DIVERSIFIED PORTFOLIOS, INC.

Investment Insights

A Resource for Investors, Attorneys and CPAs

February 2025

at a glance

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Diversification wins the day in early 2025

On Sale! International Stocks

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DIVERSIFIED PORTFOLIOS, INC.

Market Update

February 2025

Asset Class	YTD Return	3 Month Return
Large U.S. Stocks: S&P 500 Index	2.0%	5.0%
Small U.S. Stocks: Russell 2000 Index	1.3%	2.5%
Developed International Stocks: MSCI EAFE Index	3.3%	0.2%
Emerging Market Stocks: MSCI Emerging Markets Index	0.0%	-4.0%
Bonds: Bloomberg Barclays U.S. Aggregate Index	0.6%	0.5%
Cash: FTSE 3-Month Treasury Bill Index	0.4%	1.1%

Source: Schwab - as of February 3rd, 2025

2025 is strong but volatile out of the gates

Many of the market themes in 2024 have reversed to date in 2025. Investors are finally through the U.S. election but got a jolt early in the year from a relatively innocuous piece of news: a Chinese startup company released a new Artificial Intelligence (AI) program called DeepSeek that tech experts are applauding and comparing favorably to some of the AI tools developed in the United States. While advancement in technology is typically viewed favorably by investors, this news sent shockwaves across U.S. markets, as DeepSeek was developed with relatively little human and financial capital, all while using computer chips that are less advanced than the latest and greatest available on the market. Tech investors are worried that the enormous financial commitment to AI development from “Big Tech” in the United States can be replicated much more cheaply. As a result, growth stocks are trailing value stocks (financials, industrials, healthcare) to start the year.

International stocks are leading the way thus far in 2025 and came into the year with more attractive valuations than U.S. stocks. While results are good to date, the path has been turbulent, as international equities have been whipsawed by U.S. trade policy that may or may not include tariffs. Markets never like uncertainty so the recent volatility is to be expected.

U.S. economic data continues to show no signs of recession, and trends in place during 2024 are continuing early in the year. The first estimate of 4th quarter GDP came in at 2.3%, which is about the pace the U.S. has delivered since the financial crisis. Inflation data continues to be stubbornly high, but moving in the right direction, while the labor market remains healthy. The first jobs report of the year released in early February was positive.

Interest rates drifted higher towards the end of 2024, and early results for bond investors in 2025 have been solid. We welcome higher long-term rates on fixed income investments; when bond investors purchase securities in a higher interest rate environment, a further modest rise in interest rates has less impact, as coupons and yields are higher, offsetting any short-term price losses. Should interest rates fall, returns of mid to high single digits are a reasonable annual return expectation for a traditional bond investor. Balanced investors with allocations to both stocks and bonds should take solace in a more normalized interest rate environment, as bonds offer stability to an overall portfolio.

Deeper Dive: International Equities

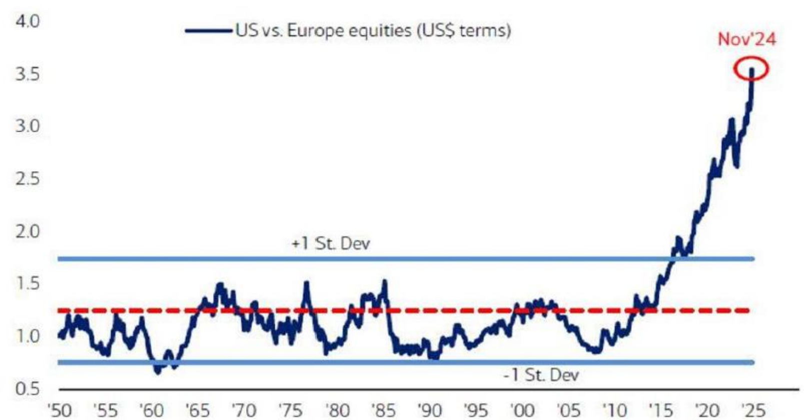
International equities are historically cheap compared to U.S. equities

Following the election, market participants have questioned the purpose of, or need to, diversify with international equities. We maintain our view that international equities are still an essential piece of an overall portfolio—they are priced very attractively heading into 2025, as investors are aware of the headwinds. We enter 2025 with the S&P 500 trading at 28 times trailing earnings. This is historically expensive. In layman's terms, investors must pay $28 dollars to receive $1 dollar in earnings, and 1 divided by 28 is an earnings yield of 3.6%. Markets are counting on significant earnings growth, which may occur but is not guaranteed. We saw a similar situation heading into 2024, and the S&P 500 returned 25% for the calendar year. However, data shows that longer term returns may be weighed down when valuations are at their current levels, thus underscoring the need for a diversified approach.

Per Bank of America, international stocks are now at their 75-year cheapest level compared to U.S. Equities, and according to the Economist, U.S. stocks are now 60% of the investible global stock market (with only 4% of the world's population). There are many reasons for this increasing divergence - the U.S. economy has had the best results by far since the pandemic, and U.S. companies are run exceptionally well. As the world's second largest economy, China has struggled to stimulate demand post Covid. In 2024, the Chinese government was focused on measures to reignite their economy. Developed Europe has struggled with a challenging demographic story and has been unable to grow at an attractive pace for global investors. There have been some bright spots, such as Singapore, India, and Malaysia, but not enough for the entire asset class to keep up with U.S. stocks.

It is important that we do not ignore 40% of the global market capitalization and are positioned to capture the diversification benefits. We do not want our clients to have all their eggs in the U.S. basket, as domestic risks can arise unexpectedly. From 2000-2010, global stocks were positive, however the S&P 500 was negative, once again emphasizing the importance of a long-term view. We want to participate efficiently in global commerce, a large part of which occurs outside the United States.

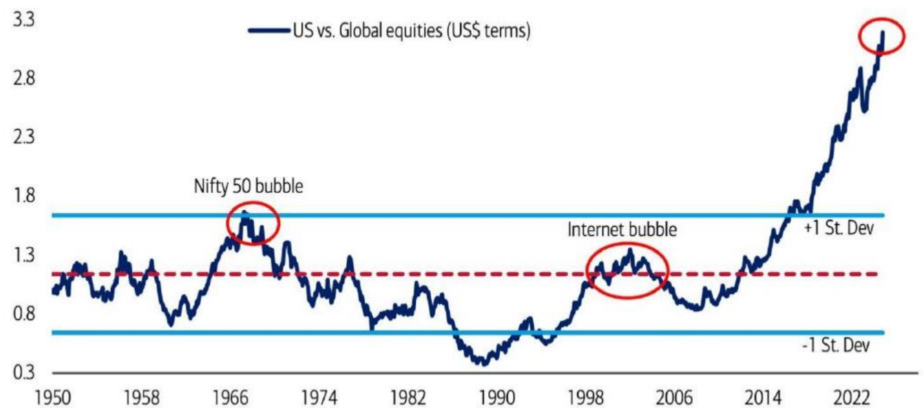
Chart 6: US stocks very "exceptional" relative to European equities
US vs Europe equities price relative (US dollar-terms)



Source: BofA Global Investment Strategy, GFD Finaeon

BofA GLOBAL RESEARCH

Chart 2: 75-year high in US stocks vs Rest-of-World
US vs Global ex-US equities (relative price performance, USD)



Source: BofA Global Investment Strategy, Global Financial Data, Bloomberg

Source: Bank of America November 2024

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Financial Planning

February 2025

We recommend working closely with your advisory team to help determine the strategies that make the most sense for your comprehensive financial plan.

2025 Reminders

- Participants in 401k, 403b, and other employer sponsored plans can contribute a maximum of $23,500 ($31,000 for those ages 50-59 & 64+; those ages 60-63 can contribute a maximum of $34,750).
- IRA contribution limits (including both traditional and Roth IRAs) remain unchanged at $7,000, ($8,000 over the age of 50).
- HSA contribution limits have increased to $4,300 (from $4,150) for individuals; and to $8,550 (from $8,300) for families.
- The standard deduction has increased to $30,000 for those married and filing jointly ($15,000 for single and separate filers).
- In 2025, individual annual gift exclusions increased to $19,000 (from $18,000) per person, per year. This includes “Super-Funding” 529 education savings plans, which allow an individual to gift up to $95,000 per person in one year.
- Unless an extension for the sunsetting of the Tax Cuts and Jobs Act is passed, marginal tax rates will increase at the start of 2026. Those in lower brackets may want to consider various tax savings strategies (such as Roth Conversions) during this potential final year.

Secure Act Update: Inherited IRA RMDs

- In 2025, Congress will start enforcing penalties for not taking Required Minimum Distributions from IRAs inherited after the Secure Act (Jan 1st of 2020). It will be even more important to consider strategic distributions during the 10-year period to best suit your tax situation, cash needs, and to avoid the 25% penalty from a missed distribution.

We’re here to help

The team at Diversified Portfolios wishes you and your families an amazing year in 2025. We are here to help with all your investment and financial planning questions. Please never hesitate to reach out to us.

Sources: www.irs.gov

Disclosures

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