

RIVERBRIDGE QUARTERLY

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MARKET COMMENTARY

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Catalyzed by a strong economy, cooling inflation, and excitement around artificial intelligence, the equity market posted an impressive year, returning nearly 25%. 2024 marked the second consecutive year of 20%+ returns—the first such streak since the late 1990s. Investors celebrated 57 record closes for the S&P 500 index. However, achieving this remarkable return required a steely resolve, as markets navigated periods of extreme volatility, an unpredictable election cycle, and shifting Federal Reserve policy.

History suggests we are unlikely to see three consecutive years of 20%+ returns. Investors must contend with elevated valuations, higher-than-expected interest rates, and continued geopolitical uncertainty in the coming year. However, robust corporate earnings expectations combined with an anticipated business-friendly administration offer hope that this strong run may extend into 2025.

At the outset of 2024, market observers highlighted two major risks to the equity market: economic growth and inflation. Yet economic growth remained vibrant, nearly doubling the consensus forecast. Even more encouragingly, inflation—which had stubbornly persisted at high levels for several years—eased to more normalized levels. Most significantly, workers' wages outpaced inflation during the second half of the year. Unlike several major global economies, the United States showcased impressive economic resilience.

Generative artificial intelligence dominated financial headlines, driving stock performance across various sectors. Speculative assets fared even better than equities—Bitcoin prices more than doubled, and gold had its best year since 2010. These speculative areas of the market benefited disproportionately from the Federal Reserve's decision to cut interest rates.

As we enter 2025, bullish investors are touting consensus expectations of strong corporate earnings, respectable economic growth, and moderating inflation. While consecutive years of 20%+ returns are rare, the 1990s saw five consecutive years of such gains. If inflation stabilizes around 2% annualized growth and corporate earnings rise by the consensus forecast of 15%, 2025 could also deliver strong returns.

Still, several risks lie in wait. The market is more concentrated now than at any other time in history. The largest 10 stocks in the S&P 500 represent 38.7% of the index, making its performance heavily reliant on a small number of companies. Valuation levels are also elevated. The S&P 500 is trading at 21.5 times forward earnings, compared to the 30-year average of 16.9 times.

Regardless of the economic and market environment, we believe Riverbridge's portfolio companies are well positioned for 2025 and beyond. Our focus on seeking out franchises that can produce self-financed, non-cyclical unit growth means that they should not need a goldilocks economy to thrive in the year ahead. In addition, we are optimistic about our portfolio positioning as we enter a new phase of artificial intelligence development. Until now, investors have rewarded companies building the infrastructure to support AI, primarily hardware providers. Starting in 2025, we anticipate entering the most consequential phase: deployment. We expect companies to leverage AI in novel ways to boost efficiency and increase productivity. We expect our strategically positioned holdings to be key partners in helping their customers incorporate the benefits of AI into their businesses.

We appreciate your trust in Riverbridge and wish all our readers a prosperous 2025.