NEW REPUBLIC PARTNERS

MARKET COMMENTARY

Q4 2024

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Market Commentary

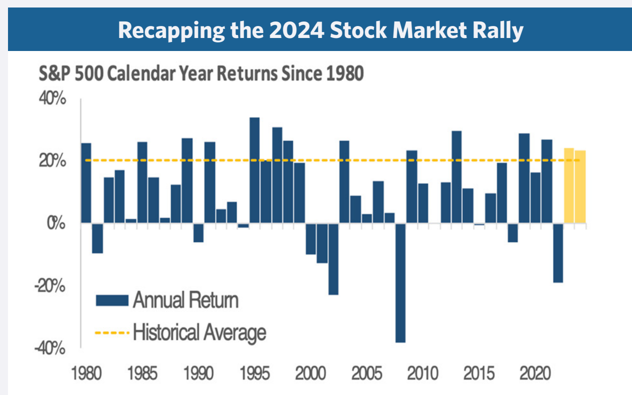
Market Monitor 2024	Q4	YTD
MSCI All-Country World Index	-1.0%	17.5%
S&P 500 Index	2.4%	25.0%
Bloomberg U.S. Agg. Index	-3.1%	1.3%
Bloomberg Commodity Index	-0.4%	5.4%

"Climbing at High Altitudes:" Q4 & 2025 Outlook

There was no shortage of market-moving events in Q4. The stock market opened the quarter with a slow start in October, but the outcome of the presidential election triggered a broad rally in November. Though the rally faded as the year ended, Q4 capped a remarkable run for U.S. investors, as the S&P 500 delivered 20+% in back-to-back years. As noted in the chart below, this run is reminiscent of the 4-year stretch from 1995 to 1998, and like the late 1990s, large-cap technology stocks played a major role in the S&P 500's gains.

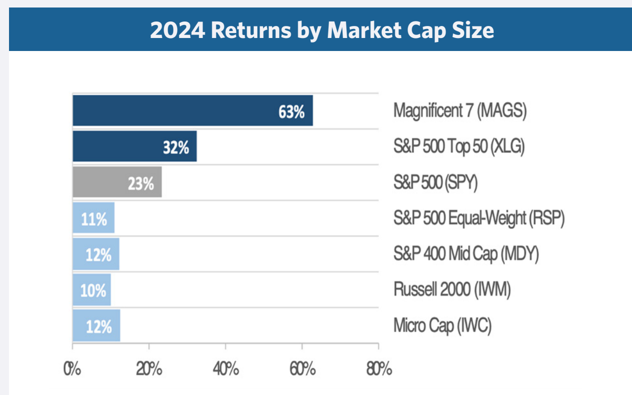
While Q3 gave hints of a broadening market rally, Q4 resumed the 2024 trend of a concentrated stock market rally, driven by the outperformance of the largest companies. U.S. small and mid caps delivered respectable returns of +10% and +12%, respectively, for the year, but those paled in comparison to the Mag 7 which was up 63%. Notably, for the second consecutive year, less than 30% of S&P 500 companies generated returns that exceeded the index's returns in 2024. This is significantly below the average of 49% since 2000 and further underscores the dominance of the largest companies in 2024.

Recapping the 2024 Stock Market Rally



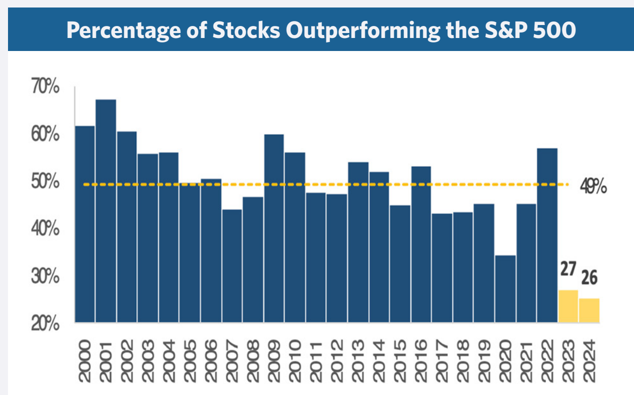
Source: MarketDesk.

2024 Returns by Market Cap Size



Source: MarketDesk.

Percentage of Stocks Outperforming the S&P 500



Source: Standard & Poor's. Past performance is no guarantee of future results.
All performance data represents price returns. Latest available data as of 12/31/24.

NRP

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Market Commentary

Equity Views for 2025

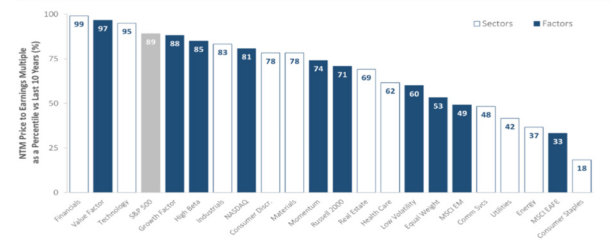
Entering 2025, most investors seem to agree on one thing: market valuations seem full and not many think assets are cheap.[1] With the S&P 500 at a 22x forward P/E and its equal-weight counterpart at a 17x forward P/E, valuations are reminiscent of 2021 just prior to interest rates increasing by 500 basis points, which led to a subsequent 20%+ decline in equity markets. Today, however, against a backdrop of fading disinflation and loosening financial conditions, a severe down-draft is not a given, but with valuations at extremes, earnings growth will likely play an important role in determining the stock market's path in 2025. With the current bull market now in its third year, the chart on the right shows returns often moderate as bull markets mature. Thus, 2025 is shaping up to be a year where companies will need to deliver on investors' earnings expectations to justify their high valuations.

One of our global equity managers, GQG, likened investing in the current valuation environment to climbing in high altitude, "There's less oxygen, so take more caution." Our preference is to not stretch for returns, but to broaden our base of exposure in Domestic Equity and have our active mangers strive to maintain a quality lens to their fundamental stock-picking in light of the elevated valuations.

Hedged Equity managers are focused on generating equity returns on the performance spread between their longs/and shorts: thus, stock market dispersion is of utmost importance to them and we believe it remains at attractive levels today.

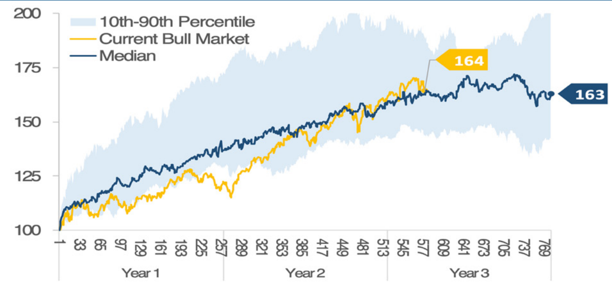
In International Equities, where valuations are in line with historical averages, we are taking a more active investment approach by emphasizing country and company exposures we believe can perform through the short-run impacts of the tariff/foreign trade policies of the incoming Trump administration. We are mindful of the U.S. dollar headwind to international equities, which will likely buffet both our International Developed and Emerging Market equity exposure in 2025. In this environment, we will remain overweight in countries that have their own "self-help" stories underpinning them. In India for example, we are encouraged to see the strong domestic investor participation in the equity markets even as record foreign outflows were recorded in Q4. And in Japan, corporate reforms are taking root as cross-sharehold-ings between companies decline, cash balances are deployed, and management teams increase their focus on driving ROEs higher. As noted in the chart below, Japan has a lot of room to increase dividends and share buybacks as corporate earnings improve and drive shareholder returns.

Equity Views for 2025



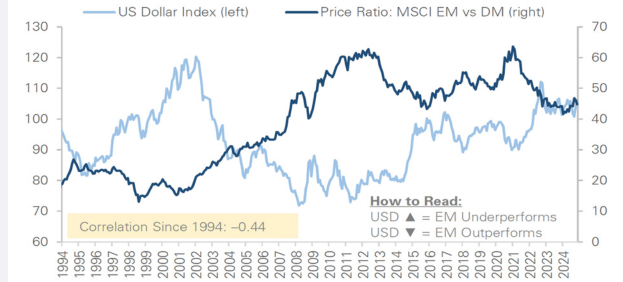
Source: MarketDesk.

S&P 500 Returns During Bull Markets



Source: MarketDesk.

U.S. Dollar Index vs Emerging/Developed Price Ratio



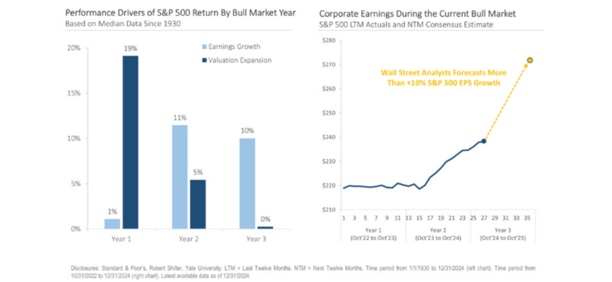
Source: MarketDesk.

Room for Japan to "Equitize"

	US	Japan
10yr dividend payout ratio (non-financial)	46.7%	30.0%
Cash % market cap	4.6%	71.9%
Corporate buybacks % market cap	1.5%	1.0%
Share of companies trading below book value	4.0%	45.2%
Household equity allocations	40.0%	13.0%
Public plan equity allocations	47.0%	25.0%

Source: Bloomberg, NASRA, Reuters, P&I Online, JPMAM, December 2024.

Performance Drivers - Expectations for Earnings Growth in 2025



Source: MarketDesk.

[1] Eaton Vance, BEAT Outlook.

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Market Commentary

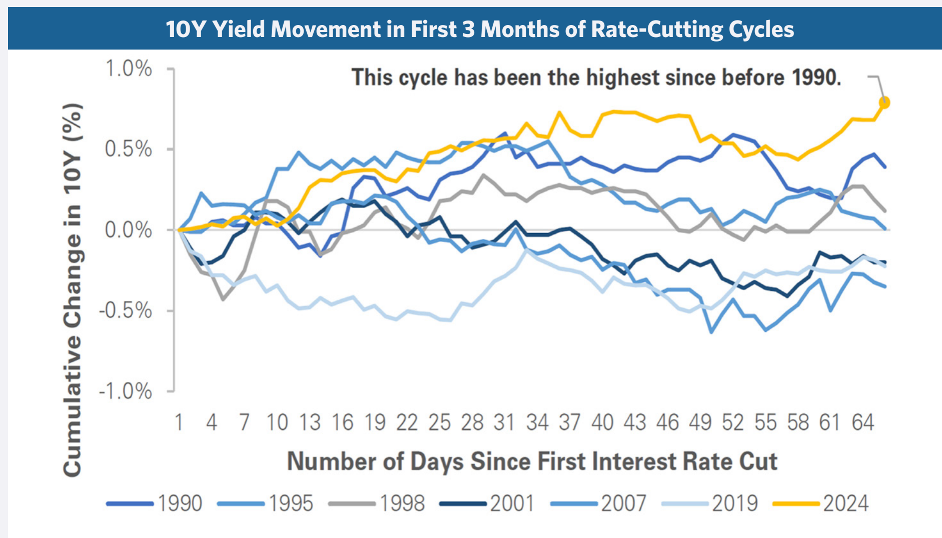
Credit Market Recap and Views for 2025

The credit market was equally active in Q4 with the Federal Reserve cutting rates by another 50 basis points. However, the major development was the changing outlook for rate cuts in 2025. The Fed and the market began to price fewer rate cuts in 2025 compared to the end of Q3, which resulted in a sharp rise in Treasury yields in Q4. While many thought rates had only one way to go with the start of a rate cutting cycle, the steadily rising 10-year Treasury rate reminded investors the Fed only has control over the short-end of the curve.

This sharp rise in Treasury yields weighed on bond returns in Q4. The biggest differentiator within the bond market was duration, or the sensitivity of a bond's price to interest rate movements. During the quarter, high-yield corporate bonds produced a total return of -0.1% due to their lower sensitivity to rising interest rates and higher absolute yields. In contrast, investment-grade bonds returned -4% as rising yields had a bigger impact on their longer maturities.

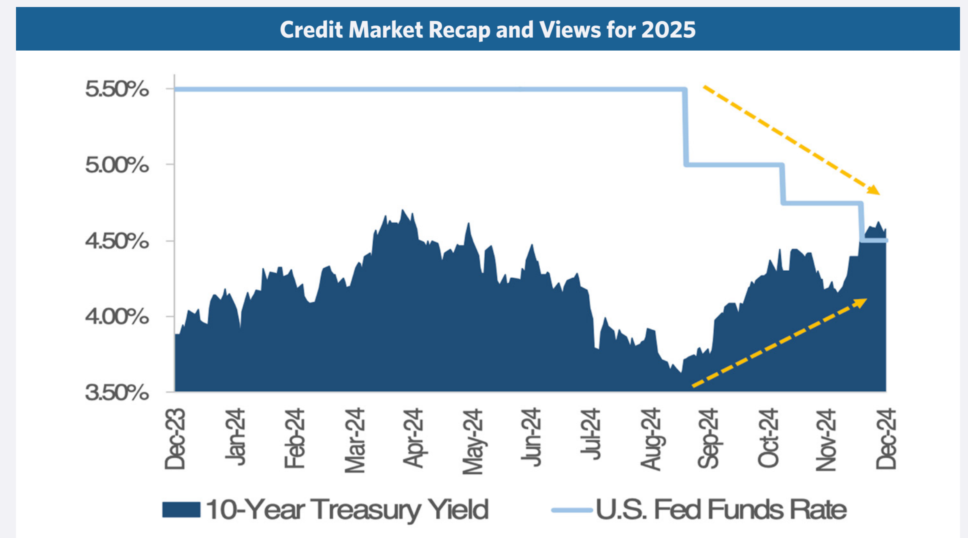
Looking back over the year, full-year credit returns highlighted the key themes that shaped the bond market. Higher-quality bonds, such as U.S. Treasuries, corporate investment-grade, and mortgage-backed securities, underperformed due to their duration as the market debated and ultimately lowered its rate-cut expectations. In contrast, lower-quality bonds outperformed as economic growth and corporate fundamentals remained solid. Meanwhile, corporate credit spreads steadily tightened throughout the year, leaving credit spreads near their lowest levels in decades. For context, the U.S. high-yield corporate credit spread is near its lowest level since 2007.

10Y Yield Movement in First 3 Months of Rate-Cutting Cycles



Source: MarketDesk, U.S. Treasury.

Credit Market Recap and Views for 2025

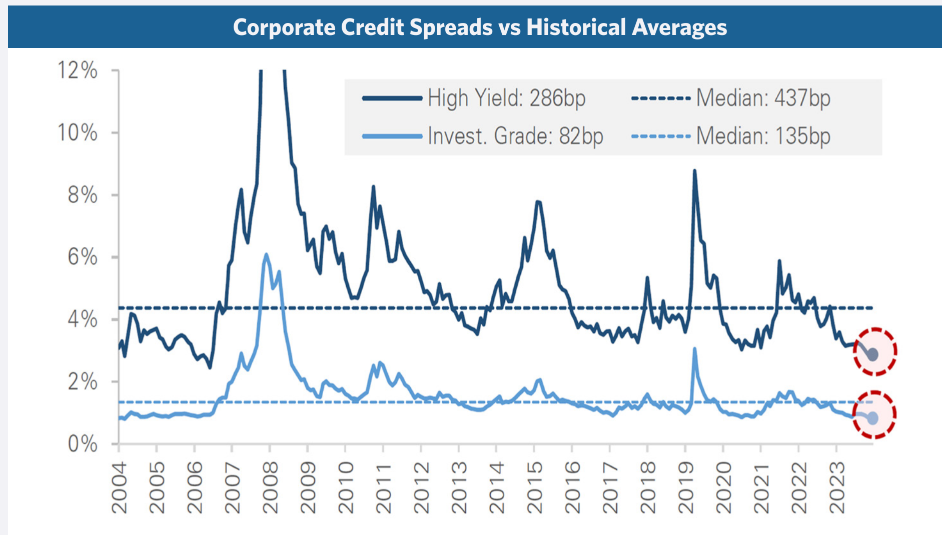


Source: U.S. Treasury, Federal Reserve. Latest available data as of 12/31/24.

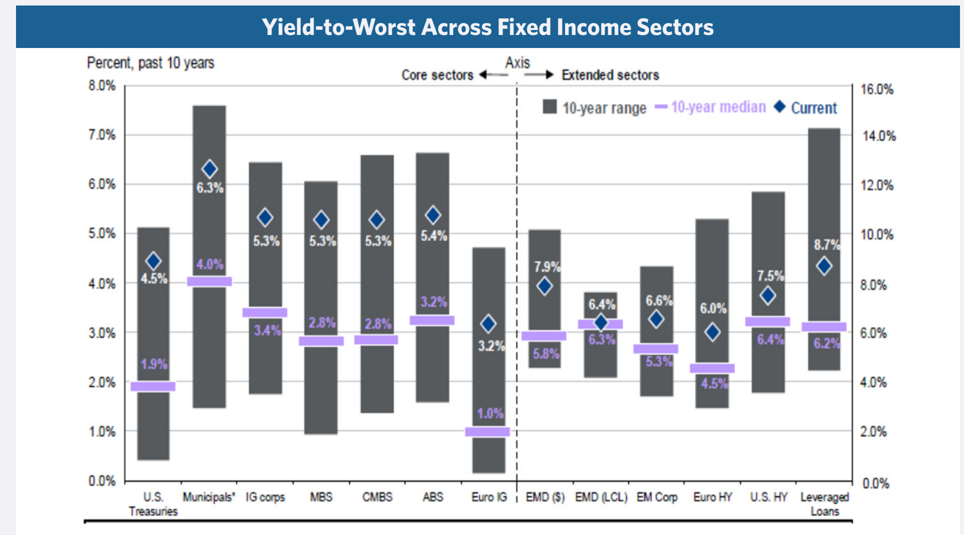
Market Commentary

Credit Market Recap and Views for 2025 continued

Looking forward in 2025, absolute yields are attractive in fixed income but "credit valuations" (i.e., tight credit spreads) are stretched. However, one segment of the credit market that looks attractive against this backdrop is securitized credit, such as mortgage-backed securities (MBS). When plotted against other segments of credit, as shown below, MBS currently trades at a reasonable yield and spread level, particularly when considering the implicit government backing for agency MBS. Over the last two years of monetary tightening, the MBS market lost two natural buyers: the Federal Reserve and banks. But as bank portfolio demand returns, the supply/demand headwind should turn into a tailwind for the market. Thus, rather than adding more duration through high-priced investment grade corporate credit, we are adding targeted securitized credit exposure to fixed income portfolios.



Source: MarketDesk. Based on Option-Adjusted Spread (OAS).



Source: JPMorgan.

Market Commentary

Private Asset Views for 2025

Private Equity

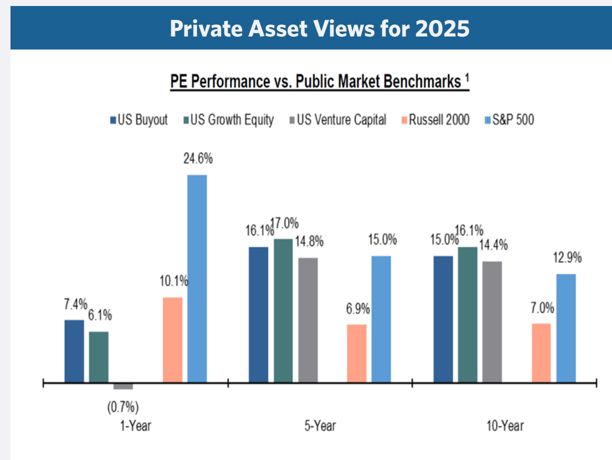
The Private Equity industry has shown signs of recovery in 2024, with U.S. deal activity on pace for $850B+ in value for the full year. This welcomed increase still lags the record levels of 2021-22 but exceeds the pre-pandemic levels from 2019-2020. The exit environment for private equity funds shows promising signs of recovery as well, with exit value increasing through the third quarter by 50% versus a low base in 2023.

Private Equity returns have been solid but not exceptional for the past two years, at a time when U.S. public equities have performed well as shown in the chart on the right. While PE returns have underperformed those of public benchmarks over the past year, it is important to remember that PE performance must be evaluated over longer cycles.

Within the Private Equity asset class, manager selection remains paramount to generating outsized returns. The New Republic Capital private equity portfolios contain an overweight in lower middle market sector specialists we believe are experts at acquiring companies in their sectors, driving operational improvements and growth initiatives, and ultimately exiting to larger PE firms or strategic acquirors. These managers do not rely on financial engineering to generate returns; instead, their returns come from implementing strategic initiatives over years to grow earnings at the portfolio companies.

Private Credit

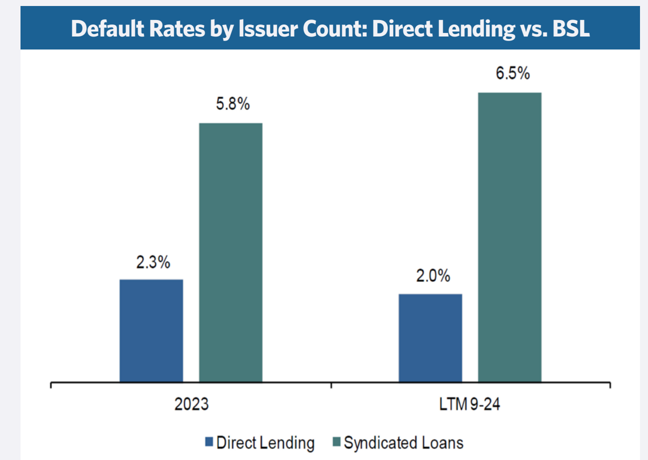
In Private Credit, performance in the direct lending market has remained solid over the past several quarters. Median returns for private credit funds raised from 2018 – 2022 range from



Source: Bloomberg, Cambridge Associates, UBS as of June 30, 2024.

9.9% to 10.8%[2], while top quartile returns for funds in this sector range from 12.5% to 13.6% over the same period. Direct lenders have generated these returns with lower loss rates than public credit markets. The conditions that enabled these compelling returns remain in place, and we believe private credit mangers are well-positioned to continue to generate strong risk-adjusted returns going forward.

While larger private credit managers will be forced to compete with banks and other participants in the Broadly Syndicated Loan market ("BSL") on terms and pricing to finance the largest private equity transactions, competition is less intense in the middle market and lower middle market. The direct lenders in the New Republic Capital portfolios strive to remain focused on these more attractive sectors of the market where they act as a value-add partner to help sponsors grow businesses. Lower and middle market lenders have more influence and control over structure and pricing. They have a greater ability to include covenants, protections



Source: KBRA DLD Direct Lending Default Research.

and rights into documentation, which gives them greater control through macroeconomic cycles. These enhanced protections lead to loss rates in the middle and lower middle market that are significantly lower than those in the BSL market, as shown in the above chart. The New Republic Capital private credit portfolio has outperformed the direct lending benchmark, with LTM default rates ranging from 0% to 1.4% across our managers.

In addition to our core allocation to direct lending, we allocate to managers focused on what we believe to be less efficient pockets of the private credit market. These managers include specialists in structured credit and asset-backed finance strategies, such as aircraft finance and consumer lending. Funds in theses markets have benefited from a retrenchment of banks in their sectors which can provide opportunities to generate low-to-mid-teens returns with significant collateral protection. Returns from these strategies should provide a strong complement to and are uncorrelated with returns from direct lending.

[2] Measured by IRRs, Pitchbook.

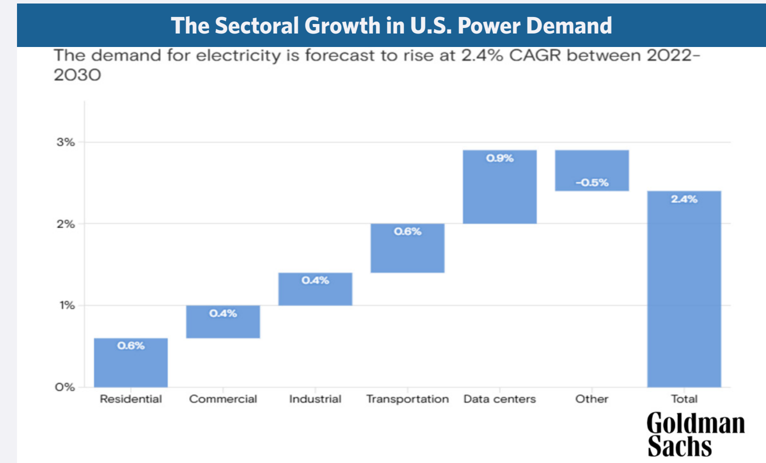
Market Commentary

Real Asset Views for 2025

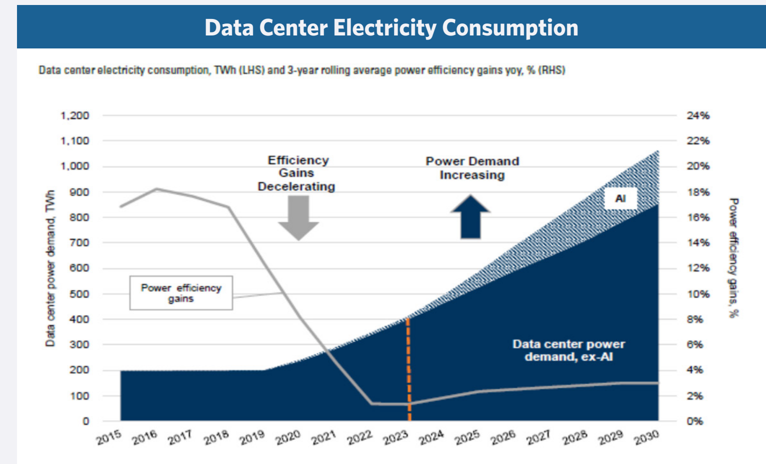
Since 2022, we have been underweight in Real Assets as this asset class tends to struggle in periods of disinflation and falling rate expectations. While it is uncertain whether the current period of disinflation is in its final innings, we think it is timely to start bringing real assets back into the picture. A long-held adage in portfolio management is to, "Hedge against the known risks, diversify against the unknown risks." And, as the risk of inflation increases over the medium term due to fiscal spending, government deficits, and potential tariffs and tax cuts by the Trump administration, real asset exposure should gain prominence as a portfolio hedge.

To that end, one additional tool in the real assets toolbox beyond real estate, infrastructure, commodities, and energy is crypto currencies. In select portfolios, we are introducing a small allocation to Bitcoin as a form of digital gold, partially due to increasing global adoption. For clients with exposure to our private equity program, this complements a small exposure to blockchain technologies through venture capital managers with deep expertise. Given the volatility of Bitcoin, its fit within a portfolio is very client specific, and we would only add 1-2% of a portfolio to Bitcoin (depending on risk appetite) as higher allocations would overwhelm portfolio risk.[3]

While the top-down case for Real Assets is improving, we believe there is an incredible opportunity to invest in the power sector which we are pursuing in multiple ways. Over the past 15 years, power demand in the U.S. has had flat to 1% annualized growth. But multiple developments across the economy will likely create a step-function increase in demand for power over the next decade. As the charts on the right show, the increased power needs from electrification, industrial reshoring, cloud computing, data centers, and artificial intelligence will potentially cause power demand in the U.S. to grow to 2.4% per year through 2030. Experts estimate that meeting this demand will require a $50 billion investment in power generation. This massive investment will likely create investment opportunities across power plants, upstream and midstream energy, data centers, industrial services, and several other sectors. We have already made investments behind this theme in both Private Equity and Private Credit and will continue to invest in power and related assets given the generational nature of the opportunity.



Source: Goldman Sachs Research, EIA.



Source: Goldman Sachs Research, EIA.

After being flattish for 2015-2019, Goldman Sachs sees power demand from data centers more than tripling in 2030 vs. 2020, with an upside case more than double the base case depending in part on product efficiencies and AI demand.

[3] Blackrock, Investment Perspectives.

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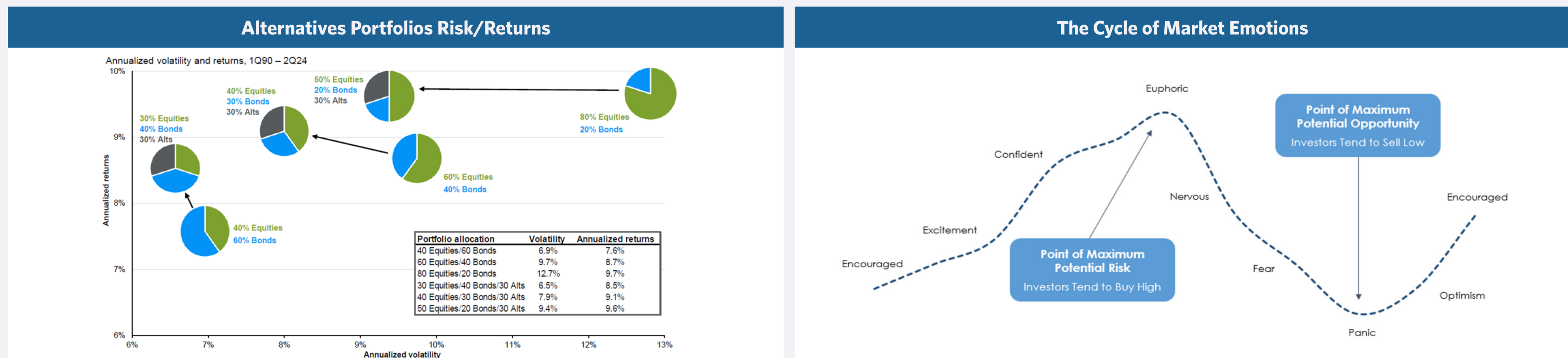
Parting Thoughts for 2025

In summary, as we look ahead to 2025, market valuations appear full across equity and credit, and earnings growth will be crucial in sustaining investor confidence. When climbing at high altitudes, a cautious yet strategic approach is essential to navigating the terrain, and to that end, we have summarized our views across asset classes in an exhibit on the following page. While the market gets more concentrated, history has shown portfolio diversification can mitigate risks and generate a more reliable return stream. Maintaining a long-term investment horizon is difficult, and, in the end, diversification guards against an investor's own behavioral biases.



Portfolio allocation	Volatility	Annualized returns
40 Equities/60 Bonds	6.9%	7.6%
60 Equities/40 Bonds	9.7%	8.7%
80 Equities/20 Bonds	12.7%	9.7%
30 Equities/40 Bonds/30 Alts	6.5%	8.5%
40 Equities/30 Bonds/30 Alts	7.9%	9.1%
50 Equities/20 Bonds/30 Alts	9.4%	9.6%

Source: Bloomberg, Burgiss, HFRI, NCREIF, Standard & Poor's, FactSet, J.P. Morgan Asset Management.

Source: MarketDesk.

—NRP Investment Committee
New Republic Partners
February 6, 2025

Disclosure

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NRP Asset Allocation Views and Positioning 2025

ASSET CLASS	VIEWPOINT	STANCE
Domestic Equity	With the S&P 500 at a 22x forward P/E and its equal-weight counterpart at 17x forward P/E, market valuations are stretched and further gains will be earnings growth dependent in 2025.	Taking caution to not stretch for returns by broadening out our base of exposure outside the Mag 7 and having our active managers maintain a quality lens to their fundamental stockpicking. Watching for more balance in earnings growth between Mag 7 and S&P.
International Equity	The disparity in valuations between the U.S. and rest of the world continues to widen, some of which is justified given the disparity in economic and corporate growth profiles.	Taking a more active approach by emphasizing country and company exposures that can weather through the short-run impacts of the tariff/ foreign trade policies. Overweight countries that have their own "selfhelp" stories - like Japan.
Emerging Markets	The strong USO continues to present a headwind to EM and proposed tariff policies are more than top of mind for EM investors, particularly in China where tariff concerns should keep a lid on cheap valuations at the least.	As with Developed International markets, we are emphasizing countries with their own "self-help" stories underpinning them, like India's increasing equity participation and domestic flows. China exposure has been reduced and is highly selective.
Hedged Equity	Hedged Equity managers are still in a good position to take advantage of market dispersion despite the concentrated market.	Still a prudent way to add growth-oriented exposure without adding market length particularly when market valuations are full — said differently, hedged equity managers are setup to deliver equity-like returns from alpha + a measured amount of beta.
Private Equity	NRC Private Equity returns have been solid but not exceptional for the past two years, at a time when U.S. public equities have performed well; this underscores that PE performance must be evaluated over longer cycles.	NRC Private Equity portfolios contain an overweight to lower middle market sector specialists that we believe are experts at acquiring companies in their sectors, driving operational improvements and growth initiatives, and ultimately exiting to larger PE firms or strategics.
Private Credit	Credit performance in the direct lending market has remained solid over 2024. The NRC private credit portfolio has outperformed its benchmark with LTM default rates ranging from 0% to 1.4% across our managers.	In addition to direct lending, we continue to allocate to managers focused on less efficient pockets of the private credit market. Asset-backed finance strategies are showing strong risk-adjusted potential returns in this market environment.
Traditional Fixed Income	Absolute yield levels are attractive at 4-6% depending on credit quality, and, yet, credit spreads are at historical tights leaving credit "valuations" stretched.	Securitized credit (e.g., mortgage-backed securities) is one segment where spreads are reasonable and on solid footing with strong household balance sheets and higher levels of home equity backing. MBS are a better risk/reward than IG corporate.
Absolute Return	Absolute return managers held their own with respect to performance in 2024, particularly relative to traditional fixed income where duration detracted from returns.	Would utilize as a source of funds for additions towards MBS or Real Assets. AR remains a core ballast position in portfolios and preferred over any use of long duration fixed income as a portfolio hedge.
Real Assets	Seeing opportunities in select RE debt and equity given market reset in both public and private markets with higher rates. Also seeing opportunities in energy and power infrastructure given the dramatic increase in spending on data centers and semiconductors related to AI by the hyperscalers.	In a scenario of rising inflation which could be due to fiscal spending, government deficits, and potential tariffs and tax cuts, real asset exposure can serve as a useful portfolio hedge. One additional tool in the real assets toolbox beyond real estate, infrastructure, commodities and energy is crypto currencies, such as Bitcoin.

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