ENTASIS ASSET MANAGEMENT

MARKET HIGHLIGHTS

FEBRUARY 2025

Commentary

Summary

- According to Goldman Sachs, the best performing investment themes for 2024 included a “who’s who” of speculative and high-growth stocks.
- We would argue that a bubble is not quantifiable, rather it is behavioral. We do not believe we are at extremes, but there are mounting signs of excess.
- Several factors may be supportive of relative strength among small-cap stocks such as a push towards deglobalization, deregulation, an unwinding of market concentration, and attractive earnings growth.
- The U.S. dollar and Treasury yields have risen as investors adjust expectations in response to persistent inflation.

For those that have followed our commentary for a number of years, we have often referenced sports analogies to make some of our points about the financial markets. Not surprisingly, as we prepared to put together our highlights for clients, several interesting and almost unbelievable baseball facts came to mind. However, one always stands out to me. Did you know……

….that during his baseball career Tony Gwynn had 40 games where he collected at least four hits, while he only struck out more than once in a game 34 times? So, as Tony stepped to the plate more than 10,000 times in his career, he was more likely to get four hits than strikeout twice. Hard to believe amid today’s strikeout totals.

As we prepared to put these comments together, we read a slew of letters from portfolio managers and market strategists. Some of the market facts were unbelievable. Did you know…..

….that in the past 24 years, the return of the S&P 500® Index has exceeded the return of the Russell 1000® Value Index by 10% or more four times? And all four of those times happened since 2020.
….that prior to 2018 no company had ever reached $1 trillion in market cap? But now there are nine companies that have done so. Nvidia, a $3.5 trillion market capitalization company, has seen over $3 trillion of that growth occur in less than two years.

The list goes on and highlights from our equity discussion will touch on some more. But why bring up these facts? In short, because it speaks to an important part of our process and relationship with our clients. Over the last three calendar years, an extremely short list of 7 stocks have accounted for roughly 50-60%+ of the total return of the S&P 500® Index. We have referred to this “magnificent” group many times before because how portfolios have done compared to the indexes in which they are listed is significant. So, it begs the question…is it a risk to NOT own something? In our view, the answer is simply – No.

We believe risk, in general, is making investment decisions that expose client portfolios to greater volatility and downside than a client is comfortable experiencing. This varies client to client and our alignment with clients about risk is critical to productive, long-term relationships. We are not averse to taking risk with clients that understand the potential downside, but most clients do not want the risk that comes with having 7% of the money they have saved for retirement in one stock like Nvidia or nearly 40% of their assets in just 7 stocks. Our investment process is designed accordingly.

Over his career, Tony Gwynn had 3,141 hits and 135 of them were home runs. We hope that over our careers we find some home runs as well. However, we would rather hit for a higher percentage and be able to brag about how few strikeouts we had investing client money when we look back on our careers.

Thank you for reading our Highlights. We welcome any questions you may have.

Bob David

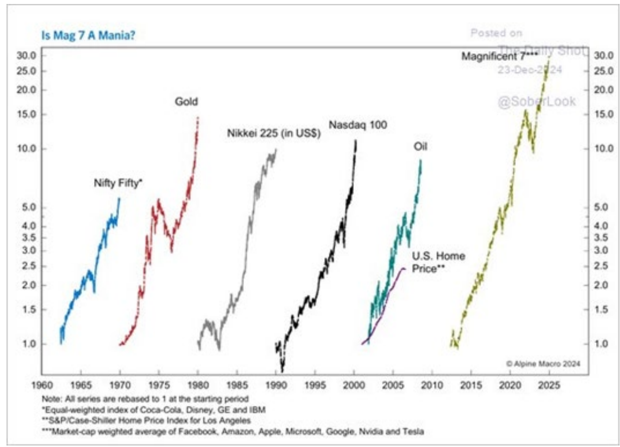
Highlight 1 – Narrow Leadership

- According to Goldman Sachs, the best performing investment themes for 2024 included a “who’s who” of speculative stocks and high-growth companies as investors largely brushed aside valuations and underlying fundamentals. The top performing themes included Mega Cap Tech, Bitcoin Sensitive, Momentum Stocks, and Memes.
- Market participation was very focused, with only 29% of companies in the S&P 500® Index outperforming the aggregate gain (See chart below). Said differently, 71% of stocks gained less than the S&P 500® Index. The last time results were this narrow for two straight years was during the 1998-1999 dotcom bubble.
- Narrow leadership was particularly prevalent amongst the largest companies in the S&P 500® Index, notably the so-called “Mag-7” stocks (Microsoft, Amazon, Apple, Google, Meta, Nvidia, Tesla). These seven stocks accounted for roughly 55% of the overall return for the S&P 500® Index in 2024. Nvidia alone contributed approximately 22%.
- Large gains in a focused group of stocks over the past two years has resulted in historic levels of stock market concentration. In fact, the top 10% largest U.S. stocks now account for 75% of the U.S. equity market. This total eclipses the previous record set before the Great Depression in the 1930s and the dotcom bubble peak in 2000. We are skeptical these companies’ run of outperformance can be sustained well into the future.

Exhibit 27: % of companies outperforming the S&P500 since 1990
Just 29% of stocks in S&P500 outperforming the index in past 2 years

Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

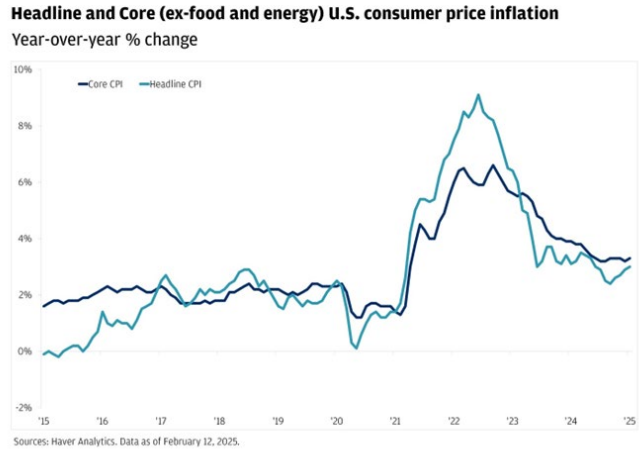


Highlight 2 – Bubble or Mania?

- Does historic market concentration mean U.S. stocks are in a bubble? The chart above, “Is Mag 7 a Mania?,” compares the trajectory of the Magnificent 7 stocks to other periods of market excess, including the Nifty Fifty in the 1960’s and the Nasdaq 100/Dotcom era of the 1990’s. From a visual standpoint, this chart would point towards the answer being yes. However, we would argue that a bubble is not necessarily quantifiable, rather it is behavioral. It centers around the belief that no matter how high prices get for certain stocks; they are never too expensive because the investment thesis is so good. In these environments, there tends to be little in the way of differing opinions. Consensus is viewed as fact, contrary opinions are ridiculed, and prices become unhinged from reality.
- While we do not believe we have reached behavioral extremes, there are mounting signs of excess. For instance, in the case of Mag-7 member Apple, it grew revenues by 5% over the past three years (net income declined -4%), yet its stock price has gone up over 40%. This has led its stock to trade at nearly 10x sales and a P/E of close to 40x.

Highlight 3 – Keeping an Eye on Little Brother

- We continue to find opportunities to invest despite historic levels of market concentration. One segment of equities we have steadily increased has been among U.S. small-cap stocks.
- The chart below looks at large-cap performance relative to small-cap performance going back to 1938. One takeaway from the data is that small-cap companies have historically experienced weaker returns relative to large-cap companies during periods of major technological innovation such as the space age, internet 1.0, and more recently, the age of AI. However, small-cap stocks then performed much better on a relative basis as those trends matured.
- Several other factors may be supportive of small-caps moving forward including a push towards deglobalization, deregulation, an unwinding of market concentration, and an improved tax environment. On a fundamental basis, we also believe future earnings growth may lead to renewed interest from investors. For example, 2-year cumulative growth is estimated to be quite favorable for small-cap indices such as the Russell 2000® Growth Index and the Russell 2000® Value Index.
- As always, we cannot predict the exact timing for changes in market leadership. However, we believe patient investors will be rewarded for investments in this area of the U.S. equity market.



Source: JP Morgan

Highlight 4 – Is Inflation Stuck?

- The January 2025 Consumer Price Index (CPI) report showed inflation tick slightly higher, with headline CPI rising 0.5% month-over-month (MoM), following a 0.4% increase in December 2024. Core CPI, which strips out volatile food and energy prices, climbed 0.4% MoM, doubling December's 0.2% gain. On a year-over-year (YoY) basis, inflation moved modestly higher. Headline CPI reached 3.0%, up from 2.9% in December, while Core CPI ticked up to 3.3% from 3.2%. (See chart above.)

  The U.S. dollar and Treasury yields have risen as investors adjust expectations in response to persistent inflation, increasing the likelihood that the Federal Reserve will maintain higher interest rates for an extended period.

  Looking ahead, a combination of looser monetary policy, tariff-related disruptions, and a resilient economy may keep inflation above the Fed's target. These factors suggest that policymakers will likely adopt a more cautious stance before considering rate cuts.

Market Performance

Annualized % Returns (As of 12/31/2024)

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	25.02	8.94	14.53	13.10
Russell 1000 Index	Mid/Large Cap Stocks	24.51	8.41	14.28	12.87
Russell 1000 Growth Index	Growth Stocks	33.36	10.47	18.96	16.78
Russell 1000 Value Index	Value Stocks	14.37	5.63	8.68	8.49
Russell 2000 Index	Small Cap Stocks	11.54	1.24	7.40	7.82
MSCI EAFE Index	Non-U.S. Developed Market Stocks	3.82	1.65	4.73	5.20
MSCI Emerging Markets Index	Emerging Markets Stocks	7.50	-1.92	1.70	3.64
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	3.36	-1.47	4.30	5.66
Barclays Municipal Bond Index	U.S. Municipal Bonds	1.05	-0.55	0.99	2.25
Barclays Aggregate Bond Index	U.S. Bonds	1.25	-2.41	-0.33	1.35
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	3.00	-0.18	0.86	1.71
BofAML U.S. Treasury Master Index	Treasury Bonds	0.51	-3.10	-0.79	0.80
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	1.33	-2.13	-0.73	0.92
BofAML U.S. Corporate Master Index	Corporate Bonds	2.76	-1.98	0.48	2.52
BofAML U.S. High Yield Master II Index	High Yield Bonds	8.20	2.92	4.03	5.08

Annualized % Returns (As of 1/31/2025)

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	26.38	11.91	15.17	13.76
Russell 1000 Index	Mid/Large Cap Stocks	26.71	11.69	14.97	13.54
Russell 1000 Growth Index	Growth Stocks	32.68	14.57	18.90	17.18
Russell 1000 Value Index	Value Stocks	19.54	8.08	10.15	9.42
Russell 2000 Index	Small Cap Stocks	19.09	5.62	8.67	8.45
MSCI EAFE Index	Non-U.S. Developed Market Stocks	8.65	5.12	6.25	5.69
MSCI Emerging Markets Index	Emerging Markets Stocks	14.75	-0.71	3.04	3.76
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	6.56	1.12	5.24	5.84
Barclays Municipal Bond Index	U.S. Municipal Bonds	2.08	0.54	0.73	2.12
Barclays Aggregate Bond Index	U.S. Bonds	2.07	-1.52	-0.60	1.19
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	3.37	0.51	0.69	1.60
BofAML U.S. Treasury Master Index	Treasury Bonds	1.24	-2.31	-1.18	0.57
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	2.31	-1.46	-0.77	0.89
BofAML U.S. Corporate Master Index	Corporate Bonds	3.23	-0.73	0.13	2.30
BofAML U.S. High Yield Master II Index	High Yield Bonds	9.67	4.35	4.31	5.15

Calendar Year % Returns (YTD as of 1/31/2025)

	YTD	2024	2023	2022	2021	2020
S&P 500 Index	2.78	25.02	26.29	-18.11	28.71	18.40
Russell 1000 Index	3.18	24.51	26.53	-19.13	26.45	20.96
Russell 1000 Growth Index	1.98	33.36	42.68	-29.14	27.60	38.49
Russell 1000 Value Index	4.63	14.37	11.46	-7.54	25.16	2.80
Russell 2000 Index	2.62	11.54	16.93	-20.44	14.82	19.96
MSCI EAFE Index	5.26	3.82	18.24	-14.45	11.26	7.82
MSCI Emerging Markets Index	1.79	7.50	9.83	-20.09	-2.54	18.31
MSCI ACWI Ex USA Small Cap Index	1.33	3.36	15.66	-19.97	12.93	14.24
Barclays Municipal Bond Index	0.50	1.05	6.40	-8.53	1.52	5.21
Barclays Aggregate Bond Index	0.53	1.25	5.53	-13.01	-1.54	7.51
Barclays Intermediate U.S. Gov/Credit Index	0.57	3.00	5.24	-8.23	-1.44	6.43
BofAML U.S. Treasury Master Index	0.55	0.51	3.87	-12.85	-2.38	8.22
BofAML U.S. Mortgage Backed Securities Index	0.55	1.33	4.98	-11.88	-1.21	4.09
BofAML U.S. Corporate Master Index	0.61	2.76	8.40	-15.44	-0.95	9.81
BofAML U.S. High Yield Master II Index	1.38	8.20	13.47	-11.21	5.35	6.07

Source: Morningstar Direct. Returns less than one year are not annualized. Past performance is no guarantee future results. Current performance may be lower or higher than that shown. All indices are unmanaged. Investors cannot invest directly in an index. Index returns do not include expenses. See page 8 for index definitions and other important disclosures.

Our Team

Bob Batchelor, CFA®, CFP®
CEO
Co-Founder

Bob J. Batchelor, CFA®, CFP® is Founder and Chief Executive Officer of Entasis Asset Management. Bob has 28 years of experience in the investment industry. Prior to founding Entasis, Bob worked at Artisan Partners where he held a variety of roles including Head of Corporate Communications, Managing Director, Head of Marketing and Technology and Head of Marketing and Communications. He also served as a member of Artisan Partners Executive Committee. Before Artisan Partners, Bob worked at Strong Capital Management as Client Account Manager and Director of Investment Research and Communication.

Bob holds an M.B.A. from Marquette University and a B.B.A. from the University of Wisconsin-Madison. He has earned the right to use the CFA designation. Bob is a member of the CFA Institute and CFA Society of Milwaukee. Bob has also earned the Certified Financial Planner™ certification and SE-AWMA™ professional designation.

C.J. Batchelor, CFA®
CIO
Co-Founder

Charles J. (C.J.) Batchelor, CFA® is Founder and Chief Investment Officer of Entasis Asset Management. C.J. has 22 years of experience in the investment industry. Prior to founding Entasis, C.J. worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Director of Investment Research. He also served as a member of Cleary Gull's Investment Policy Committee, Investment Committee and Equity Strategy Group.

C.J. holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. C.J. is a member of the CFA Institute and CFA Society of Milwaukee.

Mike Peters, CFA®
Senior Wealth Advisor
Co-Founder

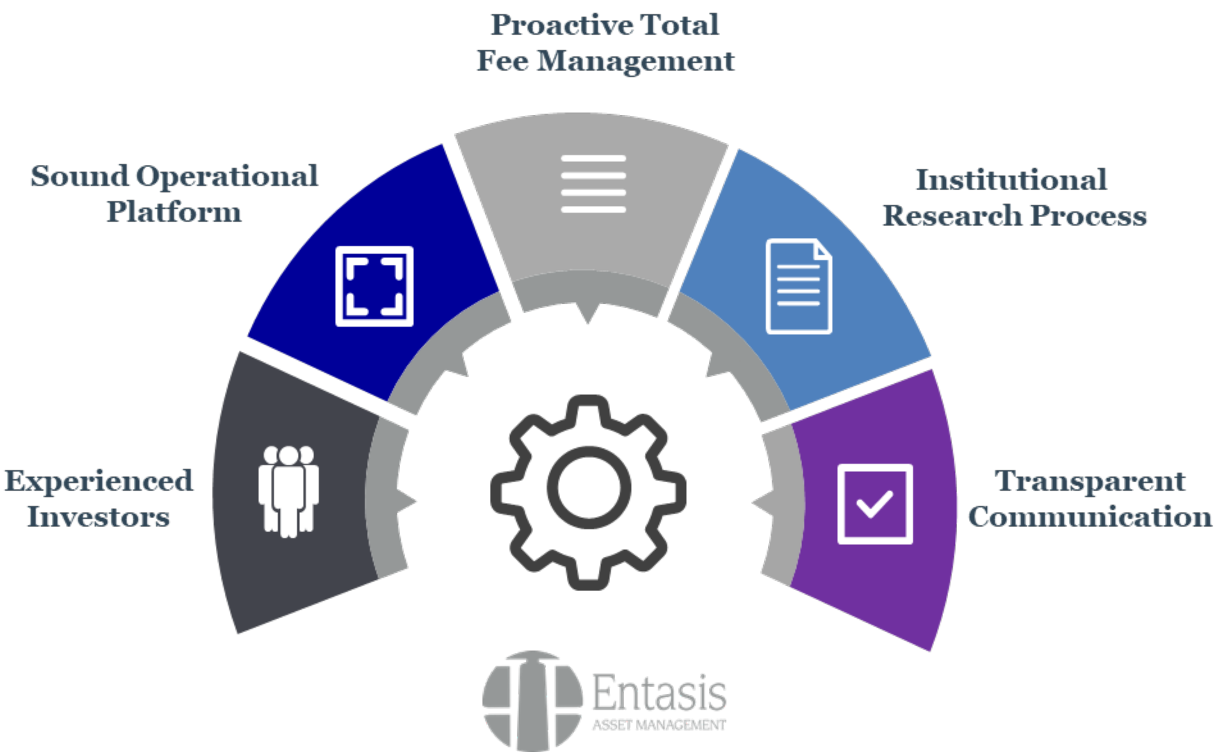
Mike Peters, CFA® is Founder and Senior Wealth Advisor at Entasis Asset Management. Mike has 22 years of experience in the investment industry. Prior to founding Entasis, Mike worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Fixed Income Portfolio Manager. In his role he served as voting member of Cleary Gull's Fixed Income Strategy Group and Complement (Alternative) Strategy Group. Before Cleary Gull, Mike worked for several years at Madison Investment Advisors, a multi-billion dollar asset management firm, as a Fixed Income Analyst.

Mike holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. Mike is a member of the CFA Institute and CFA Society of Milwaukee.

David LaCroix
Senior Wealth Advisor

David D. LaCroix is a Senior Wealth Advisor at Entasis Asset Management. David has more than 50 years of experience in the investment industry. Prior to joining Entasis, David worked at Cleary Gull Advisors, a Johnson Financial Group Company, and Cleary Gull Inc., a prior affiliate of Cleary Gull Advisors, where he most recently served as Vice President, Relationship Manager responsible for high net worth clients. Before Cleary Gull, David worked in a variety of portfolio management and client relationship management positions with A.G. Edwards and M&I Capital Markets Group.

David received his M.B.A. and B.B.A. in Finance from the University of Wisconsin-Madison. He has served as a member of the Archdiocese of Milwaukee Investment Committee, as a Trustee for the Village of Shorewood and as Director/Treasurer of Milwaukee Summerfest.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