From the Helm

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A HOST OF CONTRADICTIONS

At Spinnaker, we believe that purchasing a portfolio of outstanding companies, whether individually or through a diversified ETF, at reasonable prices and holding them for a very long time is the most assured means to maintain or enhance the purchasing power of wealth. Compounding really is the 8th wonder of the world, and as the late Charlie Munger stated, “the first rule of compounding: never interrupt it unnecessarily.” These thoughts are on our minds as we confront the multiple contradictions presented by investment conditions at the close of 2024.

2024 was a very good year for US investors. The S&P500 Index advanced 25.0% on top of the 24.0% advance enjoyed by investors in 2023. As has been well reported, the advance in the S&P500 was driven by the performance of a small number of mega-cap companies. Below is a selection of six mega-cap companies and their 2024 advance in share price (including dividends) and in earnings as well as their return on equity for the most recent twelve months and most recent price to earnings multiple.

Company	2024 Return	2024 Earnings Growth	ROE	P/E
Alphabet	35.62%	38.3%	27.4	21.2x
Amazon	44.39%	77.2%	17.5	35.1x
Apple	30.7%	21.2%	157.4	33.0x
Meta	66.05%	52.4%	28.0	23.1x
Microsoft	12.9%	10.8%	37.1	29.9x
Nvidia	171.25%	127.6%	91.5	31.2x

It is important to note that while the investment returns of these stocks in 2024 were truly extraordinary, their advances in earnings were pretty remarkable as well. And their returns on equity are almost hard to comprehend. Since the late 1990s, a series of companies, virtually all based in the United States, have led a remarkable revolution in technology that has made our lives more productive, more connected and more enjoyable. There are undoubtedly other effects, not all of them positive, but the overall impact of internet search, on-line shopping, wonderfully reliable and intuitive devices, social media, business software, and graphical processing unit chips has been nothing less than a revolution in our lives. If one questions the impact of these companies, consider the fate of newspapers, once considered powerful and profitable businesses. Today, you can buy the New York Times for a measly $8.5 billion - compared to $2.3 trillion for Alphabet, the company that undermined the New York Times' traditional business model.

Artificial intelligence holds the potential to continue or even accelerate the technology revolution. As can be seen in the above table, the shares of these remarkable companies are now very expensive by any traditional measure. But there is also no tradition of companies growing at these rates or enjoying margins at these levels. So, we confront our first contradiction: the desire to continue to be exposed to a technology revolution that shows no signs of slowing contrasted against our desire to maintain prudence in not participating in what some believe is a bubble.

The technology revolution played a big role in creating some other significant contradictions in global markets. The S&P500 has increased at a compound annual rate of 13.7% for the past ten years, while the EAFE developed international market index has compounded at 4.8%. Today, the S&P500 trades at 19 times forward earnings estimates while the EAFE index trades at 12.5 times forward earnings. Many commentators have suggested that "American exceptionalism" is overrated and that there will be a reversion to the mean, meaning that the EAFE market will outperform US indices.

However, when you look more closely at the companies and industries that make up the EAFE index, you see that the largest sectors are financials, industrials and health care in contrast to the S&P500 where the largest sectors are technology, financials, and consumer discretionary. There is far less representation of higher growth industries in the EAFE index. The more fundamental problem is that European economies are beset by substantially higher rates of government spending as a percentage of GDP and dramatically less entrepreneurial innovation – and they face the threat of further provocations from Russia and Iran. While it can be argued that US equities appear expensive, it is far less clear that European equity markets are attractive. It seems far more likely that there are some attractive, less expensively priced European businesses, but owning the broad EAFE index is not appealing. In contrast, US large cap ETFs such as the S&P500 do provide diversified exposure to the technology companies leading the American economy. So, a second contradiction is the apparent attractiveness of developed international markets undermined by important, fundamental differences in the nature of the economies in those countries and the concentrations of businesses represented in those indices. We have recently reduced our allocation to developed international markets for these reasons.

Finally, small capitalization stocks in the United States have underperformed the S&P500 meaningfully over the past five and ten years. Valuation for small caps is dramatically lower than the larger cap market – forward price earnings multiples are closer to 12.9 times as opposed to 19 times. And over very long periods of time small capitalization stocks have outperformed larger capitalization stocks. So, shouldn't we be allocating a higher percentage of equity portfolios to small caps? Again, not so fast. In 1998, 15% of all companies in the Russell 2000 (the most used index for small cap stocks) were unprofitable. Today, that number is over 40%. What has happened? We believe there are several important changes. First, over the past thirty years, we have seen enormous growth in private markets – from venture capital firms seeding startups and supporting their growth, to "growth equity" firms participating in private financings at higher valuations to support continued growth, to private equity firms buying profitable businesses with aggressive business plans to spur even more rapid growth, to secondary funds prepared to step in and buy interests in private companies or funds whose holders may need liquidity for any number of reasons. The net result is an enormous private ecosystem that is bypassing the public markets. Part of the reason for this is the extent of the burden of being a public company – from proxy fights with activists to heavy handed SEC oversight and regulation to expensive reporting and disclosure requirements. Many company leaders ask "who needs it?" The total number of public companies in the United States today is approximately 4,000 compared to a peak of 8,090 in 1996. The importance of this decline is that an important component of the most entrepreneurial activity in the United States today is now happening in private markets and is bypassing the public markets. We believe that this migration of some of the most attractive companies away from the public markets plays a big role in the changing composition of small cap indices. Special Purpose Acquisition Companies, small and mid-sized banks, biotech firms with uncertain futures and small cyclical companies are all important parts of today's Russell 2000. What is missing is SpaceX (private value $350 billion), Stripe (private value $95B), Databricks (private value $62B), Shein (private value $60B), and Plaid (private value $13.4B).

All of these companies would have powered the Russell 2000 in the past but remain private. So, while the valuation of the Russell 2000 may appear attractive, the long history of outperformance by small cap stocks may be inapplicable to today's realities. Our third contradiction is the apparent attractiveness of small cap stocks, contrasted against the changing composition of traditional small cap indices. We think there is opportunity in certain small cap stocks, and we are currently using the S&P600 small cap index for our ETF portfolios. The S&P600 incorporates only those small cap stocks that have demonstrated profitability in the past twelve months, thereby avoiding many of the most problematic elements of small cap indices today.

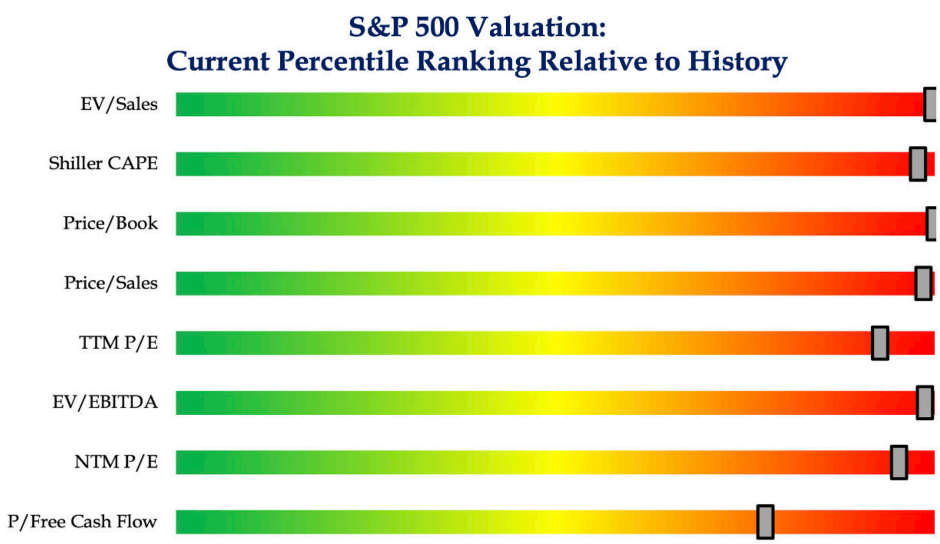
02

FOUR ABSOLUTE TRUTHS

With all of these contradictions facing investors, what is our advice as we enter 2025? We believe there are four absolute truths. First, the technology revolution is real, and it is not going away. Second, US equities are expensive. No one can look at the chart below and not be concerned that equity valuations may not be sustainable.

12/23/24

VALUATIONS HAVE RARELY BEEN SO RICH...



Source: Strategas

Third, the US fiscal imbalance is a substantial challenge that could trigger material problems for markets. A $2 trillion annual deficit, $36 trillion accumulated debt and over $1 trillion in annual interest costs together dramatically reduce the maneuvering room for US fiscal policy. Fourth, geopolitical forces are more volatile than we have seen in many years. Investors must acknowledge the potential for exogenous shocks.

This mix of factors causes us to want to remain invested in the technological innovation that is being driven in the United States but to begin to look at ways to reduce exposure to the potential issues outlined above. Our ETF and single stock portfolios achieve the goal of remaining invested in US technological leadership. The next step is to make sure that allocations to fixed income, which may have declined in the face of equity gains in recent years, are rebalanced to targets. Whether fixed income portfolios represent a certain number of future years of spending or simply an allocation for risk-management purposes, we recommend making sure it is in place – and we recommend keeping duration under that of the Bloomberg Aggregate Index. With the fiscal pressures the US faces and the prospect of some of Donald Trump's policies being enacted, there is at least some risk of greater than expected interest rates. Equities will not react well to higher interest rates, and so it is important that fixed income portfolios hold up – hence shorter duration.

Second, outside the technology sector, we are favoring sectors where valuations are the least demanding – for example healthcare. And in smaller capitalization stocks, we are moving toward a greater quality bias, trying to avoid many of the small cap names that are overleveraged, unprofitable or with uncertain futures.

2025 promises to be a year of great surprises. But tax rates are unlikely to become substantially more punitive, and generous limits on various estate planning tools remain in place. So, it is a good time to adjust portfolios to protect gains and position portfolios for the future, and it remains an outstanding time to consider long term investment and planning goals. The Spinnaker team stands ready to help our clients across the full range of investment and planning issues and looks forward to working with our clients in 2025 and beyond.

03

FIRM UPDATES

2024 was an exceptional year for Spinnaker Trust. We celebrated the retirements of two very valuable long-term team members, welcomed news ones, were honored to earn the trust of many new clients and deepened our relationships with existing clients all while delivering the most successful year to date by almost any measure.

With tremendous gratitude we said goodbye to Sara Lewis and Kate Wilkinson who each retired in 2024 after long careers at Spinnaker. Sara was a co-founder and wore nearly every possible hat at Spinnaker. Her imprint on the team and our clients will be long lasting. Kate joined Spinnaker in 2010 and was an invaluable part of not only the Spinnaker family but of each of the families she served over the years. We wish them both great joy as they enter this next phase of life.

Since our last newsletter, we have welcomed one additional member of the team, Katelyn Gustenhoven, who joins us as an ESOP Analyst. With the firm now serving as trustee of over 60 Employee Stock Ownership Plans, Katelyn's addition to our ESOP team will allow us to continue to serve clients at the highest level while continuing our steady growth. Katelyn has extensive experience in the financial services industry and currently lives in Saratoga Springs, NY.

We are thrilled to announce the elevation of three members of our team to Principals of the firm in 2025. Ainsley Gleason, SVP and Chief Operating Officer, has been a member of the team since 2012. Ainsley earned her MBA, has a CTFA designation and is responsible for all operational and compliance activities for the firm. Eben Jose joined us in 2014. He earned his CFA designation shortly thereafter, and spent many years as an integral member of our investment team. Eben is now an SVP and Client Advisor, while also leading our private investment offerings as well as serving as the firm's treasurer and CFO. Laura McHugh has been with the firm since 2017. Laura has her MBA and earned her CFP© while at Spinnaker. Laura is an SVP and Client Advisor at the firm working with dozens of families to help them achieve their financial goals.

We are also pleased to recognize the promotions of Maria Gwinn, Tax Director, Casey McCormack, Director of Real Estate, and Zachary Smolkin, Chief Trust Officer, to Senior Vice Presidents, and we further congratulate Christopher Whitney, ESOP Client Advisor, on his promotion to Vice President.

Each of these individuals is key to the success of Spinnaker Trust both now and in the future, so we can continue serving our clients with the same dedication to extraordinary service that our clients and partners have come to expect for generations to come. We wish you a happy, healthy and prosperous 2025.

04

ADOBE SIGN

We are delighted to bring clients some exciting news regarding our electronic document signing process. After a thorough evaluation, we have decided to transition from DocuSign to Adobe Sign. This change should provide clients a seamless experience, as Adobe Sign offers enhanced integration with our internal applications. We will endeavor to make this transition as seamless as possible, but should you have any questions or require assistance, please do not hesitate to reach out to your relationship management team.

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