Five Mile River Investment Management, LLC January 2, 2025
Client Quarterly Letter
4th Quarter 2024

PERFORMANCE

	Dow Jones Industrial	S&P 500* (Capitalization Weighted)	S&P 500** (Equal Weighted)
2024 Q1	5.62%	10.56%	7.91%
2024 Q2	-1.73%	4.28%	-2.63%
2024 Q3	8.21%	5.89%	9.60%
2024 Q4	0.57%	2.41%	-1.87%
2024 FY	12.96%	25.02%	13.01%

The S&P 500 closed out 2024 finishing up 25%, and in spite of December's declines, 2024 completed the best two-year run since 1998. The unique combination of declining inflation, lower interest rates, and rising earnings framed 2024 and made this market advance possible. Markets rarely advance two back-to-back years of 20+% gains. History may well show that this was a most unusual and very bullish period. Five Mile River (FMR) portfolios were up competitively with the Equal Weighted S&P 500 and Dow Jones indices. Exact client performance data is calculated by an outsourced service and will be available in the second week in January and mailed to all clients.

2025 Outlook

FMR anticipates client portfolios will grow in a range of 8% to 10% in 2025.

Wall Street renowned and respected strategist Ed Yardeni is estimating S&P 500 earnings will expand 18% in 2025, among the most bullish forecasts. Jerome Powell, Chair of the Federal Reserve, forecasts two additional interest rate reductions in 2025. These two forecasted ingredients, lower interest rates and very strong earnings growth, combine to argue that the multi-year bull market will continue for a third year.

<u>What could go wrong</u>? What may go wrong is that interest rates do not decline as much as Powell expects, as inflation remains above his 2% target and may be more intractable by continuing to run at the current annualized 3.3%+. Also, earnings expectations for 2025 appear to be too high and are likely to grow at a more normal 8% to 10% increase, similar to the expansion anticipated for the market and portfolio growth.

The weakness in markets in December followed the Federal Reserves' mid-month forecast which called for inflation to run hotter in 2025 than 2024. Instead of the September forecast of four interest rate declines in 2025, the fed is now forecasting only two are likely. The December market weakness was concentrated in the very group which was most extended and had led the market over the past two years, the Magnificent

Seven. Six of the seven are also the leaders in Artificial Intelligence (AI), Microsoft, Nvidia, Amazon, Google, Meta, and Apple. In 2024, these seven stocks' performance contributed 55% of the S&P 500 capitalized weighted return of +25% and explains the difference with the equal weighted return +13%. Microsoft was the second-best performer of the Magnificent Seven and is owned broadly across FMR client accounts. This December market downturn completely erased the Trump Rally which began in early November. Is this the signal that this AI leadership is now changing and may already be underway? History is clear on the subject that changes in market leadership usually occur during market corrections.

FMR believes risk mitigation will be the cornerstone in delivering positive 2025 performance.

FMR employes the following risk mitigation strategies: selling positions which have reached FMR valuation targets; reducing positions which become outsized relative to their portfolio weighting; and eliminating positions that have declined 20%. In addition to holding slightly higher cash positions, new investments were added that have low market correlation (low-beta). FMR's commitment is to safeguard client assets and grow portfolios without undue risk, particularly given the probability of increased market volatility in 2025.

FMR will manage client portfolios in 2025 similar to our value and dividend growth profiles employed in the past two years across growth, balanced, and income strategies. FMR intentionally avoided the crowd mania of loading up and over-weighting the favored AI stocks. The honesty of making this decision is the fact that FMR felt most of the Magnificent Seven have been fundamentally over-valued. However, Microsoft (MSFT) remains fundamentally attractive because of their fortress balance sheet, excellent management, balance of different businesses, and high recurring revenues. FMR began positions in MSFT when Satia Nadella became the new CEO in 2014. This is an excellent example demonstrating the benefit of long-term investing in individual companies, <u>something not available in Exchange Traded Funds (ETF's)</u>.

Client portfolios are chock-full of established leading companies paying and growing attractive dividends and priced at substantial valuation discounts to the market. FMR's risk mitigation strategies along with its stock selection process should prove adequate to weather a market likely punctuated with modest corrections.

Energy will be key in FMR's AI investments

An important reason supporting the continued multi-billion build out of the U.S. AI infra-structure is because the primary players are each committed to winning the competition for bringing AI to market. So, these behemoths (Microsoft, Amazon, Google, Meta, and Apple) each believe success in AI is required for future growth and each is committed to using their considerable cash to fund and strive to win this race.

FMR has written in prior client letters that the key enabling factor for AI is the build-out of the necessary plumbing to permit AI's required massive data flow. A critical component of this AI build out is sourcing the necessary uninterrupted energy to run the required data centers. An example of the increased energy caused by rolling out AI is that a single Microsoft AI query requires 4 to 10 times the energy compared to a single Google search. Another example of this energy requirement, Microsoft is funding the restart of the Three Mile Island nuclear facility next to a planned mega data center. To build out AI the locations of new data centers are being cited in proximity to those utilities that possess substantial excess energy capacity.

Natural gas pipelines are a solution

FMR's commitment to own a number of natural gas pipeline companies has been premised on their strong fundamental attributes and will now be benefitted by the new energy demands caused by increased AI usage.

In some states, demand from data centers, electric vehicles and new industrial factories is exploding. As recently as twenty years ago coal represented more than half of the U.S. electric generation capacity. Now climate goals do not want more carbon dioxide. Coal is now mostly replaced by natural gas supplied through long-term contracts with the pipeline companies. This rising electricity demand will require contributions from all energy sources: nuclear, natural gas, solar, and wind. Among those, nuclear and natural gas will be the predominant incremental sources for carbon free electricity that is needed 24/7 for the next 20+ years.

Nuclear power is a solution, however . . . .

While the U.S. has more nuclear power plants than any other country (94), their average age is over 40 years. China, India, Korea, Russia and Turkey are building 34 new nuclear plants. France already has 14 plants, and Japan has 17 and plans another 10 by 2030. The U.S. Nuclear Regulatory Commission has approved construction of small modular reactors (SMR) in Idaho, and Wyoming (Bill Gates, founder of Microsoft is funding this). SMR's hold great promise for the U.S., however, their deployment appears to be in the 2030's.

The cost overruns of major nuclear construction are the reason utility companies are not jumping back into this energy source without regulatory changes, and financial support. Big nuclear projects, under current economics, take 10 years plus to build and are budgeted in excess of $15 billion. World uranium is mainly sourced from Kazakhstan, and a handful of smaller countries. The U.S. sold U.S. based uranium producer Uranium One to Russia under the Obama administration. In early 2024 Biden declared a new national park on the land containing the only other significant source of U.S. reserves. Canada's, Cameco Corp. has significant uranium reserves and is planning to expand its production, as one of the few friendly sources to meet incremental new nuclear demand.

ENTERGY CORPORATION (ETR) & Growing Electricity Demand

Utility company stocks in general will be benefitted because U.S. electricity demand is growing after more than a decade of flat power consumption. Entergy, Sempra, and Southern Company are the three utilities FMR has selected for client portfolios. Each has the electricity capacity to attract large data center collocations, thereby significantly increasing their growth opportunities.

Entergy Corporation supplies electricity to three million customers in Arkansas, Louisiana, Mississippi, and Texas. Entergy sources 90% of its power from natural gas and nuclear power. The long-term outlook for ETR is excellent as more people migrate to these states along with businesses including new hyperscale data centers. Facebook's parent company META announced plans to invest $10 billion in Louisiana constructing its largest data center, to be powered by three new ETR natural gas plants. ETR also expects to construct a new hydrogen capable facility, the Lone Star Power Station in Texas. Finally, Entergy owns the LARGEST single nuclear power plant in the U.S., the Grand Gulf Nuclear Station on 2100 acres in Port Gibson, Mississippi. This last factor was paramount in attracting FMR's interest in the company. FMR expects ETR's yearly earnings and dividend growth in the 6% to 9% range for the foreseeable future. In just the last five months ETR's stock price has appreciated 50%.

Conclusion: existing newer, efficient and large-scale nuclear plants are very valuable assets. Entergy, Southern Company, and Sempra are attractive long-term investments with the right assets.

FMR welcomes your thoughts and comments, and we wish all a healthy and prosperous New Year.

Sincerely,

Lee Todd Martha

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**The S&P 500 Index is a market capitalized weighted index of 500 companies. It is a growth-biased index because the larger the capitalization of a company, the larger the weighting it contributes to the S&P 500 Index performance. The index referenced* <u>*includes the dividends*</u> *issued by these 500 companies. This index is used for a comparison for FMR accounts.*

***The S&P 500 performance has been driven by only six AI richly valued companies (technology) and those companies have accounted for over 55% of the 2024 S&P 500 performance. In this quarter's client letter, the S&P 500 Equal Weight Index is included in the performance chart to demonstrate how the S&P 500 Performance looks without the overweighting of the seven technology companies.*

The performance data included in this letter are not audited and have not been otherwise reviewed or verified by an outside party. While Five Mile River Investment Management, LLC endeavors to furnish accurate information, investors should not rely upon the accuracy or completeness of this information.

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