Wealth Enhancement®

SCARLETT-ROEHR-GARCIA TEAM

Northwest News – First Quarter 2025

IN THIS ISSUE

What's New 1
Stocks 2
Bonds ..... 3 - 4
Planning Desk ..... 5 - 6
Our Team 7
Top 10 Holdings 8

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It's official! As of 12-31-2024 we are the Scarlett–Roehr–Garcia Team

We want to thank each and every client for your trust in our process, for your business, and for allowing us the opportunity to manage your investments and exceed your expectations when it comes to the service you've grown to expect over the years. We truly believe we are in the best possible position to continue our independent, in-house research, investment idea generation, and account management for the long-term. Your investment management and relationship team has stayed the same, with the exception of one new addition. We'd like to welcome back Theresa O'Donnell to our group! Many of you will remember working with Theresa in years past, and we're delighted to add her extensive knowledge and skills in the world of account and client service to our already deep bench of expertise.

Our tenure at Wealth Enhancement Group is still young, but we're already seeing the benefit of streamlined administrative functioning, a team of investment technology (IT) professionals supporting our processes from within, and the cybersecurity infrastructure afforded by a much larger company (of which we remain our boutique, intellectually rigorous selves). We're eager to both expand our horizons and refocus our energy on our primary professional roles (i.e. investment management and one-on-one client service and planning).

Again, we want to thank you for your patience during the transition. Communications have come fast and furious and we've all hit the ground running. Remember, if you ever have any questions about emails you've received, notifications, account actions, or questions about the investment, financial planning, or transition process, please don't hesitate to reach out to anyone of us.

We're excited to partner with you in this new chapter. We wish you a fruitful 2025 filled with happiness and good health, and as always, we are here for you.

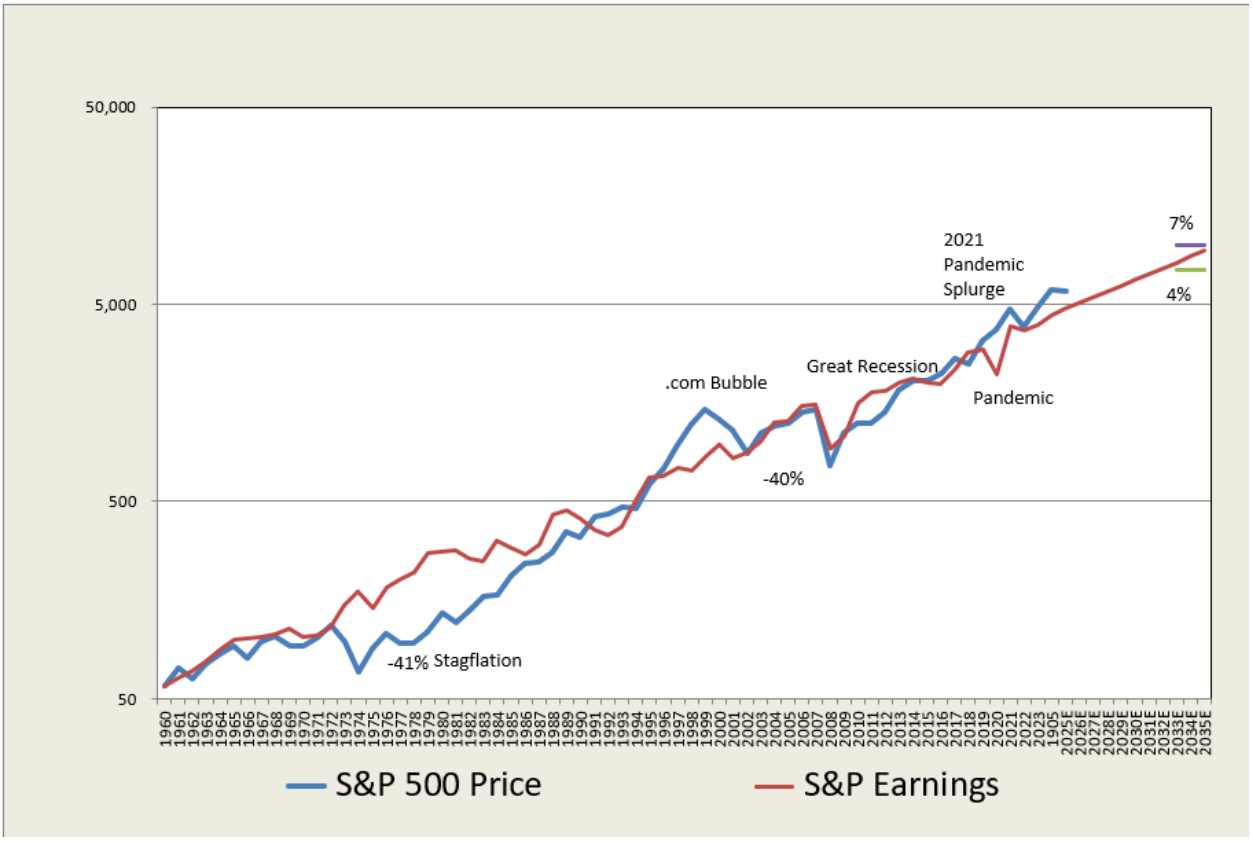
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Stocks

It was another mostly solid year for stocks with technology and U.S. stocks again leading the way. The tech-heavy S&P 500 was up 23% before dividends—that is two years in a row above 20%. The less tech exposed Dow Jones Industrials were up only about 13% before dividends. Small capitalization stocks were up about 9% before dividends *(as measured by the Morningstar U.S. Small cap index).* While 9% pales in comparison to the larger cap performance, that is still a solid year. International stocks were a dismal bunch with a return of about 3% on the year as measured by the MSCI EAFE index of developed economy stocks. International stocks were performing reasonably well in 2024 until the U.S. election signaled a coming change in economic priorities *(i.e., protectionism)*. Zooming out from the various sectors of the market, and looking at the FTSE Global All Cap Index (FTSE) of every public stock one could own, stocks were up about 16.5%. We trailed that performance a little bit on the stock side compared to the FTSE as our overweighting in U.S. stocks helped but was offset somewhat by our smaller capitalization allocation and avoidance of some high-flying technology stocks.

During 2024, we added one new investment to our Smaller Companies strategy, CBIZ Inc. CBIZ provides accounting, valuation, insurance, human resources, and other professional services to middle-market companies. CBIZ became the seventh largest accounting firm in the U.S. in 2024.

Below, the chart displays the historical earnings *(red line)* and price *(blue line)* of the S&P 500 since 1960. When the blue line is above the red, stocks are more expensive than average and vice versa. While we are not in the range of the dot-com bubble in the early 2000s, stocks (at least those that make up the bulk of the S&P 500) are expensive. This is particularly true of some of the technology stocks which have made rapid gains over the last two years on results and hype around Artificial Intelligence (AI). Our guess based on historical earnings growth and a range of price earnings ratios (PEs) is that the S&P 500 can advance between 4% and 7% annually over the next ten years on a compound basis including dividends.



Bonds

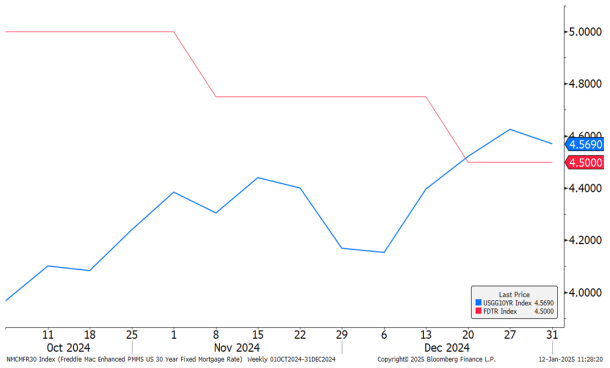
Every newsletter, we write about how the markets performed and about impactful events in the preceding quarter. But *why* do we conduct this exercise of describing the past? Afterall, our industry famously declares that past performance is not indicative of future results. We write our quarterly commentary, of course, to keep our clients informed about important market and economic events. Perhaps more importantly, we write to provide context to the seemingly binary outcome of whether their portfolios went up or down. On its own, one quarter's commentary and themes may or may not be important to read and grasp. However, over the course of a decade, a client who has read 40 pieces of quarterly commentary, may have a better sense for how and why markets behave as they do.

The bond market in 2024 illustrated the importance of context. Bond prices fell over the course of the year; however, the total return was positive. Our fixed income benchmark, the Barclays Intermediate Gov/Credit index (GVI), fell by 0.51% when considering only the price change, driven by increasing interest rates (the 10-yr U.S. Treasury rose from 3.91% to almost 4.60%) and the inverse relationship between bond prices and interest rates. The total return, which includes income, was 2.90% when accounting for GVI's 12-month trailing yield of 3.40%. The average yield to maturity of the index was 4.64%, reflecting the range of yields available on government and corporate bonds with maturities between one and ten years.

The fourth quarter was eventful, with news of a changing presidential administration, developments in Fed policy, continuing economic and labor market strength, and sticky inflation. Despite all of these, the real story for fixed income investors was that rates, outside of several points in the last 2 years, hit their highest levels in 18 years. Our contention is that even though prices could fall more in the face of sticky inflation, that should not be a deterrent, and long-term, buy and hold investors should view today's interest rates as compelling. That's the big takeaway. Read on for more details from the quarter that was in bond investing.

The fourth quarter was not the kindest for bonds, for a variety of reasons, but chief among them, was the idea that inflation is not yet defeated and could re-accelerate if the economy remains strong and/or if some of the future administration's policies prove inflationary. GVI (which, as mentioned above, is our bond benchmark) was up 4.55% through the first 3 quarters of 2024. However, it had a total return of -1.78% in Q4 including income (bond prices fell by 2.63% in the quarter) as the 10-yr Treasury rose an impressive 84 basis points. Rates increased even as the Federal Reserve cut twice in the quarter. The Fed's rate actions took a backseat to their December rhetoric, which made it clear they were likely to cut less in 2025 than originally planned. Market participants viewed December's Fed meeting as a likely indication that the Fed would pause in January and possibly beyond. The Fed's official policy is that they are apolitical and only consider a specific range of data in making their decisions. However, it wouldn't be surprising for the nation's central bank to consider the possibility that proposed policies could reignite inflation, including tariffs (which make foreign goods more expensive to domestic consumers), deficit spending (which requires the increased issuance/supply of Treasuries), and immigration policy that could reduce the supply of cheaper labor. Whatever the rationale, the market and the Fed seemed to agree that rates will need to be higher for longer.

Fed Funds Rate – Upper Bound (red) vs 10-Yr US Treasury (blue)

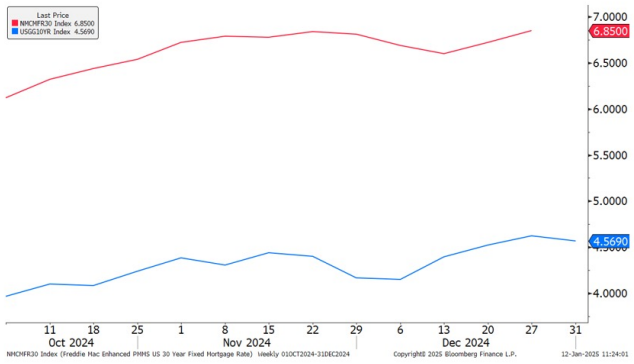


Fed policy has historically had a lagging impact on the economy. In 2024 the economy was able to withstand a higher level of real interest rates (nominal rates minus inflation) without experiencing a serious decline in economic activity or labor market strength. That said, the labor market did show signs of deterioration in 2024 (notably an increasing unemployment rate). The length of time that an economy endures higher real rates is important, and with stalled inflation progress in 2024, it's not hard to envision higher real rates eventually causing the economy to stumble. In 2024, and into 2025, most good news will be viewed as bad news, unless the good news is inflation progress. A strong jobs report or gross domestic product (GDP) release will be viewed as fuel for inflation, and will likely lead market

rates higher, potentially putting pressure on consumers, the labor market, the stock market (higher discount rates are a headwind to stock performance), and borrowers (both individuals and businesses).

Speaking of borrowers, mortgage rates, which had fallen for much of the year, approaching 6% late in the third quarter, rose again in Q4 as Treasury yields increased, ending 2024 near 7%. In addition to higher benchmark interest rates, mortgage rates rose due to increasing mortgage spreads (i.e. the additional amount a homeowner pays to borrow versus what the U.S. government pays to borrow). The spread increased to almost 250 basis points, up from around 125 basis points in 2021. The higher spreads (and thus mortgage rates) are a reflection of the market's perception of today's increased risk in mortgage lending; the decreased participation of the Fed in the mortgage-backed security (MBS) market, and reinvestment risk (investor aren't as interested in buying MBS with high rates because of the risk of prepayment should interest rates fall).

30-Yr Mortgage Rates (red) vs 10-Yr US Treasury (blue)



The primary focus of our fixed income desk is to purchase bonds for our clients that represent the best tradeoff between credit risk and yield. In the fourth quarter of 2024, given the sharp increase in nominal and real yields, we turned our focus toward the credit safety of U.S. government bonds in those accounts where appropriate, especially toward the end of the quarter. With the 10-yr Treasury again over 4.50% (4.60% at the writing of this newsletter), Treasuries offered the excellent value proposition of ample compensation and the full faith and credit of United States. At the beginning of Q4, we had shifted focus slightly to corporate bonds, conducting the due diligence for which our firm is known, reviewing the financial statements of businesses from a variety of sectors and industries, to capture yield spread for clients. Our shifts are subtle, however, and for tax-exempt and tax-deferred accounts with an allocation to bonds, we still prefer corporate bonds. In taxable accounts, especially for those clients in higher tax brackets or who live in higher tax states, we prefer Treasuries and some government agency issuers (since their income may be exempt from state taxes[1]).

Our fixed income portfolio management team also strives to know our clients, customizing bond investments to the greatest extent possible. This may mean a shorter bond ladder Our fixed income portfolio management team also strives to know our clients, customizing bond investments to the greatest extent possible. This may mean a shorter bond ladder (e.g. five years instead of our usual ten), bond maturities that coincide with life's major spending needs, or to target a specific level of income (a bond's income and return may be different if, for instance, a low-income bond is purchased at a discount to par value). Whatever the case may be, it is important for us to know the person and the story behind the account number. It is important to understand the goals, risk profile, tax profile, and general financial preferences as we construct client portfolios. We encourage you to reach out to us if you have questions about your portfolio, how additional/outside funds might be managed alongside or as part of your existing allocation, or for a wide-ranging portfolio review and financial planning session.

[1] *Please consult your tax professional on all tax matters.*

"The primary focus of our fixed income desk is to purchase bonds for our clients that represent the best tradeoff between credit risk and yield."



Cash: Sitting on the Sidelines vs Setting Guidelines

We've all heard that cash is king, but is all cash equal? Despite the term cash equivalents, no, not all cash is the same. Cash can differ by purpose (i.e. the reason for having or holding it) and it can differ in its yield (i.e. the income cash earns at different institutions or in different vehicles). There are two primary reasons we encourage clients to hold cash buffers: 1) for clients with regularly scheduled withdrawals, in which case we typically reserve for six months' worth of transfers and 2) for those clients who don't want their portfolios fully invested in the stock and bond market or who want to maintain a rainy day fund. In both cases, especially with current interest rate levels, the parking spot we prefer for cash buffers is a money market fund (one that aims to keep the share price at $1.00 at all times and preferably invests solely in U.S. Treasuries).

So, what do we mean when we say cash on the sidelines versus cash guidelines? Sitting on the sidelines is a popular, if dangerous, phrase among investors that essentially means attempting to time the market. It usually infers that an investor has sold stocks, and is sitting in cash, waiting for what they perceive to be a more opportune time to get back into the market. Investors can be lured onto the sidelines if they think stocks have run up into expensive valuation territory, or if they believe a correction is coming. Getting out of the market and putting cash on the sidelines often coincides with attractive rates on money market funds or short-term cash instruments such as T-Bills or certificates of deposit (CDs). However, this sort of market timing requires investors to be right twice, the first time when they sell, and the second time upon getting back into the market. It's not impossible, but it is difficult. It's even more difficult to do it multiple times, or over a career.

Instead of shifting cash to the sidelines, our approach is setting guidelines. By guidelines we mean setting an appropriate asset allocation, which may include a strategic cash buffer. If, for instance, through our process to understand a client's goals, timeline, risk profile, and financial situation we determine that a 50% stock and 50% bond allocation makes the most sense, we contend you are better off remaining fully invested in this allocation for the long-term than to shift around based on where markets *may* be heading. If the stock market retreats and stocks now make up 40% of your portfolio, there will be a structural process in place to guide you towards buying low (or relatively lower) and either selling higher or, ideally, holding for the long-term.

Money market fund rates have fluctuated between 4-5% in the past 18 months (in our preferred fund 4.07% at the writing of this piece), which is attractive based on recent history. However, stocks have historically, over long time periods, provided even higher returns. If you don't feel you have a long enough time horizon or the right financial situation to recover from those periods when stocks have been flat or even negative for multi-year periods, this would be the time to better understand the bond exposure in your portfolio, or potentially move to a more conservative allocation.

While we won't advocate for having cash on the sidelines, we encourage clients to maximize their earnings on the cash they want or need to hold, and to have the proper guidelines in place for their cash and their broader portfolio.

Money Movements

For some clients, deposits and withdrawals into or out of their investment accounts may be commonplace, depending on the cash flow needs in their lives. For others, depending on financial circumstances, or the type of investment accounts they have, accessing cash in their account may be a new event, for example, if they have finally reached required minimum distribution (RMD) age or if their children have begun college. Have you ever asked yourself, when it's time to access funds from my investment account arises, how will that process actually work? Understanding that your investments are generally liquid, and that they are available for your cash needs, is different than understanding the procedures and methods for tapping those funds.

There are many reasons clients need access to funds and a variety of methods at their disposal to transfer those funds to their bank or other financial institution. For our clients at Schwab, the most common method of moving funds is via MoneyLink. From Schwab's website, "This Service is the ACH service at Schwab which allows for movement of funds between your Schwab account and an external account at a bank or other financial institution ("External Account") using the Automated Clearing House (ACH) network." We can set up incoming and outgoing MoneyLinks for your account to make deposits or withdrawals. Some clients will move the money themselves, and others will allow our firm permission to move the funds on their behalf, based on their request, to the banking or other financial institution of their preference after completing the necessary paperwork and approvals.

Additionally, for those clients entering retirement, especially those considering using their investment account as either a primary or a supplementary source of income, it is common to set up a regular payment to themselves. Should the RMD be a source for ongoing income needs, the process can be automated in much the same way, with clients setting their tax withholding elections and selecting a transfer schedule (e.g. monthly or quarterly) that accommodates their cash needs.

Additional methods for moving funds include requesting a check from your account, a wire transfer, or a journal entry. Depending on the destination of the funds, the methods discussed thus far allow for transfers to be one-time or recurring in nature, and potentially allow for a standing letter of authorization (SLOA) on file, which is what allows us, the investment advisor, to move the funds on your behalf.

If you are at a stage of your life where it makes sense to begin thinking about the dynamics of inflows and outflows in your account, please set up a meeting with your relationship manager to discuss which method will be right for you. In addition, depending on your stage of life, it makes sense to include your tax professional as part of the conversation, to best understand the tax ramifications of drawing funds from certain sources at your disposal.

Please Contact Us

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(1) If there is a change in your financial situation, investment objectives, or risk profile, (2) For questions about your portfolio or to set up a quarterly review, (3) If you are not receiving statements from your custodian, (4) If you want to impose reasonable restrictions on the management of your portfolio, or (5) If you just want to say Hello!

We would like to meet with you at least once a year so please reach out if we haven't already scheduled a meeting.

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Top 10 Holidings

Blue Chip Growth Stocks

Top 10 Stocks	% of Total
Apple Inc	8%
Oracle Corp	8%
Microsoft Corp	8%
Alphabet	5%
Amazon	4%
Walmart	4%
Carrier Global Corp	3%
Accenture	3%
Honeywell	3%
Automatic Data Processing	3%

Equity Income Stocks

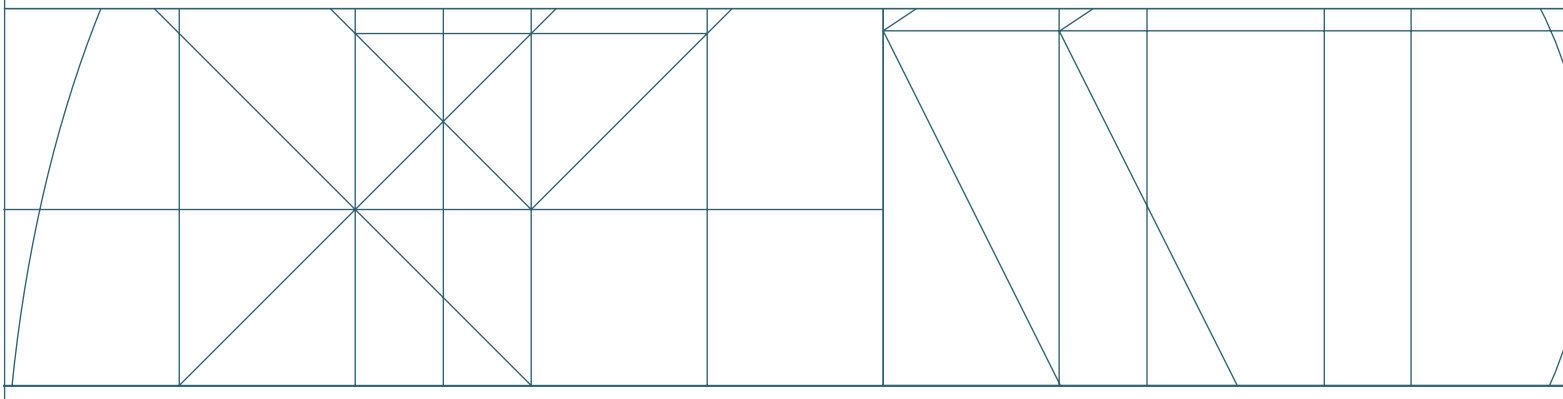
Top 10 Stocks	% of Total
Caterpillar Inc.	11%
Emerson Elec.	9%
Cisco	8%
Blackrock	7%
Bank New York Mellon Corp	7%
McDonalds	6%
Procter & Gamble	6%
Paychex	5%
Lockheed Martin	5%
Home Depot	5%

Smaller Companies Stocks

Top 10 Stocks	% of Total
Fair Isaac Co.	15%
Waters	6%
Allegion	5%
Expeditors	5%
Equifax	5%
Broadridge	4%
Illumina	4%
Generac	4%
Simpson	3%
Insperity	3%

Intermediate Fixed Income

Top 10 Bonds	Coupon/Maturity
Federal Home Loan Banks	4.750% Due 12-10-32
United States Treas NTS	2.000% Due 11-15-26
Federal Farm CR BKS	2.080% Due 12-02-30
Federal Farm CR BKS	1.720% Due 10-20-31
Johnson & Johnson	2.950% Due 03-03-27
United States Treas NTS	2.250% Due 11-15-25
United States Treas NTS	3.875% Due 08-15-34
United States Treas NTS	4.500% Due 11-15-33
United States Treas NTS	2.250% Due 11-15-27
United States Treas NTS	3.500% Due 02-15-33



This information is not intended as a recommendation. The opinions are subject to change at any time and no forecasts can be guaranteed. Investment decisions should always be made based on an investor's specific circumstances. Investing involves risk, including possible loss of principal.

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