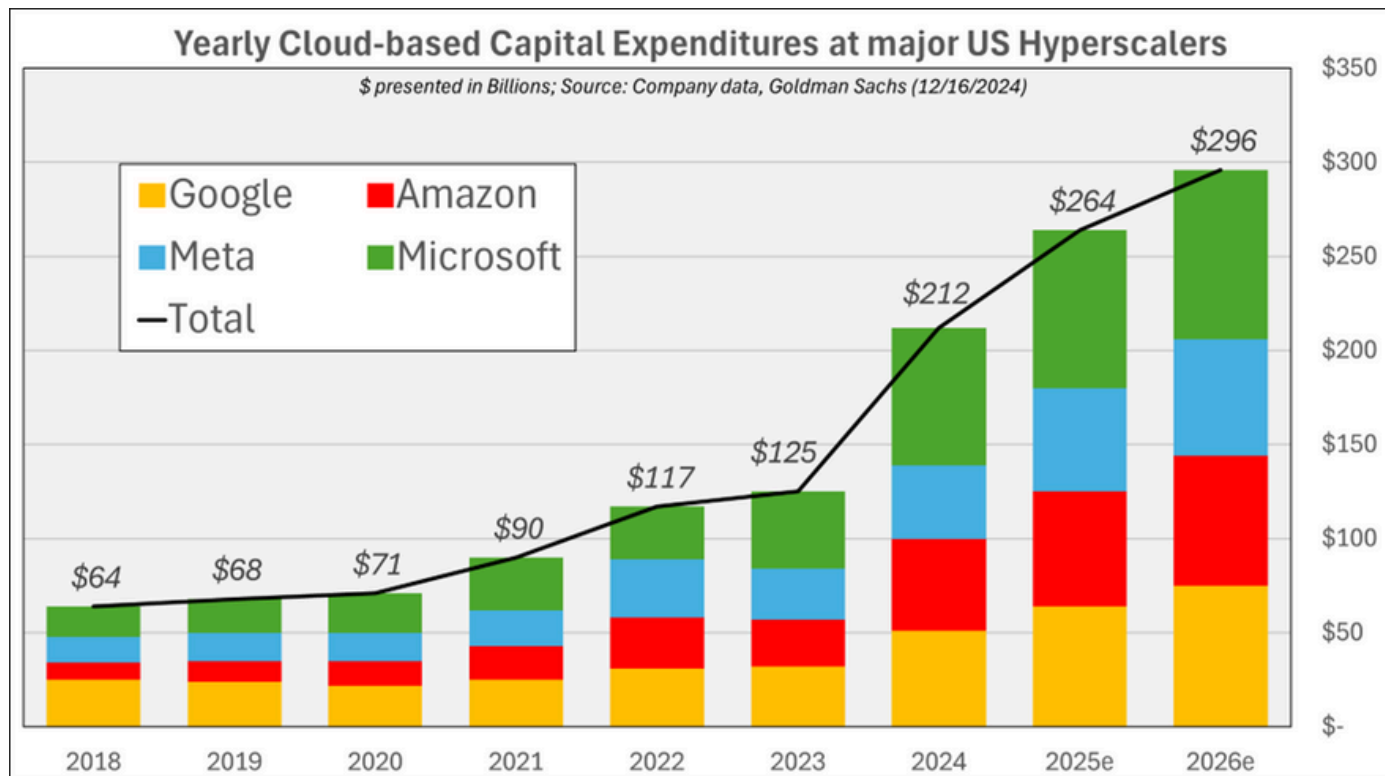
The elevated stock multiples are particularly noteworthy as 2024 was the second consecutive year that the S&P 500 index posted +25% returns. The +25% return of 2024, which followed +26.3% returns recorded in 2023, is a rare event and has not occurred in over 25 years. The last time the S&P 500 index posted consecutive +25% total returns was 1997 with +33% returns followed by +29% in 1998.

In addition to providing consecutive +25% return years, more experienced investors will recall that the late 1990s also ushered in lofty P/E ratios. As such, there appear to be several parallels between the market environment today and the late 1990s. Whether or not the current cycle ends in similar fashion to the tech bubble of the late 1990s remains to be seen. But we think prudent investors, or those who believe in “mean-reversion,” should exercise caution and monitor stock valuations and earnings growth closely.

Below is a review of the themes that we believe propelled stock prices to all-time highs in 2024.

1. Artificial Intelligence Build Out

At DSG Capital Advisors, we think 2024 will be remembered as the “AI build out phase.” As seen in the chart below, the “build out phase” was defined by significant capital expenditures by several of the Magnificent 7 companies.



Overall, spending on cloud computing by four of the world’s largest companies nearly doubled in 2024. In total, these four companies spent an astounding \$544 billion on cloud-based expenditures over the last four years. Remarkably, they are projected to spend an additional \$560 billion over the next two years.

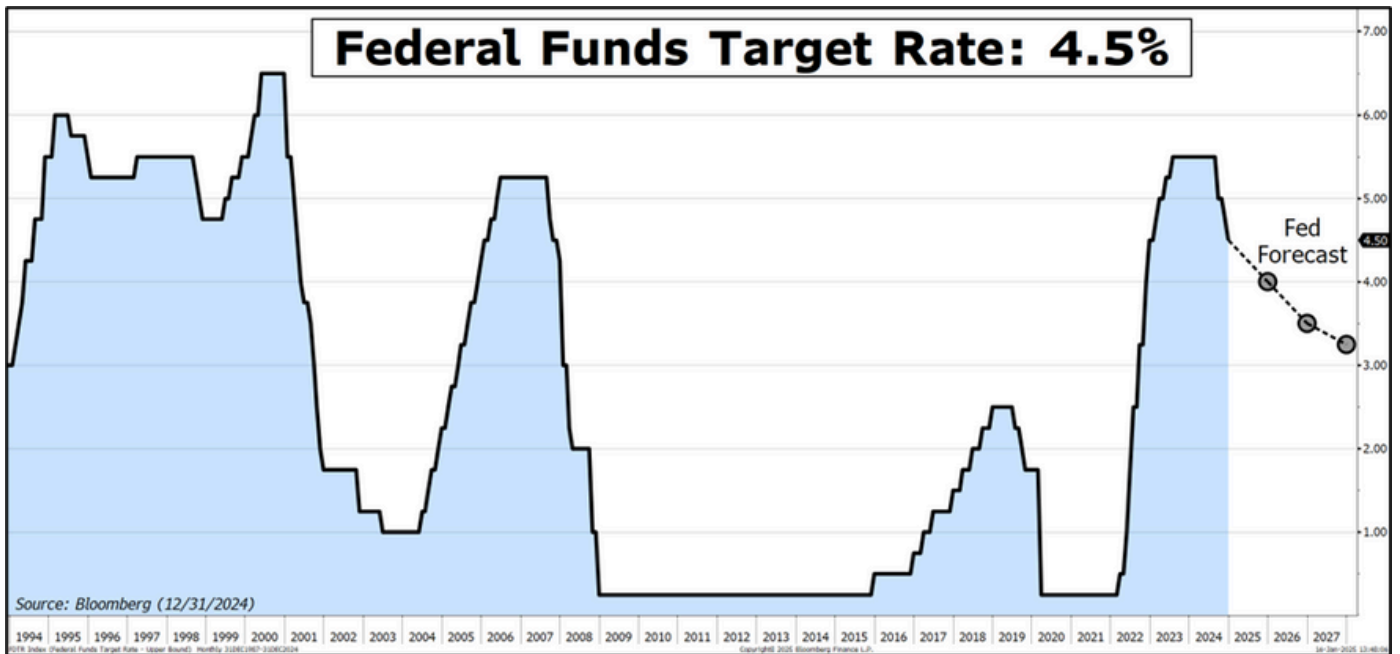
Much of the capital spending was centered on the extraordinary demand for high-performance computing chips from companies like Nvidia, Broadcom and Taiwan Semiconductors.

2. Federal Reserve Interest Rate Policy

In comparison to Artificial Intelligence capital expenditures, changes in the Federal Reserve’s interest rate policy were arguably just as – if not more – impactful on stock prices.

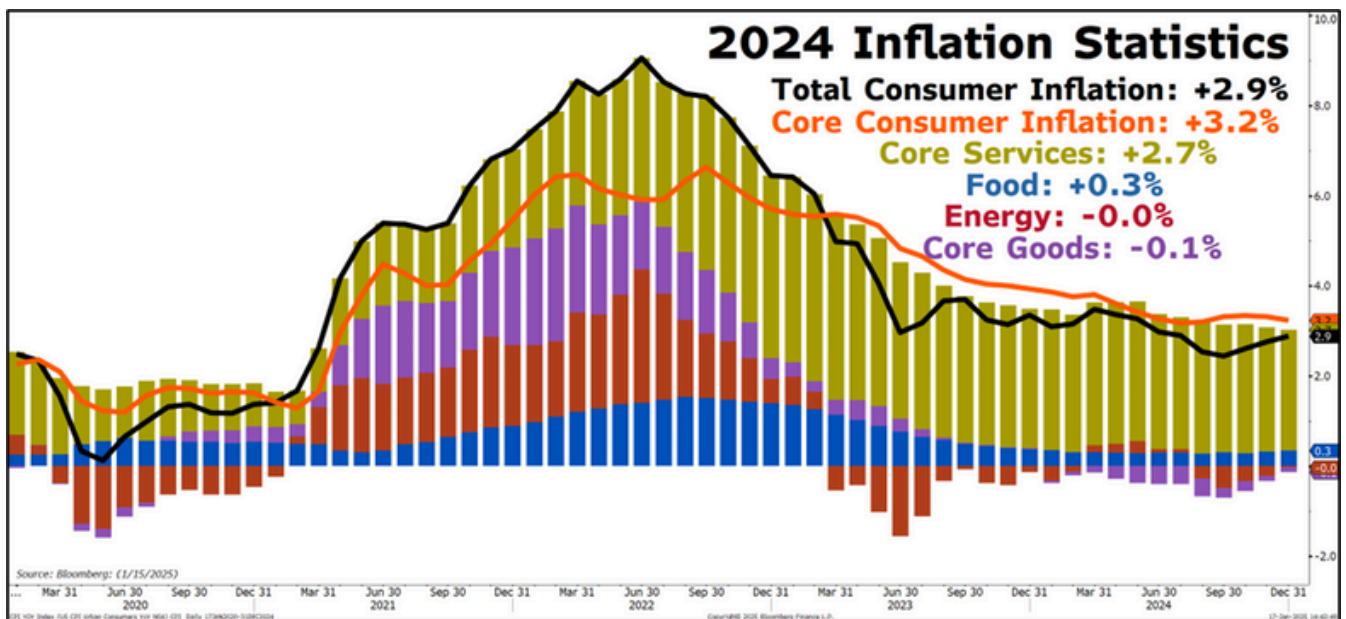
After raising interest rates at an unprecedented rate (i.e., from 0% to 5.5% in less than 18 months), the “data dependent” Federal Reserve began cutting interest rates in September 2024.

As shown in the chart below, the Fed followed through with additional rate cuts in November and December leading to a year-end 2024 Federal Reserve rate range of 4.25% - 4.5%...a full 1% below where it stood in the summer of 2024.

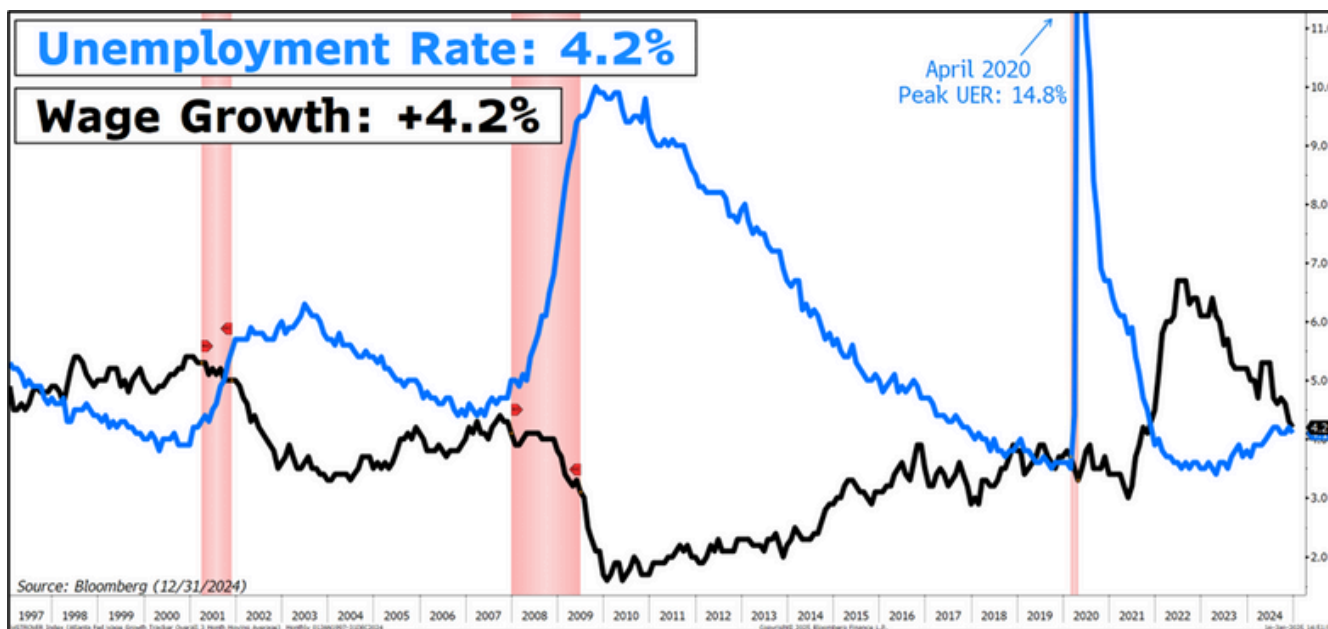


The Federal Reserve was able to reduce interest rates because inflation continued to moderate. Specifically, consumer inflation, as measured by CPI, fell to a 2.9% annualized rate as shown in the chart below.

The inflation components that fell the most following the pandemic spike were Food +0.3%, Energy 0% and Core Goods -0.1%. The moderating pressure from these components in 2024 lead to sub 3% inflation for the first time since the pandemic started.



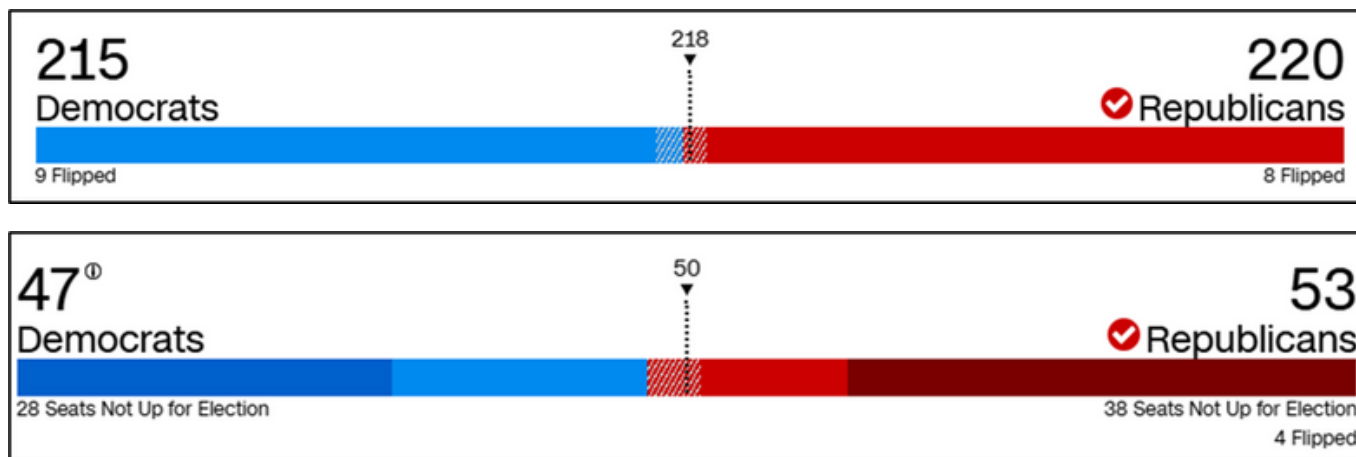
Similar to falling inflation, labor markets also decelerated in 2024. The combination of an unemployment rate that ticked up marginally and ended the year at 4.2%, and moderating wage growth, provided the Federal Reserve with the data set it needed to cut interest rates in the second half of 2024.



3. U.S. Elections

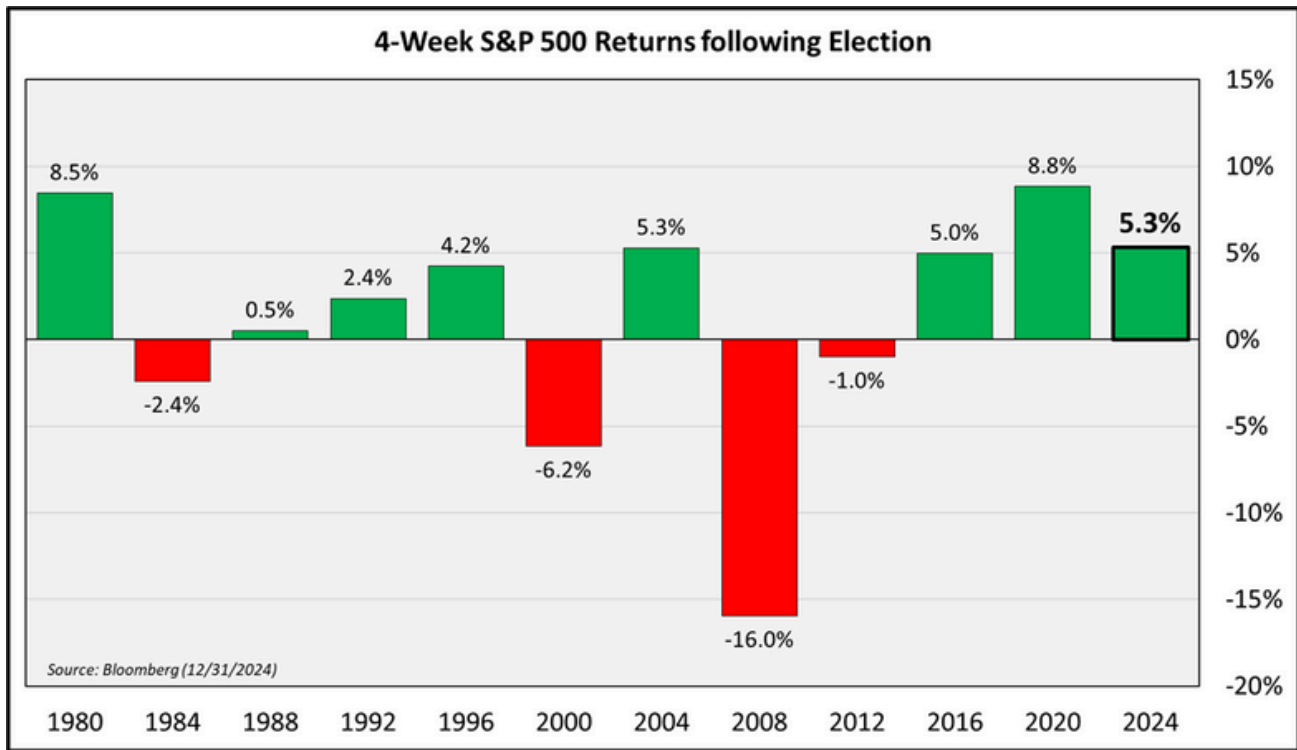
2024 was one of the most significant global election years in recent history. According to research firm Strategas, more than 40% of the world’s population elected new heads of state – the highest percentage over the last 20 years.

The U.S. elections saw a changing of the guard: former President Trump retook the White House and Republicans retained a razor thin majority margin in the House of Representatives (Republicans 220 to Democrats 215 and took control of the Senate (Republicans 53 to Democrats 47).



Source: [CNN Senate election results 2024](https://www.cnn.com/2024/11/05/politics/senate-election-results-2024/index.html) | CNN Politics

The election results appeared to cement investors' hopes for a growing economy fueled by government downsizing, deregulation and tax cuts. The combination of these campaign promises ignited the stock markets' "animal spirits" and the S&P 500 increased +5.3% in the 4 weeks after the election. This tied 2024 as the third-best 4-week post-election increase since President Regan was elected in 1980.



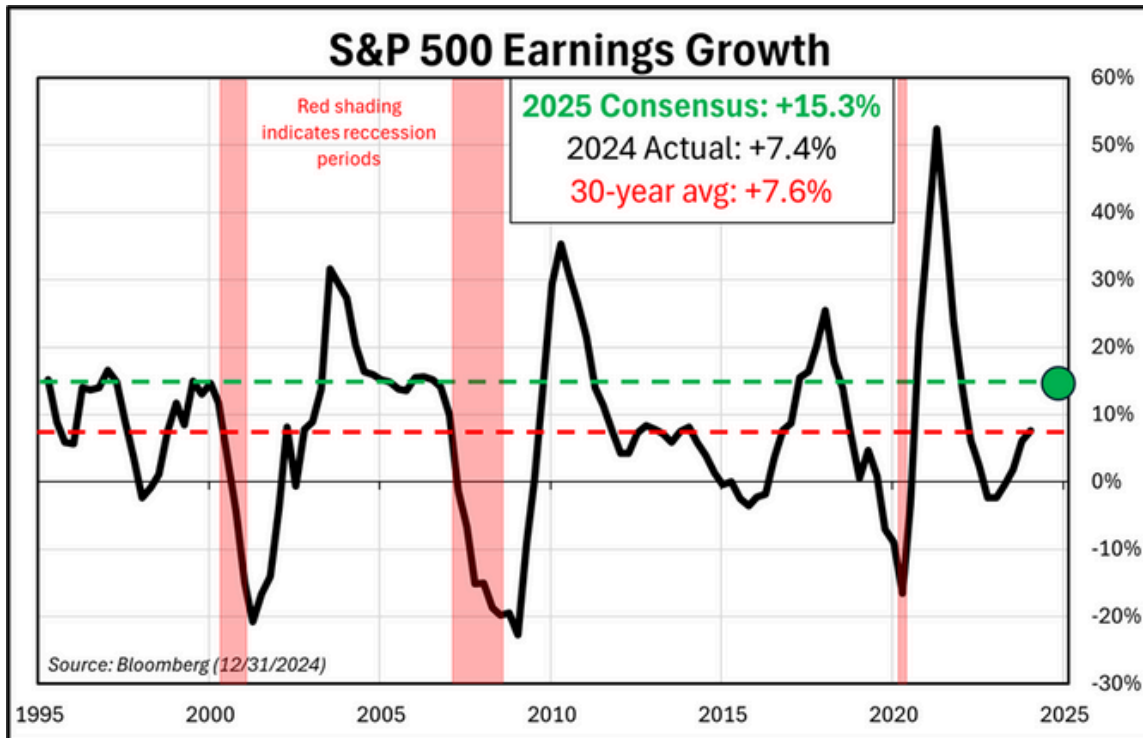
4. Strong Consumers

The U.S. consumer remained remarkably resilient in 2024. Buoyed by relatively low unemployment rates, reasonable wage growth, and moderating inflation, the U.S. consumer continued to be a bastion of strength for the U.S. economy. Real spending growth increased +2.9% in 2024, above its historic average.



5. Corporate Earnings Growth

Although multiple expansion can increase stock prices over the short-term, sustainable increases in stock prices over the long-term require earnings growth. As shown in the chart below, S&P 500 earnings per share (EPS) grew at +7.4% in 2024, slightly below the 30-year average of +7.6%.



This means that much of the stock price growth in 2024 was attributable to increasing stock multiples rather than resulting from earnings growth.

As we observed in the late 1990s, multiple expansion without earnings growth warrants caution. With a new Administration, and the possibility of more business-friendly policies, potential tax cuts and a regulatory friendly backdrop, analysts anticipate the S&P 500 can grow earnings +15.3% in 2025. This level of earnings growth would allow P/E ratios to trend lower if stock prices don't increase significantly in the year ahead.

It should be noted that analysts are notoriously overly optimistic. There are a variety of issues that could prevent a more business, tax and regulatory friendly landscape from forming. Plus, earnings growth of +15% is double the 30-year average.

At DSG Capital Advisors, while we would welcome +15% earnings growth in 2025, we think it appears overly optimistic. While we anticipate that more business, tax and regulatory friendly policies could spur economic growth, and lead to higher-than-average corporate earnings growth, +15% earnings growth is a high hurdle to achieve.

We also anticipate productivity enhancements from AI implementation to support higher than average EPS growth. But we wouldn't be surprised to see corporate earnings growth settle in the high single or lower double digits in 2025, assuming there is no shock to the markets.

We would be remiss if we didn't state that increasing economic growth from more business, tax and regulatory friendly policies is much easier said than done. Our optimism that the new Administration can successfully create this economic boost is tempered by indications that some policies could put downward pressure on economic growth and corporate earnings.

For example, if the new Administration's policies increase budget deficits from tax cuts and/or increased spending, reignite inflation from easy monetary policies, dampen consumer spending through the implementation of large tariffs, or create labor shortages through tighter immigration policies, then the hope for robust economic growth may need to be tempered.

Overall, we expect 2025 to be an interesting and exciting year for the country and in the markets!

DSG Capital Advisors 2025 Preview

What should investors expect to see unfold in 2025? After returning more than 25% in 2023 and 2024, how likely is a third year of +20% returns? In short, not very.

Only seven unique times over the past 100 years has the S&P posted at least +20% total returns 2 years in a row: (1) 1927 – 1928, (2) 1935 – 1936, (3) 1942- 1943, (4) 1954 – 1955, (5) 1975 – 1976, (6) 1982-1983, and (7) 1995 – 1999.

[S&P 500 Total Returns by Year Since 1926](#)

After those seven instances of consecutive 20% returns, there were only four occurrences where the S&P 500 provided positive returns in the third year: 1944 +19.8%, 1956 +6.6%, 1984 +6.3% and 1997 +33.3%.

Amazingly, there has only been one instance over the past 100 years when the S&P 500 rose 20+% three or more years in a row. During the period of 1995 – 1999, the S&P 500 posted +20% total returns five consecutive years: 1995 +37.6%, 1996 +23.0%, 1997 +33.3%, 1998 +28.6% and 1999 +21%.

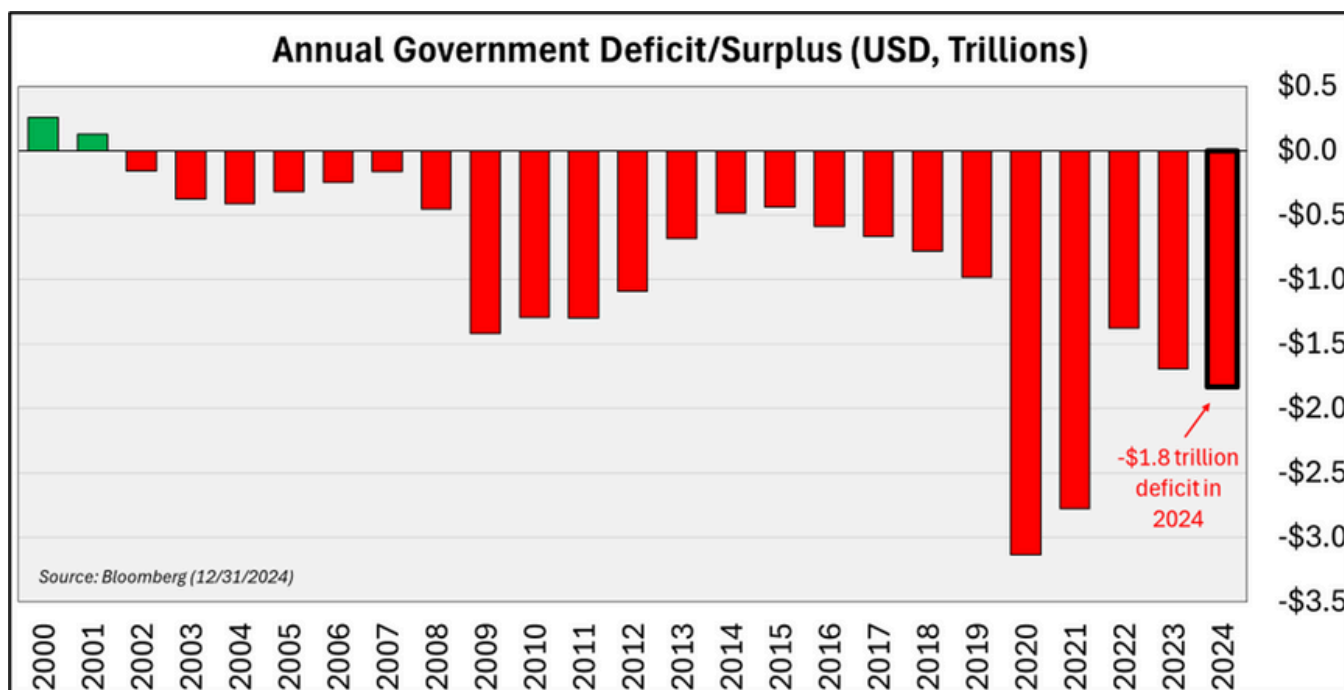
At DSG Capital Advisors, we start 2025 with healthy optimism and believe that, absent unforeseen shock to the markets, conditions are positioned so that the S&P 500 could very well provide positive returns in 2025. But with history as our guide, we think the probability of another year of +20% returns in 2025 is unlikely unless several of the key issues discussed below come into perfect alignment.

Below we examine the key issues that we anticipate will impact markets, as well as asset returns, in the year ahead.

1. The Debt Problem

I must confess that it is hard to start a discussion about being optimistic about the year ahead and then immediately address an existential problem that has been getting worse for the past 23 years. But since all issues pale in comparison to the magnitude of the U.S. debt problem, I feel compelled to tackle the issue right out of the gate. So here it goes...

Every year since 2001, the Federal Government has spent more money than it has brought in. This annual budget shortfall is referred to as the annual “deficit.” Every year, the amount of U.S. debt has grown larger, and the U.S. government needed to borrow money to pay for this funding gap. As shown in the chart below, some years the deficit is much larger than others, but the amount of debt the U.S. has accumulated has been more than 23 years in the making.



In 2024, the U.S. government had a deficit of \$1.8 trillion, meaning it spent \$1.8 trillion more than it made in revenue from taxes and other sources.

By way of comparison, in 2007, the year before the financial crisis, the Federal Government spent only \$161 billion more than it brought in in revenue.

To provide context on the persistency of this issue, the last time the Federal Government had an annual budget surplus was 2001, when George W. Bush became President.

At DSG Capital Advisors, we view the U.S. government debt issue as an American issue, not a political issue.

To illustrate how this problem unfolded over the past 23 years, I am going to use an analogy.

We will use “Bob” as an individual in our example. Bob has a good job and a stable income, but he loves to spend money. In most years Bob receives a modest raise, but he consistently spends more than he makes.

To support his spending habit, Bob uses his credit card. Bob's credit card is unique, however, as it has two features that aren't possible in the world today. First, the interest rate on his outstanding debt balance, or his APR, continuously decreases. This has the impact of disguising the level of Bob's spending, because his interest costs don't increase with his outstanding debt. Second, Bob's credit card has no limit.

Because of these unique features, Bob never pays down his debt, he only pays the interest expense on the debt. Year after year, Bob adds more debt onto his credit card. Because the interest rate continues to go down, he simply continues to accumulate more and more debt.

Bob keeps spending. He becomes addicted to the lifestyle that his credit card affords him. Budgeting never crosses his mind – there are virtually no consequences for spending money that he doesn't have. For 23 years, month after month, year after year, Bob puts more debt on his credit card.

One day, Bob is informed that the interest rate on his credit card will increase. And not only does it increase, the interest rate rises faster than Bob imagines it could. Bob can no longer pay the interest expense on his credit card.

Over the course of 23 years, Bob compiled a debt load that was roughly 6x his annual income. Due to the combination of the size of his debt load, and rising interest rates, the annual interest grows to 20% of Bob's annual income. It looks bad for Bob.

How is Bob going to continue to stay solvent and pay the interest expense on his credit card?

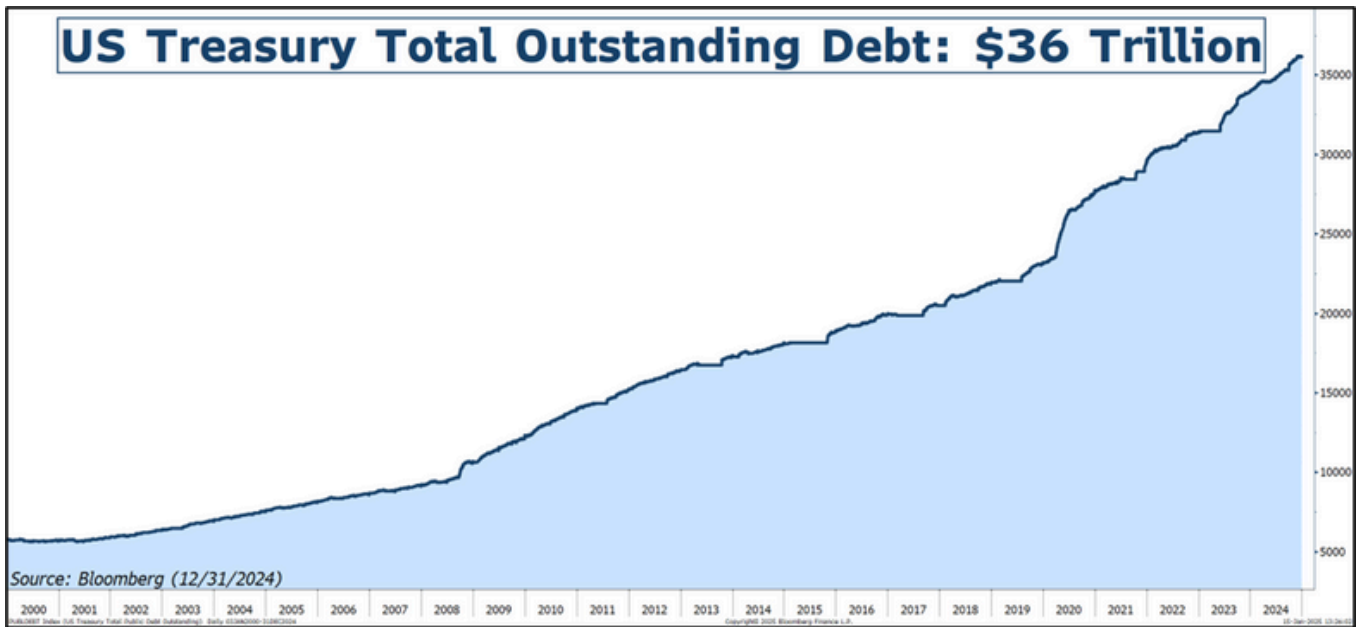
Bob pays for his credit card interest by charging it to his credit card! Remember, there is no credit limit on his credit card. Adding the annual interest expense to his debt causes the amount of debt to grow much faster. Bob is not only using the credit card to support his overspending, but now he is using the card to pay for the interest payment on the growing debt.

Subconsciously Bob starts to grasp the seriousness of his situation. But he remains reassured knowing that as long as his credit card is unlimited, he will never have to pay the outstanding balance down and he will never have to face the financial consequences of 23 years of overspending. So, Bob keeps spending. Until...

One day the credit card company tells Bob his credit card is maxed out and he can't finance his lifestyle on the credit card anymore. What can Bob do?

In this example, Bob is the U.S. Federal Government. To continue spending more than it makes in revenue each year, the U.S. government simply borrows more money by issuing more Treasury bonds. As long as investors continue to buy the Treasury Bonds, there is virtually no limit on the amount of bonds the Federal Government can issue to borrow more money.

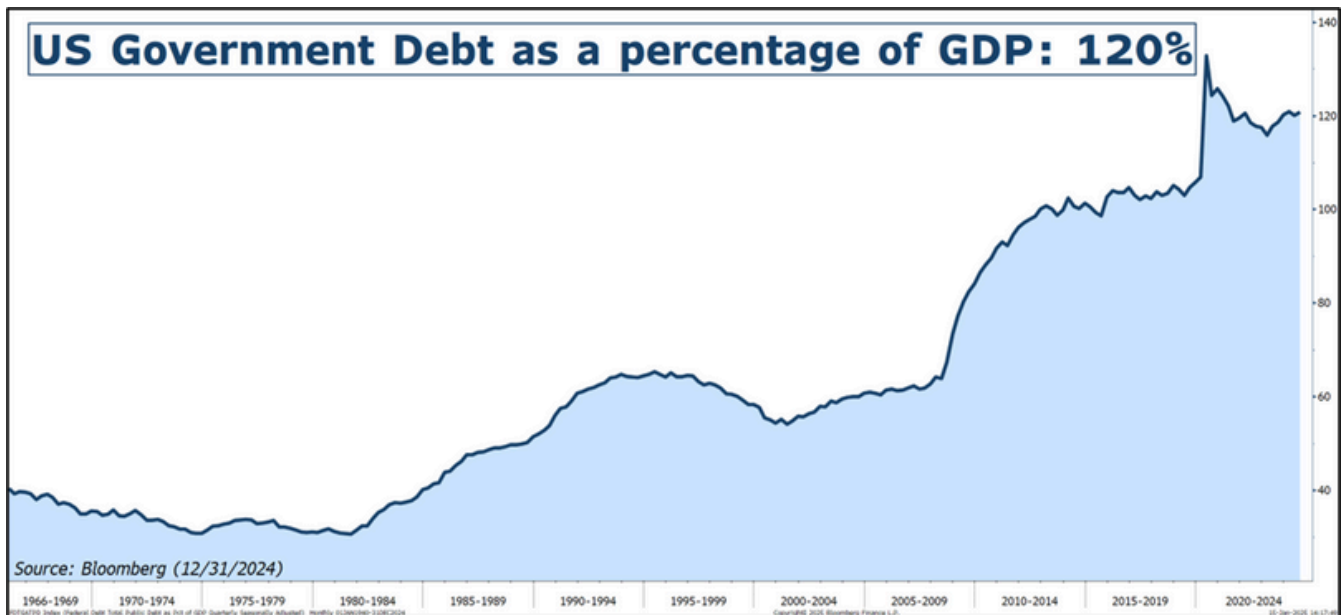
As shown in the chart below, the total amount of U.S. debt now stands at an astounding \$36 trillion. To provide some context, the total level of U.S. Federal debt in 2001, the last year the U.S. had budget surplus, was approximately \$5.8 trillion.



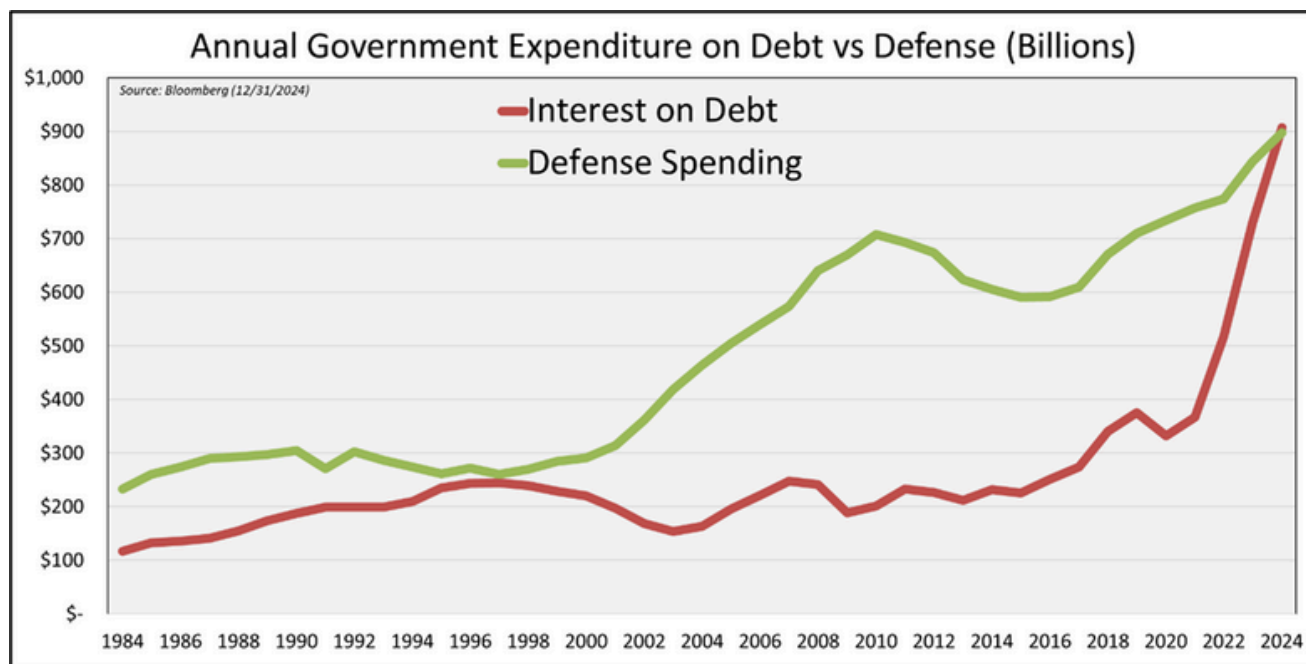
This means the U.S. Federal Debt has risen over +510% in 23 years. In comparison, U.S. total economic growth (real GDP growth plus inflation) grew +177% over the same time period.

Therefore, U.S. Government debt has grown significantly faster than economic output. Over this time period, nominal GDP growth has increased +4.5% per year on average while the Federal debt has grown nearly double at an +8.2% annual rate. This is Bob, in our example spending significantly more than he makes every year.

The total amount of debt as a percentage of the U.S. economic output, as measured by GDP, now stands at 120%. The total amount of U.S. debt is now 7 times larger than annual income. Other than a brief period of time during Covid, this is the highest percentage of debt to GDP in American history.



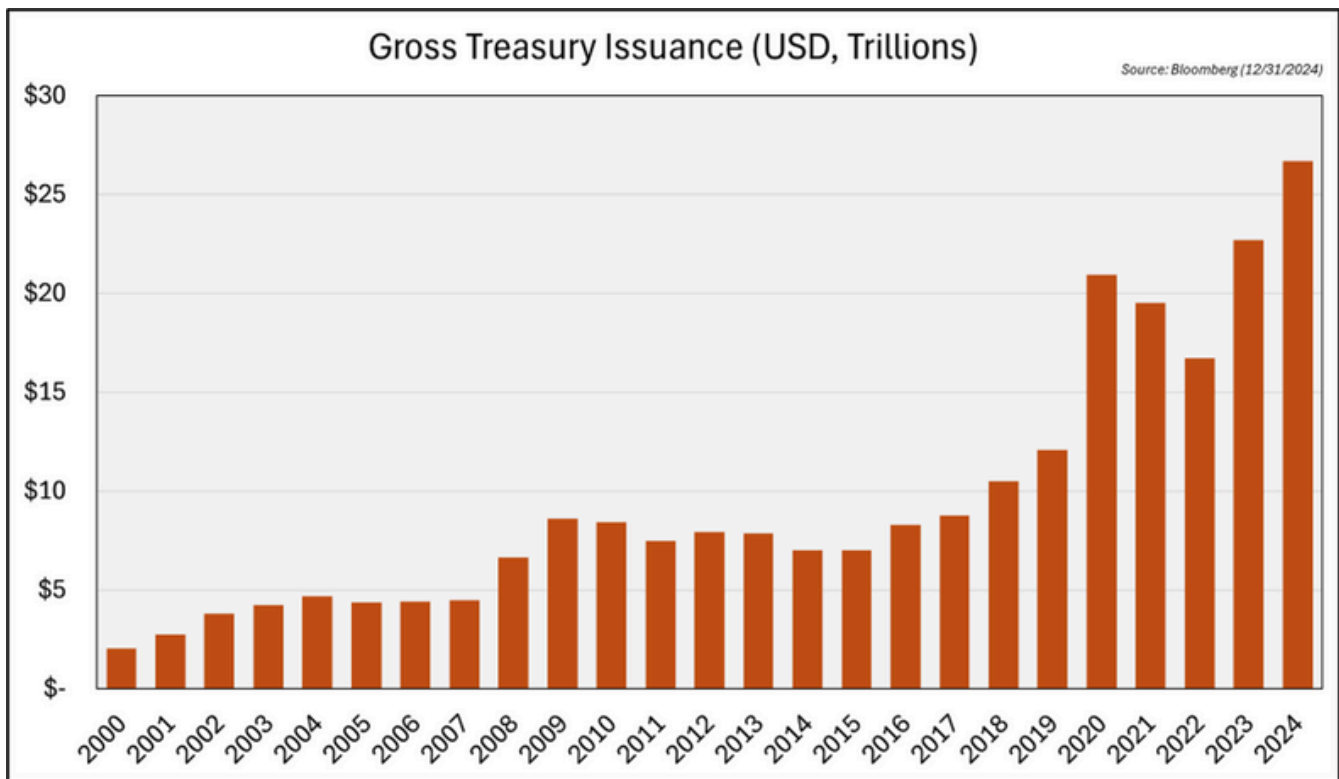
In addition to a growing debt problem, due to the rise in interest rates, the U.S. now has a debt payment problem. As shown in the chart below, the annual interest cost on the U.S. debt has grown from \$200 billion, where it roughly was from 1994 - 2015, to over \$900 billion today. And given the growing amount of debt, this annual cost is only going to rise.



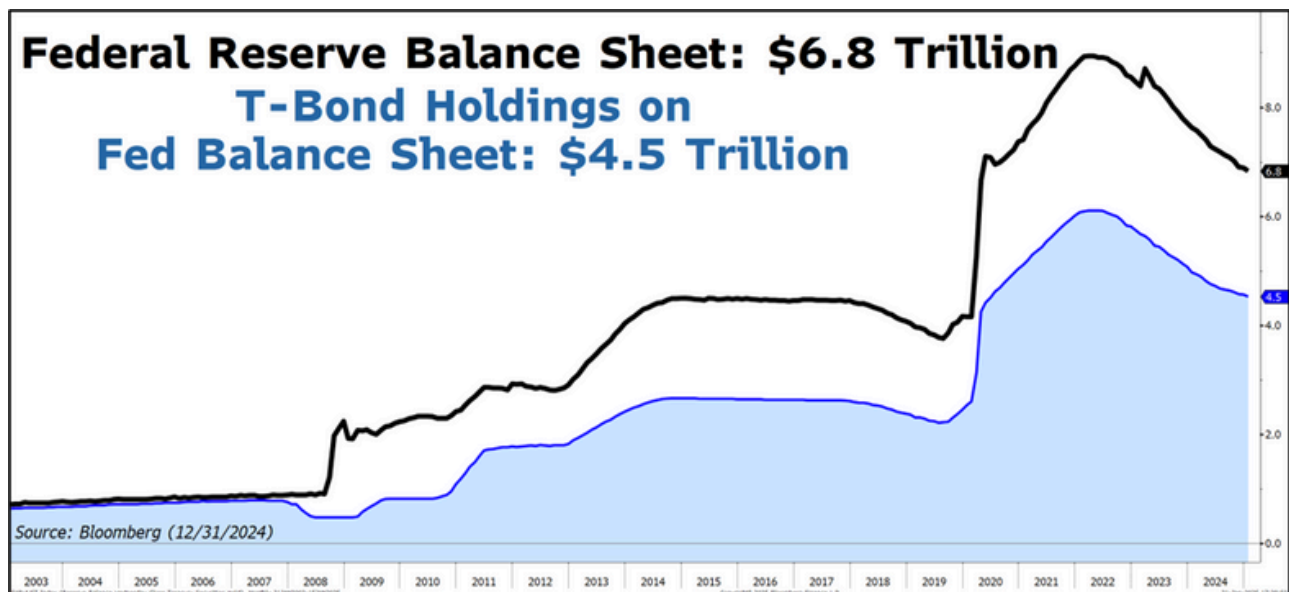
The meteoric rise in annual interest cost is a direct consequence of the Federal Reserve aggressively hiking interest rates in 2022 and 2023.

With total government spending now approximately \$6.8 trillion per year, the over \$900 billion annual cost to pay the interest on the debt now consumes approximately 15% of total U.S. spending. This is more than the total amount of non-defense discretionary spending which is approximately \$870 billion (12%) and recently surpassed total defense spending of \$897 billion (13%).

How does the government pay for all this debt? It issues Treasury bonds which are essentially an IOU from the U.S. government to the holder of the bond where the bond value will get paid back, with interest, at some date in the future. The chart below shows the escalating level of Treasury Bond issuance from 2000-2024.



What is not shown in the above chart is who is purchasing all these Treasury bonds. What many investors don't realize is that over the past several years, one of the most significant purchasers of Treasury bonds to finance the debt is the government itself! That's right, the U.S. Treasury Department auctions the bonds, and then the Federal Reserve purchases those bonds and holds them on its balance sheet.



Now that we have explored the U.S. debt problem, what should investors do about it? At DSG Capital Advisors, we think there are three possible solutions to the U.S. debt problem.

a. U.S. Default on Debt

The first, and least desirable option, is that the U.S. could default on its debt. It should be stated at the outset that the U.S. Federal Government has never defaulted on its debt. If it were to default, the U.S. would inform investors that it is not able to pay either the interest on, or possibly the outstanding balance, of its debt.

The result of the U.S. defaulting on its debt would be catastrophic, not only for the U.S. but for the rest of the world. As the global reserve currency, a U.S. default would send shock waves through every part of the global financial system. Accordingly, defaulting on its debt to solve the debt problem appears both untenable and unlikely.

b. Austerity Measures

The second option would be to enact austerity measures to drastically reduce spending. Given the size of the projected annual deficits, in addition to the total amount of outstanding debt, it is unlikely that reasonable austerity measures could turn the tide on the U.S. debt.

As previously discussed, the 2024 U.S. budget is approximately \$6.8 trillion while total revenues were only \$5 trillion. This means austerity measures would need to fill a \$1.8 trillion gap.

In the 2024 budget, mandatory spending on programs such as Social Security, Medicare and Medicaid cost the U.S. government almost \$3 trillion per year. Unfortunately, specific taxes to fund these programs only generated \$1.7 trillion in revenue.

The combination of all non-defense discretionary spending (social welfare, education, transportation, veterans' health, law enforcement and justice, science, etc.) totals roughly \$870 billion per year. Annual defense spending is close to \$900 billion annually.

Enacting meaningful government austerity measures would require massive alterations to core Federal programs and spending...much larger than what we anticipate the Musk's DOGE committee will uncover.

Additionally, in the current climate, U.S. politicians' appetite to ask American citizens to "go without" doesn't appear plausible. Politicians know this would be political suicide. Put simply, the current American culture unfortunately does not appear receptive to this type of request.

At DSG Capital Advisors, we think the only practical way that an austerity measure would work is if it was "forced" on both politicians and the American people and there was no other choice. How would this occur?

It could occur if Treasury bond investors required a larger term premium to be compensated for the perceived risk associated with the sheer size of the U.S. debt. Under this scenario, "bond vigilantes" would, in essence, compel Congress, the Administration and the American people to address the debt problem. The threat would be that if the problem is not addressed, "bond vigilantes" would demand higher interest rates on Treasury bonds to such a level that there would be no choice but for the government to concede.

At DSG Capital Advisors, we think it may be just a matter of time before the “bond vigilantes” step into the Treasury bond market and demand higher interest rates on U.S. Treasuries. As we have previously written, there are some initial signs that this could be emerging.

Although it would take decades to work through the current debt problem, and it would change the way of life for Americans as we now know it, spending austerity could one day be forced upon us... and the result would not be pleasant.

c. Hybrid Approach: Reduce Spending, Increase Revenues and Inflate Away Debt

The third, and in our opinion, most plausible option, is for the U.S. Government to take a hybrid approach that involves decreasing spending and increasing revenues (i.e., through higher taxes and tariffs) to reduce the size of the annual budget deficits going forward.

Once the deficits are contained (again, easier said than done), then government policies could be enacted to increase economic growth, and as a result inflation, and inflate away the debt problem.

We have written for years about how inflation is a powerful force that eats away at the value of assets and the purchasing power of savings. This is the downside of inflation. The positive aspect of inflation is that it does not care what it erodes the value of...even debt.

By limiting the size of the annual deficits for a sustained period of years and allowing inflation to eat away at the enormous amount of U.S. debt, the U.S. could, over many years, put itself in a more stable and sustainable financial position.

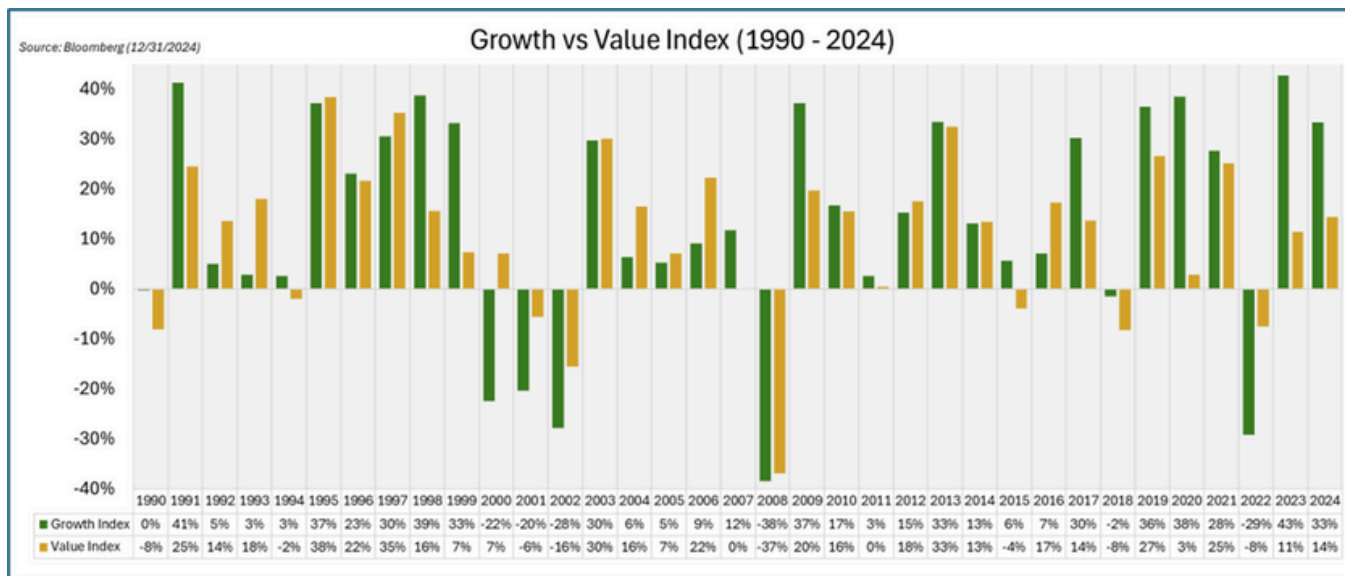
How to Invest Assets under Hybrid Approach of Solving the Debt Problem

a. Growth Stocks

If the U.S. chose to let inflation eat away at the cost of its debt, what could investors do to protect their assets? In a policy that attempts to spur economic growth by creating higher economic output, wages, interest rates, bond yields and inflation, we think investors should consider investing in assets that “outgrow the problem.”

In this scenario, we would encourage investors to consider investing in high growth companies whose revenues and earnings provide *real growth*, meaning they grow faster than the rate of inflation. By doing so, investors could provide a hedge against elevated inflation levels.

In periods of accommodative monetary policy and large fiscal stimulus, U.S. growth companies have historically outperformed value companies. As shown in the chart below, since the U.S. began “deficit” financing its way out of financial problems during the financial crises of 2008, growth companies have largely outperformed value companies. Additionally, growth companies have typically performed better in periods of elevated inflation.



A word of caution is required when investing in growth companies, especially in the current environment. The higher the P/E multiple of a company (growth stocks often have higher P/E multiples than value companies), the more significantly it can be impacted by rising interest rates.

Internally at DSG Capital Advisors, we refer to high multiple P/E companies as “long duration” companies. This is because just like long-duration bonds, it takes longer to earn your investment back with a longer-duration asset. As a result of the discounting mechanism associated with long duration, or higher P/E stocks, growth companies are often more severely impacted by rising interest rates.

As such, we believe that an added dose of prudence is warranted for investors who are considering investing in growth companies following two consecutive years of 25%+ returns for the S&P 500. We would advise investors to do their homework and be very selective in the growth stocks they invest in.

Specifically, we do not believe investing in growth companies at “any price” will be rewarded over the long-term. Rather, we think investors should look for companies who offer growth at reasonable valuations. These are often companies whose PEG ratio, or Price/Earnings ratio divided by the growth rate, is attractive.

With a current P/E of 21.7x and expected earnings growth of 15.3%, the S&P 500’s PEG ratio is currently 1.4x. This means that investors are willing to pay 1.4 times P/E per percentage of growth. This is below the 10-year average of 1.9x.

But the rationality of the valuation is driven by the projected growth rate. As previously discussed, if stocks are not able to grow earnings at the +15.3% projected rate in 2025, but revert closer to the +7.6% historical average, then we believe current stock prices would be too elevated and stock price declines could occur. And remember, the higher the multiple stock, the larger the potential decline.

b. Real Assets

In addition to growth stocks, we think investors should consider real assets that have historically increased in value with inflation. Examples of real assets include real estate and select commodities. Additionally, assets that provide a hedge against falling currency values, such as gold, could be an attractive investment option.

c. Caution with Bonds

We would be cautious about investing in assets that “lock-in” a fixed rate of return over longer periods of time. We think these assets would not be able to maintain their purchasing power in periods of higher inflation and could be susceptible to declines.

2. The New Administration

As we enter 2025, President Trump will be sworn into office and the Republicans will have majority control over both the Senate and the House of Representatives. The incoming Administration will be faced with a variety of issues ranging from budget deficits, government spending, tax policy, regulation, and immigration.

These policy decisions could have significant ramifications on practically every economic and investment issue including asset performance, sector performance, interest rate policy, government debt levels, Treasury bond yields, inflation, immigration policy, and the labor market.

It appears that the cornerstones of initial policy planning for the new Administration will revolve around the extension of the 2017 Tax Cuts and Jobs Act (TCJA) tax breaks for individuals and corporations. In a nutshell, the TCJA targets cuts in nondefense discretionary spending, deregulation, immigration reduction, and foreign import tariffs.

A full extension of the TCJA could lower taxes for businesses and consumers by an average of about \$550 billion per year through 2028, while partial TCJA extensions would lower taxes by roughly \$350 billion per year through 2028.

[The-Cost-and-Distribution-of-Extending-Expiring-Provisions-of-TCJA-01102025.pdf](#)

The impact of the newly created Department of Government Efficiency (DOGE) is unclear. While Elon Musk has made significant headlines, the advisory body has limited executional abilities and appears it would operate primarily by presenting ideas to the U.S. Congress.

More tenured investors may remember Ronald Reagan’s “Grace Commission” of 1982; a presidentially directed investigation to reduce Federal government waste and inefficiency led by the rallying call to “Drain the Swamp”. While Congress largely ignored the Grace Commission’s policy recommendations, the findings appeared to focus congressional attention on expanding deficits and government waste.

We think DOGE could play out similarly as the Grace Commission: ineffective at driving meaningful policy changes, but perhaps a starting point for legislators to recognize the true extent of the spending problem.

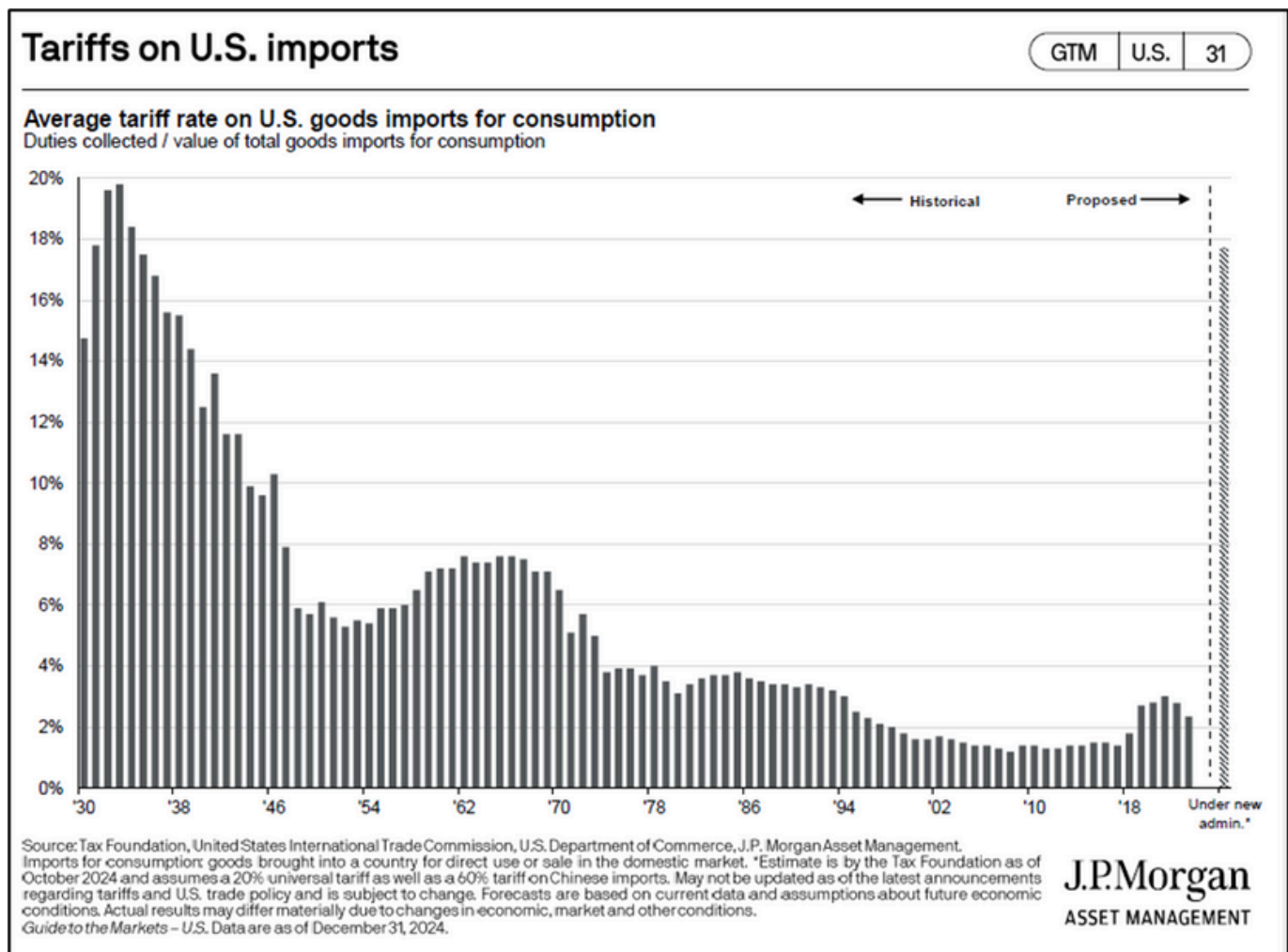
[President’s Private Sector Survey on Cost Control \(Grace Commission\) | Ronald Reagan](#)

Immigration reform under the new Administration is equally unclear in terms of both “how” and “how much.” While the magnitude is unknown, we believe that the incoming Administration will support immigration policies for skilled workers such as the H-1B visas and enact policies that allow for the planned manufacturing renaissance in the U.S. to unfold. If this occurs, it could concurrently put downward pressure on U.S. working age population growth.

The Trump Administration's platform prominently emphasized reducing government regulations and cutting red tape. A significant focus of these efforts is expected to be the energy sector, with initiatives such as loosening restrictions on where oil companies can drill, withdrawing from the Paris Climate Agreement, and rolling back regulations on vehicle emissions. Similarly, the banking industry is poised for deregulatory measures, including scaling back the "Basel III endgame," lowering capital requirements for financial institutions, and appointing a more mergers and acquisitions friendly FTC chair.

If these deregulation efforts materialize, we anticipate a boost in domestic oil production which could lead to lower oil and natural gas prices. Additionally, we would expect to see expanded bank lending, and a surge in M&A and IPO activity.

Although President Trump has floated the concept of 20% tariffs on U.S. imports, many analysts think this is more of a negotiating tactic than firm policy. As shown in the chart below from JP Morgan, 20% tariff rates haven't been implemented since the 1930s.



Even if 20% tariffs were implemented, the most optimistic revenue projections indicate that total net revenues collected from the tariffs would be approximately \$225 billion annually. Given the U.S.'s 2025 projected spending budget is \$6.8 trillion, and forecasted revenues are \$5 trillion, the projected increased revenue from tariffs would only fill about 12% of the 2025 deficit.

[Trump Tariffs: Revenue Estimates | Tax Foundation](#)

In our view, the most realistic policy result is that the new Administration lowers taxes, provides minor spending cuts, deregulates energy production and banking, reduces net working-age population growth, and applies limited-scope tariffs.

On the positive side, this policy mix would likely be stimulative for nominal economic growth. Lower corporate taxes and deregulation should boost corporate profitability, while workforce reduction and personal tax breaks should drive both wage growth and take-home pay higher for households.

Targeted tariffs and deregulation could also end up driving growth for a U.S. manufacturing base that has seen output stagnate over the last 10 years and create domestic labor jobs.

The mix is also likely net positive for stock prices; with higher nominal growth translating into faster earnings growth for corporations.

The downside is that this policy mix could add to the enormous debt problem and debt servicing issues previously discussed. This outcome could push Treasury yields higher and increase borrowing costs for consumers and companies alike.

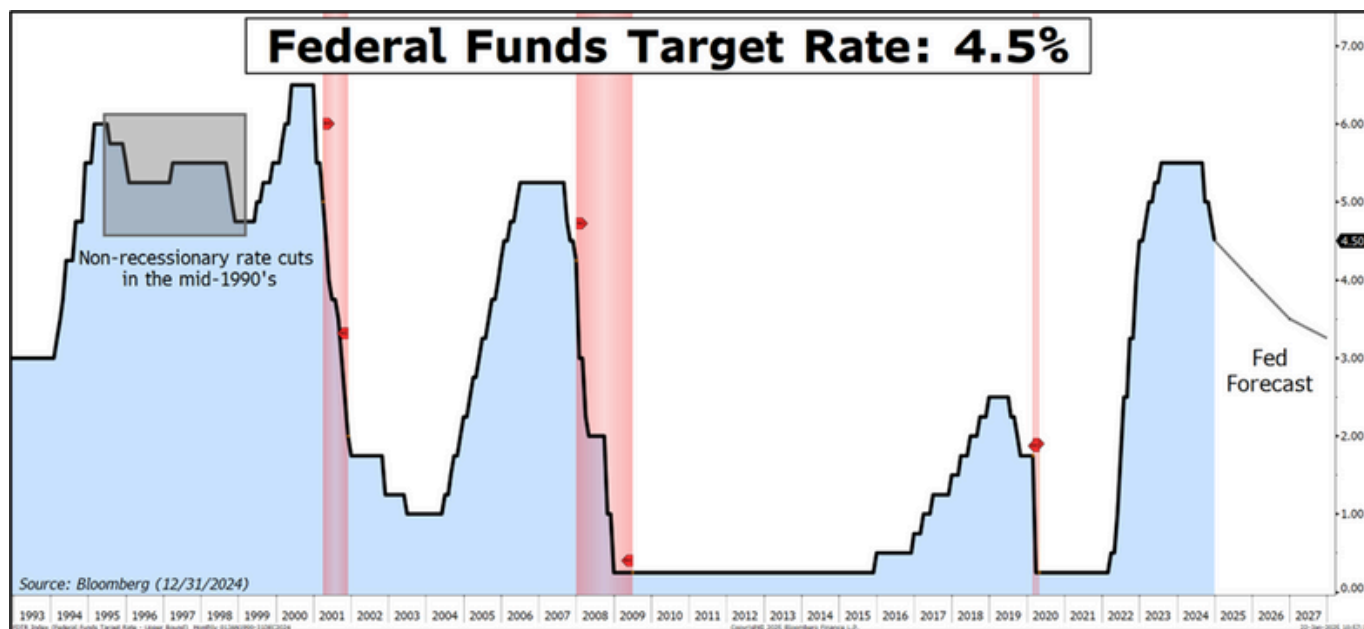
Additionally, higher nominal growth could also translate to higher inflation, especially if a stimulated economy sees surging wage growth. If the economy is overstimulated, the Federal Reserve could be required to raise interest rates to keep inflation in check.

3. The Federal Reserve & Interest Rates

As has become commonplace in recent years, the Federal Reserve's monetary policy will continue to have meaningful ramifications for financial markets.

At the Federal Reserve's December 2024 meeting, it cut interest rates by 25 basis points to a range of 4.25% – 4.5%. Following the 1% rate reductions in the final four months of 2024, the Fed signaled to investors that it is planning to keep rates steady entering 2025.

Currently, both the Federal Reserve and financial markets are forecasting two rate cuts in 2025. If this path to interest rate policy “normalization” plays out as projected, interest rates would end 2025 with a target range of 3.75% - 4%. As seen in the chart below, the last time the Federal Reserve was this judicious in cutting interest rates following major interest rate increases was the mid-1990s.



As illustrated in the chart above, the Federal Reserve frequently follows significant rate increases with significant rate decreases. The Fed has historically demonstrated a pattern of raising interest rates to slow down an overheated economy. As economic activity subsequently slows, the economy falls into a recession. The Federal Reserve then aggressively cuts interest rates to once again stimulate the economy. It is a vicious cycle.

To wit, a recession has followed 8 of the last 11 Federal Reserve policy tightening cycles since 1965. Of the 3 hiking cycles that didn't result in a recession, 2 were considered “no landing” periods as the Federal Reserve did not tighten rates significantly.

It should be noted that not all recessions are caused by the Federal Reserve. The pandemic recession in 2020 is an example of external forces that created a recession rather than the Federal Reserve.

In a paper published by former Fed Vice Chair Alan Blinder, as illustrated in the chart below, Blinder postulates that just 3 of the 11 cycles saw true hard landings driven by Federal Reserve policy. Blinder goes on to classify 2 “softish” landings where the economy experienced only a mild recession, and 3 more hard landings that were caused by external factors.

The Eleven Monetary Policy Tightenings since 1965

	Dates	Total basis points (effective rate)	Inflation two years later	Landing hard or soft?
1	Sept. 1965–Nov. 1966	174	Higher	Quite soft—but was it a landing?
2	July 1967–Aug. 1969	540	Lower	Softish
3	Feb. 1972–July 1974	962	Higher	Hard
4	Jan. 1977–Apr. 1980	1,300	Lower	Hard
5	July 1980–Jan. 1981	1,005	Lower	Hard
6	Feb. 1983–Aug. 1984	313	Lower	Very soft—but was it a landing?
7	Mar. 1988–Apr. 1989	326	Higher	Likely would have been a soft landing
8	Dec. 1993–Apr. 1995	309	Lower	Soft
9	Jan. 1999–July 2000	191	Same	Softish
10	May 2004–July 2006	424	Higher	Hard—but not due to Fed
11	Nov. 2015–Jan. 2019	228	Lower	Hard—but not due to Fed

[blinder-2023-landings-soft-and-hard-the-federal-reserve-1965-2022.pdf](#)

Whether or not the Federal Reserve is “responsible” for recessions, it is undeniable that recessions following Fed hiking cycles are the most frequent outcome. Just one of eleven hiking cycles is considered to have been a true soft landing – the 1993 – 1995 cycle.

At present, it appears the Federal Reserve is on track to negotiate another fabled “economic soft landing.” If it accomplishes this rare feat, and the U.S. economy does not fall into recession, then the Federal Reserve may need to only cut interest rates minimally to bring them to a “neutral” rate. This would enable economic activity to grow without the need for further rate cuts, as occurred in the 1993 – 1995 “soft landing.”

If the Fed can continue to successfully balance monetary policy such that economic output continues to grow without requiring additional rate cuts (or rate hikes), then the conditions could be in place for the U.S. to address its debt problem.

Of course, if the economy starts to run “too hot” in 2025, the Federal Reserve could be required to raise interest rates to keep inflation in check. This would again be reminiscent of the late 1990s when interest rates were raised aggressively, then cut modestly, only to be raised again.

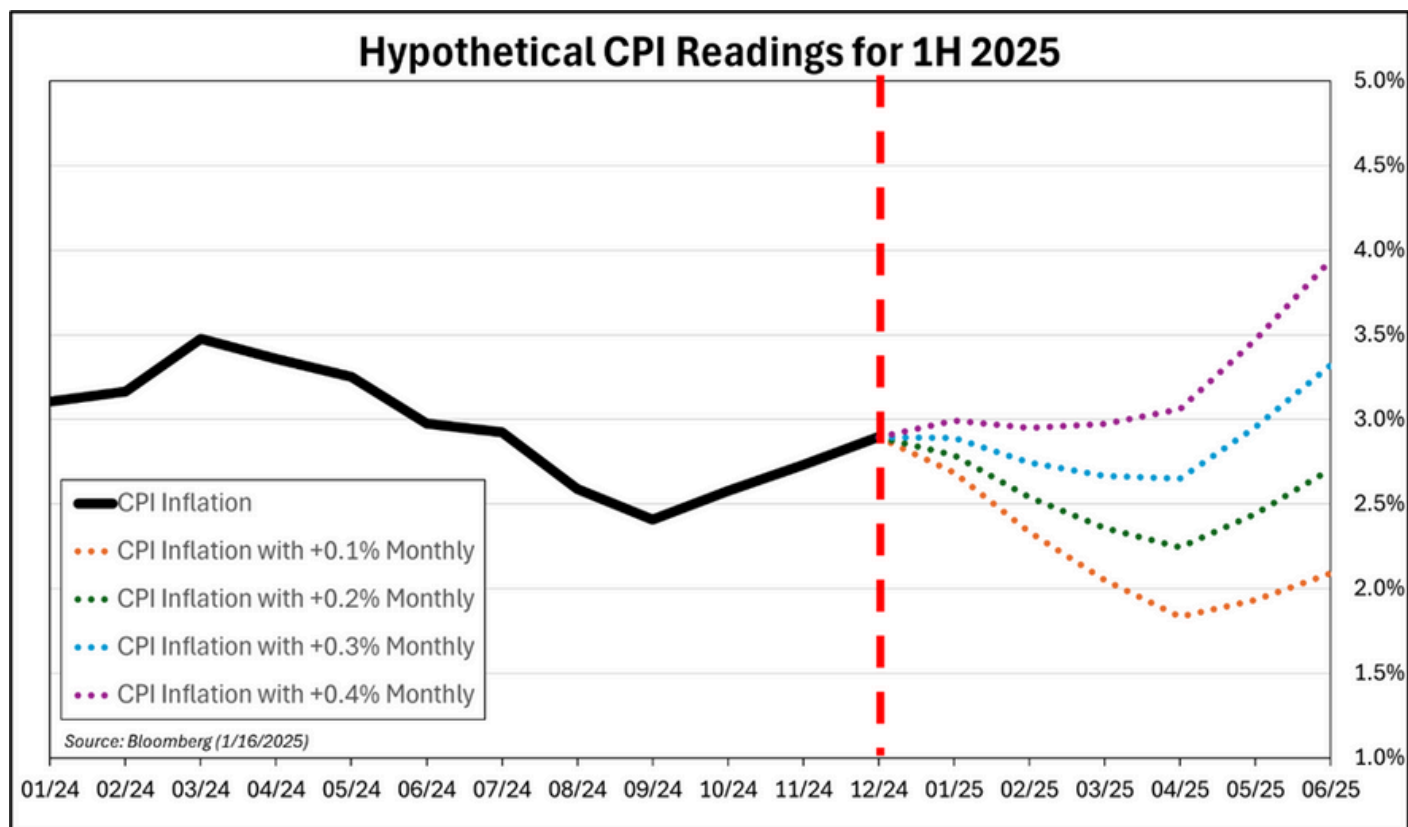
All told, it seems the Federal Reserve deserves credit for the deft monetary policy navigation following self-admitted mistakes in 2020 and 2021. After which, the Federal Reserve subsequently raised rates further and faster than anyone expected, stayed resolute through the worst year for stocks since the 2008 financial crisis, smoothly navigated a banking scare, held rates “higher for longer,” and then delivered a series of rate cuts -- all while driving inflation lower and keeping labor markets healthy.

Round of applause aside, it is probably still too early to deliver verdicts on recent policy with any sort of finality. The daunting task of steering the behemoth U.S. economy through a series of never-ending curveballs requires vigilance, foresight and a healthy dose of luck.

4. Inflation

After rising above 9% in July 2022, consumer inflation, as measured by CPI, ended 2024 at 2.9%. For the first time since the pandemic started, the annual rate of inflation was below 3%, and significantly below the 3.4% of 2023, 6.5% of 2022, and 7% of 2021.

As a result of the “base effect,” which is simply the dropping of data more than 12 months old, **it appears that CPI will remain below 3% for the first quarter of 2025.** The table below shows possible paths for CPI in 2025 given various monthly readings. While inflation should not be a concern in Q1 2025, investors hope that new economic policies won’t reignite inflation to undesired levels as we navigate our way through the year.



As discussed previously, given the size of the U.S. debt problem, we think maintaining inflation at a slightly higher rate may not be a bad idea. Rather than forcing inflation down to the Federal Reserve’s 2% target, why not allow the economy to grow and allow inflation to grow with it?

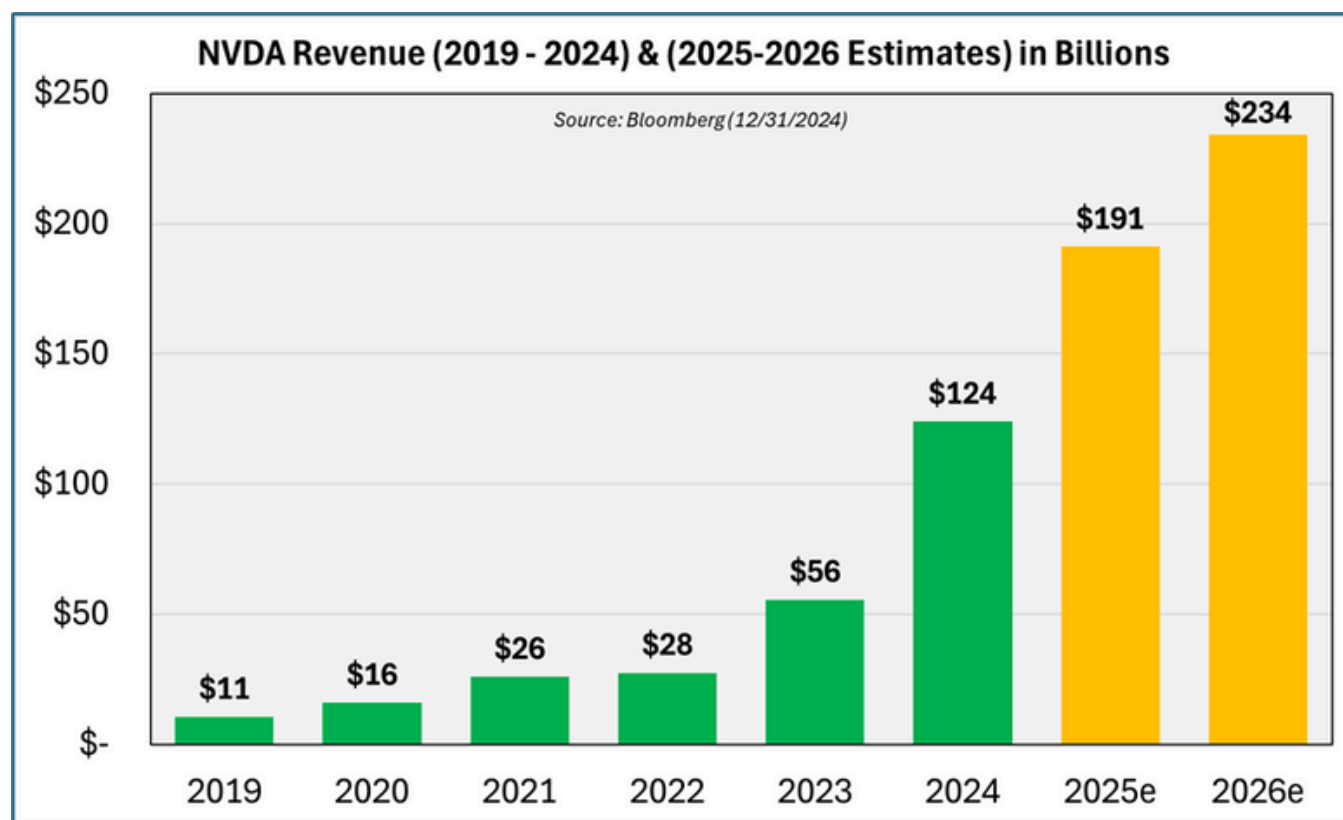
Of course, we are not suggesting that inflation should be allowed to rise unabated as it did following the pandemic driven policies. However, we opine that a stabilized inflation rate closer to 3% may be what the US economy needs to help address the debt problem.

5. AI – Transitioning from Build Out (semis) to Adoption (software)

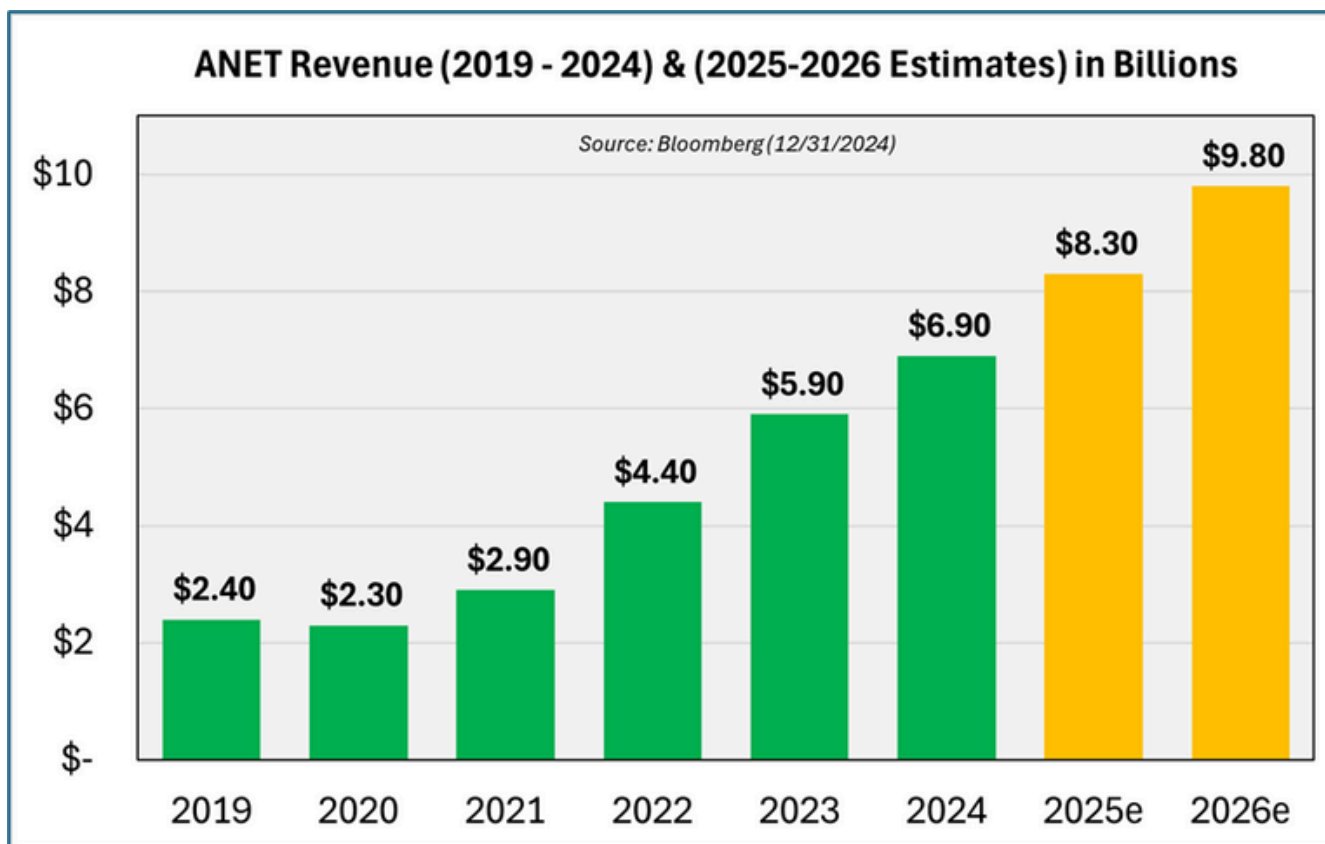
Over the past 2 years, we have dedicated a significant amount of time and effort analyzing and writing about the impact of Artificial Intelligence on stock prices. As addressed in the 2024 review, we have labeled 2024 as the “AI build out phase” where the Magnificent 7 and other large technology companies spent hundreds of billions of dollars purchasing semiconductor chips and other products to scale for AI implementation.

Below we have provided charts showing revenue growth for three of the companies that we have invested in and that have benefited from the “build out” phase of AI development. Each of these charts displays the dramatic impact that AI build out has had on these companies’ revenue growth.

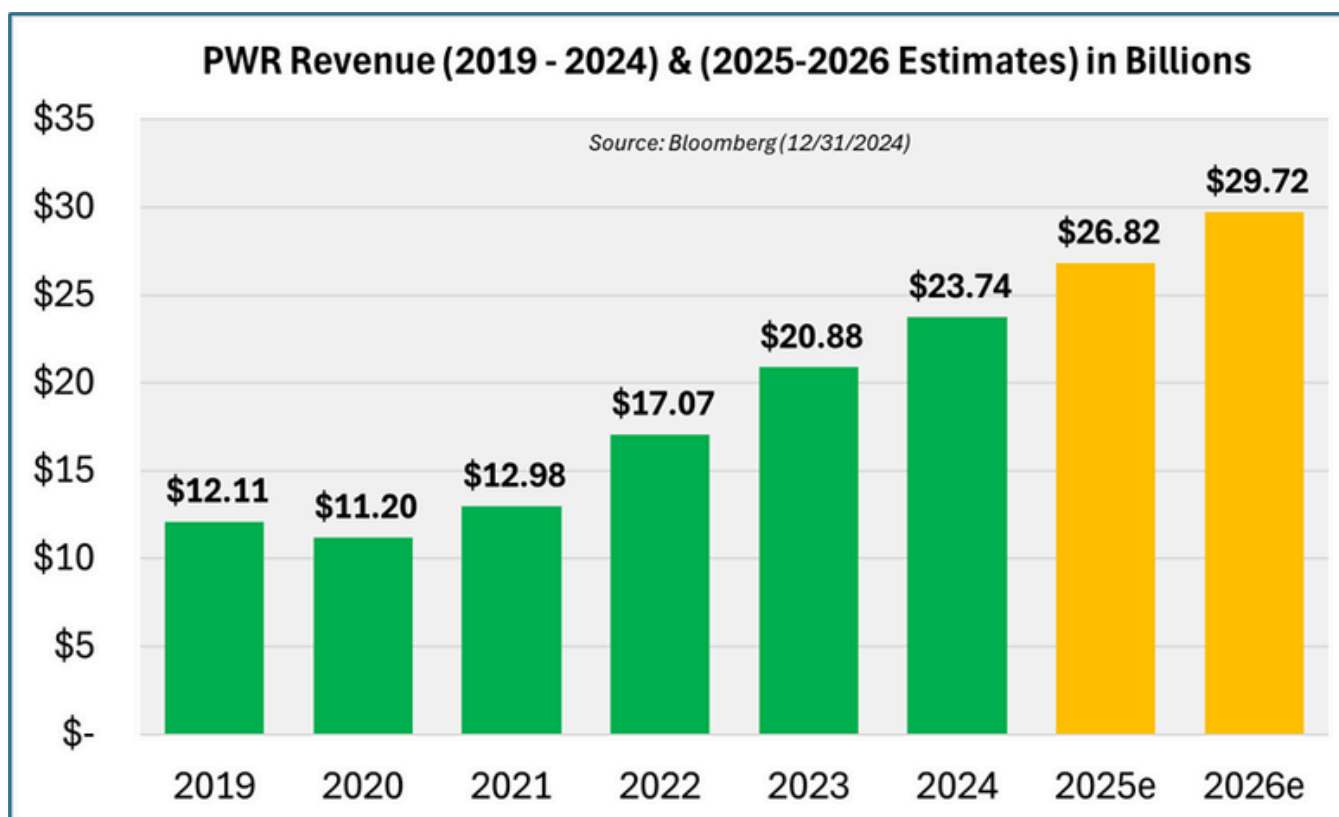
Nvidia (NVDA): Chip System Design



Arista Networks (ANET): Data Transmission for Large Data Centers



Quanta Services (PWR): Infrastructure Solutions for Energy Systems



a. Similarities between current times and the late 1990s

At DSG Capital Advisors, we think it is important for investors to understand that we do not think that the “AI build out phase” mirrors the technology bubble of the late 1990s. As shown in the charts above, companies supplying semiconductors, data center systems, power controls, etc. are generating actual revenues that, in many cases, have grown exponentially.

We believe the next phase of AI development will be what we are labeling as the “Adoption Phase.” We think it offers investors many exciting opportunities. But we also believe it could pose a key risk – speculation. Due to this risk, we will be analyzing companies closely.

As AI infrastructure continues to mature (which we anticipate will take several more years to complete), it will be up to individual companies to leverage AI technology to increase productivity, efficiency and profitability.

As we witnessed in the late 1990s, we anticipate that there will be some companies that tout the idea of their system capabilities, but they will be unproven and will not possess the requisite revenue growth. Similar to what we witnessed in the 1990s, we anticipate that some companies may see an influx of capital based simply on an idea or concept.

We think these unproven accomplishments could catch some investors off-guard and result in a loss of capital. As we have done throughout our history, we prefer to invest in high-quality companies with proven track records and “defensible moats” that enable them to grow revenues and profits over time.

b. More than technology companies will benefit from AI

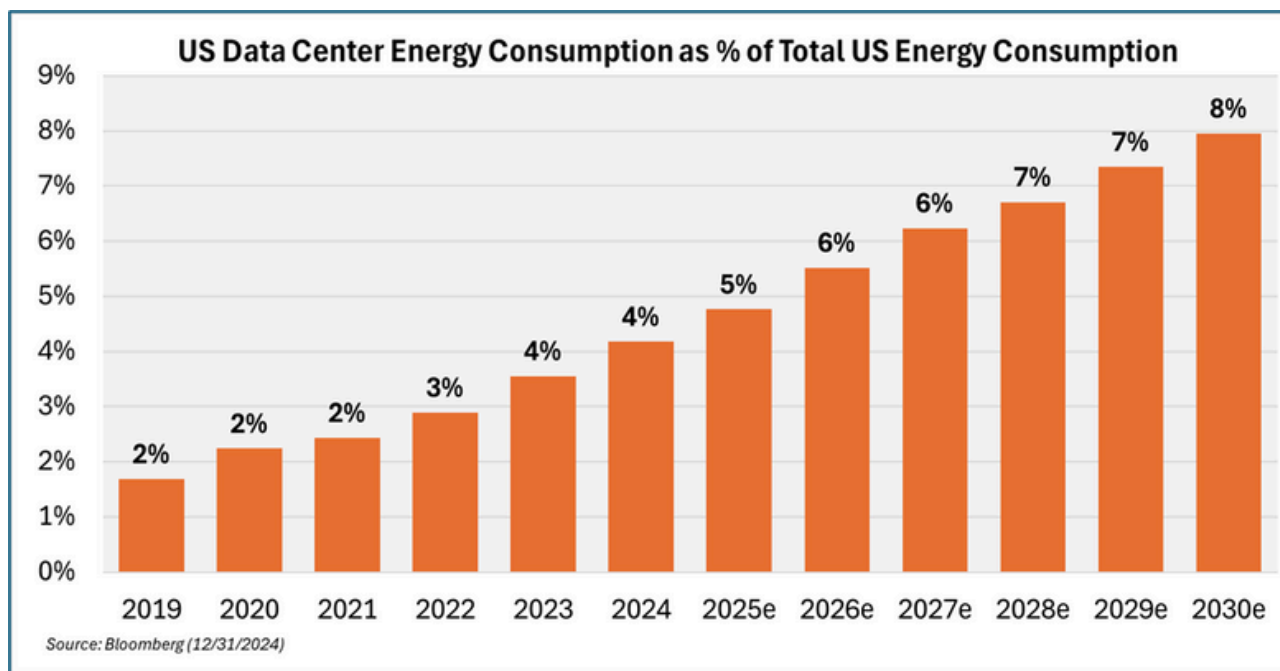
The economic implications of AI extend beyond technology companies. Its ripple effects could enhance productivity across the broader economy, driving revenue and sales growth in adjacent sectors like manufacturing, logistics, and healthcare.

For example, healthcare companies are deploying AI to accelerate drug discovery and optimize clinical workflows, while manufacturers leverage it for predictive maintenance and supply chain management. Identifying companies that are on the forefront of leveraging AI to enhance efficiency and cut costs will be a focal point for investors while the technology integrates into the economy.

c. AI and the need for power generation

One subsector of AI build out and adoption that we have been analyzing over the past year is the energy production that is required to power the AI infrastructure and implementation. Massive amounts of power are needed to build and operate the data centers that house the advanced computing technology.

Below is a chart that shows the growing percentage of U.S. data center energy consumption as a percentage of total U.S. energy production. As you can see, data center usage is anticipated to double from 2024 to 2030.



Hedge funds and institutional investors have increasingly turned to unconventional solutions, such as buying stakes in nuclear power plants, to ensure steady energy supplies. This trend highlights the growing intersection of energy and technology, where economic growth and industrial innovation rely heavily on scalable and sustainable energy sources.

At DSG Capital Advisors, we continue to analyze companies that have proven track records in the build out and implementation phase, but we are also looking for companies that can help fill the large energy consumption needs of these companies.

6. EPS Growth and DSG Capital Advisors Investment Process

While we discussed EPS growth as it relates to AI, growing revenue and earnings are the lifeblood of any company.

At DSG Capital Advisors, we often refer to our data driven analytics research process. Put simply, we believe being data dependent allows us to cut through the noise of financial markets, helps prevent us from being caught up in the volatility of daily headlines, and unlock durable insights that we can use to benefit our clients.

To accomplish this, we have built computer programs and algorithms that scan the largest 1,000 U.S. companies constantly and analyze over 500,000 data points.

Our process begins with our Quality algorithm that generates a quality score for each company. The algorithm analyzes 10 independent metrics such as free cash flow, return on invested capital, asset turnover and debt. This data provides us with a clear picture of each company’s capital efficiency and debt intensity. Our algorithm then ranks each company’s quality score across the universe of the 1,000 largest companies in the U.S.

To analyze a company's growth history and trajectory, we examine revenue, EBITDA, and EPS growth over the past 5 years. We normalize and compare the growth using standard deviations to the universe of 1,000 companies, the industry that the specific company resides in, and the company itself.

We conduct the same process for valuation as we do for growth.

Finally, we condense the 500,000 data points into 43 detailed data groupings and then refine down to 18 unique scores that provide us with a quantitative analysis of a company's quality, growth, valuation and stability.

Once we have developed our quantitative blueprint of a company, we use a formulaic process to identify companies that meet our stringent quality, growth, valuation and stability thresholds.

We then conduct a qualitative analysis on targeted companies to see if there are qualitative factors to further inform our opinion on a company.

Finally, we perform technical analysis on companies that meet our quantitative and qualitative criteria to determine when to purchase or sell a company.

The above process is the compilation of approximately 15,000 hours of work by the DSG Capital Advisors investment team, past and present. We are currently working on the fifth version of this process in our quest to incrementally obtain increased accuracy and efficiency of our process.

Over the past decade, this process has been a labor of love. People may question the rationality of spending this amount of time, effort and brain power to develop and constantly refine this process. However, I simply don't know any other way to provide better risk adjusted returns for our clients.

At DSG Capital Advisors, we look forward to the year ahead and are thankful to our clients for the continued trust and confidence they place in us every day

Best wishes in the new year!

Denver

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Compliance Date: 01/22/2025