1515 Mockingbird Ln., Ste. 400
Charlotte, NC 28209

Mailing: P.O. Box 11984
Charlotte, NC 28220

Phone: (704) 533-8900
Fax: (704) 414-2680

TAGStone CAPITAL INC

FOURTH QUARTER MARKET OVERVIEW

Fourth Quarter **2024**

W. REID CULP III
PRESIDENT

I sincerely appreciate the trust and support you've shown to TAGStone. Your introductions are the foundation of our growth and success. If you know anyone who could benefit from my expertise in investments or financial planning, I would be honored to be introduced.

Your relationship is highly valued, and I'm grateful for the opportunity to serve you.

The Newsletter is mailed quarterly to clients and friends to share interesting insights. Material in this work is provided by TAGStone Capital. Reproduction or distribution of this material is prohibited, and all rights are reserved.

Year-End Update

I am pleased to report on another year of steady progress toward your most important financial goals. Our strategy—one grounded in patience and discipline—remains unchanged. We don't make decisions based on economic forecasts or market predictions and won't start now. Instead, we stick to what works: owning attractive businesses and high-quality fixed income and allowing time and compounding to do their work.

The past year rewarded those who stayed diversified, though a handful of technology stocks grabbed most of the headlines. As the year closed, we saw signs that other sectors might finally be getting some attention, but trying to predict leadership shifts is a fool's errand. The best strategy remains the simplest: stay invested, rebalance when needed, and let your portfolio do the heavy lifting.

A Lesson in Market Cycles

"Speculation is most dangerous when it looks easiest."

—Warren E. Buffett

The markets, like the seasons, follow a familiar rhythm. Euphoria breeds excess, excess leads to reckoning, and from that reckoning emerges opportunity—though few recognize it at the time. Over the years, I have spent more ink cautioning investors

SELECTED 2024 EQUITY INDICES

	Dec. '24	4th Qtr.	YTD
S&P 500 Total Return (Large-Cap Stocks)	-2.38%	2.41%	25.02%
Russell 2000 Total Return (Small-Cap Stocks)	-8.26%	0.33%	11.54%
MSCI EAFE (Developed International Stocks)	-2.27%	-8.11%	3.82%
MSCI Emerging Markets (International Emerging Stocks)	-0.14%	-8.01%	7.50%

SELECTED 2024 FIXED INCOME INDICES

	Dec. '24	4th Qtr.	YTD
Bloomberg U.S. Aggregate (Broad Domestic Bonds)	-1.64%	-3.06%	1.25%
Bloomberg 1-5 Yr. Credit (Short-Term Domestic Bonds)	-0.14%	-0.48%	4.72%
Bloomberg 5-10 Yr. Credit (Intermediate-Term Domestic Bonds)	-1.56%	-2.82%	2.96%
Bloomberg U.S. TIPS (Treasury Inflation Protected Securities)	-1.58%	-2.88%	1.84%
FTSE World Gov't 1-5 Yr. Hedg'd (Short-Term Global Bonds)	0.12%	0.15%	4.31%

about the perils of bear markets rather than celebrating bull markets because discipline is tested in tough times. However, as evidenced by today's somewhat stretched valuations, let's talk about the other great pitfall: the fear of missing out (FOMO).

There are two moments that shake investors to their core. The first is when a bear market reaches its final, gut-wrenching phase—when despair is so thick that even sensible people consider throwing in the towel. At that moment, the intrinsic value of attractive companies is quietly rising in relation to their falling stock prices. And yet, the temptation is to believe: *This time is different. This is the end.*

The second—and possibly more dangerous—moment is when markets soar, optimism is boundless, and prices defy gravity. Suddenly, trees are expected to grow to the sky, and investors forget that every great technological breakthrough, from the railroad to the internet, has followed the same trajectory: from miracle to commodity. And yet, the chorus sings: *This time is different. This is a new era.*

During such times, rational investors face an irrational urge to abandon a carefully constructed, broadly diversified portfolio and chase what has doubled or tripled in a year. It feels safe—after all, the crowd is doing it—but history has shown that few strategies are more reliable at destroying wealth than performance-chasing.

Price is What You Pay; Value is What You Get

I have always maintained that while prices fluctuate, true value endures. I remain optimistic about the long-term prospects of our global economy. Innovation drives progress, businesses expand, and hardworking people continue to build the future. The secret isn't to chase last year's hottest stock; it's to acquire a well-balanced collection of attractive businesses—whether they're large or small, from various industries and corners of the world. A diversified portfolio, maintained in proper proportions and adjusted when needed, is about as close as you can get to a reliable recipe for long-term success.

Too often, investors stray from their disciplined allocations, piling into stocks simply because their prices have been on a tear. This approach prioritizes price momentum over intrinsic value. A stock that's risen sharply might not be a bargain if its price no longer reflects its inherent worth. While chasing rising prices might boost short-term returns, it also increases the risk of holding overvalued companies, particularly if revenues, cash flows, or earnings falter.

"The investor of today does not profit from yesterday's growth."

—Warren E. Buffett

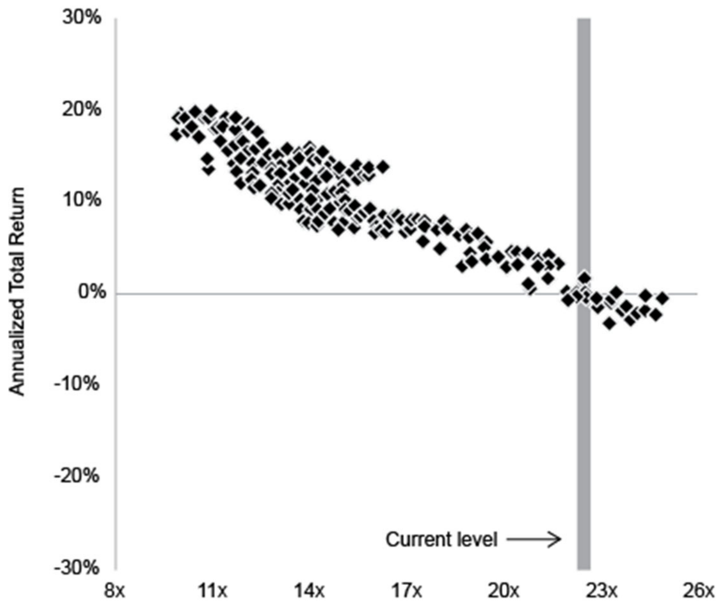
Consider U.S. large-cap tech stocks as an example. These companies have enjoyed an impressive 15-year run. However, history shows that overconcentration in any asset class—especially one with lofty valuations—often leads to below-average returns over the next decade. Chasing yesterday's winners is effectively betting that past trends will continue uninterrupted. Often, investors end up paying a premium for what has already been realized.

Howard Marks of Oaktree Management highlighted a J.P. Morgan Asset Management graph that illustrates this point. The graph, covering monthly data from 1988 through late 2014, shows the forward P/E ratio on the S&P 500 at the time and the annualized return over the subsequent ten years. This data reveals some key insights:

- There is a strong relationship between starting valuations and subsequent ten-year returns. Higher starting valuations consistently lead to lower returns and vice versa.

- Today's P/E ratio is firmly in the top decile of observations.
- During that 27-year period, when the S&P 500 was bought at P/E ratios similar to today's multiple of 22, subsequent ten-year returns ranged from +2% to -2%.

S&P 500 forward P/E ratios and subsequent 10-year returns



In November, several leading banks projected ten-year returns for the S&P 500 in the low- to mid-single digits. This relationship between price and returns explains their outlook. The return on an investment is significantly influenced by the price paid for it. Therefore, investors should not ignore today's market valuation when making decisions.

When Horses Turn to Mice

As we reflect on the solid returns of 2023 and 2024, it's easy to think that a lower expected return for stocks might not be so bad. That's certainly true if the market were to plateau for the next decade while earnings grow and valuations come back to earth. But before you get too comfortable with that view, consider an alternative: a sharp correction, where market multiples compress rapidly in just a year or two—something akin to the market declines of 1973-74 or 2000-02. This wouldn't be a "benign" scenario.

Let's revisit some key lessons from recent years:

- **2022:** Inflation surged to 9%, prompting the Federal Reserve to raise interest rates sharply. The outcome? It was a devastating year for the traditional 60/40 portfolio, which posted its worst performance since 1937.
- **Tech stocks in 2022:** These fell by 36%, a sharp contrast to the broader market's 25% drop.
- **2020:** A global pandemic triggered a near-total shutdown of the economy, sending the market down by 34% in just 33 days.

The big takeaway? Markets rise, and markets fall, often without warning. As investors, we don't need to predict every twist and turn; instead, we prepare for the inevitable ups and downs that come with the territory.

The Ritual of Rebalancing

There's an old saying: *The stock market is designed to transfer money from the impatient to the patient.* And if there's one discipline that ensures you stay on the right side of that transfer, it's rebalancing.

Rebalancing isn't exciting. It won't make headlines, and nobody brags about selling a high-flyer to buy bonds or an undervalued stock at a cocktail party. But make no mistake—it's an effective tool that helps investors keep emotions in check and stay the course. By systematically trimming what's soared and reinvesting in bonds or underweighted stock positions, you keep your emotions in check and resist the temptation to chase performance.

Of course, rebalancing isn't a magic trick that guarantees success overnight. Instead, it's the final step in a series of rational decisions made when you set up your investment plan. Those decisions were:

1. **Determine your risk profile.** Understand how you feel about and have reacted to price volatility. If you don't know how you will respond in the future, any portfolio mix will work—but probably not the one you want.
2. **Build a portfolio that aligns with your risk profile.** Assemble a mix of stock and bond assets that match your risk profile.
3. **Commit to the plan.** Stick with your predetermined asset allocations throughout your investing journey (unless your goals change). Don't let fads, crowds, or market manias steer you off course.
4. **Be a long-term investor.** Attractive businesses create value over years, not weeks. To avoid chasing performance, own a broadly diversified and appropriately weighted portfolio of attractive businesses and high-quality fixed income.
5. **Accept that downturns are part of the deal.** Build and maintain your bond positions during bull markets so you can rely on them during the occasional stock market storm. This is the price of earning long-term equity returns.
6. **Tune out the noise.** Media headlines and marketplace chatter will always try to make you act. Your job is to stick to your plan and let your investments do the work.
7. **Rebalance when necessary.** Do it not when it feels comfortable but when your disciplined approach calls for it.

Rebalancing often feels counterintuitive. Selling what's been performing well and buying what appears to be lagging isn't the natural impulse for most, but that's exactly why it works.

THE SIXTY-TWO YEAR LIFETIME SCORECARD

While performance chasing and valuations may be things to worry about in the short term, the long-term outlook for business remains bright. To affirm this point, let's consider the lifetime investment scorecard for someone approaching retirement—i.e., the performance of mainstream U.S. equities over the last 62 years.

If you were born in 1963, you've lived through wars, recessions, inflation spikes, and technological revolutions. You've seen good times and bad times, booms and busts. And yet, despite it all:

- The price of mainstream U.S. equities has risen **78-fold.**
- Annual dividends have grown from **$2.35 in 1963 to $73.40 in 2024.**
- Inflation has climbed from **31 to 318**—a nearly **tenfold** increase.

For someone turning 62 this year, investing in a balanced portfolio of high-quality fixed income and a diversified mix of attractive businesses has been one of the simplest, most effective ways to build real wealth—without needing to predict what would happen next.

As we enter 2025, we wish all our clients and friends—because to us, they're one and the same—a happy, healthy, and prosperous new year. Thank you for your trust. It is a privilege to serve you.

Past performance does not guarantee future results. All investments include risk and have the potential for loss as well as gain.

Data sources for returns and standard statistical data are provided by the sources referenced and are based on data obtained from recognized statistical services or other sources we believe to be reliable. However, some or all information has not been verified prior to the analysis, and we do not make any representations as to its accuracy or completeness. Any analysis nonfactual in nature constitutes only current opinions, which are subject to change. Benchmarks or indices are included for information purposes only to reflect the current market environment; no index is a directly tradable investment. There may be instances when consultant opinions regarding any fundamental or quantitative analysis do not agree.

The commentary contained herein has been compiled by W. Reid Culp III from sources provided by TAGStone Capital, as well as commentary provided by Mr. Culp, personally, and information independently obtained by Mr. Culp. The pronoun "we," as used herein, references collectively the sources noted above.

TAGStone Capital, Inc. provides this update to convey general information about market conditions and not for the purpose of providing investment advice. Investment in any of the companies or sectors mentioned herein may not be appropriate for you. You should consult your advisor from TAGStone or others for investment advice regarding your own situation.