RiverFront WEALTH ADVISORS

January 2025

Dear Clients and Friends,

"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas." This advice from Nobel-winning economist Paul Samuelson reminds us that investors often make poor decisions when they are driven by adrenalin; patience is more likely to produce positive results in the long run. Samuelson's advice is just as important now as it was in 1970. With the dizzying pace of change today, patience continues to be a virtue.

The U.S. economy grew moderately in 2024, at a consensus estimate of 2.8% for real GDP growth (*Source: The Bureau of Economic Analysis*). Inflation continued to subside but remained above the Federal Reserve's target rate. As many companies posted record earnings, the U.S. stock market generated above-average returns for investors for the second year in a row. Meanwhile, the more defensive assets classes like bonds and commodities lagged their historic averages.

The U.S. large cap S&P 500 Index was up more than 25%, U.S. Russell mid-cap Index posted a 15% return, and the small-cap Russell 2000 Index rose 11%. At first glance, international and emerging markets indices both recorded solid returns for the year; however, the strength of the U.S. dollar reduced returns for U.S. investors. The MSCI EAFE (Europe, Australasia, and Far East) International Index was up 11.8% in local currency but returned only 4.3% in U.S. dollars. And the same held true for emerging markets, with the MSCI Emerging Markets Index posting a 13.7% return in local currency but 8.1% in U.S. dollars. *(Source: Bloomberg, Wells Fargo Investment Institute Daily Market Update as of December 31, 2024).*

When investors think of the S&P 500, they often think they are buying equal shares of 500 companies, but that is not the case. The S&P 500 is a capitalization-weighted index, meaning that companies with larger market capitalization make up larger shares of the index. As of December 31, 2024, the top 10 companies by market capitalization made up 38.5% of the index. Many of you have probably heard of the Magnificent 7: Apple, Amazon, Alphabet, Meta, Nvidia, Microsoft, and Tesla. These 7 mega-cap companies accounted for 55% of the performance of the S&P 500 in 2024, returning an average of 48%, while the other companies in the index returned an average of 10% *(Source: JP Morgan Guide to the Markets)*.

99 Canal Center Plaza | Suite 310 | Alexandria, VA 22314 | RiverFrontWealthAdvisors.com

Tristan M. Caudron, CFP®
Managing Partner
571-380-6181
TristanCaudron@RiverFrontWealthAdvisors.com

Matt Megary
Managing Partner
571-380-6182
MattMegary@RiverFrontWealthAdvisors.com

Laurie J. Backburn, CFP®
Managing Director
571-380-6183
LaurieBlackburn@RiverFrontWealthAdvisors.com

Ivana K. McNeill, CFP®
Senior Vice President
571-380-6184
IvanaMcNeill@RiverFrontWealthAdvisors.com

Sometimes, a singular event or a confluence of events triggers the repricing of an individual stock or the broad-based stock market. For example, on January 27, 2025, Nvidia, one of the largest companies in the world, lost close to $600 billion in market capitalization as its shares plunged 17%, the largest one-day loss in value in U.S. history on a U.S. dollar basis. The loss was attributed primarily to increased competition in the development of artificial intelligence. To put this sell-off in context, a $600 billion loss in market capitalization is greater than the entire value of many companies in the S&P 500. It also raises concern about how diversified the S&P 500 really is. More on diversification later.

Bond markets continued to underperform their historical averages last year. The Federal Reserve gradually lowered the Fed Funds target range by 1%, to the current target range of 4.25%–4.50%. Despite cuts in short-term interest rates, longer-term rates remained relatively high. The Bloomberg U.S. Treasury Index was up only 0.6% for the year, and the Bloomberg Aggregate Bond Index closed the year up 1.3%. Tax-free municipal bond indices performed comparably to their taxable peers, with the Bloomberg Municipal Bond Index up 1.1% for the year and the Bloomberg Municipal Bond High Yield Index posting a 6.3% return. *(Source: Bloomberg, Wells Fargo Investment Institute Daily Market Update as of December 31, 2024).* We continue to believe that bonds are an important part of a diversified portfolio, particularly for investors who are drawing income from their portfolios.

As we believe from experience, market returns are not linear and can change dramatically during a given year. Since 1980, the average annual return for the S&P 500 was 10.6%. However, the average annual decline was around 14% *(Source: FactSet, Standard and Poor's, JP Morgan Asset Management).* History also teaches us that the outperformance of a few companies or even one sector of the market is not sustainable. Investment volatility is inevitable.

We believe that diversification, which aids in balancing risk and return, is the best tool to mitigate the impact of volatility. Although a natural response to the recent dominant performance of the S&P 500 Index may be to ask whether diversification is still the prudent way to invest, our answer is a resounding yes. When reflecting on the risk of your portfolio, diversification is especially important now, during this late-stage bull cycle. Considering the recent record highs in the stock market, we think it's wise to return to our investment

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principles. In our managed portfolios, we continue to favor broad diversification, taking into account your risk tolerance and investing with your goals in mind.

The chart following our letter may be one of the most important pieces of information that we send you every year (separate PDF attachment titled “The Value of Asset Allocation 2024”). It illustrates dramatically how broad-ranging the market can be and reveals the importance of diversification. Each major market index (explained on the second page of the chart) is color coded, and each is the same color year to year. You can see how each index performed (best performance at the top) for every year going back 15 years. The chart shows us how the heroes one year can be the goats the next, and vice versa. It is one of those lessons that keeps getting relearned…year after year, cycle after cycle.

Many economists and market strategists are optimistic about equity markets in 2025. The stock market is a multifaceted, forward-looking mechanism. In determining the current price of a stock, the market reflects a variety of factors, such as current and future economic conditions, the potential for earnings growth, geopolitical risks, valuations, and investor confidence. As a consequence, the stock market has begun to price in the expected economic impacts of the new administration’s actions. Policies with the potential to fuel inflation, such as increased tariffs and immigration reduction efforts, are being weighed against the expected benefits of fewer regulations and a pro-business administration. However, whatever may be in store for markets in 2025, we believe that they will eventually fall – we just don’t know when, why, or by how much. And that’s why it is crucial to have enough liquid assets to meet your short-term cashflow needs and to have a longer-term investment plan to meet your lifelong goals.

Many of you are asking when to expect your 2024 tax forms. They will be sent out by February 15 at the latest. With the past two years of strong market performance, we have larger taxable income estimates. Higher income during strong investment years is one of those occasional “hard” realities of investing. When your investments make money, and you see that reflected in your taxes. So, on this point, remember one of our favorite sayings, “*Don’t let the IRS be your investment advisor.”*

As you know, last year we transitioned our business affiliation to the independent channel, Wells Fargo Advisors Financial Network, and changed our team’s name to RiverFront Wealth Advisors. The transition went smoothly and has allowed us more autonomy in running our day-to-day business while enabling us to enhance the independent, sound, and objective advice we

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provide to you. We are excited about enhancements in the services we can deliver, and we look forward to new, more sophisticated, and robust investment planning software that we will roll out later this year.

On behalf of Tristan Caudron, Matt Megary, Laurie Blackburn, Ivana McNeill, and our entire team at RiverFront Wealth Advisors, we thank you for the trust and confidence you place in us and for affording us the honor and the pleasure of working with you. We hope that you had a wonderful 2024 and that your new year is off to a great start.

Sincerely,

Tristan M. Caudron, CFP®
Managing Partner

Matt Megary
Managing Partner

Laurie Blackburn

Laurie J. Blackburn, CFP®, CDFA®
Managing Director

Ivana McNeill

Ivana K. McNeill, CFP®
Senior Vice President

*****The Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000 index, which represent approximately 25% of the total market capitalization of the Russell 1000® Index.***

*****The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of 21 developed markets, excluding the U.S. and Canada.***

*****The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.***

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