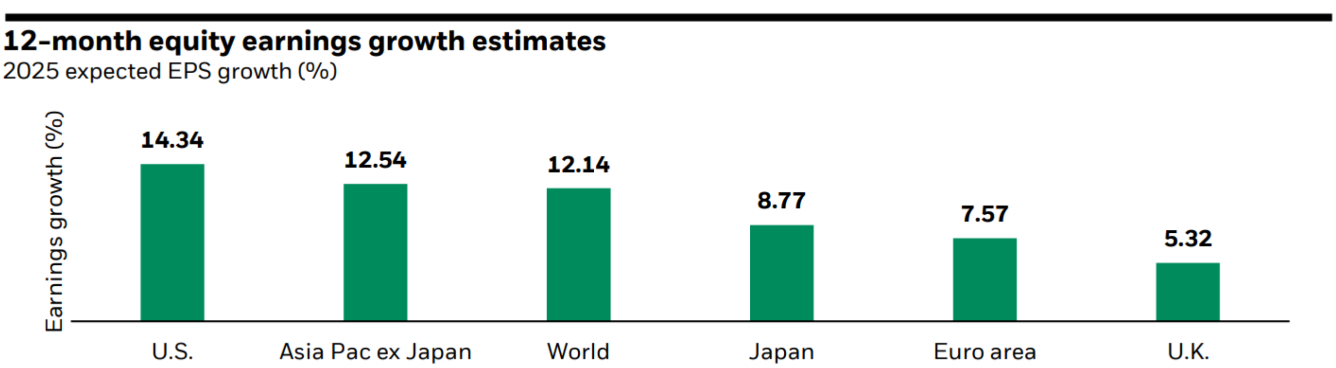
January 17, 2025

Dear clients and friends,

During the full year of 2024, the S&P 500 index delivered a total return of 25.0%. This strong performance in US equities followed a 26.3% gain in 2023. It is worth noting that more than half of Index performance during 2024 can be attributed to the Magnificent 7 (Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia, and Tesla.) With the exception of Tesla, each of these companies currently possesses an extraordinarily competitive moat and has been exceptionally profitable.

Meanwhile, the total return of the Bloomberg U.S. Aggregate Bond Index was 1.25% for the year ending December 31, 2024. Bond investors' investment results were tempered as the yield curve steepened during the year. Bond prices and prevailing interest rates are inversely related.

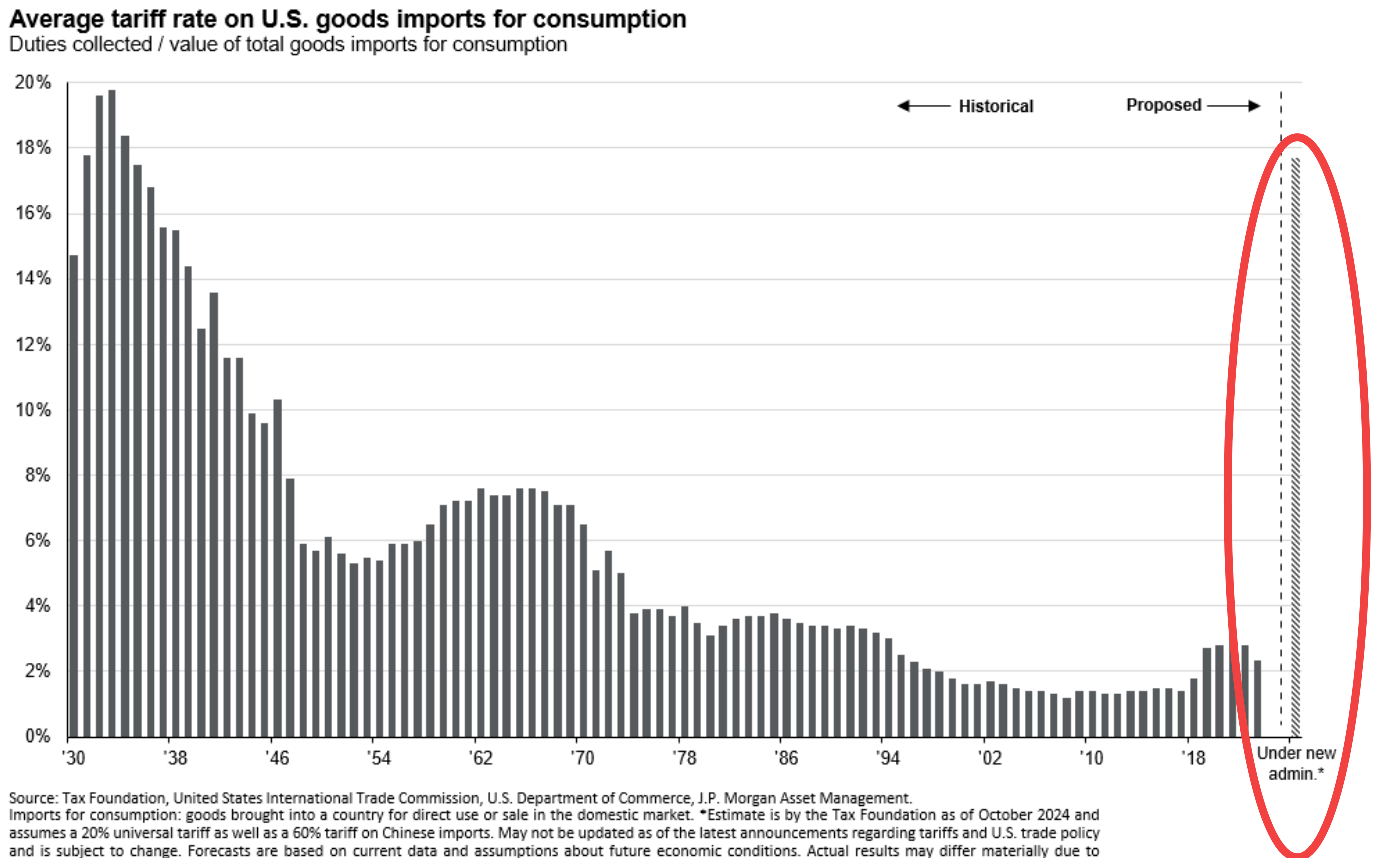
Looking ahead, earnings growth in the United States is expected to outpace that of other countries. It is important to note that the projections shown below are based on companies' domiciles, not necessarily where they generate revenue or earnings. This distinction is crucial, as 41% of revenues of companies included in the S&P 500 Index are generated in foreign countries. Global interconnectedness increases the potential effects of aggressive tariffs.



Source: BlackRock, Reuters, MSCI. Earnings estimates by LSEG. U.S. as represented by MSCI USA Index, Asia Pac ex Japan as represented by MSCI Asia ex Japan Index, World as represented by MSCI World Index, Japan as represented by MSCI Japan Index, Euro area as represented by MSCI Europe Index, UK as represented by MSCI United Kingdom Index. As of 12/10/2024. Forward-looking estimates may not come to pass.

Tariffs lead to retaliation and inflation, and hamper overall economic efficiency. Unintended consequences are a certainty. The tariffs that have been proposed by the incoming administration are higher than any that have been imposed since the Great Depression, which exacerbated the global economic downturn at that time. If history is a guide, the level of proposed tariffs is clearly untenable. Over the coming weeks and months, we will begin to see how much of the rhetoric is implemented.

Tariffs on U.S. imports



Source: Tax Foundation, United States International Trade Commission, U.S. Department of Commerce, J.P. Morgan Asset Management.
Imports for consumption: goods brought into a country for direct use or sale in the domestic market. *Estimate is by the Tax Foundation as of October 2024 and assumes a 20% universal tariff as well as a 60% tariff on Chinese imports. May not be updated as of the latest announcements regarding tariffs and U.S. trade policy and is subject to change. Forecasts are based on current data and assumptions about future economic conditions. Actual results may differ materially due to changes in economic, market and other conditions.

When producers leverage their comparative advantages, consumers reap the benefits. China's low labor costs represent a significant advantage in this regard. In 2025, the annual minimum wage in the United States varies from $15,080 (in sixteen states) to $36,400 (in, amusingly, Washington D.C.). China's highest provincial minimum wage stands at just $4,440 per year. The US and other developed countries that trade with China “lost” much of their low-end manufacturing capacity but gained from importing less expensive goods. This relationship contributed to a higher standard of living in China, as well as in countries that trade with China.

While tariffs may sound like a tool that could protect certain domestic industries, they can fuel inflation as goods from low-cost providers become “artificially” expensive. This amplifies economic pressure on low-income households while stifling efficiencies that otherwise increase prosperity in aggregate. Inflation acts as a cruelly regressive tax, placing a disproportionate burden on low-income households, as price increases represent a larger proportion of their income.

The future is unknowable, but we believe that investors will be rewarded for owning securities issued by high-quality companies irrespective of macroeconomic factors. Exceptional investment performance can be achieved by limiting the opportunity set to businesses that generate extraordinary operating results and that are purchased at prices to further mitigate the risk of permanent loss. We keep the following attributes in mind:

- Sustainable competitive advantages
- Proven management with the right incentives
- High, sustainable margins
- Free cash flow growth
- High returns on capital
- Attractive reinvestment opportunities
- Financial strength
- Reasonable valuation

With respect to bonds, we continue to be reluctant to invest in long-term fixed income securities given the absolute level of interest rates, as well as the potential for higher inflation. Our yield curve positioning was one of our key differentiators in client portfolios during 2024 and we are pleased with the results.

Thank you for your continued interest in Sapphire. Should you have any questions or wish to discuss your portfolio or our views in more detail, please call at any time.

Respectfully,

Paul Stropkay

Paul Stropkay, CFA

Sources

• J.P. Morgan Asset Management *Guide to the Markets®* U.S. 1Q 2025 as of December 31, 2024

• BlackRock 2025 Investment Directions, January 13, 2025

• China Briefing, *A Guide to Minimum Wages in China (As of January 3*, 2025)

• Paycom, *Your 2025 Guide to Every State's Minimum Wage*, November 27, 2024

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