SORFIS
INVESTMENTS

February 24, 2025

2024 Annual Letter

2024 felt like 2023. American stock market indices posted strong returns, led by technology, and the bond market posted a small positive return.

It also felt a lot like 2021, which was one of the most speculative times in stock market history. Both 2024 and 2021 saw the S&P 500 end at valuations at or approaching those of the internet bubble of the late 1990s into 2000; and both saw certain corners of the tech sector reach astronomical valuations—although the overpricing in 2024 was far less widespread than in 2021. The meme stock craze of 2021 was replaced by the meme coin craze in the cryptocurrency market in 2024, although both years saw overlapping euphoria in both markets.

While we're always paying attention to what's going on in all aspects of the markets, we continue to think about getting good value for our money and to focus on the long term when putting clients' hard-earned capital to work. In our **Diversified Strategy**, we mainly experienced positive returns in the mid-single-digit range for clients in the strategy for the entire year. We've positioned our equity exposure toward value and away from growth in this strategy. Value was a reasonable place to be from January through July, but detracted from performance as the growth indices outperformed the value indices by approximately 25% during the rest of the year. Given the valuation discrepancy between the United States and the rest of the world, we also increased our exposure to some cheaper international equities during the year.

In our **Absolute Return Strategy**, we mainly experienced positive returns in the upper-single-digit and low-double-digit percentages for clients in the strategy for the entire year. While we still have some core holdings we've held for years, the shifting nature of value led us to some new positions—and additions to some previously held smaller positions—in 2024 and early 2025. A few of those positions are companies within the Consumer Staples sector where we've been able to invest in companies we believe are trading at attractive absolute valuations, and at relative valuations at or near decade lows. Like the energy purchases we made in 2020-2021 that helped us in 2022, and the tech purchases we made in 2022 that helped in 2023, we think the purchase of these quality businesses at attractive prices will help us earn decent returns in the years to come, especially if we return to a more difficult market environment for overall stock market returns.

2025 and Beyond

This year will likely produce plenty of excitement for both the stock market and the economy. The new U.S. Administration has shown during its first month that the government and our trade policies are going to look far different during the next four years than they have in a long time. Whether these changes are positive, negative, or a little of both is something we don't know. We don't base our investment decisions on such things, anyway. Generally, volatility is good for us, as it opens the door for more bargains, even if it can create some near-term pain on paper.

The S&P 500 is trading at an overall valuation that just about matches or exceeds that of any other time in history, depending on the metric used to measure value. Even a couple of the big investment banks, which are generally more optimistic than most investors, have come out with research during the last couple of months suggesting that 10-year forward index returns are likely to fall within the 0-3% per year range. While we won't make an official prediction, that's about the range we'd guess if forced to pick a number based on where the market sits at the beginning of 2025.

The index has also reached an all-time high level of concentration, with the top 10 companies in the S&P 500 making up 37.7% of the index as of January 31, 2025—largely driven by the so-called "Mag 7" tech names, as the optimism for what artificial intelligence (AI) will do for our future continues to dominate the narrative. The staggering amount of capital expenditures the big tech companies have announced during the last couple of years—and increased announcements during the last couple of months—are something few predicted before the AI hype took hold.

Whether or not the benefits of those expenditures accrue to the companies in the form of a good return on investment or to the customers—as we saw during the build-out of the internet's infrastructure—is yet to be seen and is probably too early to predict. But given the size of the numbers and capital committed, the eventual answer matters a lot. As Charlie Munger once said:

"The great lesson in microeconomics is to discriminate between when technology is going to help you and when it's going to kill you. And most people do not get this straight in their heads…. There are all kinds of wonderful new inventions that give you nothing as owners except the opportunity to spend a lot more money in a business that's still going to be lousy. The money still won't come to you. All of the advantages from great improvements are going to flow through to the customers."

We've entered 2025 with both caution and excitement. Last year saw the highest level of U.S. corporate bankruptcies since 2010, as the higher interest rates we've seen during the last couple of years are starting to have real-world economic effects, as indebted companies attempt to refinance. High valuations are often their own catalyst in bringing about lower valuations when the world realizes that trees don't grow to the sky. But suppose the economic cycle also turns down. In that case, it's likely that even moderately valued companies won't be spared, considering the depth of potential losses that could occur from a starting point of high overall valuations in the broad market indices and a swing in investor sentiment from greed to fear. As such, on the scale of aggressiveness vs. defensiveness, we are currently positioned more defensively, although each strategy and each client account may express this in different ways depending on individual circumstances.

The excitement we have comes on two fronts. First, despite our concerns about where valuations stand, we don't have to own the whole market—and we don't. There are opportunities available if one strays away from the most popular stocks and is willing to hold unconventional portfolios. We're still proceeding with caution and care, given the environment, but we have plenty to do, and plenty of things where we hope a little volatility will give us more attractive prices to buy or add to certain positions. And in some cases, where we can be more aggressive because moderate prices have given way to downright bargains.

Secondly, we've begun to implement Life Planning as our process for financial planning. Simply stated, Life Planning is a process that puts clients and their aspirations for living full and fulfilled lives at the center of their financial plans. That may sound obvious, but it's less common than you might think. Through our training with the Kinder Institute of Life Planning, we're excited to add what we think will be incredibly important value to both current and future clients.

Final Thoughts

Theresa and I thank you for your continued support. And we'd especially like to thank those clients who have introduced us to their family, friends, and colleagues. Referrals from those happy with our work mean the world to us.

For those new to Sorfis, my appearance on the Guardians of Finance Podcast on June 4, 2024, should give you a good, big-picture overview of Sorfis. We'll also be updating the website later this year with more information on Life Planning.

Our contact information is included below for easy reference. As always, feel free to call or email us if you have any questions.

All the best,

Joe Koster

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