

Crossroads 2025 Annual Letter

January 30, 2025

So much is going on right now! Politics and markets stand at a major crossroads, and the road forward will not be smooth. With the Trump Administration already driving bold changes, expect twists, sharp turns, and whiplash.

A sharp right turn toward pro-business, limited government, and low-tax policies is underway—not just in the U.S., but similar movements are starting in Europe, Canada, and South America. As familiar routes shift and detours emerge, now is the time to reassess **realities**, explore **opportunities**, and adjust to navigate this rapidly **evolving landscape**.

To set the table, our equity framework prioritizes investments that generate free cash flow, which results in dividend growth, buybacks, or debt reduction. The quality bonds we buy provide income and stability, while alternatives like gold and managed futures hedge against adverse markets. This investment focus keeps us from reacting to political shifts.



Yet politics now exerts a growing influence on markets. Government excess has pushed asset prices to extremes through spending, liquidity support, and policy interventions. The U.S. national debt has soared to \$36 trillion, with global public debt nearing \$100 trillion. Years of near-zero interest rates and reckless government spending have fueled a speculative mood (and inflation), diverting investor attention away from timeless investment principles we steadfastly apply.

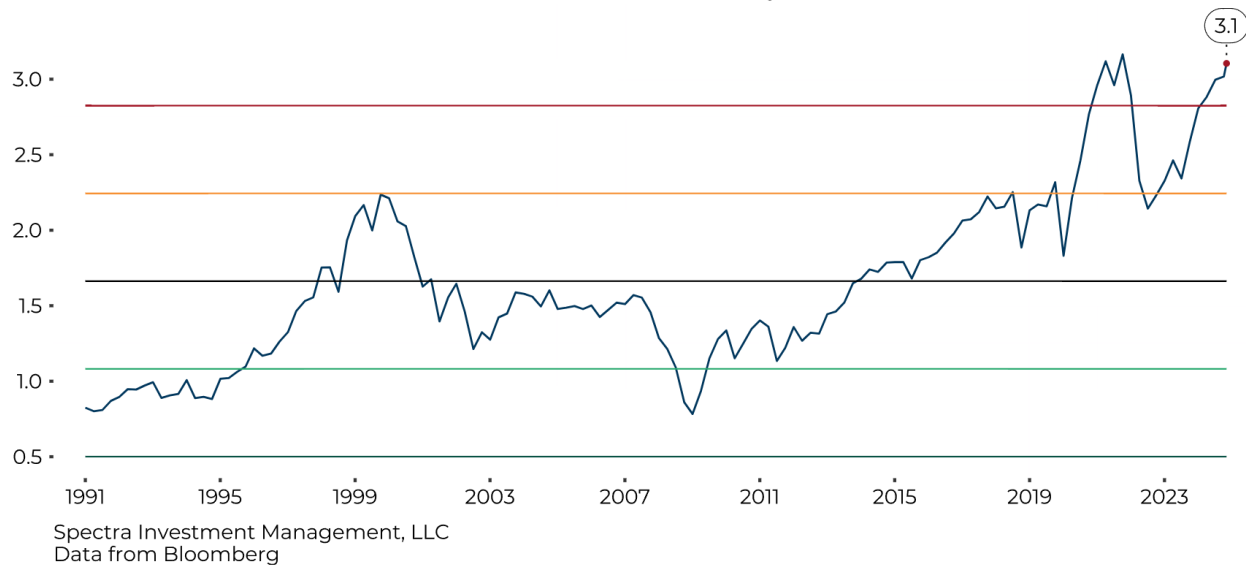
Sharpening this point, Jason Zweig of *The Wall Street Journal* highlighted a 2010 prescient observation from the famed value investor Seth Klarman:

*"By holding interest rates at zero, the government is basically tricking the population into going long on just about every kind of security except cash, at the price of almost certainly not getting an adequate return for the risks they are running. **People can't stand earning 0% on their money**, so the government is forcing everyone in the investing public to speculate."*

Classic valuation metrics like Price/Earnings (Exhibit A) and Price/Cash Flow clearly show stock market excess. However, the most straightforward metric of them all, the S&P 500's Price-to-Sales ratio, far exceeds the dot-com bubble peak and is now returning to the 2021 high. At this level, there is little room for a market-excess counterargument. Simply put - miracles need to happen to justify the current Price-to-Sales level of the S&P 500.

S&P 500 Price to Sales Ratio

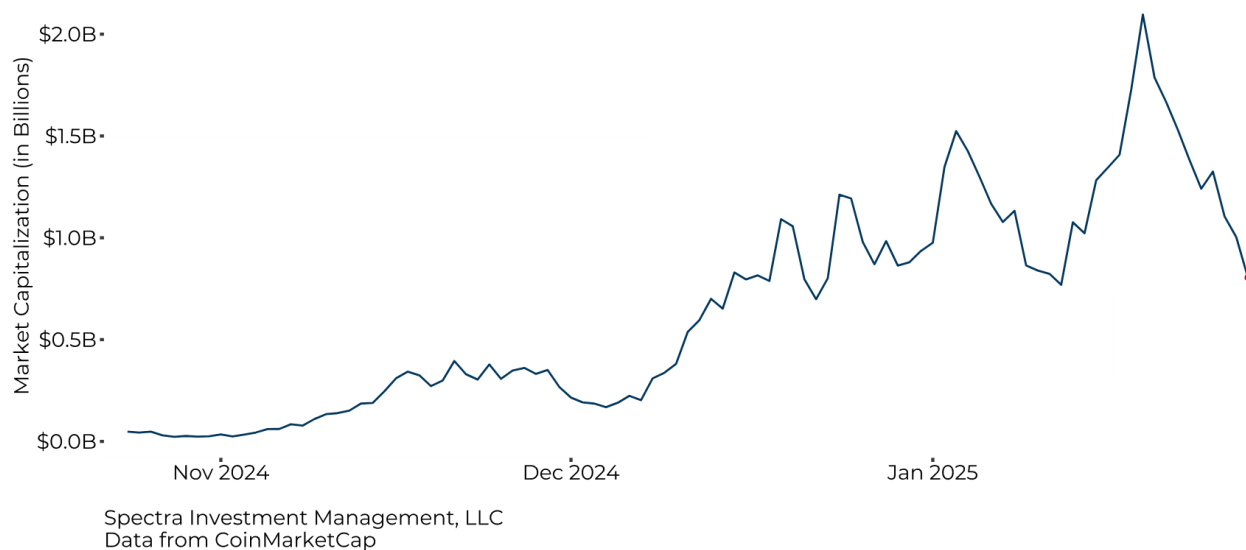
From March 29, 1991 to January 29, 2025



If you are skeptical that the speculative mood is alive and well, look at the cryptocurrency market—where meme [joke] coins routinely hit billion-dollar valuations. Case in point: **\$Fartcoin**. This meme coin, likely created by a kid in study hall, exploded to a \$2 billion market capitalization in January, outvaluing over a thousand legitimate publicly traded companies.

Fartcoin Market Capitalization

October 19, 2024 to January 28, 2025



No – assets, products, services, revenue, or employees. Just pure, unbridled speculation.

Global Economy

The U.S. economy is at a crossroads—steady growth is offset by stubborn inflation. Despite frothy stock and housing markets, the Fed’s easing policy stance raises doubts about its commitment to controlling prices. Trump’s pro-business tone sparks optimism, but the history of inflation suggests caution. If inflation lingers and the Fed isn’t dropping rates, expect Trump to reignite his 2019 Twitter/X battles with the Fed.

Strong growth won’t tame inflation; proposed tariffs only add to the uncertainty. Even a pro-business administration doesn’t ensure market gains—just six months into President Reagan’s first term in 1981, the U.S. fell into its deepest recession since the 1930s.

Apologies for the extra analogies, but President Trump is caught between a rock and a hard place—balancing inflation, growth, tariffs, interest rates, soaring stock prices, and lofty expectations. Or, as Trump’s golf buddies might put it, Mr. President, you are 225 yards out with only a 1-iron in the bag—only Ben Hogan and God can hit that shot.

Europe is stuck in a rut, wishing for an intersection. Growth is sluggish, and the war in Ukraine dampens economic confidence. Germany, Europe’s growth engine, is tangled in messy politics and failed green energy bets. Rising energy costs, worsened by Russia cutting off natural gas, continue to squeeze these economies. While a few countries show glimmers of growth, the outlook remains bleak.

China’s slowdown is a global headache. As China’s economic engine sputters, its leaders are throwing every monetary tool at the problem—with mixed but mostly underwhelming results. Slower growth in China can spread to all of Asia, adding another layer of uncertainty to an already shaky economic landscape. If Trump imposes tariffs on China, it would further weaken Asia.

Equities: Bad Breadth

U.S. Equity markets had a great 2024, but risks are mounting. The AI boom has driven record-high valuations and an unhealthy dependence on a few companies. By year-end, the top 10 stocks comprised 37% of the S&P 500’s value and half its annual return. Similar periods of extreme concentration preceded significant bear markets in 1929-32, 1973-74, 2000-02, and 2022, highlighting the dangers of narrow market leadership or “bad breadth.”

This situation is frustrating for an investor focused on **cash flow** and margin of safety! No one can predict what event will trigger the pop of this valuation bubble. These trigger events are evident in hindsight but challenging to forecast. An unfavorable antitrust ruling against Microsoft ended the dot-com bubble, and a sudden rise in oil prices triggered the 2007-08 housing market collapse.

Case in point: over the weekend, the relatively unknown Chinese startup DeepSeek launched a ChatGPT rival, reportedly developed for just \$10 million using open-source code. Unlike its U.S. counterparts, DeepSeek’s model requires significantly less energy and isn’t reliant on NVIDIA chips. The news sent shockwaves through US AI stocks, with NVIDIA losing nearly \$600 billion in market value on Monday—the largest single-day loss

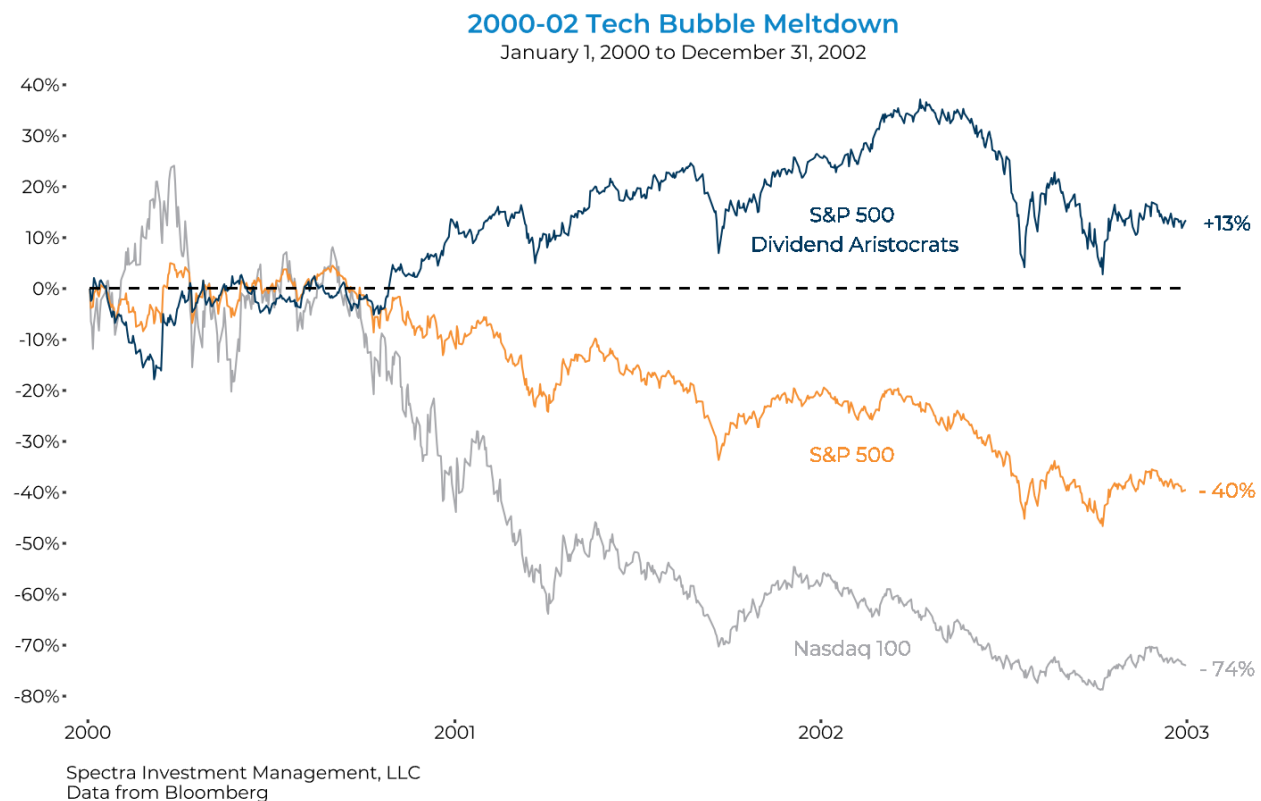


CartoonStock.com

ever for a single company. DeepSeek's breakthrough challenges the notion of U.S. dominance in AI and raises questions about the sustainability of the current AI supply chain. A **broader re-evaluation** could be the pin that bursts this tech bubble—stay tuned.

Mark Twain famously said: "History doesn't repeat itself, but it often rhymes." Based on the history of greed and fear in markets, we would add that **history rhymes, and rhymes, and rhymes and...** Today's tech bubble mirrors the dot-com era, with sky-high valuations and rampant speculation. Out of the gate, 2025 has already been volatile, with three January days dropping over 1% compared to fifteen 1% drops in 2024 (Exhibit B).

A focus on free cash flow and dividend-paying equities is the antidote for navigating high valuations and volatility. The 2000 Tech Bubble provides an example: ten weeks before the Nasdaq's peak, the S&P Dividend Aristocrats Index faltered as the Nasdaq surged. But when the bubble burst, the Nasdaq plummeted -74%, the S&P 500 fell -40%, while the Dividend Aristocrats significantly outperformed.



Bonds: Debt Dilemma

The bond market reached a crossroads last year and took an unexpected turn. Performance remained calm, but inflation risk and the \$36 trillion U.S. national debt were plastered on every billboard along the route. Surprisingly, the 10-year Treasury yield climbed over 1% despite the Fed rate cuts. This rise broke from the historical pattern of falling yields during rate-cut cycles.

High debt and persistent inflation could signal a rough road ahead. With the Fed cutting rates but the 10-year Treasury yield rising, the bond market may be signaling **“the jig is up”** and demanding higher compensation for these risks. By prioritizing high-quality, short—to intermediate-term bonds, we're prepared for bumps along the way.

Alternatives: Defensive Moves

Lastly, alternative assets continue to play an important hedging role in your portfolios, providing true diversification during periods of high market uncertainty. As we highlighted in previous pieces like *Free Lunch*, *Rethinking Gold*, and *Dividends Ahoy*, gold and managed futures have provided that portfolio protection. This was particularly true during the awful 2022 market for stocks and bonds.

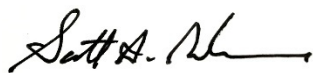
Given this outlook, we recently adjusted our allocations. We sold a high-dividend foreign stock fund and reallocated the proceeds into managed futures and U.S. dividend-focused value stocks. We believe this offers a stronger balance of preservation and growth than European equities.

Key Takeaways

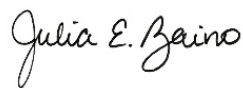
1. **A Market at a Crossroads**—With the Trump Administration’s whiplash changes - expect volatility.
2. **Equity Risks Is Back**—The AI boom has fueled extraordinary technology valuations and unhealthy market concentration. Timing is always hard to predict, but we believe cheaper dividend-paying, free cash-flow-focused equities will be the market leaders going forward.
3. **Bonds Face A Debt-Level Reckoning**—Inflation and a \$36 trillion national debt complicate the bond outlook. Our focus on high-quality, short—to intermediate-term bonds helps us navigate this foggy road.
4. **Alternatives**—With geopolitical risk and volatility rising, gold and managed futures are important components of our equity portfolio.

Thank you for your trust and support as we navigate this fast-changing landscape. We appreciate the opportunity to guide you through these crossroads and look forward to compounding your capital in the years ahead. Let’s connect soon!

Very truly yours,



Scott A. Roads
Founding Principal

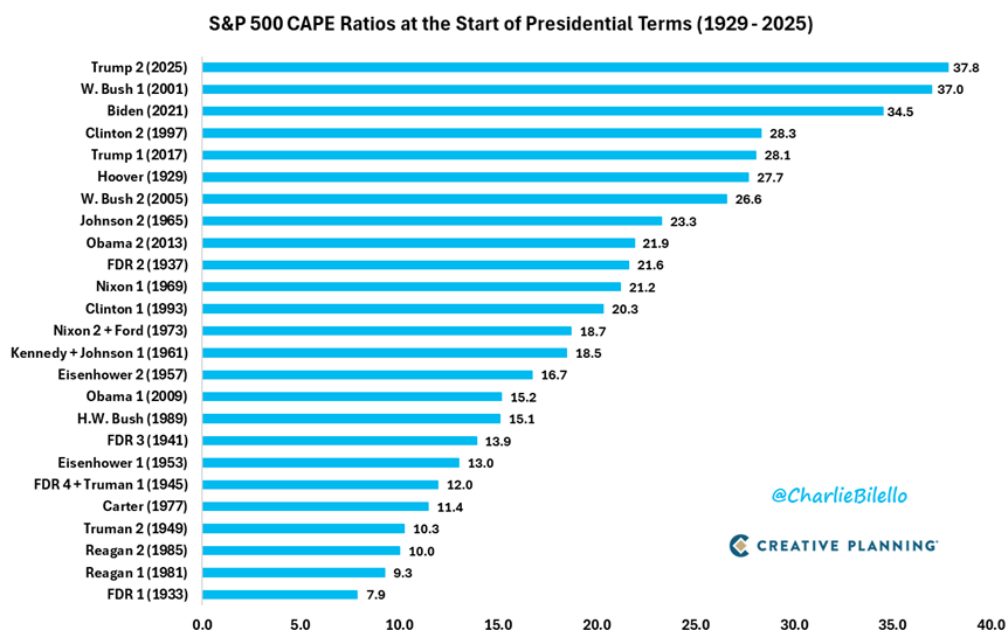


Julia E. Zaino
Principal

If you are not a current client of Spectra, this letter is for entertainment purposes only and not intended as, nor does it constitute, an offer or solicitation in any form to buy any security or other financial instrument. Investing involves the risk of loss, and we encourage you to research investing with a high degree of due diligence and skepticism. © 2025 Spectra Investment Management

Exhibits

A. S&P 500 Cyclically Adjusted Price/Earnings ratio at the start of Presidential Terms Source: @CharlieBilello



B. S&P 500: Numbers of Large Down Days from 1928 to 2025 Source: @CharlieBilello

S&P 500: Number of Large Down Days (1928 - 2025)															
Year	-1% Days	-2% Days	<-3% Days	Total	Year	-1% Days	-2% Days	<-3% Days	Total	Year	-1% Days	-2% Days	<-3% Days	Total	
1928	23	2	2	27	1961	2	1	0	3	1994	14	1	0	15	
1929	19	10	19	48	1962	28	4	2	34	1995	4	0	0	4	
1930	38	16	16	70	1963	2	1	0	3	1996	14	2	1	17	
1931	42	28	27	97	1964	3	0	0	3	1997	25	5	1	31	
1932	27	18	50	95	1965	7	0	0	7	1998	20	7	5	32	
1933	33	15	27	75	1966	22	3	0	25	1999	31	9	0	40	
1934	32	20	7	59	1967	9	0	0	9	2000	35	15	4	54	
1935	31	8	1	40	1968	9	0	0	9	2001	41	9	4	54	
1936	18	6	5	29	1969	17	1	0	18	2002	43	22	7	72	
1937	28	17	17	62	1970	29	4	0	33	2003	32	4	1	37	
1938	40	15	12	67	1971	14	0	0	14	2004	20	0	0	20	
1939	29	15	8	52	1972	6	0	0	6	2005	17	0	0	17	
1940	23	4	8	35	1973	37	5	1	43	2006	13	0	0	13	
1941	23	3	3	29	1974	52	13	2	67	2007	23	10	1	34	
1942	24	2	0	26	1975	32	3	0	35	2008	34	18	23	75	
1943	13	1	3	17	1976	14	0	0	14	2009	27	16	12	55	
1944	7	1	0	8	1977	12	0	0	12	2010	27	5	5	37	
1945	14	7	0	21	1978	23	1	0	24	2011	27	15	6	48	
1946	23	4	10	37	1979	12	1	0	13	2012	18	3	0	21	
1947	25	3	2	30	1980	30	6	1	37	2013	15	2	0	17	
1948	19	2	5	26	1981	26	4	0	30	2014	15	4	0	19	
1949	12	3	0	15	1982	32	5	1	38	2015	25	4	2	31	
1950	15	3	4	22	1983	25	1	0	26	2016	17	4	1	22	
1951	16	1	0	17	1984	16	0	0	16	2017	4	0	0	4	
1952	8	0	0	8	1985	7	0	0	7	2018	17	10	5	32	
1953	14	1	1	16	1986	19	4	2	25	2019	10	5	0	15	
1954	4	1	0	5	1987	22	14	6	42	2020	20	9	16	45	
1955	14	4	1	19	1988	26	3	2	31	2021	16	5	0	21	
1956	21	0	0	21	1989	12	1	1	14	2022	40	15	8	63	
1957	20	5	0	25	1990	34	7	1	42	2023	27	1	0	28	
1958	4	1	0	5	1991	23	1	1	25	2024	15	4	0	19	
1959	13	1	0	14	1992	11	0	0	11	2025 YTD	3	0	0	3	
1960	16	1	0	17	1993	6	1	0	7						

CREATIVE PLANNING Data as of 1/27/25 @CharlieBilello

Important Disclosures:

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS. THE POTENTIAL FOR PROFIT IS ACCOMPANIED BY THE RISK OF LOSS.

Spectra Investment Management, LLC (SIM) is registered as an investment adviser based in Stuart, Florida and West Palm Beach, Florida. SIM is registered with the SEC and only conducts business in states where it is properly registered or is excluded from registration requirements. Registration is not an endorsement of the firm by the SEC and does not mean the adviser has achieved a specific level of skill or ability.

There is no guarantee investment strategies will be successful. Investing involves risks including possible loss of principal. All expressions of opinion are subject to change. This article is distributed for informational purposes, and it is not to be construed as an offer, solicitation, recommendation, or endorsement of any particular security, products, or services. Clients should under no circumstances rely upon this information as a substitute for obtaining specific legal or tax advice from their own professional legal or tax advisors. Readers other than clients should seek professional advice before investing in any security or fund.

Spectra Investment Management, LLC

401 SE Osceola Street, Ste 202, Stuart, Florida 34994 Phone: 772-324-5640

501 Palm Street, Ste B-6, West Palm Beach, Florida 33401 Phone: 561-623-8305
