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Have "Animal Spirits" Returned?

"Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits—of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities."

- John Maynard Keynes, The General Theory of Employment, Interest, and Money (1936)

John Maynard Keynes, the father of modern macroeconomics, coined "animal spirits" to describe how market sentiment often drives human behavior more than rational analysis. This concept resonates as pro-growth, America-first policies propelled Republicans to take control of the presidency and Congress in November's elections, elevating expectations for robust economic growth. Thus far, the U.S. economy remains strong, even before any impact from these policies takes root after the new administration is installed. While the outlook remains largely optimistic, the impact of these policies will be impacted by several macroeconomic factors that are showing the potential for a modest cooling of overheated conditions:

- **Sticky Inflation**. The Federal Reserve (the Fed) continues to express confidence in controlling inflation, though achieving its 2% target may take longer due to persistent core inflation pressures. While rate cuts are expected to follow a gradual path, a 50-basis-point increase in the 10-year Treasury term premium owing to continued stickier-than-desired inflation could pose significant risks to market stability.
- **Continued Job Growth**. These risks to higher inflation are further supported by the labor market's continued robust job growth, supported by increased workforce participation. While this job growth has filled critical gaps in key sectors, contributed to economic resilience, and reinforced expectations that the U.S. will maintain a leadership position amid global economic uncertainties, it has also complicated the Fed's balancing act between controlling inflation and maintaining full employment.
- **Sustainability of Market Momentum**. Economic momentum has also been shaped by the 2022 interest rate shock, which ushered in a healthier environment of scarcer, more expensive capital, which thus far has not abated momentum in either the economy or equity markets. Despite this, questions linger about the sustainability of market trends, as high interest rates suggest a more modest long-term outlook. Technological innovation, particularly advancements in artificial intelligence (AI), remains a key driver of optimism but also raises concerns about whether these developments will meet market expectations or prompt revaluations. Importantly, favorable credit and liquidity conditions continue to support asset prices, though any disruptions in these areas could have outsized effects on equity markets.
- **Geopolitics & Leadership.** The Republican-led government's policy agenda has increased optimism in markets, with potential extensions to the Tax Cuts and Jobs Act beyond 2025 aimed

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at boosting corporate profitability. Treasury Secretary nominee Scott Bessent's trade stance signals a balanced approach, though pressures on China and emerging markets persist. Early 2025 may bring continued macroeconomic volatility due to geopolitical uncertainties and shifts in political leadership, although reduced geopolitical tensions in regions like the Middle East and Ukraine have served to help bolster sentiment.

Public Markets

Despite high valuations, strong U.S. economic growth and the Fed's shift toward rate cuts indicate we are in a mid-cycle phase rather than near the end of the economic expansion. Equity market strength is supported by robust growth, easing monetary policy, and tight corporate credit spreads that reflect investor confidence. Broader market participation, sectors with price volatility below long-run averages, and high corporate profit expectations—fueled by AI-driven productivity gains and limited wage inflation—further bolster the outlook. The direction of the U.S. dollar could positively affect U.S. relative performance whether there is fiscal tightening or stimulus: fiscal tightening could strengthen the dollar, hurting international assets, while fiscal stimulus may weaken the U.S. dollar but help to maintain stout U.S. growth, which also could serve to widen the U.S.-international performance gap. In fixed-income markets, bonds are again generating meaningful income as the 10-year Treasury yield exceeds 4.5% and real yields surpass 2.2% for the first time since 2007.

Balentine's strategy outperformed benchmarks in Q4 and in 2024, driven by effective equity and fixed-income selections. In equities, we held overweight positions in U.S. Large-Cap Growth and Quality stocks, alongside limited exposure to underperforming international markets. A tactical allocation to shorter-duration Treasuries also added value, taking advantage of inverted yields without excessive interest rate risk. We maintain our long-term strategic average ranges for stock and bond allocations while continuously seeking to diversify alpha drivers.

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Private Markets

Balentine continues to expand its private capital program with the launch of **Sun Belt Plus Real Estate Opportunities I**,* a partnership designed to capitalize on real estate market dislocations caused by rising interest rates and cap rates. This fund opens with three initial investments: **Hillpointe**, an Orlando-based manager building affordable workforce housing in the Sun Belt; **Benefit Street Partners**, a real estate debt manager lending at attractive yields amid reduced lending; and a co-investment in student housing at the University of Georgia, secured through a **private family office partnership**.

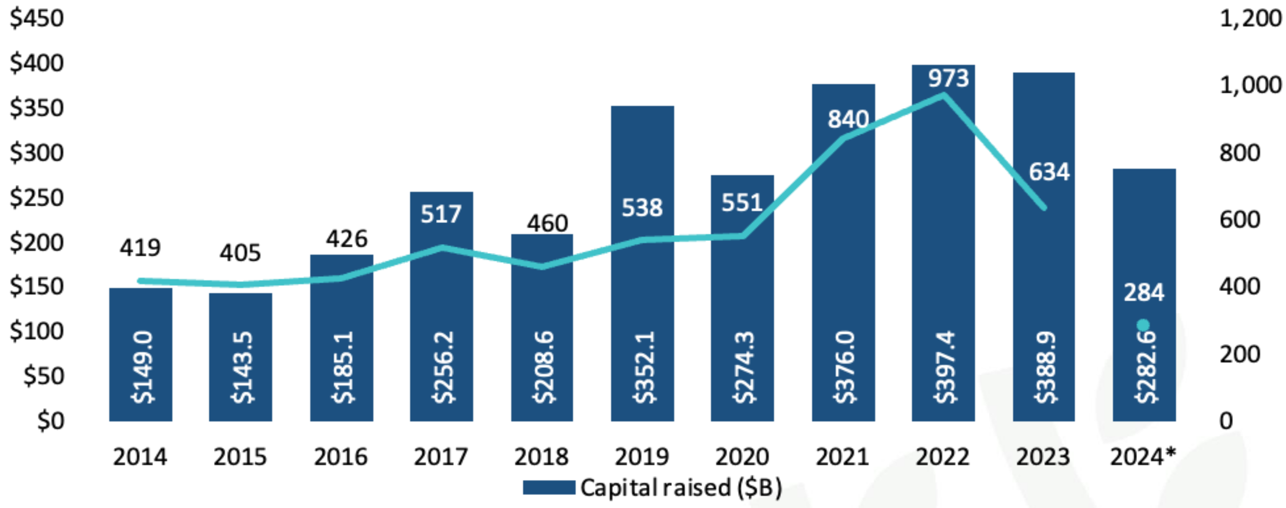
We also continue to deploy capital across our existing partnerships. **Private Credit Opportunities II*** funded an allocation to **Pantheon's** senior debt secondaries, acquiring discounted mature debt portfolios. Additionally, we further diversified our lineup of managers by approving and funding an investment to **Madryn**, a manager focused on lending to healthcare companies. **Decarbonization 2022**,* **Industrial & Aerospace 2022***, and **Credit Opportunities 2023*** made capital calls in Q4 as they identified new opportunities in their respective sectors.

We're excited to offer a direct investment in **NFL Teams*** in 2025, following the league's approval of private equity participation. With only four managers selected, this rare opportunity leverages the scarcity and strength of the NFL brand, offering a compelling risk/return profile with lower downside risk compared to traditional private equity.

In private markets, we are closely monitoring the impact of higher interest rates on exit activity and fundraising. High interest rates have slowed private equity exits; according to Pitchbook, 51% of private equity capital is tied up in funds over six years old, and 20% in funds over a decade old. This could lead to non-fundamental sales of quality companies at attractive prices. At the same time, private equity fundraising is stalling, with 2024 totals expected to fall below 2023 levels (FIGURE 1). We see this combination of forced sales and reduced fundraising as an ideal time to deploy capital and plan to launch two private equity partnerships in 2025—one focused on early-stage investments and another on late-stage opportunities.

*Private Capital internal partnerships are available exclusively to Balentine clients. Clients, your Relationship Manager will discuss the best opportunities for your individual financial situation. Please reach out to them with any questions.

FIGURE 1: Private Equity Fundraising Is Stalling, with 2024 Totals Expected to Fall Below 2023 Levels



SOURCE: Pitchbook
*as of Nov. 2024

Opportunities & Risks

The U.S. economy is well-positioned for continued growth, supported by a resilient labor market, low energy prices, and the anticipation of further interest rate cuts within the next 12 months. Although additional factors, such as potential tax cuts and deregulation, could further boost growth, risks could temper the economic outlook. The final stretch to the Fed's 2% inflation target may be slow, keeping interest rates elevated longer than expected. Unfunded tax cuts could increase debt servicing costs and add fiscal pressure, fueling market volatility. Geopolitical tensions, such as conflicts involving China and Taiwan or ongoing instability in Ukraine, while in a lull for now, could flare anew and disrupt global markets. Domestically, stricter immigration policies could strain labor supply and complicate the Fed's balance between controlling inflation and supporting employment. Additionally, elevated market expectations raise the bar for positive surprises, making markets more sensitive to policy or economic setbacks.

In Closing

In 2024, U.S. Large-Cap stocks surged 23%, propelling the S&P 500 to a more than 50% gain since the start of 2023—the best two-year performance since 1998. U.S. technology companies led the charge, outperforming nearly every other asset class, while the MSCI All-Country World Index climbed 16%. However, strong index-level performance masks underlying volatility, with a third of the largest 500 companies posting annual losses, and the bottom quartile down more than 20% on average.

Fixed-income markets saw mixed results. While Treasury yields remained elevated across maturities, a broad gauge of Treasuries posted a modest annual gain; high-Yield bonds delivered a 15% return, second only to U.S. Large-Cap stocks. The Bloomberg Dollar Spot Index had its strongest year in nearly a decade, while the Bloomberg Commodity Index ended flat. Gold posted its best performance since 2010, while oil prices remained steady, reflecting ongoing dispersion across asset classes.

As we look ahead to 2025, our structural outlook remains optimistic on the prospects for equity markets investors and the U.S. economy. However, there will likely be challenges during the year, including but not limited to: inflation's trajectory and the resulting Fed policy response, the potential impact of pro-growth policies on consumer prices and federal finances, and the market's reaction to the new administration's policies. These factors bolster expectations that returns could be more muted in the shorter term as the markets digest additional economic, financial, and geopolitical data. Mid-cycle markets often appear smooth in hindsight but can be difficult to navigate in real time. We believe this underscores the importance of our disciplined, data-driven approach to navigating markets.

In addition, with the bull market entering its 16th year, many wonder: is a bear market ahead? As noted in our 2025 Capital Markets Forecast, we believe any recession that would come to pass would be brief, providing a foundation for future growth rather than signaling a prolonged downturn reminiscent of the early 2000s. We encourage you to read the article for a more detailed analysis.

We remain committed to helping you navigate this evolving landscape. Thank you for the trust you have placed in our team and process. If you have questions or want to explore upcoming investment opportunities, we hope you will reach out to our team.

Sincerely,

David Damiani, CFA
Chief Investment Officer
Chief Financial Officer

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The Bloomberg Dollar Spot Index (BBDXY) tracks the performance of a basket of leading global currencies versus the U.S. Dollar. The index represents both developed and emerging market currencies that have the highest liquidity in the currency markets and the biggest trade flows with the U.S. The annually updated composition and diversified representation of currencies aims to provide a global measure of the U.S. Dollar.
The Bloomberg Commodity Index (BCOM) is constructed using 24 commodities across energy, grains, softs, livestock, industrial and precious metals. The index is calculated on an ER basis and reflects commodity price movements. The index rebalances annually weighted 2/3 by trading volume,1/3 by world production and weight-caps are applied at the commodity, sector and group levels.

The MSCI All Country World Index (ACWI) is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI captures large and mid-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. With approximately 2,900 constituents, the index covers approximately 85% of the global investable equity opportunity set.

The S&P 500® Index is the Standard & Poor’s Composite Index of 500 stocks and is a widely recognized, unmanaged index of common stock prices.

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