1860 INVESTMENT FUND

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1860 Investment Fund

Our View: 2025

A sector-by-sector outlook based on our analysts' research and insights.

**As of February 23, 2025*

Table of Contents

An Overview of 1860

William Carter, President & Portfolio Manager

The 1860 Investment Fund was created by a group of LSU students in 2024 to provide hands-on experience in portfolio management and equity research to undergraduates in the EJ Ourso College of Business. Founded on the principle of paying one's accomplishments forward and being a mentor to peers in a competitive industry, 1860 has built a community of like-minded, driven individuals and helped to place them into prestigious roles in high finance and investment management.

Structured similarly to a real-world firm, new members enter as junior analysts, where they undergo a fast-paced education process and gain exposure to financial markets. Upon completing the education program, members serve as analysts on teams that are grouped by sector. Six members are selected to serve as sector heads to lead each team, and the fund is led by an elected board of four portfolio managers: President, Executive Vice President, VP of External Affairs, and VP of Education. Membership in 1860 lasts for the entire duration of one's undergraduate years at LSU.

Our sector teams are structured as follows:

- **The Technology Sector Team** covers Technology, Media & Telecommunications
- **The Financials Sector Team** covers Financial Services & Real Estate
- **The Consumer Goods Sector Team** covers Consumer Staples & Consumer Discretionary
- **The Industrials Sector Team** covers Industrials & Materials
- **The Energy & Utilities Sector Team** covers Energy & Utilities
- **The Healthcare Sector Team** covers the healthcare sector

In building 1860's first piece of published work, we've prioritized highlighting the individual research and analysis performed by each of our sector teams. You may notice that each section differs very slightly in style—that's because the following outlook has been created sector-by-sector, with each team credited for their work at the beginning of each section. While this outlook serves to demonstrate our market insights for the year ahead, it also reflects our members' collective dedication to learning, leading, and developing a disciplined, research-driven investment process.

Our portfolio is structured to mirror the S&P 500 while making targeted adjustments to potentially outperform, without introducing excessive downside risk. By slightly overweighting sectors like Technology, Industrials, Utilities, and Financials—where we see opportunities—and underweighting areas like Healthcare, Communications, and Real Estate, we aim to capitalize on our highest-conviction ideas while maintaining broad diversification and a risk profile similar to the benchmark.

The insights in this report not only provide a forward-looking perspective on key sectors but also reflect the depth of our team's research, the strength of our analytical framework, and our commitment to continuous improvement as investors.

Where We're Investing

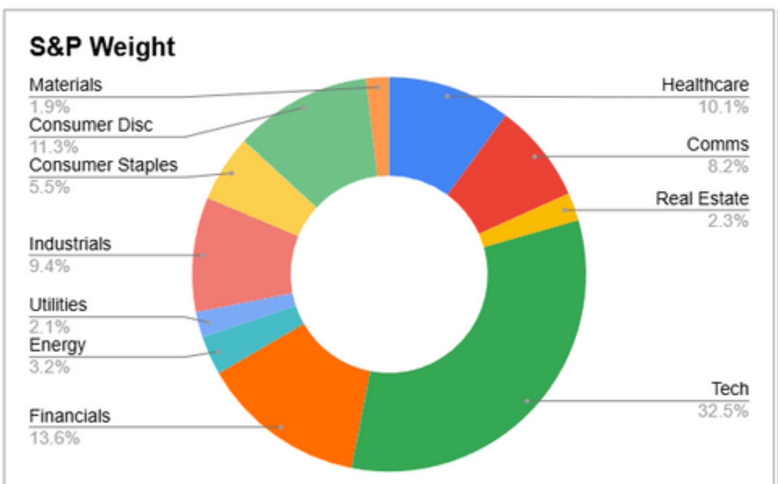
William Read, Vice President of Education & Portfolio Manager

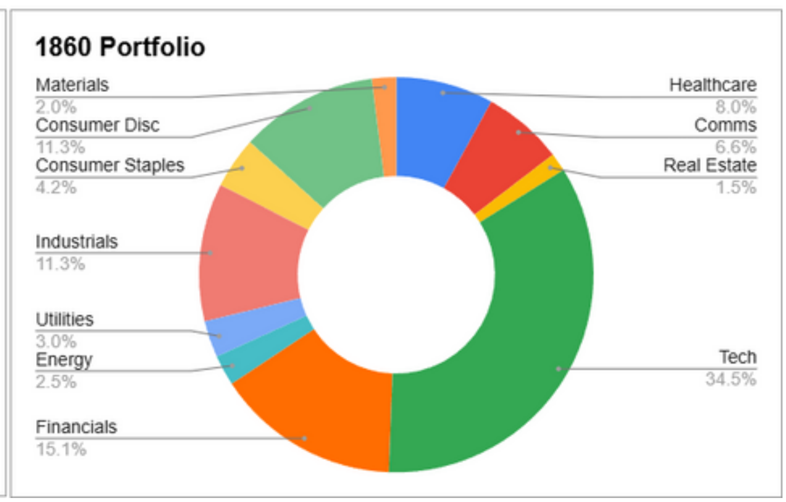
In 2025, our investment fund is positioning our portfolio to capitalize on emerging trends and market opportunities. This section details our sector allocations and contrasts them with the S&P 500, showcasing where we see value and growth potential.

We're driven by a growth-oriented approach, focusing on sectors with strong long-term potential shaped by our analysts' insights into macroeconomic trends and policy shifts.

Our fund is bullish on technology, driven by AI, cloud computing, and semiconductor growth, despite valuation risks and US-China tensions. We're also bullish on industrials, supported by onshoring, infrastructure investments, and aerospace recovery, although mindful of policy uncertainty and high interest rates. Financials offer a cautiously bullish perspective, led by elevated interest rates and deregulation under the new administration, despite rising loan defaults. We also see a bullish case for utilities, driven by surging power demand from AI and data centers, and supported by investments in grid modernization and nuclear energy.

The energy sector presents a bearish outlook due to oversupply, geopolitical risks, and slow renewable adoption. We are similarly bearish on the real estate sector, challenged by prolonged high interest rates and declining commercial demand. We adopt a cautious stance on healthcare, recognizing its long-term growth potential but concerned by significant regulatory uncertainties and policy risks. Lastly, we hold a neutral stance on consumer discretionary, balancing the positives of tax reform and stabilized inflation against the challenges of elevated interest rates and potential tariff impacts on imports.





Technology

Karly Robledo, Sector Head; Robert Kasongo, Analyst; Sam Krachuk, Analyst; Kyle Goodner, Analyst

In 2024, the tech sector underwent transformative shifts that will likely define 2025. Artificial intelligence led the charge, with generative AI embedding itself into all sectors such as healthcare and finance, shaping how businesses operate. Quantum computing took significant steps forward, while cloud computing services expanded as businesses prioritized faster data processing. Investments in data centers surged as these demands grew, driven by the rise of AI workloads, which require massive computational power and storage. Tech titans like Amazon, Microsoft, and Google led the charge, pouring over $200 billion into expanding their global data center to support the increasing need for efficient infrastructure, ensuring the efficiency needed to support the next generation of AI and cloud computing advancements.

Macroeconomic Overview

Technology sector has generated 32% of global equity returns and 40% of the US equity market returns since 2010. Global tech sector's earnings per share have risen about 400% from its peak before the great financial crisis, largely driven by a small group of powerful stocks that include Apple, Alphabet, Nvidia, Tesla, etc. The exponential growth is largely attributed to key factors such as advancements in AI, the post-pandemic rebound, and the impacts of election results. Despite the Magnificent 7 having an advantage to the AI market share, new companies are constantly emerging, with over 60,000 patents issued by the end of 2022 about an 800% increase from 2014, highlighting rapid innovation within the sector.

Category	Market Weight %	Market Cap ($ billion)	24-month forward P/E
Magnificent 7 (2025)	33	17420	38
Tech Bubble Leaders (2000)	26	2530	52
Japan Financial Bubble (1989)	29	613	67
Nifty 50 Bubble (1973)	20	34	34

Up from 31% in 2024, the Magnificent 7 continues to dominate the S&P 500, making up an astounding 33% of its weighting. The P/E ratio of 38 indicates that tech stocks are currently expensive, but compared to historical bubbles, they are not as extreme. With the rampant growth from 2024 flowing into 2025, many speculate an AI bubble to be realized by the end of the year. Though this could be a possibility if growth did not experience slowdowns, it is unlikely because corrective actions are already happening within the industry.

The tech sector has an EV/EBITDA industry averages ranging from 20.0x-25x. While the tech sector is projected to grow over 7% for 2025 due to increased capital expenditures on AI, many investors still remain cautious about companies' valuations following 2024. In 2024, tech stocks brought remarkable returns of over 37% for the S&P 500, outpacing the average return of 23%. The momentum of this growth is expected to trickle into 2025, driving a return of around 10%. This indicates a slowdown of growth compared to 2024, but will still be relative to the overall growth of the S&P 500. The reality is that companies are not reducing their AI spending, with Google, Microsoft, and Meta planning to splurge $215 billion on capital expenditures, largely tied to the creation of AI data centers.

Key Technology and Sector Trends

The Technology Sector Select SPDR ETF summarizes the breakdown of the different sectors within the tech industry. The key catalysts for the industry are going to be macroeconomic tailwinds, AI and cloud integration, semiconductor expansions, and geopolitical & regulatory developments regarding the US-China tensions. Enterprise AI spending is projected to grow at a 37% CAGR through 2030, which is expected to propel the demand for AI chips and cloud computing. This will highlight the competitive edges of companies like Nvidia, Google, and AMD. The global semiconductor market is expected to reach $1 trillion by 2030 with AI-driven demand accelerating revenue growth, as the two sectors remain highly correlated. Finally, the US-China tensions and AI regulations could impact supply chains and investment flows in key tech segments affecting semiconductor manufacturers like Nvidia and companies that are reliant on Chinese supply chains like Apple. When it comes to investment trends, the global AI market is projected to reach 305.9 billion in 2025, growing at a 27.3% CAGR from 2023 to 2020. The semiconductor industry is expected to hit $650 billion in 2025, up from $556 billion in 2023. Cloud computing is expected to reach $1.35 trillion by 2025 growing at a 17.5% CAGR. According to our analysts, the global fintech market is expected to reach $556 billion by 2025 growing at 20.5% CAGR with Bitcoin and Ethereum ETF projected to bring in $100+ billion in new capital flows in 2025.

Risks and Challenges

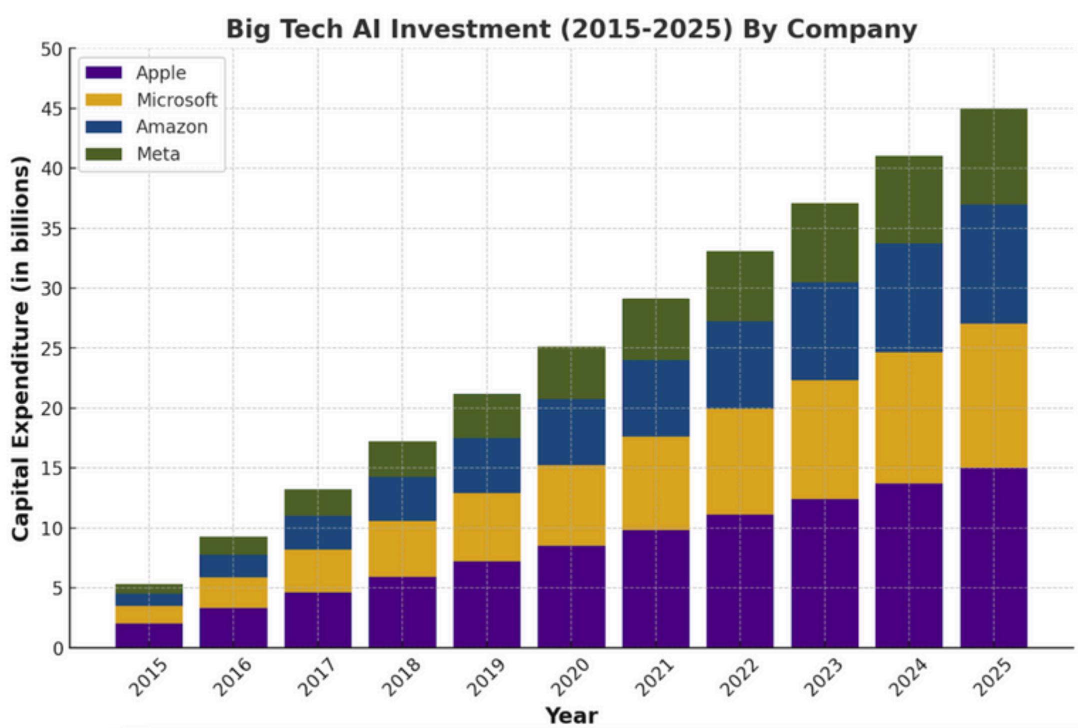
Despite the long strides of the Magnificent 7 in previous years, the tech market remains highly cyclical and is relatively sensitive to interest rates, political tensions, and news. A particularly notable scare came with the emergence of the Chinese AI, DeepSeek, whose advancements demonstrated that high-performance AI models may be developed at a fraction of traditional costs in the near future. This news erased almost $1 trillion in value from tech stocks.

Political tensions, specifically between the US and China, may create some supply chain challenges and regulatory problems, especially with the recent threats of tariffs. President Trump has implemented a 10% tariff on all Chinese imports, and there is a proposal of imposing a 100% tariff on semiconductors produced in Taiwan is in the works as well. Companies expected to be the most adversely affected include Apple and Nvidia and these political tensions pose various implications for other tech leaders.

The emergence of DeepSeek AI caused significant disruption, erasing over $1 trillion in market value, as they have proved that high performance AI models can be developed at a fraction of the costs, challenging the demand for massive computational power. Looking ahead to 2025, the sector must balance the increase in innovation with navigating political risks and economic uncertainty.

Investment and Outlook Opportunities

Artificial Intelligence has been a key concept within the technology industry for the past few years. Specifically, the development and implementation of large language models have offered new and innovative ways to perform tasks. AI chatbots are offered by many different companies now, Open AI's ChatGpt, Meta's llama, Alphabet's Gemini, X's Grok, Anthropic's Claude, and most recently out of China, DeepSeek's new model. However, the implications of creating and running models in a more efficient way can significantly impact tech companies' approach to AI. A changing data center landscape can significantly impact the semiconductor market which has been running at very high valuations. US tech companies, have invested heavily on building out infrastructure needed to support their AI operations. The 2025 outlook remains consistent, with many tech companies publicly stating they will increase capital expenditures beyond 2024 levels. These companies' CAPEX spending can be reflected in the stacked bar chart, and it is rising at a rapid pace. If LLMs (Large Language Models) become more cost-effective and efficient, semiconductor companies may see decreased sales as demand for high-powered chips declines. Nvidia initially had a negative reaction to the DeepSeek news but has since rebounded as US tech companies have not made comments about decreased spending. 2025 is predicted to be a year dominated by tech companies' attempts to improve on AI models continuing to create better, more capable versions. A looming question is when the investment costs will start to show profits for companies, as it has shown not to be profitable yet.



Final Thoughts

The technology sector experienced unprecedented growth in 2024 propelled by the advancements in AI, expansion of cloud computing, and semiconductor innovation. On a macroeconomic level, tech stocks outpaced the benchmark, delivering an attractive 32%. The Magnificent 7 has solidified their dominance, representing 33% of the S&P 500, and driving most of the 32% historical return. Upon their outstanding performance, investors have speculated valuations as industry average P/E ratios resemble previous bubbles within the market. Despite the expensive stocks, analysts believe corrective events are already in place. The Federal Reserve is keeping interest rates high, tariffs are being imposed on tech imports, and overall growth is slowing down. High-growth technology companies can sustain high P/E ratios for a lengthy amount of time, so it may not be a cause for concern. Looking ahead to 2025, Enterprise AI spending is projected to grow at a 37% CAGR through 2030, reinforcing Nvidia, Google, and AMD's competitive edge. The semiconductor market is expected to reach $1 trillion by 2030, with AI-driven demand accelerating revenue growth. With the challenges remaining, some analysts anticipate negative returns, but with corrective actions already taking place, this scenario is unlikely. Instead, moderate but sustainable growth is projected, with S&P 500 tech stock returns expected to slow from 37% in 2024 to around 10% in 2025, still outperforming historical averages and overall GDP growth.

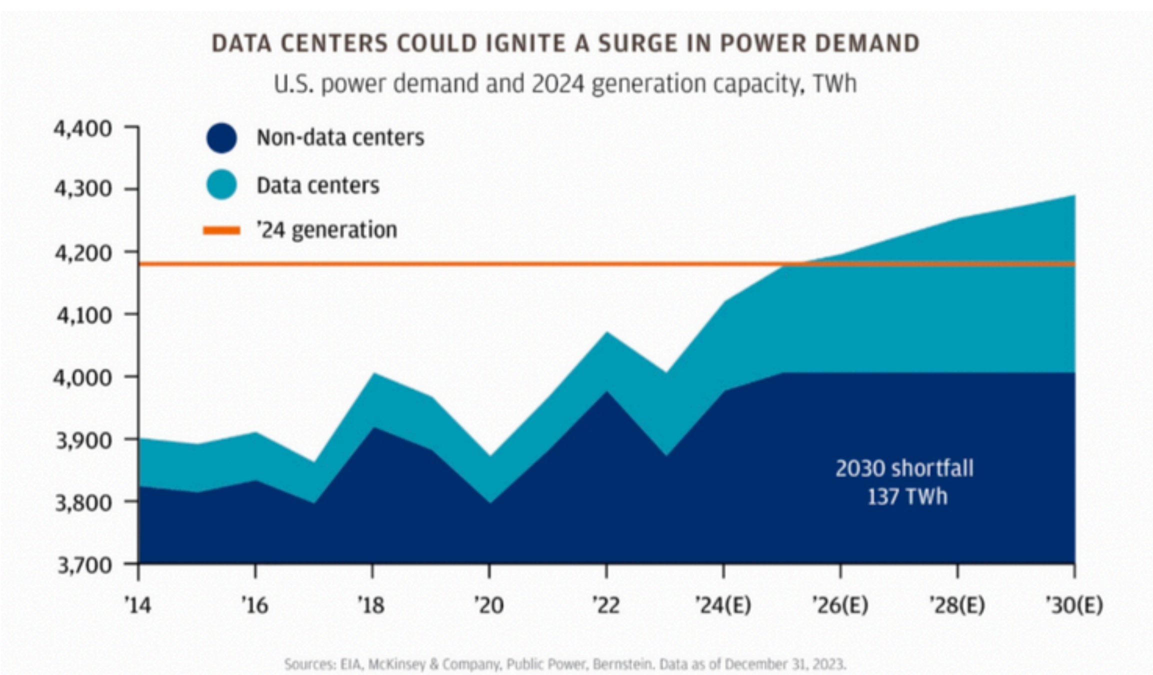
Energy & Utilities

Caroline Pellegrini, Sector Head; Alexandra Vogt, Analyst; Brock Bordelon, Analyst

The energy and utilities sectors are uniquely positioned in 2025. Geopolitical tensions continue to drive uncertainty. OPEC+ production and trade policies are expected to impact the efficiency of supply chain operations. Nuclear power is increasingly establishing itself as a source to help meet the increasing power demand driven by the expansion of AI and data centers. Additionally, regulatory shifts following the 2024 U.S. elections have the potential to slow the growth of low-carbon investment strategies for energy companies.

Utilities and Power Generation

The utilities sector is positioned to see positive and significant changes in 2025. Demand is expected to increase sufficiently as a result of the growing adoption of AI. J.P. Morgan Private Bank stated that they expect power demand growth in the United States to increase by 5x to 7x over the next 3-5 years. With data centers demanding more electricity, more water will be required for cooling and chip fabrication. To emphasize the scale of the water required in the process of creating chips, Interface provides this statistic: “A large semiconductor fabrication plant (fab) uses up to 38 million liters per day, equivalent to the daily water consumption of around 300,000 people”(Hess, 2024). However, the sector is facing issues related to grid reliability. Companies will need to invest in safety and reliability as infrastructure ages and cybersecurity threats raise more concerns. Overall, the utilities sector provides an opportunity for investors to capitalize on the substantial boost in demand for power.



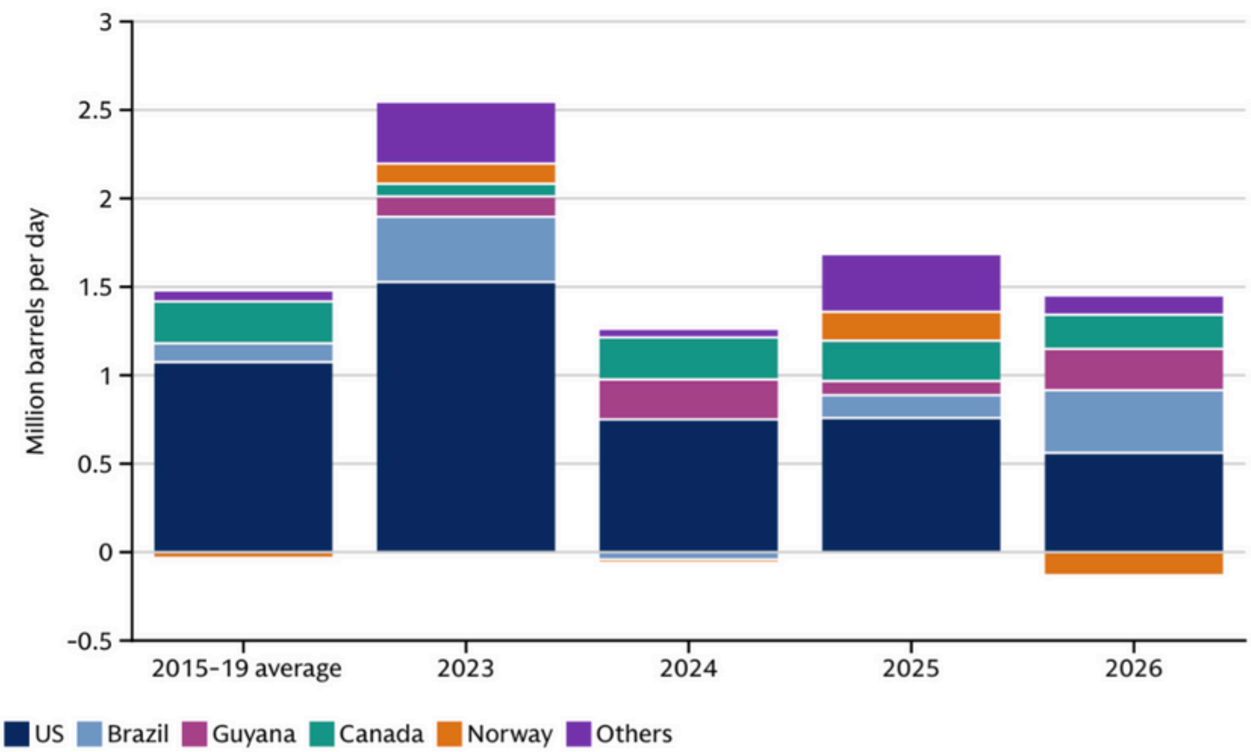
Oil & Gas

Throughout 2024, geopolitics made for an unpredictable year in the oil markets. Brent crude oil averaged around $80 a barrel but fell to as low as $70 at times. Higher spare oil supply coupled with steady global demand is likely to put a cap on oil and gas prices. The surplus is expected to primarily come from ramped-up production in non-OPEC+ nations. Contributing to this growing supply is the expected boost in the production of oil under the policies of the new administration. According to Goldman Sachs, most of the growth will come from the US, in particular, as well as Canada, Brazil, and Guyana. Oil demand is expected to remain resilient. Emerging markets are expected to increase GDP by roughly 4% in the next five years, and as these nations become more wealthy, more energy will be needed to fuel the developing economy. Additionally, plastics and air travel are facing decarbonization challenges that contribute to a resilient demand. However, it is unlikely we will see enough growth to match the pace of increasing supply.

OPEC+ production cuts will keep oil prices stable in early 2025, but as more oil is produced and demand continues at its same pace, prices are expected to fall. Brent crude is forecasted to average $74 per barrel in 2025 and drop to $66 in 2026.

Oil production in non-OPEC nations is set to increase in 2025

Non-OPEC ex. Russia liquids supply growth by region



Source: IEA, Goldman Sachs Research
Goldman Sachs Research uses the IEA for 2015-2019 averages. Kazakhstan (190 kb/d), Sudan+South Sudan (90 kb/d), and Oman (60 kb/d) drive the "Others" growth in 2025.

Goldman Sachs

Global oil supply is expected to grow by 1.9 million barrels per day in 2025 as non-OPEC countries ramp up production and OPEC+ relaxes its cuts. We expect larger, integrated companies like Exxon and Chevron to show resilience against declining market prices because they diversify revenue streams across renewables, exploration, refining, retail, chemicals, etc. Geopolitical events often impact oil markets significantly. Any unprecedented tensions could change the trajectory of our current predictions.

The oil and gas industry is currently seeing a significant amount of consolidation as M&A activity picks up. Major players are taking advantage of their excess cash reserves by acquiring other firms in order to position themselves for greater scale and efficiency.

Renewables & Energy Transition

For renewables and the energy transition, we will continue to see innovation in the space, but near-term challenges will serve as headwinds for new developments. AI and machine learning will improve the efficiency and costs of the energy transition. Reshoring of solar panels and battery manufacturing will ease supply chain complications and potentially help with growth. Policies such as the Inflation Reduction Act (IRA) have historically provided significant incentives for renewable energy development. However, policy changes under the new administration could slow the pace of the growth trajectories. Storage and transportation issues for alternative energy sources such as wind and solar prevent them from providing consistency. Nuclear power is being reconsidered as a stable, low-emission solution. The nuclear power industry is seeing significant investment and will likely continue to be a focal point in the clean energy transition. Despite existing challenges, renewable energy sources are still expected to see growth.

Key Players

The oil, natural gas, and utilities sectors are dominated by several key players across a variety of different segments. In oil and gas, supermajor integrated firms like ExxonMobil and Chevron operate across the entire value chain, while national oil companies such as Saudi Aramco and PetroChina control their respective national supply. Independent producers, such as EOG Resources, focus on exploration and production, particularly in U.S. shale, while midstream firms like Kinder Morgan manage transportation and storage. The majority of these firmly positioned companies are also investing in renewable energy. Together, these companies shape global energy markets while navigating shifts toward carbon efficiency and energy security.

ExxonMobil is one of the world's largest and most influential energy companies, playing a dominant role in the downstream, midstream, upstream, and renewables spaces. ExxonMobil's production volume is expected to double by 2027, primarily influenced by its acquisition of Pioneer Natural Resources. The overall performance of this company plays a major role in the performance of the energy sector and is crucial to meeting global demand. Occupying 1.3-1.5% of the weighting of the S&P, ExxonMobil’s stock value is a major driver in the success of many S&P 500-based funds, placing immense pressure to continue to perform and provide positive returns.

Southern Company is one of the largest regulated utility companies in the U.S., providing electricity and natural gas to millions of customers across the Southeastern states. As a key player in the U.S. utilities sector, Southern Company plays a vital role in the overall success of the sector. Amid the energy transition, Southern Company is poised for growth based on its investments in nuclear energy and grid modernization.

Baker Hughes is a leading oilfield services and energy technology company with a large market share in the energy transition sector. It is a key partner for some of the supermajors in oil and gas integration, ensuring the company's need for traditional oilfield services.

Cheniere Energy is a leading producer and exporter of LNG in the United States, benefiting from strong global demand and long-term export contracts. Cheniere is well-positioned to capitalize on growing LNG exports, particularly to Europe and Asia. The company’s stable cash flows, expansion projects, and shareholder-friendly capital returns make it an attractive stock to watch.

Final Thoughts

Global oil markets are likely to be characterized by a combination of increasing production and steady demand. Despite current challenges, the long-term outlook for renewables remains promising. Utilities are positioned for growth as demand for power surges. Capitalizing on the energy and utilities sector in 2025 requires an understanding of these potential impacts on the sector and the ability to adapt to an evolving energy landscape.

Industrials

Alexander Bares, Sector Head; Vincent Palermo, Analyst; CJ Gullotta, Analyst

The industrials sector is composed of a diverse set of industries, including aerospace and defense, construction and engineering, transportation, machinery, and electrical equipment. This sector plays a fundamental role in economic growth, as its performance is often correlated with infrastructure investments, manufacturing output, and global trade trends.

In 2024, industrials faced challenges from high interest rates, supply chain disruptions, and fluctuating demand across different subsectors. However, onshoring efforts, increased infrastructure spending, and commercial aerospace recovery have provided a strong foundation for growth moving into 2025.

Figure 1: The Industrials sector underperformed the broader S&P 500 Index
Source: Fidelity Viewpoints

Market Performance & Macroeconomic Environment

The industrials sector has shown modest growth over the past year, supported by government policies aimed at revitalizing domestic manufacturing. While the S&P 500 grew 18.21% in 2024, industrials saw a more moderate return due to capital expenditure constraints caused by elevated borrowing costs. However, inflation easing and potential interest rate cuts in 2025 may stimulate growth in key areas such as housing, construction, and aerospace.

Onshoring and Infrastructure Investment

One of the most prominent trends driving the sector is the continued push for onshoring and domestic manufacturing expansion. Government initiatives such as the Inflation Reduction Act, CHIPS Act, and Infrastructure Investment and Jobs Act have fueled a surge in large-scale industrial projects. As of late 2024, approximately $1.9 trillion worth of new manufacturing projects have been announced, with only 25% of these entering the construction phase. This suggests strong future demand for industrial equipment, transportation, and construction services.

Beneficiaries of this trend include:

- Eaton Corp. (ETN): Electrical systems provider benefiting from increased investments in infrastructure and electrification.
- United Rentals (URI): A leader in construction equipment rental, positioned well to support large-scale manufacturing projects.
- Parker Hannifin (PH): A key supplier of motion and control technologies in industrial and aerospace applications.

Commercial Aerospace Recovery

The aerospace industry is recovering from years of turbulence, as airlines continue to rebuild fleets and expand capacity following the COVID-19 pandemic. Supply chain challenges and labor shortages have delayed aircraft deliveries, leading to increased demand for aftermarket services and aircraft components. Increasingly, companies are identifying technological integration to address the need for enhanced efficiency. AI-powered operational planning systems can add predictability to sustainment practices, helping expedite aircraft availability.

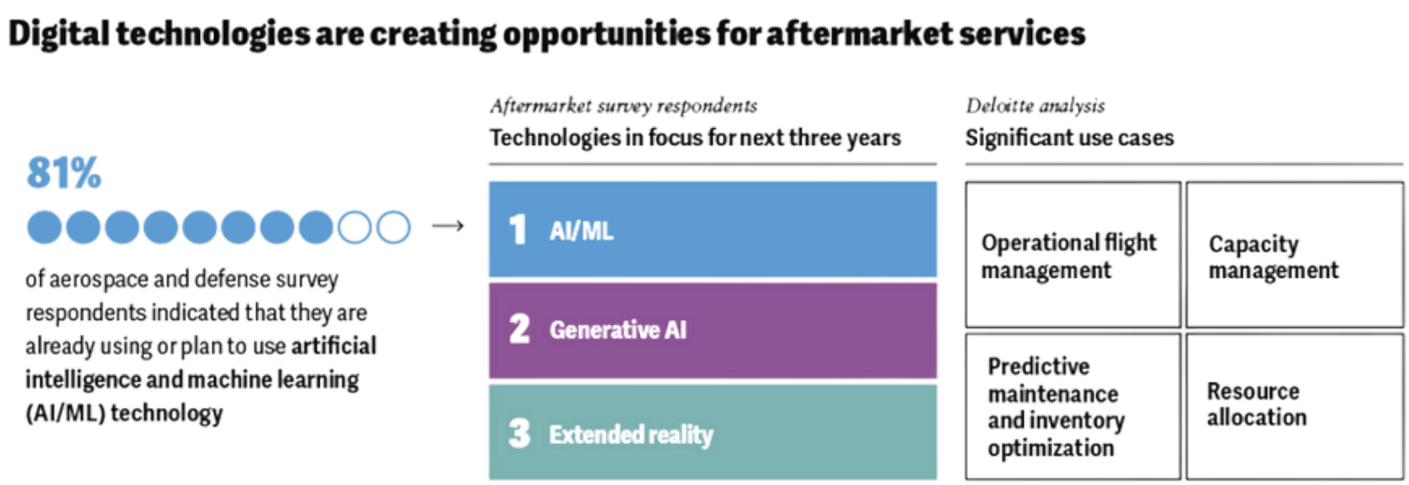


Figure 2: AI and ML helps mitigate supply chain issues
Source: Deloitte Future of Digital Customer Experience survey

Companies poised to benefit include:

- GE Aerospace (GE): A major supplier of aircraft engines and repair services.
- TransDigm Group (TDG): Specializing in aftermarket aerospace components, benefiting from airlines extending the life of older aircraft.
- Boeing (BA): A core manufacturer expected to increase production as demand for commercial aircraft continues to grow.

Housing Market & Building Products

Despite a slowdown in new home construction due to high mortgage rates in 2024, the housing sector may gain momentum in 2025 with potential Federal Reserve interest rate cuts. This could boost demand for building materials, HVAC systems, and construction-related industrials.
Key beneficiaries include:

- Trane Technologies (TT): A leader in HVAC solutions, benefiting from increased residential and commercial renovations.
- AZEK (AZEK): Specializing in outdoor building materials, positioned well for increased housing activity.
- Fortune Brands Innovations (FBIN): Focused on kitchen, bath, and security products, likely to gain from home improvement trends.

Growth Potential & Risks

Growth Drivers:

- Government Infrastructure Spending: Public funding for roads, bridges, and electrical grids supports long-term industrial demand.
- Nearshoring & Supply Chain Restructuring: Manufacturing returning to the U.S. increases demand for industrial equipment and logistics solutions.
- Electrification & AI Integration: Increased investment in smart factories, automation, AI-driven manufacturing, and data centers is driving demand for industrial technology solutions.

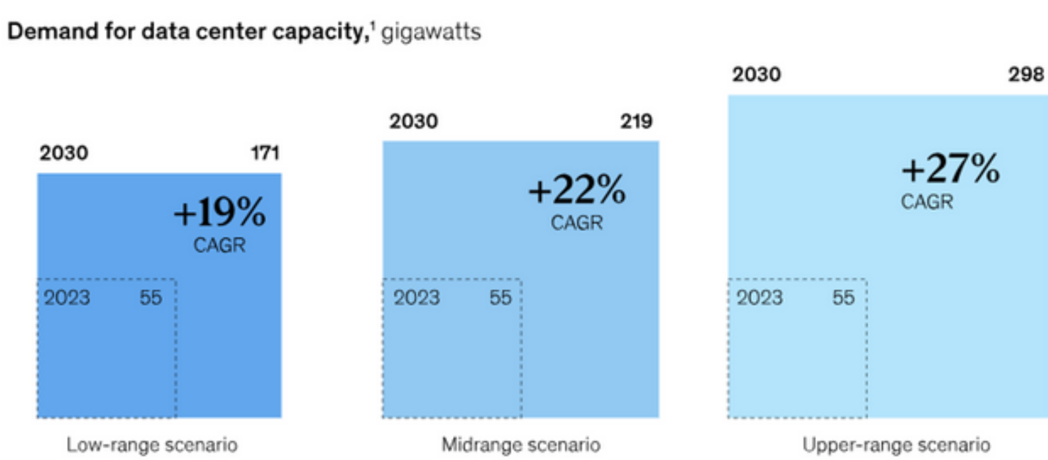


Figure 3: Global demand for data center capacity could more than triple by 2030
Source: McKinsey & Company Data Center Demand model

Key Risks:

- Regulatory Uncertainty: Changing trade policies and geopolitical tensions may impact global supply chains and industrial exports.
- Persistent Inflationary Pressures: While inflation has moderated, rising labor and input costs remain a concern for industrial manufacturers.
- Labor Shortages: The inability to attract and retain skilled workers could limit production capacity in key industrial segments.

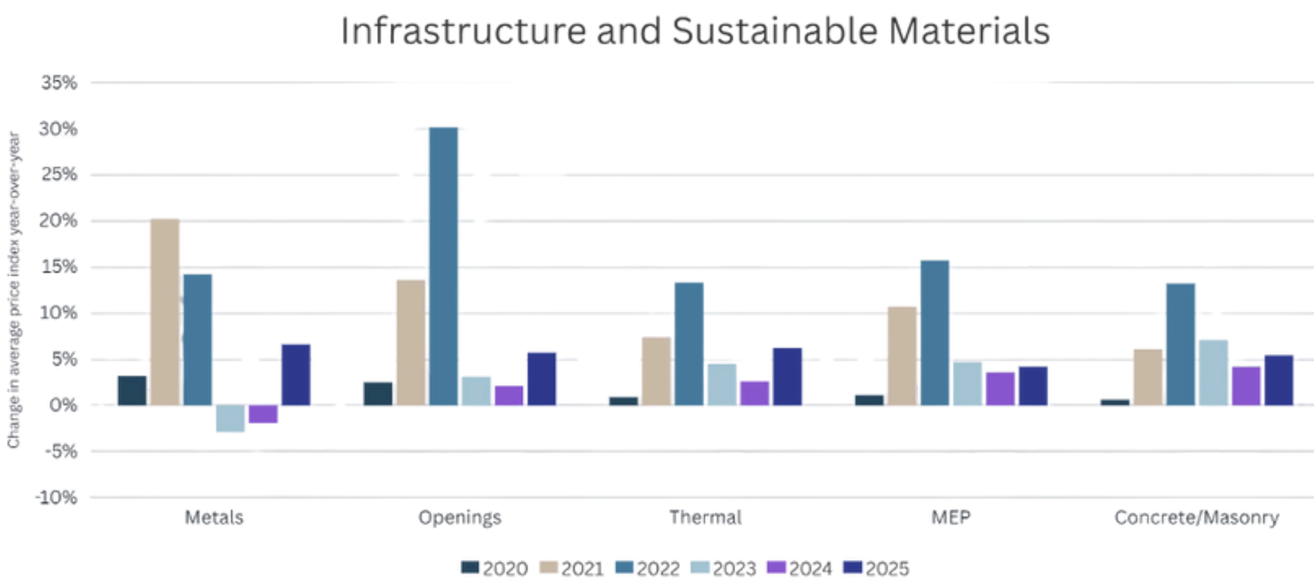


Figure 4: Projected Rise of Infrastructure Materials Costs
Source: JLLResearch

Final Thoughts

The industrials sector is well-positioned for long-term growth in 2025, supported by strong macroeconomic trends such as onshoring, infrastructure investment, and aerospace recovery. While risks remain, particularly around policy shifts and inflation, many industrial companies appear poised to capitalize on continued demand for manufacturing, construction, and transportation solutions. Investors should closely watch policy developments and economic data to identify the best opportunities within this dynamic sector.

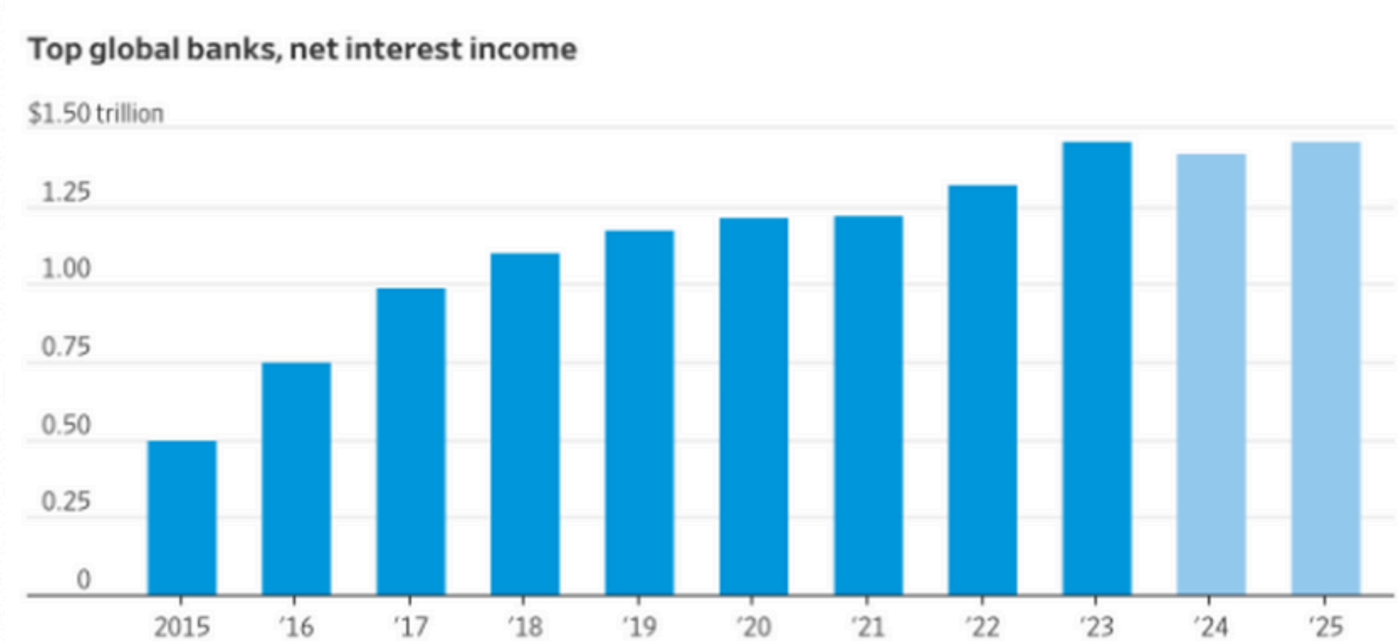
Financials & Real Estate

Landin Sanborn, Sector Head; John Genung, Analyst; Eli Hope, Analyst

For 2025, we believe that the financial services sector will continue to benefit from ongoing macroeconomic and policy trends, capturing the momentum from the previous year which saw a 24.61% return for the sector. Namely, with the slow and stable cut of interest rates, decreasing regulation of financial markets, and resulting positive demand shifts, firms in this sector should profit from a very favorable environment for the year to come.

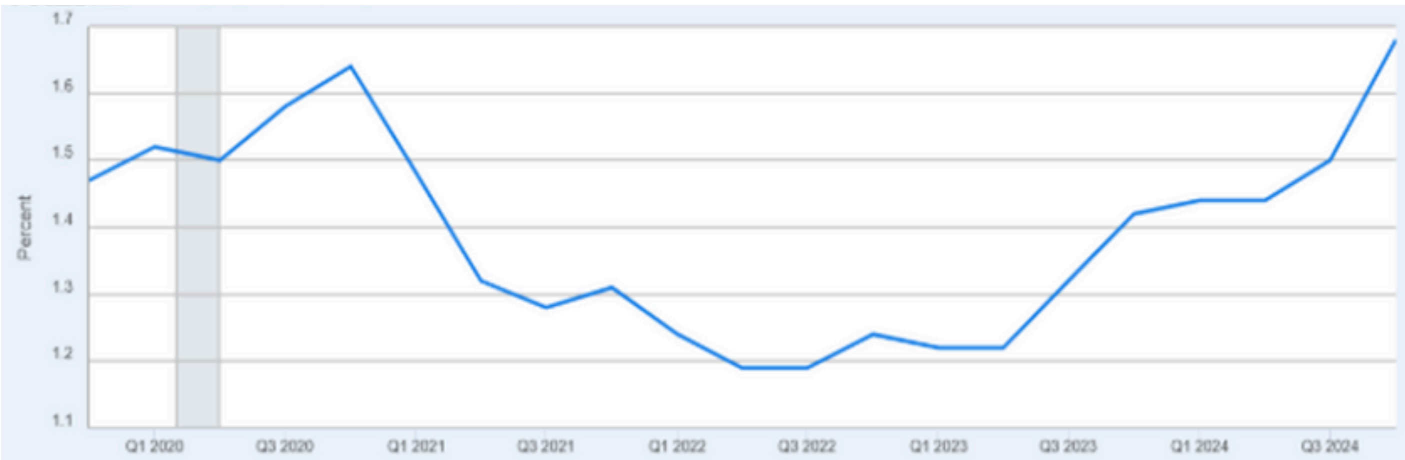
Macroeconomic Overview

As a result of the macroeconomic environment, the Federal Reserve is expected to keep interest rates elevated for a prolonged time. Speaking to the Senate banking committee, Jerome Powell stated the central bank is not "in a hurry to adjust our policy stance." We expect this to have several implications in the financial services sector: first, this should keep the net interest margin (NIM), or the difference between the interest rates an institution earns on its assets and the rates it pays on its liabilities, elevated for companies during at least the first half of 2025. Generally, NIM increases during periods of higher rates. Likewise, assuming rates aren't cut until later in the year as expected, and combined with positive demand factors, financial institutions should expect an increase in net interest revenue in the meantime.



Notes: Only includes banks with more than $100 billion in assets. Lighter bars are median forecasts by analysts.
Source: Visible Alpha

Secondly, with postponed and less drastic cuts, we expect a wave of higher loan demand. For example, according to Raddon Research Insights, an estimated 48% of consumers expect to apply for a loan in the next 12 months going into 2025, the second highest level they've ever recorded. Likewise, credit providers should see more increases in revenue in the near future. The only corresponding risk is that loan defaults are on the rise, a notable issue, but not one that has negatively impacted firms in the past several years. However, if delinquency rates (pictured below) continue to rise, this risk could become much more serious.



Delinquency Rates on All Loans, All Commercial Banks
Source: FRED

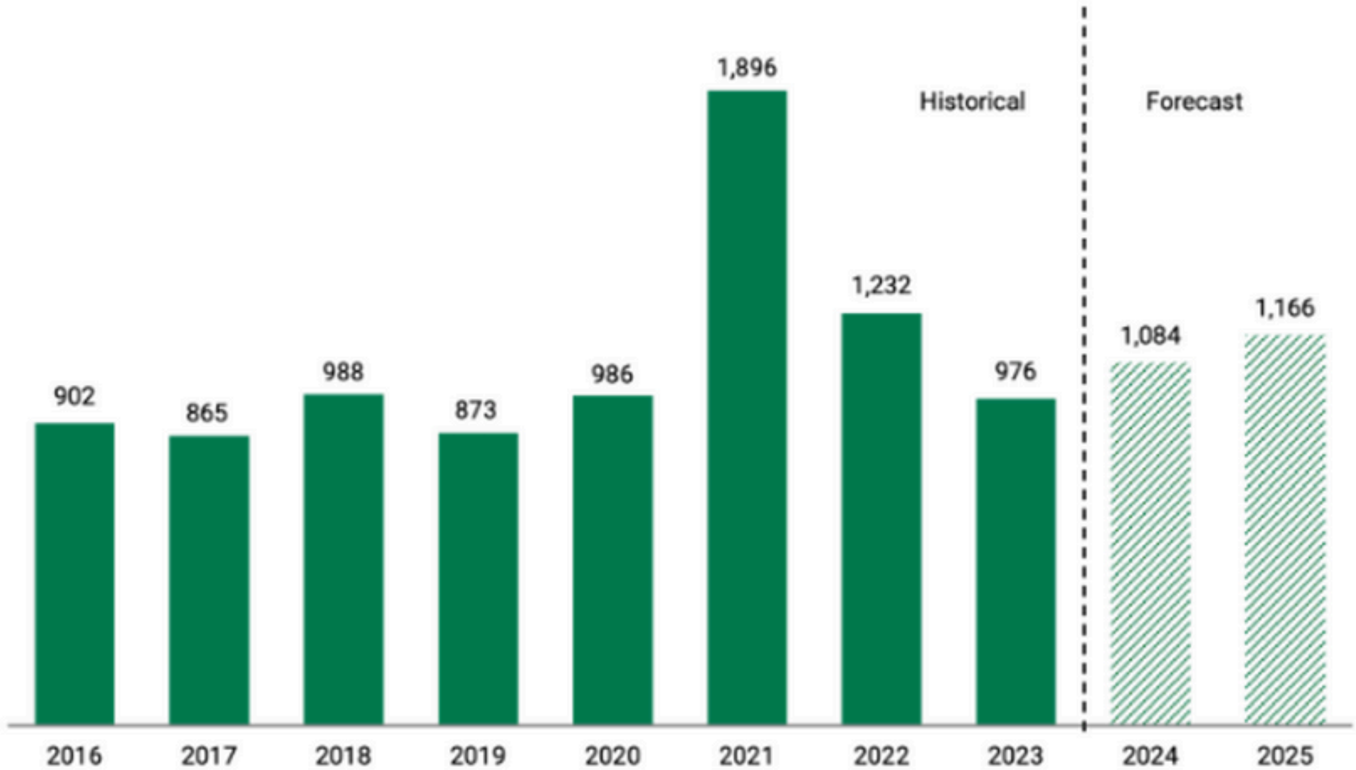
Public Policy Impacts

In addition to economic trends, with the election of Donald Trump to the presidency, we expect political tailwinds to further bolster the sector. For example, Trump recently signed an executive order requiring a review of all current federal regulations, and as a result, many of the regulations involving the financial services industry are likely to be revoked or revised, clearing red tape for firms in the sector. In addition, Trump has signed an executive order giving the administration more oversight of independent federal agencies such as the Securities and Exchange Commission or the Federal Trade Commission, a decision that makes deregulation easier for the administration. Also, Trump's appointments to several key offices will magnify this trend. For example, Jonathan Gould, the recently nominated head of the Office of the Comptroller of the Currency, oversaw many deregulatory initiatives during Trump's first term and is expected to implement more bank-friendly policies. Given the policy shifts, firms in the financial services sector should especially see a friendlier environment in which there is more room for profitability and a lower likelihood of compliance costs or issues.

In particular, as a result of fewer regulations and lower rates, we anticipate more M&A activity for the upcoming year. Not only will mergers and acquisitions be cheaper to finance with debt, but they'll be more likely to be approved by federal officials going forward.

M&A Activity

As so, most projections for M&A activity forecast a significant increase in 2025. One forecast by EY-Parthenon (shown below), for example, suggests a 10% increase in total U.S. deal volume from 2024. If these projections hold up, investment banks in the industry who underwrite these deals should continue to see a large benefit to their revenue streams.



Data from 6/30/2016 – 12/31/2025 for disclosed deals $100 million or greater. Data for 2024 and forward are estimates as of 11/21/2024. Subject to change. Forecasts are not a reliable indicator of future results. Source: Dealogic, EY Parthenon.

Potential Headwinds

Despite these positive catalysts, there are some possible headwinds for the financial services industry. As mentioned before, there is an elevated risk of more widespread loan defaults in the future. Although unlikely, this could present the chance of larger negative impacts on firms' revenue streams.

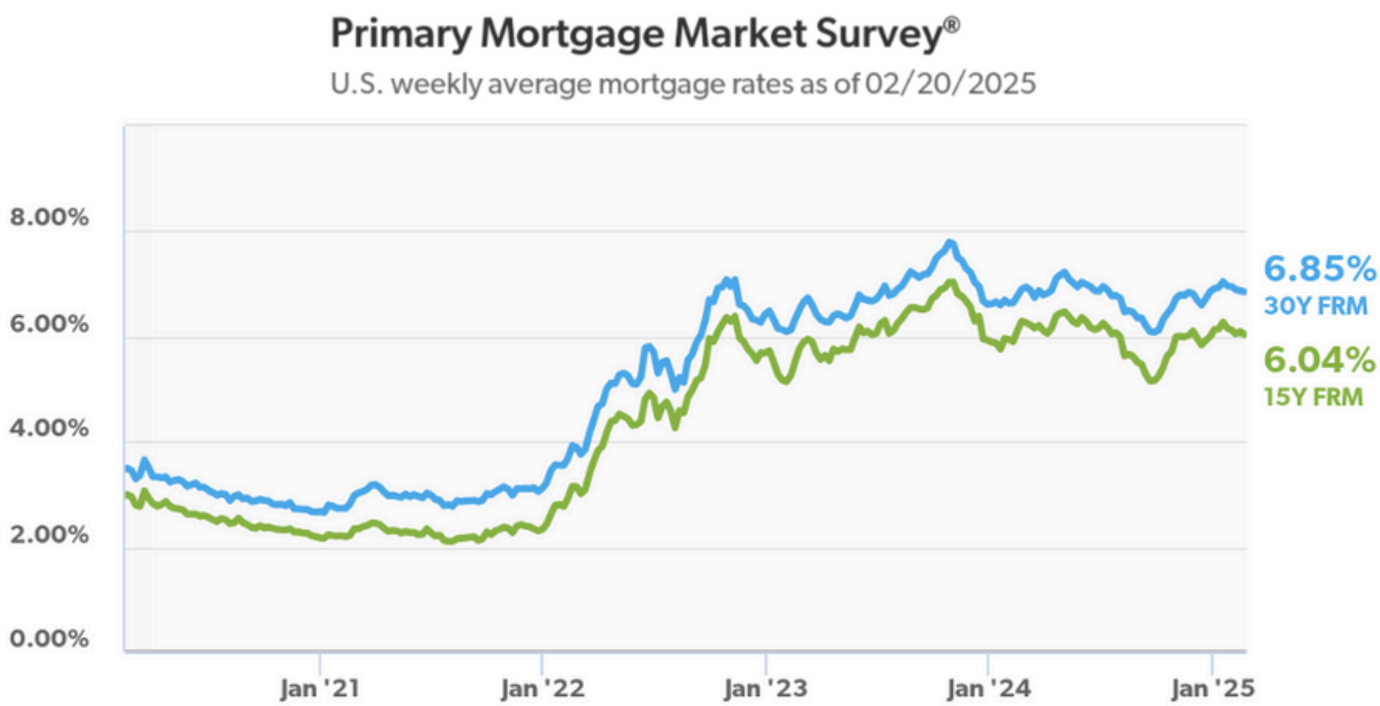
Additionally, the insurance industry faces serious risks from more frequent and more serious natural disasters which could lead to large scale losses. Some firms are adapting by changing their rates or where they offer certain services; however, regulations could challenge how insurance companies mitigate risk. For instance, one California law requires that insurers receive approval from the state's Department of Insurance before changing rates, a process that some argued drove insurance companies out of the state before the wildfires at the start of 2025.

Lastly, under the new presidential administration, there are some market-wide fears about the economy stemming from trade and immigration policy which could pose a headwind to demand for financial services, although this effect is unclear so far. While some of these risks are difficult to identify or quantify, they could have a real effect on the sector.

Real Estate Overview

In 2024, the real estate sector of the S&P 500 struggled considerably, underperforming the index by nearly 20%. Among a variety of causes were prolonged higher interest rates, a weak commercial real estate market, and both housing demand and supply struggling. Going into 2025, these issues are either ongoing or worsening, leading to a bearish outlook for the real estate market.

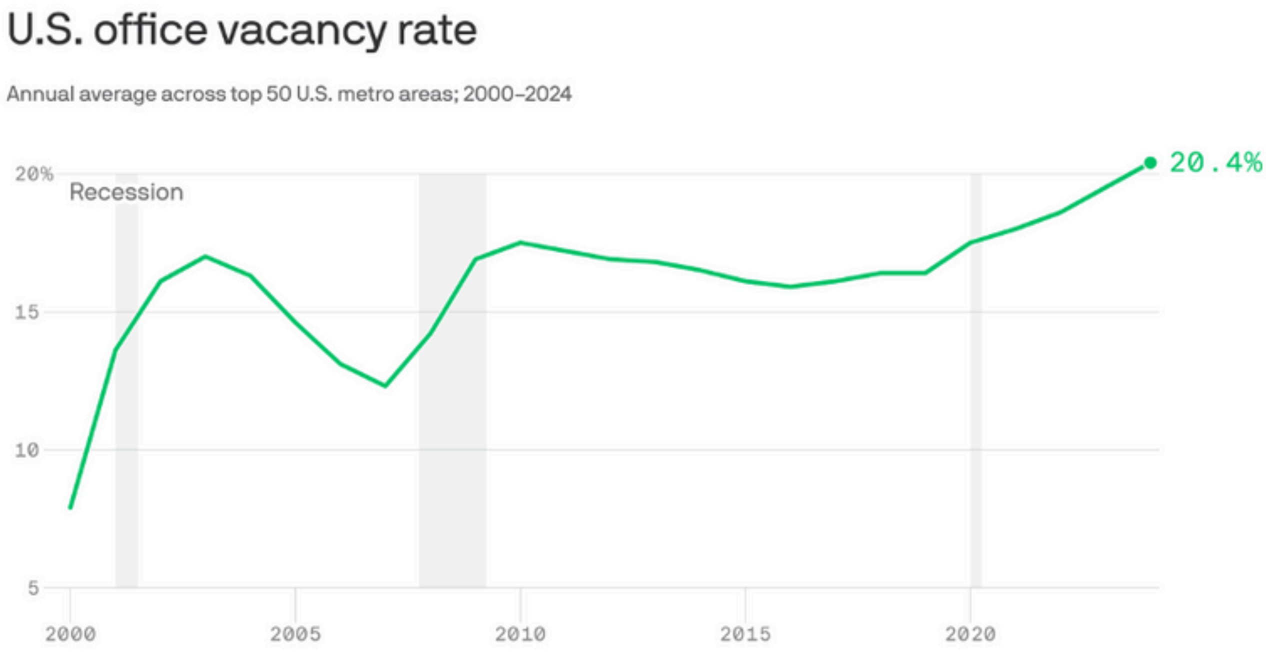
Firstly, short term interest rates are being cut at a much slower pace than originally anticipated. Whereas most economists and consumers believed interest rates would continue to be cut going into 2025, they're now not expected to be cut until the middle of 2025, and even then, only at a gradual pace. Additionally, long-term interest rates have actually increased since Donald Trump's election over fears of long-term inflation. Having already been high since 2022, increasing rates are likely to continue stifling demand for real estate.



Source: Freddie Mac

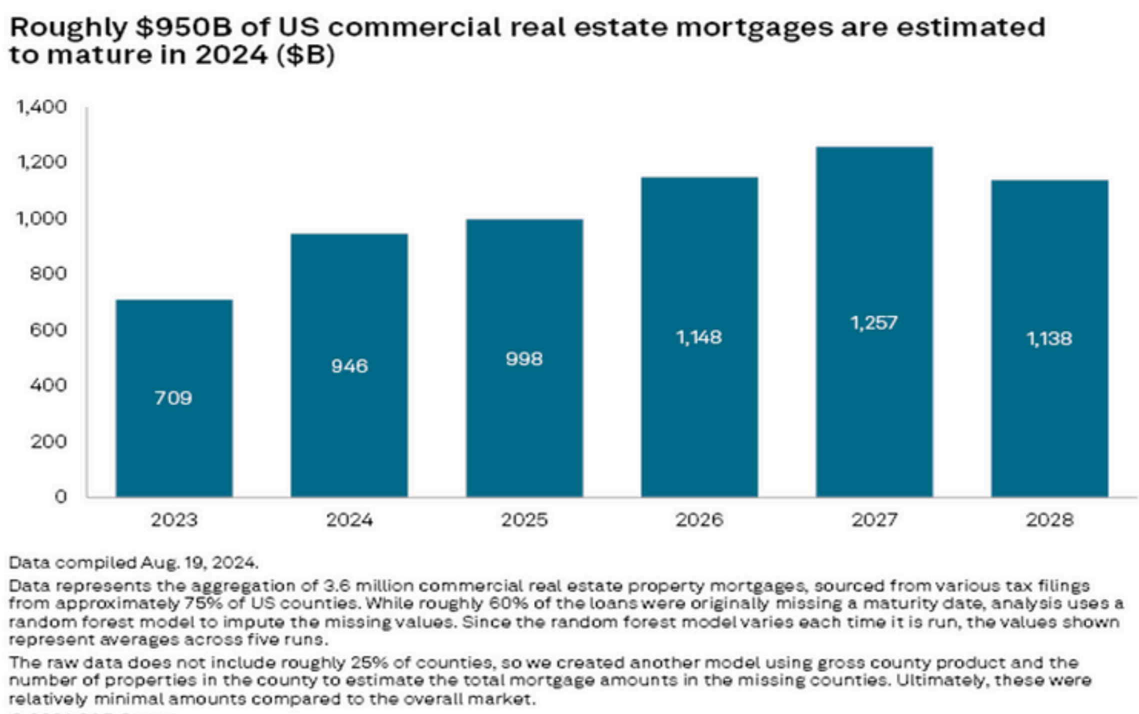
Commercial Real Estate

In addition, the commercial real estate market is already struggling with decreasing demand. Specifically, with companies' transitions to hybrid and remote work over the past 5 years, office space isn't as valuable as it once was. Increasing office vacancy rates (which have recently hit all-time highs according to Axios, as shown below) could significantly hurt margins in the commercial real estate industry as firms are forced to charge less for rent to meet demand.



Annual average across top 50 U.S. metro areas; 2000-2024
Data: Moody's; Chart: Axios Visuals

Additionally, this industry will face a maturity wall in 2025 where many long-term debt obligations (made when interest rates were much lower) are due this year. Since interest rates are considerably higher, the cost of refinancing this debt could be extremely costly. This especially pertains to the commercial real estate industry where some property values have seriously declined after the COVID-19 pandemic. According to S&P Global, this wall could grow to upwards of $1 trillion in 2025.



As landlords struggle to refinance debt, the industry may see more distressed asset sales or defaults leading to significant losses. In addition, banks with high exposure to these loans may begin to pull back on lending, leading to higher rates, and worsening the issue. Given that long-term interest rates are unlikely to come down much and companies are likely to keep moving away from in-office work, we expect these trends to continue to negatively impact returns in this sector.

Additional Factors

Moving away from commercial real estate, we also expect negative supply and demand shifts in the residential market also. Starting with supply, we believe tighter immigration policy may make new home construction more difficult and costly. An estimated 30% of all U.S. construction workers are immigrants, and roughly 10% of immigrants are employed in construction. Restrictive immigration policy, either through deportations or other means, could negatively impact labor, and likewise housing, supply. On the demand side, restrictive immigration policy would mean less renters and home buyers in the U.S., which could drive down rent/home prices, as well as the volume of home sales. Although the effect on home prices is unclear with both negative supply and demand shocks, the quantity of housing supplied would almost certainly fall depending on the measures taken by the new administration. Likewise, certain real estate firms would see a decrease in revenue and lower growth in 2025.

In terms of positive catalysts, the real estate sector should still see rate cuts later in 2025 which would possibly bring demand back to the market. Also, if wage growth can exceed inflation in the near future, the higher real incomes could bolster demand too. If not, a weakening dollar could also make U.S. real estate cheaper and more attractive for foreign investors. Although these catalysts rely on hypotheticals, they provide a silver lining for an otherwise struggling sector.

Final Thoughts

Overall, we feel bullish on the financial services sector due to the economic and political climate going into 2025. While there are possible risks in some industries, the upsides heavily outweigh these, and with the right diversified portfolio, this sector is poised to deliver more great returns this year.

The risks present in the real estate market today lead us to feel bearish on the real estate sector as a whole. Although there are possible positive catalysts, they're outweighed by adverse economic and political circumstances. Still, this could change by the end of the year, but such a change would be highly dependent on looser monetary policy.

Healthcare

Milford Davis, Sector Head; Barrett Broussard, Analyst; Joseph Liberto, Analyst

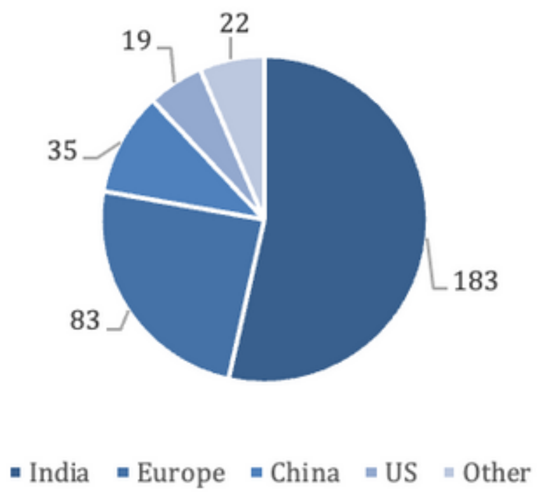
The healthcare sector is built upon by many sub-sectors. Pharmaceuticals, healthcare equipment, biotechnology, and managed healthcare are the largest and most weighted in the sector. Pharmaceutical companies develop vaccines, prescriptions, and Over-the-Counter drugs and medications. The healthcare equipment industry builds medical equipment for surgery and patient care. Biotech firms use molecular techniques to develop treatments and drug materials. R&D is important for this sub-sector as investments are being made for new discoveries in healthcare.

The healthcare sector is a defensive sector that is driven by constant demand. The sector faced challenges last year due to political factors and uncertainty, most of this coming from an election and the possibility of a new administration. Year to date, the sector had a return of -1.47%, which was significantly below the S&P 500's +18.2%. The underperformance of the sector has led to a potential entry point and presents long-term growth opportunities.

Figure 1: Healthcare Sector Performance vs. S&P 500.
Source: Yahoo Finance

Although the macroeconomic environment plays a major role in shaping the healthcare sector's performance, so for this year, the sector has been shaped by policy uncertainties with a new administration. Along with this, macroeconomic factors have played a role. With inflationary pressures easing since 2022 highs and interest rates stabilizing, healthcare companies may benefit from lower borrowing costs. Although this can impact the sector performance, regulatory uncertainties with the new administration are still prominent influencing the sector into 2025.

The Department of Human and Health Services led by RFK has already started to influence healthcare policies in the United States. With his recent confirmation, we expected to see increased volatility around his policy announcements. Markets tend to respond negatively to uncertainty, which could lead to potential selloffs in the sector. These potentially impact biotech and pharmaceuticals the most. If this administration proposes changes or new vaccine policies, large pharmaceuticals could face challenges. RFK has also proposed FDA reforms that could cause an FDA delay. This could slow the drug approval timelines. In the past, he has also criticized high drug costs which could maintain pressure on profit margins.



The Trump administration has recently proposed a 25% tariff on pharmaceuticals that could impact the sector if implemented. With this, Indian and Chinese generic drug makers could face higher costs when exporting to the United States. Since India supplies over 40% of generic drugs in the U.S., tariffs could increase these drug prices for American consumers and healthcare providers. These price increases could actually benefit U.S. drug makers by making their prices more competitive with generic drugs.

Figure 2: Number of factories making more than 10 active ingredients for the U.S. market.
Source: Bloomberg

Pharmaceuticals

The pharmaceutical industry has seen success with GLP-1 obesity drugs and is expected to have revenue growth this year. Key areas contributing to this growth include immunology and continued demand for GLP-1 based drugs.

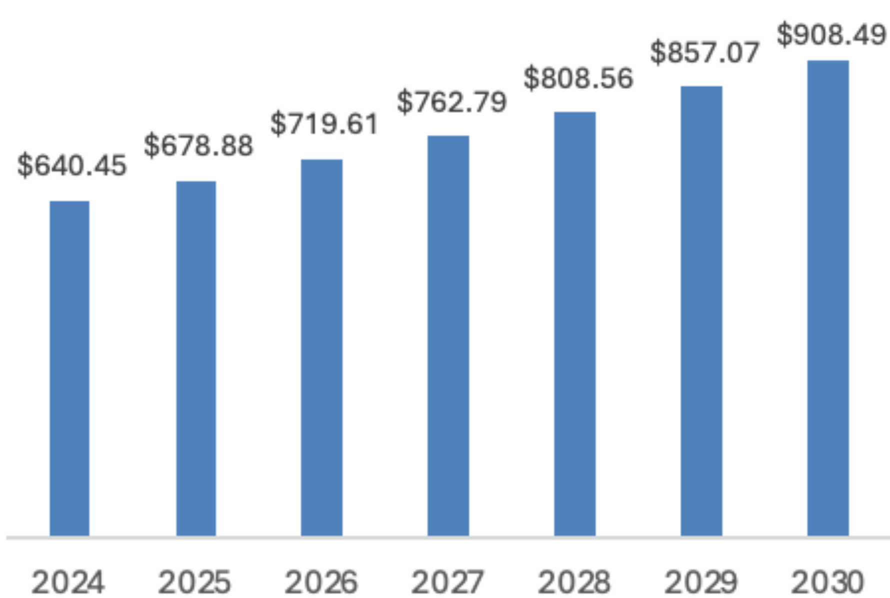


Figure 3: Medical Devices Market Size (USD Billion)
Source: Precedence Research

Healthcare Equipment

In 2024, this subsector was valued at about $640.45 billion and is expected to reach $678.88 billion this year. This growth has been increasing due to many factors but largely due to an aging population and increasing prevalence of chronic diseases.

Biotechnology

Similarly to pharmaceuticals, this subsector is expected to have growth in 2025 with advancements in gene editing and AI-driven drug discovery. M&A is also expected to increase with stabilizing borrowing rates. Regulatory and policy shifts within the FDA could create challenges for this subsector this year.

Managed Care

In 2024, this subsector faced challenges with increased usage due to resumed treatments that were postponed during the pandemic. This led to higher costs for insurers. If these utilization rates stabilize in 2025, companies under this sector could see financial improvements.

Growth Potential and Risks

Overall, M&A is expected to increase in biotech and pharmaceutical companies with borrowing rates starting to stabilize. The need for these companies to expand their drug pipelines is also expected to increase. This, along with constant demand for healthcare, shows potential for long-term growth opportunities in this sector. Although there are these long-term opportunities, there are major risks that can bring volatility to this sector in 2025.

Key risks include:

- Regulatory Uncertainty: Possible drug regulations like pricing caps and FDA policy changes could affect production and profits.
- Macroeconomic Challenges: Recent inflation data shows that although it has eased since 2022, inflationary risk still lingers. Labor shortages also continue to impact the sector.
- Reimbursement Pressures: Potential changes in Medicare and Medicaid funding could affect profitability in some subsectors.

Final Thoughts

Overall, the healthcare sector does have potential for growth in 2025, especially due to its current market position. Although it does have this potential, we believe that there is still significant uncertainty surrounding market conditions. We also see these uncertainties around policy changes from the new administration. Currently, this risk overshadows many of the opportunities for the sector and will have a continuous influence on how this sector performs during the year.

Consumer Goods

Drew Brignac, Sector Head; Kyle Goodner, Analyst; Guy Hargon, Analyst; Declan Connolly, Analyst

The Consumer Goods Sector is divided into two main subsectors: Consumer Staples and Consumer Discretionary. Consumer Staples or “defensive” include essential goods such as food, beverages, household products, and personal care items, which maintain steady demand regardless of economic conditions. On the other hand, Consumer Discretionary or “cyclical” goods include non-essential items such as apparel, luxury goods, electronics, and automobiles, which are more sensitive to economic cycles and consumer confidence.

Staples are considered fairly defensive, especially in relation to Discretionary. Staples are driven by constant inelastic demand, and it performed considerably above the S&P’s whole performance of +17.03% for the year, finishing at around +30.32% for the year. Discretionary finished at 18.72% for the year, about half of a percent above the S&P.

Yahoo Finance - Consumer Defensive Performance

Discretionary is a different case. It just slightly fell below the S&P’s return coming in at +16.32%. Discretionary stocks lagged as a result of higher interest rates, which softened demand for high-ticket items, and a shift in spending towards services like leisure travel and dining. Some also reported soft holiday sales and profit margin compression driven by promotions and inventory issues. Uncertainty on trade—Tariffs threatened by Trump included—also stoked fears of a cost increase of imported goods, putting pressure on investors' nerves.

Yahoo Finance - Consumer Cyclical Performance

Macroeconomic Policy

The consumer goods sector is highly influenced by economic factors such as inflation, interest rates, and labor market conditions. With inflation stabilizing from its 2022 highs, consumer purchasing power has improved, benefitting discretionary spending. However, potential headwinds remain:

- Interest Rates
  - Federal Reserve's stance on rate cuts will impact the cost of borrowing for corporations as well as consumer access to credit. Discretionary spending can see a boost if rate cuts are implemented, since borrowing for high-value items like automobiles and home furnishings will be cheaper. Conversely, when rates are steep, consumer financing charges will weigh on spending.
- Wage Growth & Employment
  - Consumer confidence is supported by a strong labor market, but long-term wage growth could put pressure on company margins. Increased labor costs in the retail and manufacturing sectors can strain profit, particularly for firms with poor pricing power. However, strong levels of employment could still drive spending on high-end and premium goods.
- Regulatory Changes
  - The Trump administration has telegraphed probable tax reform and trade policies, including possible foreign consumer product tariffs that would precipitate supply chain disruption and impact pricing strategies. Possible increases in tariffs on goods from China and Mexico would escalate input prices of apparel, electronics, and appliances.
- Trump's Proposed Tariffs
  - The Trump administration has also previously proposed a blanket tariff of 10% on all foreign imports, which would have a significant impact on this sector. Such tariffs would increase the costs for companies relying on foreign manufacturing, which could then be passed on to consumers as price hikes. This would particularly target discretionary items such as electronics, apparel, and automobiles, where supply chains are significantly globalized. While some domestic producers could benefit from waning competition, import-dependent businesses would face margin compression, thus leading to smaller earnings growth and poor stock performance.

Sub-Sector Performance and Key Trends

Consumer Staples:

Consumer staples should be able to sustain steady growth, benefiting from high brand recognition and pricing power.

- Cost Pressures: Input costs of food and household items have declined modestly, but labor shortages and distribution remain their bugbears.
- Private Label Competition: Retailers like Walmart and Costco are expanding their private-label offerings, putting more pressure on name brands.

Consumer Discretionary:

- Luxury Apparel & Goods: Consumer spending among high-net-worth individuals remains strong, particularly in the luxury space, fueled by solid global demand.
- E-commerce & Retail Trends: DTC and omnichannel strategies remain in focus, with brands leveraging AI and data analytics to design personalized shopping experiences.
- Automobiles & Travel: Car sales have bounced back with supply chain normalization, and travel demand remains solid despite economic uncertainty.

Opportunities

- M&A Activity: With interest rates settling, consolidation across both staples and discretionary categories will continue to grow.
- AI & Automation: Companies leveraging AI for supply chain efficiency and consumer engagement can achieve margin expansion.
- Health & Sustainability Trends: More demand for organic food, plant-based foods, and sustainable products provides long-term growth opportunities.

Risks

- Consumer Sentiment Change: In the event of economic weakness, discretionary spending could decline, affecting retailers and luxury companies.
- Supply Chain Disruptions: Geopolitical tensions or trade policies can create bottlenecks for foreign imports.
- Regulatory Uncertainty: Taxation, tariff, and labor law adjustments under the new administration could influence profitability.
- Tariff Effects: If tariffs are recently instituted, particularly on Chinese and Mexican imports, companies that rely on foreign-produced goods may face higher costs, which would most probably lead to increased prices and decreased demand for discretionary goods.

Final Thoughts

The consumer staple space remains a mixed investment ground in 2025. Although consumer staples are defensive plays, discretionary stocks remain higher-growth plays if the economic environment continues to be healthy. Inflation moderation and potential Fed rate cuts would be bullish for discretionary consumption, but concerns such as supply chain pressures and regulatory shifts continue to linger.

For an outperforming S&P 500 investment strategy, a balanced combination between high-quality consumer staples for stability and selective exposure to discretionary names with strong pricing power and brand loyalty can provide the best risk-adjusted returns. Macroeconomic indicators and policy developments will be critical to watch in order to position within this sector.

Thank You,

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