

Key Insights

- **Market Rally and AI Dominance:** The stock market demonstrated extraordinary strength in 2024, with the S&P 500 surging 73.23% from its October 2022 low. The rally was predominantly driven by AI-related enthusiasm, with the 'Magnificent Seven' technology giants.
- **Earnings and Valuations:** Corporate performance exceeded expectations, with 80% of S&P 500 companies beating earnings estimates and 62% surpassing revenue forecasts in Q4 2024. The blended earnings growth rate of 12.7% marked the highest since Q4 2021. However, elevated valuations persist, with the S&P 500 Index forward P/E ratio at 22.2x, significantly above historical averages.
- **Economic Resilience and Growth:** The U.S. economy maintained robust growth, with GDP expanding 2.8% in 2024, including a 2.3% gain in Q4. The labor market remained strong, highlighted by December's 256,000 job gains. Consumer spending showed vigor, advancing at a 4.2% pace in consecutive quarters for the first time since 2021.
- **Federal Reserve Policy and Rates:** The Federal Reserve shifted to a more measured stance in early 2025, following a full percentage point of rate cuts in late 2024 that brought the federal funds rate to 4.25%-4.50%. Chair Powell emphasized in January that officials are not in a hurry to lower rates further, citing strong economic conditions and a moderately restrictive monetary policy.
- **Bitcoin: From Crypto to Institutional Asset:** Bitcoin has transitioned from a niche cryptocurrency to a mainstream investment asset, with sophisticated exchange traded fund (ETF) products, institutional adoption, and regulatory clarity creating new opportunities for investors.
- **Political and Policy Impact:** The November 2024 election significantly influenced market dynamics.

Donald Trump's return to the White House and Republican control of Congress boosted certain sectors, with financial services gaining 11.6% and consumer discretionary rising 15.4% post-election. However, healthcare stocks faced pressure amid policy uncertainty.

Monthly Recap

The stock market demonstrated remarkable strength throughout 2024, achieving multiple record highs and establishing a two-year bull market run. The year's performance was dominated by the extraordinary influence of the "Magnificent Seven" technology giants - Apple, Amazon, Google, Meta, Microsoft, Nvidia, and Tesla. These companies surged by an average of 67.37% while the remaining 493 stocks in the S&P 500 Index returned a more modest 17.21% on average.

The market demonstrated unprecedented resilience in the face of significant geopolitical challenges throughout the year, including ongoing Middle East conflicts, the Ukraine war, and Chinese economic challenges. However, the November elections proved to be a pivotal moment for markets, fundamentally reshaping sector performance and investor expectations.

Donald Trump's return to the White House, accompanied by Republican control of Congress, triggered profound market reactions across various sectors. Financial services emerged as a major beneficiary, with the Financial Select Sector SPDR Fund gaining 11.6% since the election. Regional banks showed strength, with the SPDR S&P Regional Banking ETF surging 10.5% as investors anticipated regulatory relief and a more favorable interest rate environment.

The election results also significantly impacted the energy sector. Traditional energy companies saw renewed interest as markets priced in expectations of reduced environmental regulations and a more fossil fuel-friendly policy stance. Consumer discretionary stocks also

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demonstrated strength, rising 15.4% since the election, as investors anticipated tax cuts would boost consumer spending.

Conversely, certain sectors faced headwinds from the election outcome. Healthcare stocks experienced notable pressure as uncertainty around potential policy changes weighed on the sector. The technology sector showed mixed results, with concerns about increased regulatory scrutiny and potential trade tensions with China partially offsetting ongoing AI-driven enthusiasm.

The election's impact extended beyond domestic markets, influencing currency dynamics and international trade relationships. The potential for new tariffs, particularly targeting Chinese imports, led to significant shifts in market positioning. However, recent indications of a gradual approach to tariff implementation have helped ease some market concerns, as evidenced by strengthening in the euro against the dollar following news of a measured implementation strategy.

The start of 2025 has brought significant market volatility, highlighted by a historic selloff in technology stocks. On January 27, 2025, Nvidia, which had been the market's leading performer throughout 2024, experienced its largest single-day decline since March 2020, plunging 17% and erasing an unprecedented \$589 billion in market value - the largest one-day loss in U.S. stock market history. The selloff was triggered by concerns about Chinese AI startup DeepSeek's new low-cost AI model, which reignited worries that U.S. companies might have over-invested in expensive AI infrastructure.

Despite these challenges, the economic backdrop remains resilient. The U.S. economy has maintained momentum, with gross domestic product (GDP) expanding at an annualized 2.3% rate in Q4, following a 3.1% increase in Q3, bringing full-year 2024 growth to 2.8%. The labor market continues to show strength, with nonfarm payrolls increasing by 256,000 in December, marking the strongest job gains in nine months. Consumer spending remains robust, advancing at a 4.2% pace - the first time since late 2021 that outlays have exceeded 3% in consecutive quarters.

Corporate earnings have shown remarkable strength in the fourth quarter. With 16% of S&P 500 companies reporting, 80% exceeded earnings expectations and 62% have posted positive revenue surprises. The blended earnings growth rate stands at 12.7% year-over-year, potentially marking the highest growth rate since Q4 2021. This represents an improvement from the estimated growth

rate of 11.8% at year-end, with six sectors reporting positive earnings surprises.

However, market valuations remain elevated, with the S&P 500's forward 12-month P/E ratio at 22.2x, significantly above both the 5-year average of 19.7x and the 10-year average of 18.2x. This premium suggests markets are pricing in continued strong earnings growth, particularly from AI-related companies, though it also creates potential vulnerability should earnings fail to meet these high expectations.

Inflation expectations have become increasingly polarized along political lines, creating unique challenges for markets and policymakers. The University of Michigan's survey shows consumer expectations for long-term inflation have jumped to 3.3% - the highest level since 2008. More notably, there's a stark political divide, with Democrats bracing for 4% inflation while Republicans expect just 0.1%. The market's view on inflation, as measured by the 10-year breakeven rate, has risen to the top of its two-year range, generating some disquiet among investors

The Federal Reserve (Fed) has emerged as a critical factor in this economic landscape, with Chair Jerome Powell signaling a cautious approach to monetary policy. In a recent statement, Powell emphasized that the Fed is not in a hurry to lower interest rates, despite having reduced rates by a full percentage point in the final months of 2024. The central bank is carefully monitoring economic indicators, particularly inflation trends, and waiting to assess the potential impact of the new administration's policies on economic growth. Powell noted that while the economy remains strong, with a solid labor market, the Fed wants to see "serial readings" suggesting sustained progress on inflation before making any significant rate adjustments.

The Fed's stance is further complicated by the uncertainty surrounding the new administration's economic policies. Powell explicitly acknowledged that the committee is in "wait and see" mode, particularly regarding potential policy changes related to immigration, tariffs, and taxes. This cautious approach is reflected in the Fed's projection of only two potential rate cuts for 2025, a more conservative outlook than previously anticipated. With the federal funds rate maintained in the 4.25%-4.5% range and officials describing the current policy as "meaningfully but not highly restrictive," investors are advised to carefully monitor the interplay between monetary policy, economic indicators, and emerging political and economic developments.

Early 2025 has revealed interesting divergences across investment styles and market capitalizations. Value stocks took the lead, with the Russell 3000 Value gaining 4.44% compared to just 0.24% for Russell 3000 Growth. The broader market, as measured by the iShares Russell 3000 ETF, has risen 2.2%, while small-cap stocks have shown relative strength with the Russell 2000 ETF up 3.2%. International markets have also performed well, with the Vanguard FTSE Developed Markets ETF gaining 5.1%, outpacing U.S. markets.

Looking Ahead

The market outlook for 2025 is being shaped by several interconnected factors. The implementation of trade policies, particularly the planned gradual approach to tariff increases, will likely be a key driver of market sentiment. The administration is considering imposing blanket levies of 30% on Chinese exports along with targeted tariffs on other trading partners, with market reaction thus far favoring a measured approach to implementation.

The Federal Reserve's monetary policy stands as a critical element in this economic landscape. Chair Jerome Powell has signaled a deliberate and cautious approach to interest rate adjustments, emphasizing that the Fed is not in a rush to lower rates. The Fed's current projection suggests only two potential rate cuts for 2025, reflecting a measured stance that balances economic growth with inflation control. This approach adds another layer of complexity to market expectations, as investors must now navigate the interplay between monetary policy, political developments, and economic indicators.

Economic growth dynamics present both opportunities and challenges. U.S. growth is expected to outpace European peers, though the impact of policy changes remains uncertain. Business optimism has increased post-election, particularly among Republican-leaning leaders, though these high expectations could create vulnerability if not met.

As we progress through 2025, the market faces a complex environment characterized by strong economic data, rising inflation expectations, and policy uncertainty. While the economy continues to show remarkable resilience, high valuations and concentrated market leadership suggest investors should remain vigilant to potential risks and market adjustments ahead.

Topic of the Month: Bitcoin (BTC)

In October 2008, amid the global financial crisis, an anonymous figure using the pseudonym Satoshi Nakamoto

published a white paper that would fundamentally reshape the concept of money. The paper began with a revolutionary vision: "A purely peer-to-peer version of electronic cash would allow online payments to be sent directly from one party to another without going through a financial institution." This simple yet profound statement laid the foundation for Bitcoin, which launched in January 2009. The timing was no coincidence - the genesis block contained a reference to newspaper headlines about bank bailouts, underlining Bitcoin's purpose as an alternative to traditional financial systems that had just demonstrated their fragility.

Bitcoin's journey from its first recorded price of less than a penny to surpassing \$100,000 in 2024 has been marked by several distinct phases of evolution. The experimental phase from 2009 to 2013 saw early adoption primarily by technology enthusiasts, with the first real-world transaction of 10,000 BTC for two pizzas marking a crucial milestone in establishing Bitcoin's practical value. During this period, Bitcoin transformed from a technological curiosity into a tradable asset.

The emergence phase from 2014 to 2017 brought growing mainstream awareness and the development of crypto exchanges. This period saw the first signs of institutional interest and the establishment of initial regulatory frameworks in major markets. The maturation phase from 2018 to 2020 was characterized by deeper integration with traditional finance, the development of sophisticated trading infrastructure, and the emergence of institutional custody solutions.

The current institutional phase, from 2021 to 2025, has been marked by watershed moments including ETF approvals, corporate treasury adoption, and integration with mainstream payment systems. What began as a radical experiment in digital currency has evolved into a multi-trillion-dollar asset that spans retail and institutional investors, while maintaining a core principle of decentralization and fixed supply.

The Fundamentals of Cryptocurrency Markets

The cryptocurrency ecosystem represents a fundamental innovation in database technology that enables the peer-to-peer transfer of value without intermediaries. At its core, blockchain technology creates a distributed database system that is accessible to everyone but controlled by no single entity. This breakthrough architecture relies on a network of participants who collectively validate and maintain the system's integrity through a carefully designed consensus mechanism.

AI systems increasingly utilize blockchain infrastructure for secure data transmission and verification. The bitcoin transaction process follows a specific and secure protocol. First, a user initiates a transaction by proposing it to the network. Specialized participants called miners then aggregate valid transactions into blocks, competing to solve complex mathematical puzzles. The winner earns the right to propose the next block of transactions, which the network's participants then verify collectively. This system operates through economic incentives, primarily through mining rewards, which encourage honest behavior and secure the network.

Market Structure and Trading Dynamics

Bitcoin's value dynamics have evolved significantly during its transition from a niche digital asset to a mainstream investment vehicle. The cryptocurrency has demonstrated multiple distinct characteristics that have shaped its market behavior. As a high-tech risky asset, it shows strong correlation with technology stocks, particularly evidenced by its recent 0.67 correlation coefficient with the Nasdaq 100 over the last year. Simultaneously, it functions as a hedge against loose monetary policy, demonstrated during periods of significant central bank intervention. The coins also serve as an alternative to the US dollar and to digital gold which has become increasingly prominent in an era of geopolitical fragmentation.

Portfolio Integration and Investment Implications

The integration of Bitcoin into institutional investment portfolios marks a major development in modern asset management. According to BlackRock's Investment Institute, optimal Bitcoin exposure typically ranges between 1% and 2% of a diversified portfolio - a measured approach based on its comprehensive risk analysis. When implemented in a conventional 60/40 stock-bond portfolio, this allocation creates risk exposure comparable to positions in individual mega-cap technology stocks, while potentially providing unique diversification benefits due to Bitcoin's distinctive value drivers.

Investment implementation options have evolved substantially, offering multiple paths to Bitcoin exposure. Direct custody represents the purest form of ownership but demands significant technical expertise and robust security measures. Regulated mutual funds provide simpler integration with existing portfolio systems, though they may trade at premiums or discounts to their net asset value. Futures contracts and venture capital vehicles round out the range of available options, each with its own risk-reward characteristics.

The introduction of sophisticated ETF products has transformed Bitcoin accessibility. These institutional-grade investment vehicles eliminate many traditional technical and security challenges of cryptocurrency ownership. Notably, crypto ETF shares held through registered broker-dealers carry SIPC insurance protection - a crucial safeguard unavailable with direct cryptocurrency ownership. This insurance applies because investors hold regulated securities (ETF shares) rather than digital assets directly, protecting against broker-dealer failure. Of course, SIPC protects against fraud, not market losses and is limited to \$500,000 per account.

Institutional acceptance continues to expand, with major corporations not only investing in Bitcoin but also adopting it as a payment method. Companies like Microsoft, Apple, and AT&T now accept cryptocurrency payments, enhancing Bitcoin's utility and supporting its long-term value proposition. The regulatory environment has also evolved favorably, particularly under the Trump administration's supportive stance toward digital assets.

Recent developments have strengthened the case for institutional Bitcoin investment. The Financial Accounting Standards Board's landmark rules on digital currency recognition and measurement, issued December 2023, exemplify this evolution. Tesla's experience illustrates the practical impact - the company reported a \$600 million mark-to-market benefit from its Bitcoin holdings following the adoption of these new accounting standards. This accounting clarity removes a significant barrier to corporate Bitcoin adoption.

Political Landscape and Regulatory Framework

The political environment for cryptocurrencies has undergone a remarkable transformation, particularly in the United States. The Trump administration's approach to cryptocurrency regulation has marked a significant shift in governmental attitude toward digital assets. Following the 2024 election, several key initiatives have emerged, including proposals for a national Bitcoin reserve and executive orders supporting crypto-friendly regulations. This political support has coincided with broader institutional adoption, as evidenced by the approval of spot Bitcoin ETFs and subsequent inflows exceeding \$35 billion.

However, the regulatory landscape remains complex and evolving. While some jurisdictions have embraced cryptocurrencies, others maintain more cautious approaches.

The challenge for policymakers lies in balancing innovation and consumer protection, particularly as the technology becomes more deeply embedded in the financial system.

Market Psychology and Trading Behavior

Trading patterns in cryptocurrency markets reflect complex investor psychology. Historical analysis shows Bitcoin has experienced multiple cycles characterized by approximately three-year bull markets followed by 14-month bear markets. Recent data suggests increasing market maturity may be altering these patterns, though volatility remains significant.

The impact of institutional flows has become more pronounced, as evidenced by the \$35 billion in inflows following ETF approvals in 2024. Traditional market metrics are increasingly relevant, with factors like liquidity, market depth, and order flow analysis gaining importance in price discovery.

Outlook and Market Considerations

Looking ahead to the remainder of 2025 and beyond, several key factors will likely influence Bitcoin's development and adoption. The market has established a recent trading range between \$90,000 and \$110,000, reflecting a maturation phase characterized by increased institutional participation and more sophisticated price discovery mechanisms. Market experts suggest this consolidation phase may persist as the market digests recent gains and adapts to evolving macroeconomic conditions.

The relationship between Bitcoin and traditional financial markets continues to evolve. While correlation with technology stocks, especially AI stocks, remains significant, Bitcoin's unique characteristics as a fixed-supply digital asset may provide differentiation during periods of market stress or inflation. The potential implementation of a national Bitcoin reserve, though still uncertain, could fundamentally alter the asset's role in the global financial system.

As Bitcoin enters its next phase of development, the interplay between its original vision as a decentralized currency and its emerging role as a mainstream financial asset continues to evolve. The success of cryptocurrency investment strategies will likely depend on understanding and adapting to this dual nature. For institutional investors, the challenge lies in capturing the potential benefits of blockchain technology and digital scarcity while managing the associated risks and volatility.

The future of Bitcoin and the broader cryptocurrency ecosystem will be shaped by continued technological innovation, regulatory developments, and institutional adoption patterns. As the market matures, the balance between maintaining cryptocurrency's distinctive characteristics and integrating with traditional financial systems will be crucial in determining its long-term value proposition. This evolution requires ongoing monitoring and analysis to ensure investment strategies remain aligned with both market realities and portfolio objectives. However, no one can deny that cryptocurrencies have become an essential part of modern portfolio management.

Conclusion

The economic and market landscape of early 2025 presents a nuanced and challenging environment for investors. The year has been defined by several critical factors: the continued dominance of AI-driven technology stocks, the market's sensitivity to geopolitical and policy changes, and the Federal Reserve's cautious monetary approach. Despite significant volatility – most notably the historic sell-off in Nvidia's stock – the underlying economic fundamentals remain robust, with strong GDP growth, a resilient labor market, and impressive corporate earnings.

However, multiple warning signs demand careful attention. The market's heavy concentration in a few technology giants, particularly those tied to AI, creates potential systemic risks. Elevated market valuations, with the S&P 500's forward P/E ratio significantly above historical averages, suggest that investors are pricing in exceptionally optimistic growth scenarios. The stark political polarization in inflation expectations further complicates the economic outlook, creating additional uncertainty for policymakers and investors alike.

Beyond traditional markets, emerging asset classes like cryptocurrencies are experiencing their own transformative phase. Bitcoin stands at a critical juncture, navigating between its original vision as a decentralized currency and its emerging role as a mainstream financial asset. The cryptocurrency ecosystem is increasingly characterized by a delicate balance between technological innovation, regulatory developments, and institutional adoption. For investors, success will hinge on understanding this complex landscape, capturing the potential benefits of blockchain technology and digital scarcity while managing associated risks and volatility.

The interplay between monetary policy, trade regulations, and technological innovation will likely be the primary drivers of market performance in 2025. Investors should prepare for continued volatility, diversify their portfolios, and remain adaptable to rapidly changing economic conditions. The potential for significant market shifts remains high, driven by factors including the Federal Reserve's measured approach to interest rates, the new administration's economic policies, and the ongoing global AI technology race.

Ultimately, while challenges exist, the underlying economic resilience and continued innovation – particularly in artificial intelligence and technology – provide reasons for cautious optimism. Success in navigating this complex market will require a combination of strategic patience, diversification, and a keen understanding of the evolving economic and technological landscape.



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