2024

GKV CAPITAL

FOURTH QUARTER

MARKET REVIEW AND OUTLOOK

Unencumbered by Conviction

2024 DATA POINTS

S&P 500	+23.3%
GLOBAL EX. US	+2.0%
REAL ESTATE	+4.9%
US BOND INDEX	+1.3%
10-YEAR TREASURY YIELD	4.58%
S&P 500 LTM DIVIDEND YIELD	1.27%
S&P 500 12-MONTH EPS	$271.25
S&P P/E	21.7x

Opening Thoughts

We are excited to relaunch our commentary in the new year- both this published report as well as our video content. We haven't yet found artificial intelligence to be intelligent enough to provide real investment insights that can replace producing this report the old-fashioned way. We greatly appreciate the feedback from clients and colleagues that have been asking for our market prospectives and outlook. It is always appreciated to know that people do read our commentary.

2025 marks the 50th anniversary of GKV Capital Management. Our firm was incorporated in California on December 4th, 1975, by Peter Vogel. While the legal structure for our model was created by the Investment Advisers Act of 1940, the personal finance industry was still dominated by fixed commission stockbrokers even 35 years later. Peter made a move to become one of the few independent advisors. We continue to build upon that move, growing alongside our many long-standing clients and their families. We now manage more than $315 million in assets for approximately 120 families and individuals. To best serve our clients we have some additional new faces that we are very excited about.

Sarah Ellis, CFP® joined us in September of last year working out of the Thousand Oaks office. Sarah has been working as an investment advisory representative for the last six years in Southern California. She is a Certified Financial Planner® and has extensive experience working with high-net worth clients and family offices. She does all things planning related and we are excited to add her expertise to the firm. You can stop in our new office space in Westlake Village, and say hello to Sarah, Tina and Peter.

With the start of the new year, Elaine Kwei, CFA joined our team in Walnut Creek. Elaine has a broad background in finance. She began her career on Wall Street as a senior equity research analyst in the clean energy and electric vehicle industries. After more than fourteen years in investment banking, she transitioned to the corporate finance world working at Meta Platforms and most recently, Lucid Motors. Wanting to work directly with clients in the world of personal finance, she is completing her financial planning certification. Her unique skillset will also be invaluable for investment analysis and asset allocation in the management of our client portfolios.

Thank you to all our clients and professional partners that have been instrumental in our success over the last 50 years. We look forward to many more in your service.

GKV CAPITAL MANAGEMENT IS AN INDEPENDENT REGISTERED INVESTMENT ADVISOR. FOR MORE INFORMATION ABOUT US PLEASE CALL (805) 497-2616 OR VISIT GKVCAPITAL.COM

2024 Review

It's been a great two years for U.S. equity market investors. With the close of 2024, the two-year performance is the best back-to-back run this century. Looking back, the performance is noteworthy in its strength despite high inflation, fear of a pending recession, economic weakness in Europe and China, increased global political instability, and a pervasive feeling of negative economic sentiment across the US.

The broad S&P index, which is the most appropriate benchmark for the broad large-cap stock market, gained 23.3% in 2024. While the media still frequently looks to the performance of the Dow Jones Industrial Index, the historical benchmark has long ago lost its place as a relevant indicator of general stock market performance.

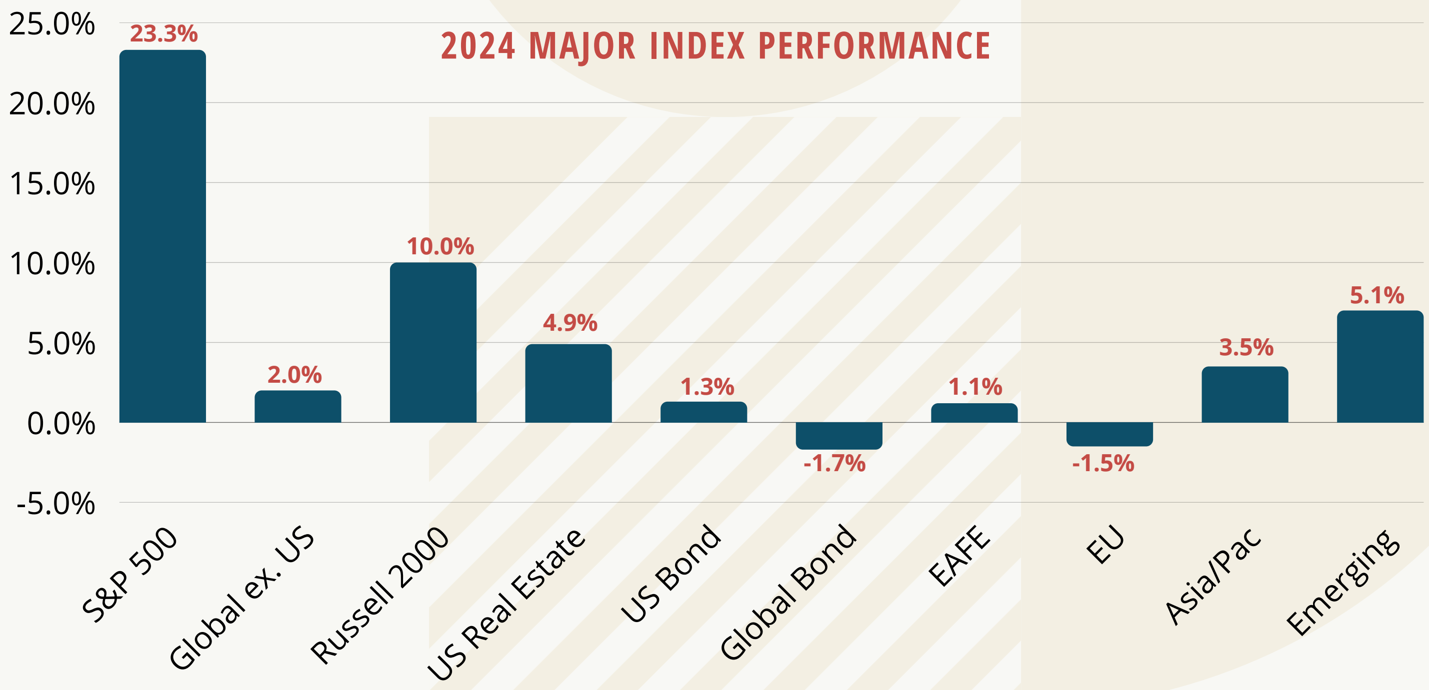
The second major index we like to keep track of is the Russell 2000 Index, which tracks the roughly 2000 companies that are considered US small cap companies. For 2024, the Russell 2000 ended the year with a gain of 10.0%, well behind the performance of the S&P 500 which tracks the approximately 500 largest companies in the US. The disparity in performance between the two reflects the strength of the few mega cap companies that led stock market gains the last few years. The third index we regularly track is the Barclays Aggregate Bond Index. With the rise in interest rates, fixed income investment has become more attractive again, although performance in 2024 remained weak as interest rates remained more elevated than many anticipated. The Barclays Aggregate U.S. Bond Index gained 1.3%.

Market gains in the last two years have been driven largely by a narrow concentration of companies. The ten largest companies now comprise nearly 40% of the total value of the 503 companies in the S&P 500.

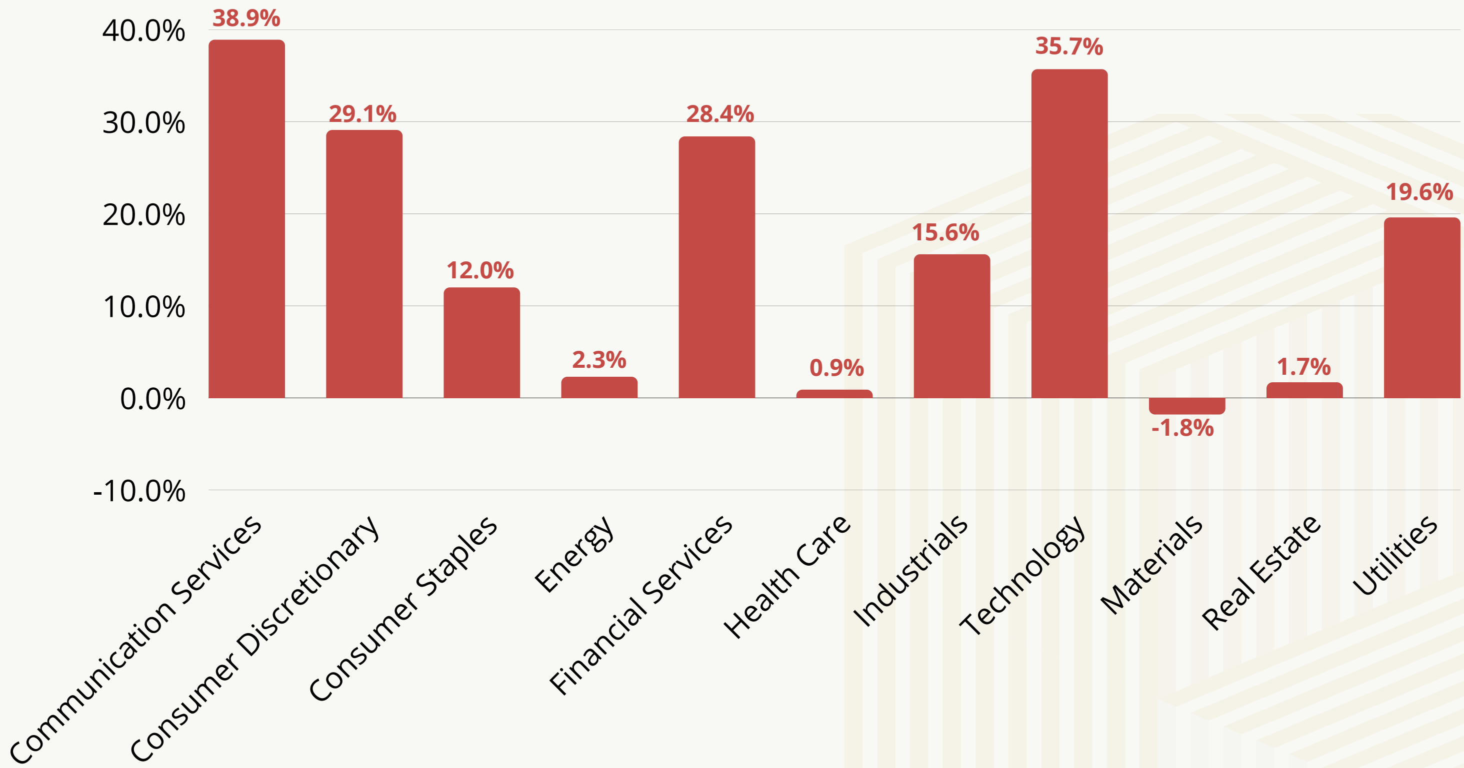
This representation is double from 2016 when the 10 largest companies comprised 20% of the S&P 500 value. Not surprisingly, the top 10 companies are mostly technology companies with the notable exceptions of Berkshire Hathaway and JP Morgan Chase. One can argue whether Tesla should be considered a technology company or a car manufacturer.

As a result of this concentrated performance of the largest companies, there is little surprise in the breakdown in performance by industry sector in 2024. Communication services closed the year up 39% followed closely by information technology, up 36%. Within technology, semiconductors and electronic components were the best performers up 85% and 45% respectively due to massive spending to build out artificial intelligence capability.

Outside the US, equity markets remained weak, particularly in the



2024 SECTOR PERFORMANCE



developed markets. The MSCI EAFE (Europe, Australia, Far East) Index ended the year up only 1.1%.

Economic malaise continues in Europe, where equities declined 1.5% for the year. Emerging markets performed somewhat better, picking up 5.1% for the year. With continued relative economic weakness outside the US, the dollar continues to rise against a broad basket of global currencies, ending the year 7% higher. The rise in the dollar has had a benefit for US consumers resulting in lower prices for imported goods and foreign travel and helping to moderate inflation. If the rise in the dollar continues, it will begin to put pressure on US companies that export products outside the US.

Core economic fundamentals ended the year in the U.S. showing continued strength. Over two-thirds of the US economy is driven by consumer spending.

We track employment data, income, debt, interest rates and inflation rates to gauge the health of households and by extension, the health of the US economy. Unemployment has moved up over the last two years from the post-pandemic low of 3.4% back in April of 2023 to 4.2% at the close of 2024. While the labor market has shown some signs of marginal weakness, unemployment remains low. Disposable income is up 4.6% over the year-old period while retail sales gained 4.1%. Many of these indicators are backward looking- they won't tell you what is going to happen in the future, but weakening trends can provide some insight into the direction of the broad economy.

Although Europe has been particularly weak, the global economy is growing at a healthy pace driven largely by strength in the US and China, although China's growth has declined from the blistering pace of past years. The global GDP forecast for 2025 is 3.0%. The US GDP forecast calls for 2.0% while Europe is forecast at 1.3%.

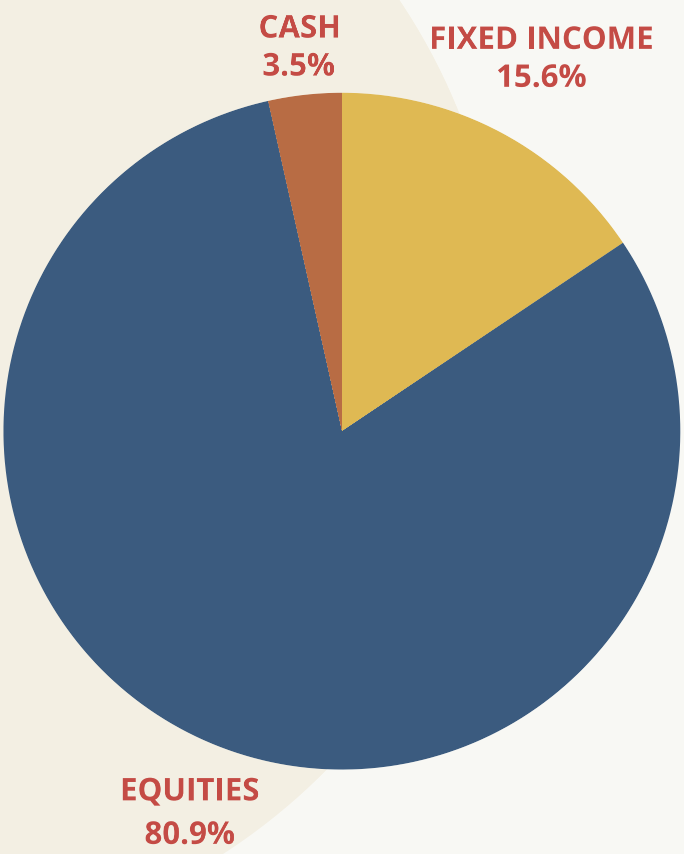
The strong gains in US stocks have come from a combination of earnings growth and investors willing to pay higher price-to-earnings multiples for expected future growth. Combined earnings for all of the companies making up the S&P 500 are forecast to reach $271.25 per share. This represents a 16% increase from what is likely to be approximately $233.28 per share for the full year 2024. For comparison, earnings grew 8.4% in 2023 over 2022 and 9.3% last year. Meanwhile, stock prices gained 19.6% and 20.3% each year respectively. The 2025 earnings forecast of 16% earnings growth appears optimistic, but as long as any downward revision remains slight, stocks can continue to move higher in 2025, in our view.

The 10-year Treasury yield ended the year at 4.58%. The U.S. Federal Reserve reduced the Federal Funds Rate three times during 2024 from 5.5% to 4.50%. Despite the 1% rate cut, the 10-year Treasury yield has declined only 0.12% from the 2024 high. It is clear that the bond market does not anticipate further substantive interest rate declines in the near term. Lending rates from credit cards to auto loans and mortgage rates are dependent on the 10-year Treasury. As a result, we do not anticipate any material reduction on mortgage rates from the 6.85% year-end 30-year fixed mortgage level. The US housing market is likely to remain moribund with little supply in the secondary market as homeowners with sub-3% mortgages are unlikely to want to give up their historically low rates.

The U.S. Aggregate Bond Index closed the year with a meager gain of 1.3%. Fixed income performance was lower than anticipated as the expected lowering of interest rates failed to materialize. We anticipate better performance in the bond market this year with performance likely to equal current yields of around 4-5%.

Firmwide, we ended 2024 nearly fully invested with 3.5% of assets in cash, 15.6% of assets in fixed income securities and 80.9% in equities. There are always significant risks: Economic cycle risks, fiscal policy risks from Washington, geopolitical concerns, financial crisis contagion and even biological contagion. We will continue to focus on earnings, earnings growth and appropriate valuation multiples of future expected earnings. For the moment, we remain cautiously optimistic that equity valuations will move higher in 2025.

WE MANAGE SEPARATE ACCOUNTS FOR EACH OF OUR CLIENTS. EACH PORTFOLIO IS CUSTOM TAILORED FOR THE CLIENT



GKV FIRMWIDE
Asset Allocation

Unencumbered by Conviction

In our update at the start of 2023, we made the case that the economic fundamentals remained positive and that recession fears were overdone. Inflation had soured the mood of many consumers, but the real economy had enough strength to absorb an increase in interest rates without forcing a recession. Since that time, the two-year performance of the US equity markets has been surprisingly strong with the S&P 500 exceeding 20% in back-to-back years for the first time in more than 25 years. At the start of 2025, artificial intelligence continues to drive massive investment, inflation has moderated, interest rates have declined slightly off the highs and the US economy is outpacing the rest of the developed world. However, high stock market valuations are already discounting these positive expectations creating the risk of a correction if the outlook is too optimistic.

As always, there is an optimistic bull case for the markets to move higher, and there is a counter argument to be made that valuations are overextended. Either scenario is possible, but we think the most likely outcome is something between the bull and bear case. There is good reason to be optimistic that stocks can move higher in 2025, but high valuations coupled with too much optimism can be a perilous combination and warrant increased caution.

The bull case says we are still in the early stages of an information technology revolution driven by rapid advances in artificial intelligence. Companies are racing to build out AI infrastructure. Like the development of the Internet that began in earnest in approximately 1994, we are in the initial stages of a long process that will fundamentally change the economic landscape. Artificial intelligence requires massive computing power necessitating specialized microchips, vast new data centers, and infrastructure to run those data centers including electronic components, significant new sources of electrical power, and customized hardware and software. Although the public has been exposed to applications like Chat GPT, enhanced search capabilities and image generation, there will be a vast array of applications for both businesses and consumers that will be as revolutionary in time as the development of the Internet.

In the mid-1990s Internet technology leaders were online services like AOL and Prodigy and search engines such as AltaVista and WebCrawler. But it was really the networking companies like Cisco and semiconductor companies that benefitted as corporate development of Internet capabilities took off. Sure, there were many companies that didn’t survive, but there is no question that the development of the Internet created the platform for everything from Netflix to Amazon, the Apple iPhone, and made the information technology industry the multi-trillion-dollar industry it is today.

WE FIND MERIT IN BOTH THE BULL AND BEAR CASES AND ARE POSITIONING PORTFOLIOS TO TAKE ADVANTAGE OF EITHER SCENARIO

There is an investment race focused on building out the required infrastructure to develop and provide artificial intelligence capabilities. So far, the winners are the semiconductor companies that are providing the microchips required for the highly intensive computational capabilities necessary for artificial intelligence. As large language models and other applications are developed utilizing the increased capacity of infrastructure investments, software will become more capable.

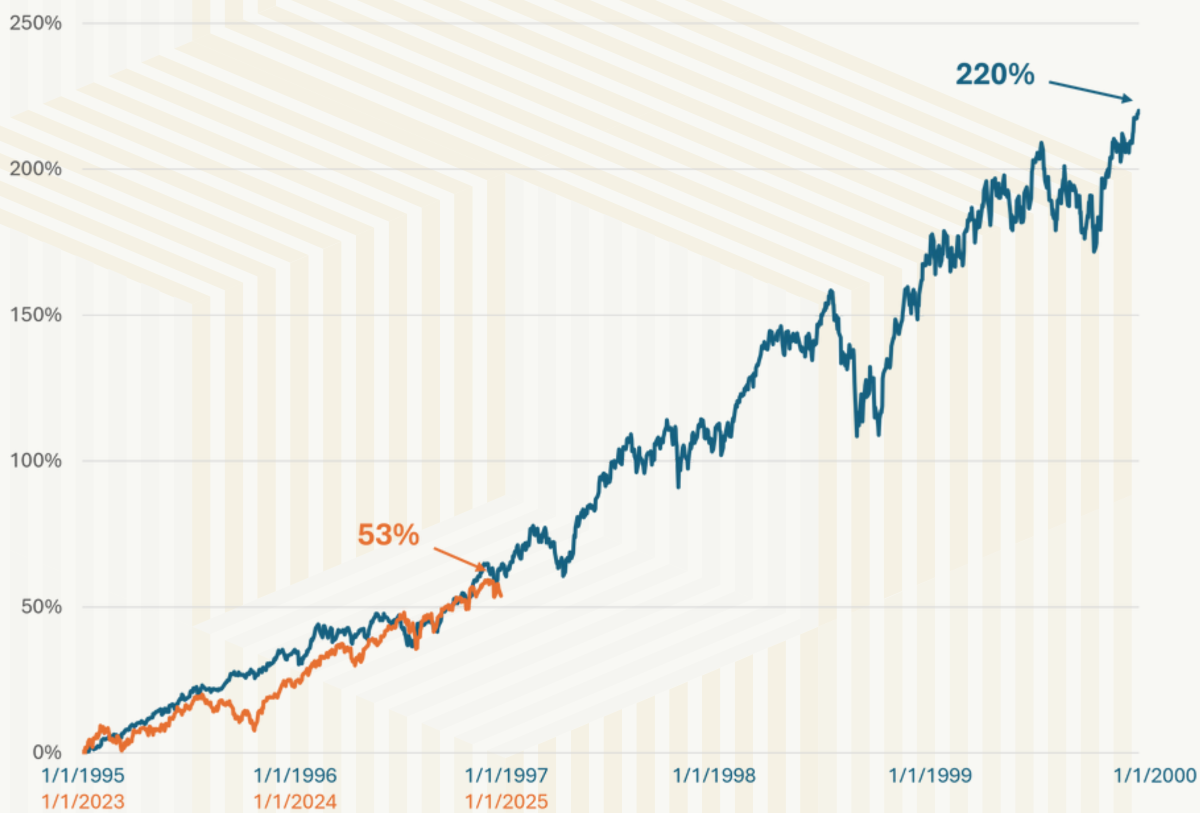
More than $1 trillion will be spent this year to build out AI capabilities. This is a greater investment than the annual US defense budget. Microsoft alone is spending more than $80 billion in AI development in fiscal 2025.

The chart below shows the performance of the S&P 500 from 1995-2000. Overlaid is the performance of the S&P 500 from 2023 to 2025. Yes, the euphoric expectations around the internet came crashing back to reality in 2000-2001 but there were significant investment gains leading up to that reckoning and so far, companies have been valued based on strong earnings projections rather than an uncertain possibility of future earnings as many companies were up until 2000.

Furthermore, artificial intelligence is not the only innovation that is driving growth. The GLP-1 weight loss drugs are driving growth for pharmaceutical companies with leading products, for example. Corporate earnings have been growing faster than 8% the last two years and are forecast to accelerate to increase more than 16% into 2025.

The bear case says that valuations are stretched on an overoptimistic outlook. As we start 2025, the forward price-to-earnings ratio of the S&P 500 companies is 21.7 times. The

»S&P 500 PERFORMANCE 1995-2000



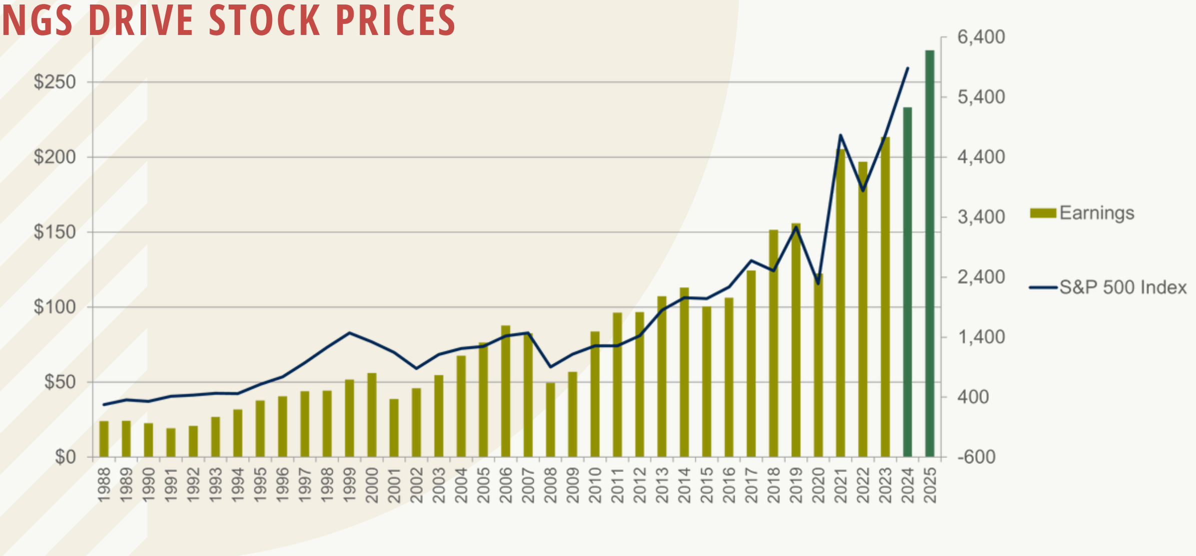
average price-to-earnings for the S&P 500 since we began tracking the data in 1988 is 18.2 times. A mild economic slowdown resulting in a downward revision to the earnings outlook, or worse, a recession, would rapidly push valuation multiples toward the average resulting in a 25% or more correction from current market levels.

There are reasons to believe that the forecast for 16% year-over-year earnings growth in 2025 is too optimistic. Corporate profit margins are currently about 19%. This is the highest level of profitability since we started tracking the data in 2006. If profitability doesn't have room to increase, growth in earnings must come from sales growth coupled with a boost from stock buybacks. In 2024, earnings increased 9.25% but more than 8% of that growth was due to margin expansion. Revenue growth will have to accelerate from the current level of 5-7% growth over the last several quarters to achieve the expectations that the valuations imply.

And there are plenty of risks that could force a lower reassessment of earnings expectations which would in turn cause a correction in valuations. Incoming President Trump has indicated that he wants to slap significant tariffs on goods from multiple countries immediately. It's impossible for us to tell whether this is posturing or likely reality. A trade war with China is likely and possibly more with other significant trading partners. Such an action will slow growth and raise prices, curtailing demand. A reacceleration in inflation is possible which will force higher interest rates for longer. This will, in turn, affect borrowing costs including corporate capital expenditures, consumer credit card debt and mortgage rates and slow economic growth, negatively affect unemployment and lower earnings expectations. Artificial intelligence spending won't drive growth alone. More than two-thirds of our economy is dependent on the consumer.

We find merit in both the bull and bear cases and are positioning portfolios to take advantage of continued momentum in technology while increasing allocations to defensive and even fixed income assets. Investor enthusiasm around fundamental new technologies often exceeds reasonable levels before correcting. Demand for AI enabling technologies is real and will continue through 2025. Valuations are high, although not outside a justifiable range. As we point out in the bear case, a price-to-earnings multiple at 21.7 times is above average, but since 1988, the values have moved between 13 times and 23 times two-thirds of the time. The growth rate of earnings is most important. We are concerned that the earnings forecast is too optimistic. The US economy is doing well. We are encouraged by the fundamentals of low unemployment, strong household income and stable sales growth but a continued 10% earnings growth in 2025 is more likely than 16% in our view. Such a downward revision would be enough to hold the market back but not enough for a sustained correction.

EARNINGS DRIVE STOCK PRICES



The rise in stocks in the last few years has been very concentrated, and many companies are trading at more attractive values. There is opportunity to continue to ride the massive investment in AI and GLP-1 drugs while diversifying into well managed companies with strong growth in sales, earnings and even dividends that have reasonable valuations.

The broad S&P 500 is trading at 21.7 times 2025 earnings, which is historically expensive. Looking in greater detail, the 10 largest companies, generally these are the ones most likely to benefit from the potential growth in AI, including Apple, Nvidia, Microsoft, Amazon, Google and Broadcom, are trading at 29.8 times earnings. Excluding the top 10, the remaining 493 companies in the S&P 500 are trading at 18.2 times. While we still wouldn't qualify this as an inexpensive price to pay, it is a far more reasonable and defensible valuation. Not all of the market is expensive.

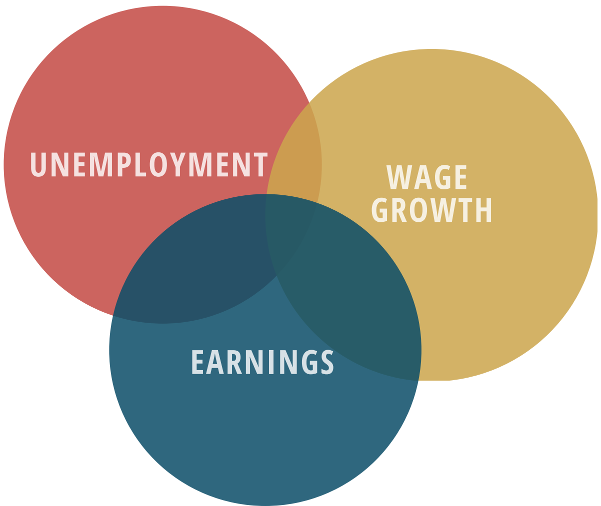
Our thinking going into 2025 is to continue to take advantage of the potentially massive opportunity of AI. It may be that we are in the early stages of a technology revolution like the development of the Internet. If true, initially the infrastructure companies will benefit. Later, the software and application and even consumer device companies will benefit. Along the way, the required return on investment calculations will be adjusted. Not all the companies will be winners in this race. There will likely be a correction (or two) along the way. At the same time, there should be diversification. There are plenty of opportunities to invest in good companies that have been left behind. There are companies with relatively boring businesses that pay solid dividends and have less downside risk in the event of a correction.

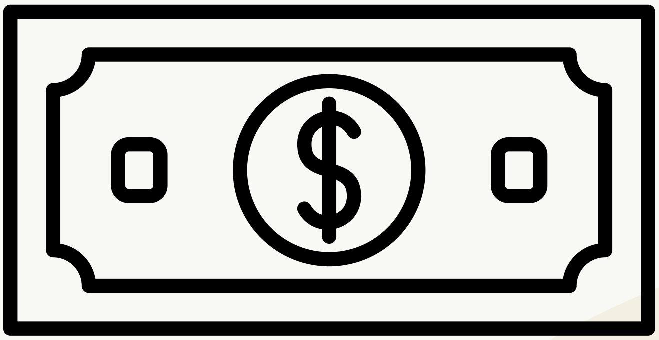
Investors experienced historic gains betting on the Internet from 1995 to 1999. The hangover from the party in 2000 to 2001 was particularly painful. So far, corporate earnings are significantly greater this time around, but investors should be careful. It may be that the ROI on AI will take longer to materialize than the market is currently discounting.

We want to take advantage of the potential opportunity and momentum in new innovations. Meanwhile we will continue to allocate significant portfolio investment to lower valuation companies, high dividend stocks and increase our allocation to fixed income especially when investment grade bonds are paying more than 5% and high-yield rates exceed 7%.

As always, the future is uncertain. We are unencumbered by conviction and will adjust portfolios as circumstances merit. Most often we find that there is truth in both the bull case and bear case and the long-term outcome usually lies somewhere between the two.

INVESTORS EXPERIENCED HISTORIC GAINS BETTING ON THE INTERNET FROM 1995 TO 1999





Bitcoin at $100,000

At this time, we believe a Bitcoin or any crypto investment is speculative and not driven by any economic or financial fundamentals. We like to keep an open mind but have found that more faith than rigorous financial analysis is required when it comes to crypto.

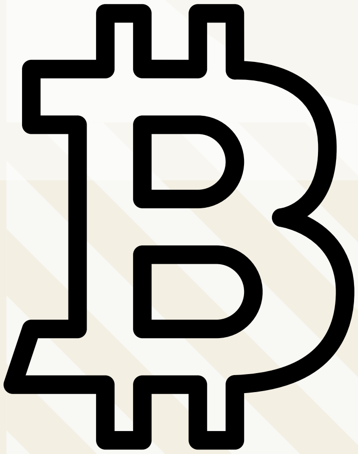
There is likely to be less regulation with the incoming Trump administration and we expect greater productization of crypto by Wall Street. There will be more funds and ETFs providing greater access to crypto currencies. All crypto currencies are designed with a constrained supply and if demand increases it should follow that the price will rise.

We find the speculation that Bitcoin will become a fiat currency of any significance unlikely. We don't see any viable reason for Bitcoin to replace the US dollar or the Euro or Renminbi or Rupee.

Crypto is unique as a currency because it can combine the convenience of being digital and remain anonymous like cash. Unlike other electronic payment platforms, a third-party intermediary such as a bank or government is not needed. This is particularly useful to move capital offshore to protect against extreme inflation or devaluation if you live in a country where that is a particular risk, for example. Frequently this is illegal which makes the anonymous feature of crypto currencies attractive. Of course, this is what also makes the currency attractive to extortionists and money launderers.

It is unlikely that a meaningful strategic reserve of crypto currencies will be created in the US despite recent proposed legislation. There is simply no benefit for the US Treasury to hold a reserve in Bitcoin. The US Treasury currently has more than 207,000 Bitcoin but these holdings are the result of confiscation due to illegal activities rather than purchase on the open market.

Bitcoin as an investment is entirely dependent on others willing to pay a higher price in the future than what you paid. If no one wants to buy what you are selling the price goes down. This is true for stocks but there is a very important distinction. Investments in stocks or bonds or real estate or equipment have cash flows. Companies produce earnings and dividends. Bonds and loans have yields or interest payments. Real estate or equipment can be rented for cash flow. There are no cash flows from the ownership of a crypto currency.



Like buying a gold bar, it is a store of value, and the value exists only as long as other people decide it has value. As a result, the price can double or go to zero on any given day. Over the last 7 years the price of Bitcoin has declined by 50% on several occasions as you can see in the chart below. The price of crypto assets and the value of stocks are highly correlated, meaning, when stocks decline, the price of crypto declines only crypto falls further faster. For example, on March 11th, 2020, as the COVID pandemic became a global crisis the price of Bitcoin declined 38%. In one day. It makes no sense to buy Bitcoin or any crypto for that matter as a place to hedge against a potential disaster and there is no real benefit to diversifying into crypto to avoid losses in other asset classes. Crypto assets are completely speculative. If demand holds up, the price will rise. Forecasting the future price of any crypto asset is tantamount to forecasting which way the wind is blowing and anyone that calls themselves a crypto analyst should be viewed with skepticism. Investments in crypto may work out very well. Or they may not. It's a coin flip... but you will need an actual coin if you want to start playing heads or tails. In short, don't invest more in crypto than you can afford to lose.

BITCOIN PRICE VOLATILITY

2024

BUILD YOUR WEALTH

To Fund Your Passions

GKV Capital Management is an independent investment advisory firm registered with the Securities and Exchange Commission since 1975. We provide portfolio management services for our clients which include individuals, families, charitable trusts, corporations and retirement plans. We are an independent, fee-only advisor. We do not receive commissions, and we do not sell any financial products. We have a fiduciary responsibility to put our clients' interest first.

Client accounts are separately managed and tailored to meet the specific needs, including risk tolerance, investment objectives, and tax consequences of each client. Client assets are held at an unaffiliated brokerage firm.

With extensive expertise in security analysis, we make direct investments on behalf of our clients buying individual securities. This eliminates costly mutual fund fees and increases the flexibility to manage volatility. We actively allocate capital to take advantage of investment opportunities altering exposure to individual companies, industry sectors, and asset classes in anticipation of the changing investment and economic environment.

We are transparent in all facets of our asset management practice and believe it is important for our clients to know what they own, why, what their performance is, and what they are paying in fees. We build comprehensive portfolios for our clients with a goal of reducing volatility and producing prudent growth.

We protect and build wealth at GKV Capital.

GKV CAPITAL

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