The Bottom Line - Q1 2025

THE BOTTOM LINE

FIRST QUARTER : 2025

BUFFALO FINANCIAL QUARTERLY NEWSLETTER

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OPTIMISM

BY JEREMY I. BECK

The outlook for the U.S. economy remains robust, with no signs of a major slowdown as we enter 2025. We anticipate that interest rates will stay elevated for an extended period, even with the Federal Reserve's ongoing monetary easing efforts. It is too early to fully evaluate the potential impact of new policies with Donald Trump being re-elected as U.S. President.

However, if his key policy goals—such as lower taxes, higher tariffs, and reduced immigration—are implemented, they could drive higher interest rates, bolster asset prices, fuel inflation, and strengthen the dollar.

OPTIMISM - CONT'D

The U.S. economy has carved out a unique trajectory in the post-pandemic era, diverging not only from its historical performance in the context of higher interest rates but also from its historical correlation with other developed economies, particularly Europe and Japan.

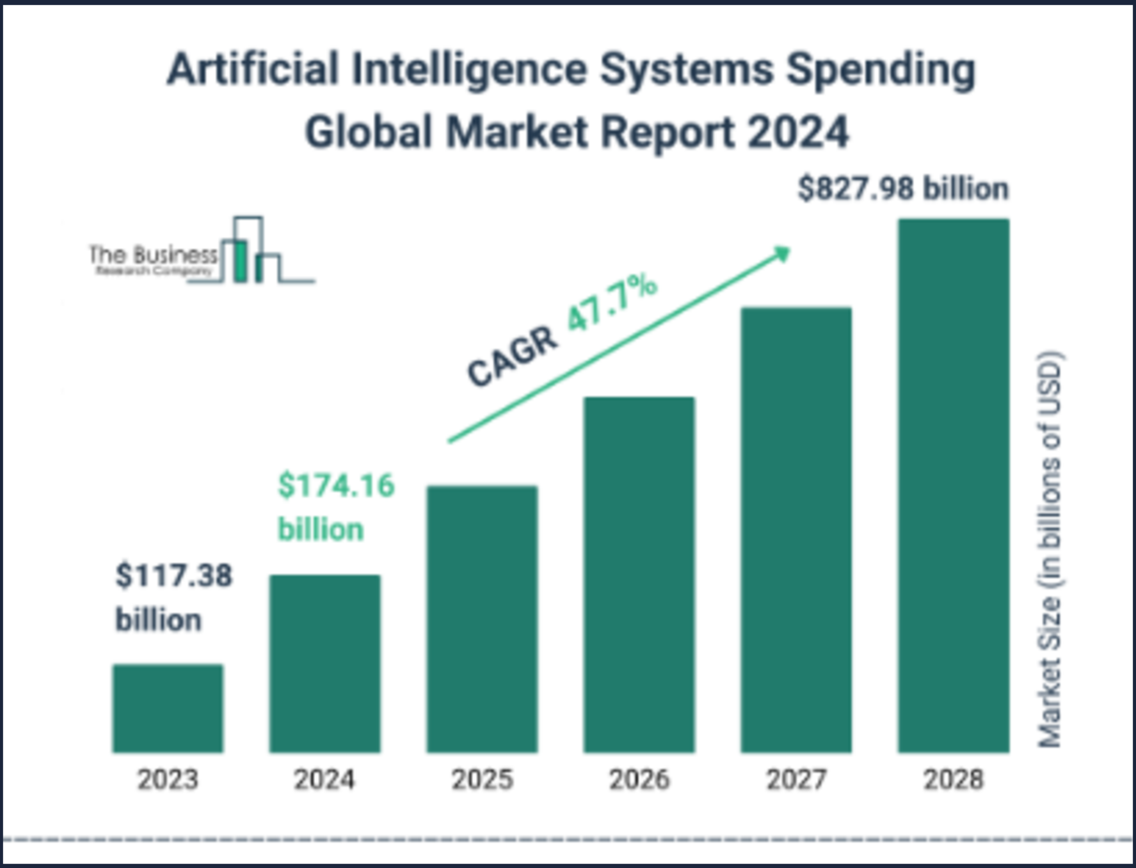
Why is this happening?

- Interest Rate Sensitivity: The U.S. economy has proven to be less sensitive to the Federal Reserve's rate hikes compared to previous cycles. This is due to certain structural factors, such as large, liquid, and long-duration fixed-rate markets for mortgages and corporate bonds, which have enabled both individuals and corporations to lock in historically low interest rates for extended periods—sometimes up to 30 years.

- Government Spending Initiatives: The U.S. stands out for its fiscal support following the COVID-19 pandemic. It has outspent other developed nations by a significant margin, providing strong economic tailwinds through landmark legislation such as the CHIPS and Science Act (2022), the Inflation Reduction Act (2022), and the Infrastructure Investment and Jobs Act (2021). These government investments, alongside private-sector spending in AI and green energy, have been critical to the nation's economic resilience. With a current 6% budget deficit, fiscal policy remains expansive.

- Surge in Artificial Intelligence: The U.S. is experiencing a surge in corporate and research spending, driven by the ongoing Artificial Intelligence (AI) revolution. **(Exhibit I)** This development is unprecedented, even compared to other developing nations or China. The AI boom is structural, widespread, and pervasive, encompassing investments by technology giants in AI development, as well as the infrastructure needed to support it—ranging from semiconductor design and manufacturing to the construction of data centers, increased energy generation, and further automation of supply chains.

Exhibit I:



Source: The Business Research Company: December 2024

OPTIMISM - CONT'D

We are also pleased that gross domestic product (GDP) continues to grow at a steady pace, expanding 2.7% in the third quarter of 2024. Employment has remained strong, with the labor market adding 227,000 jobs in November, a surge from October. Unemployment remains within reach of the Federal Reserve's target and is expected to nominally increase to 4.4% in 2025. Inflation is dramatically lower than the peak of 9.1% we saw in 2022. Although we remain above the Fed's 2% target, the current reading of 2.6% is very close to reaching their goal.

Consumer spending grew a whopping 3.7% in the third quarter of 2024. Even with a slowdown to the 2.5% range expected in 2025, consumers in the United States remain extremely healthy. This can also be said of corporate America. Businesses increased their investment in equipment and intellectual property throughout 2024, mostly led by the insatiable demand for chips and software that run AI. Corporate defaults were very low in 2024 with the combination of low interest rates and strong corporate earnings.

As we look ahead to what the future may hold, we are encouraged by the opportunities we see across various markets. In other words, despite the current uncertainty, we maintain a positive perspective. On the equity side, we foresee stronger nominal EPS growth in 2025, particularly in the U.S. We are particularly bullish on domestic consumption stories, such as those in the U.S. and India, corporate reform stories in Japan, and services-driven economies like Spain. We also believe that a broader earnings expansion in the U.S. will contribute positively to market breadth across major equity indexes.

We are also encouraged by the current technical market outlook. Historically, bear markets often coincide with tightening financial conditions, declining earnings, and an increase in both the quantity and lower quality of market supply. However, today's environment presents a different picture, as we see neither a significant increase in corporate debt issuance nor a surge in IPO activity.

One area of potential concern within our base case forecast is the elevated expectations for growth.

Over the past two years, GDP growth estimates were below 1%, but for 2025, projections have now risen to above 2%. This shift is also reflected in the equity market, with an increasing number of strategists raising their earnings and valuation forecasts for the coming year. Additionally, we remain cautious regarding a major Federal Reserve rate-cutting cycle in 2025, which sets a higher bar for investors hoping for an upside surprise.

Despite these elevated expectations, we maintain an optimistic outlook as we head into 2025. We believe that, at this point in the cycle, overall returns are compressing. As such, the potential for alpha through security selection and the need for greater diversification will become significantly more important within the global macroeconomic landscape we foresee. In this context, we see a growing role for alternative investments as well as sector specific allocation (meaning, select infrastructure, real estate, A.I., etc.). Non-correlated assets will become increasingly essential, acting as 'shock absorbers' against volatility driven by large budget deficits, geopolitical tensions, ongoing energy transition, and persistent inflation. In summary, these factors present a compelling opportunity for astute capital allocators as we enter 2025.

Jeremy I. Beck, Founder & CEO

2025 FIXED INCOME OUTLOOK:

BY MATTHEW J. PITROLA

At first glance, 2025 looks like it could be another volatile year for fixed income investors. On one end of the spectrum, we have the Federal Reserve slowly lowering short term yields, attempting to find a new neutral rate for the US economy.

On the other end, we have longer term interest rates moving higher. This is because 2025 is ripe with uncertainty. We have an economy that is running strong, but the unknowns around the incoming administrations effects on inflation and our large federal deficit are keeping longer term rates higher for longer.

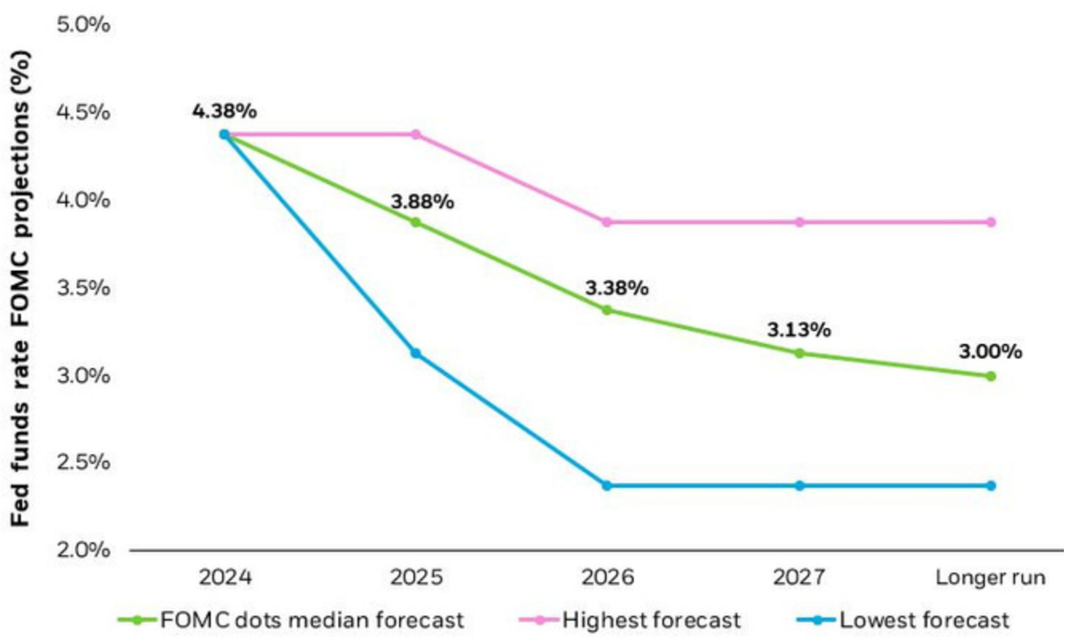
Path of the Federal Reserve:

In the final weeks of December, the Federal Reserve confirmed their 3rd and final rate cut of 2024. Thus, taking the benchmark yield on the Effective Federal Fund Rate too the 4.25% - 4.50% range. Throughout this cutting cycle, the Fed was able to reduce interest rates by a full 1.00% from the highs at the end of 2023.

The market reacted negatively to the most recent FOMC meeting, with stocks falling and longer-term yields rising. This negative reaction was due in part to the recent updates on future interest rate cuts. As of my writing, the Federal Reserve is guiding for two additional rate cuts over the course of 2025. (Down from 3 rate cuts at the September meeting) I have attached the Dot Plot from the most recent Summary of Economic Projections report to showcase longer term interest rate projections below.

Figure 1: Summary of Economic Projections Dot Plot

Figure 2: December 2024 "Dot Plot"



Source: US Federal Reserve **Summary of Economic Projections** as of 12/18/2024.

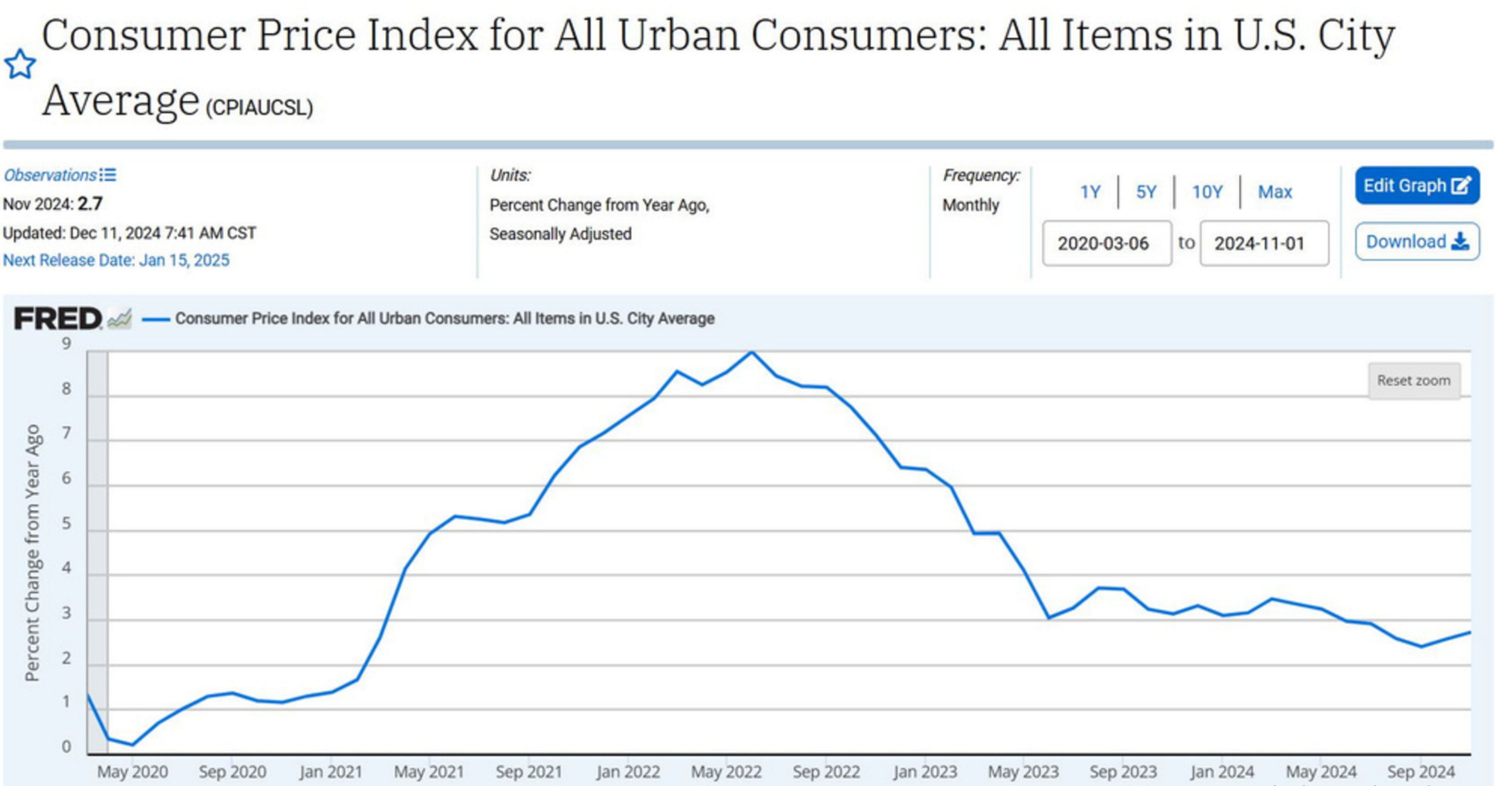
Chart description: Line chart displaying the FOMC "Dot Plot," which contains the highest, median and lowest forecasts for the target Fed Funds Rate.

2025 FIXED INCOME OUTLOOK:

Path of inflation

Over the course of the last 12 months, inflation in the U.S. has been trending lower. This has allowed the Federal Reserve to begin reducing interest rates as we have noted above.

Figure 2 :Chart of CPI (Consumer Price Index)



Source: Federal Economic Database

But a already strong economy plus the incoming administration brings along a plethora of inflation risks with their policy proposals ranging from - tariffs, limitations on immigration / deportation and of course tax cuts. The full extent of how these policies will be implemented is still to be seen, but in theory some of these proposals could drive inflation in the U.S.

Figure 3: U.S. 10 Year Treasury Yield

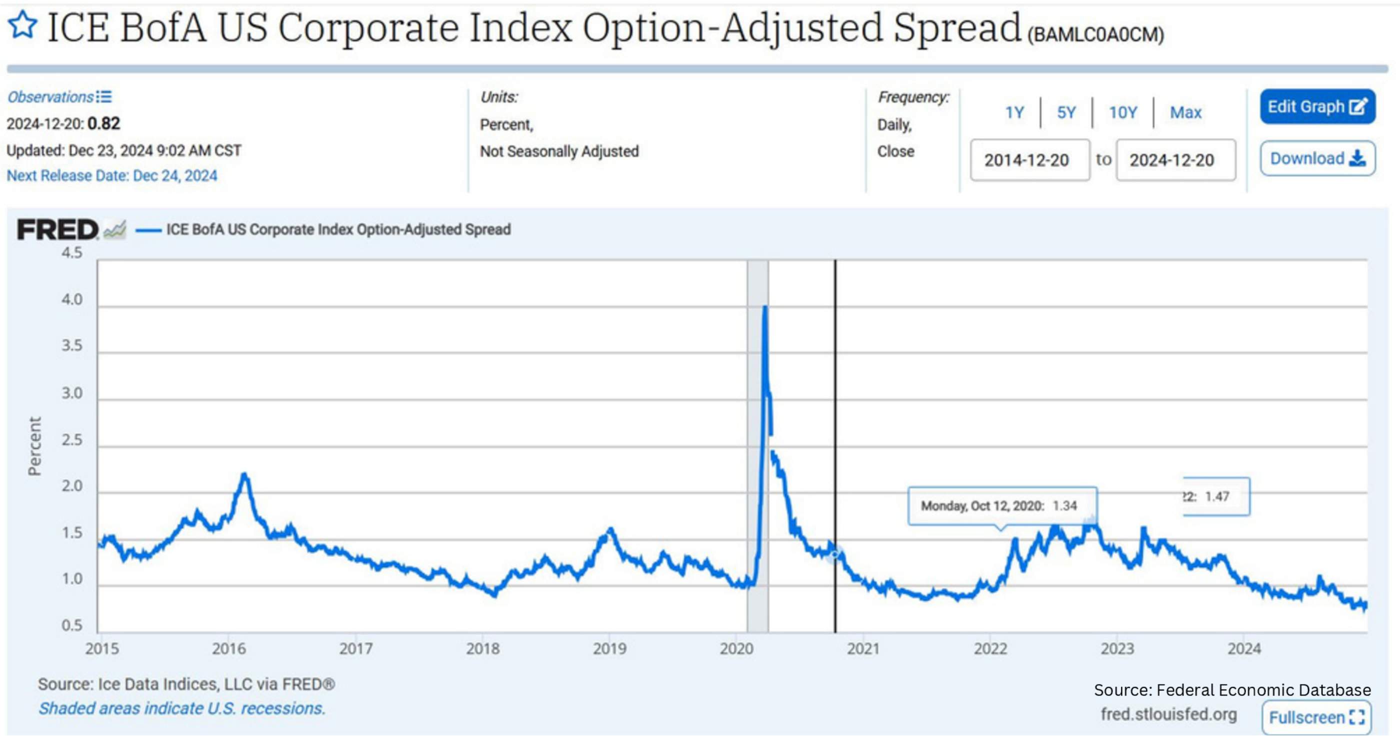
Source: CNBC

2025 FIXED INCOME OUTLOOK:

Credit Spreads:

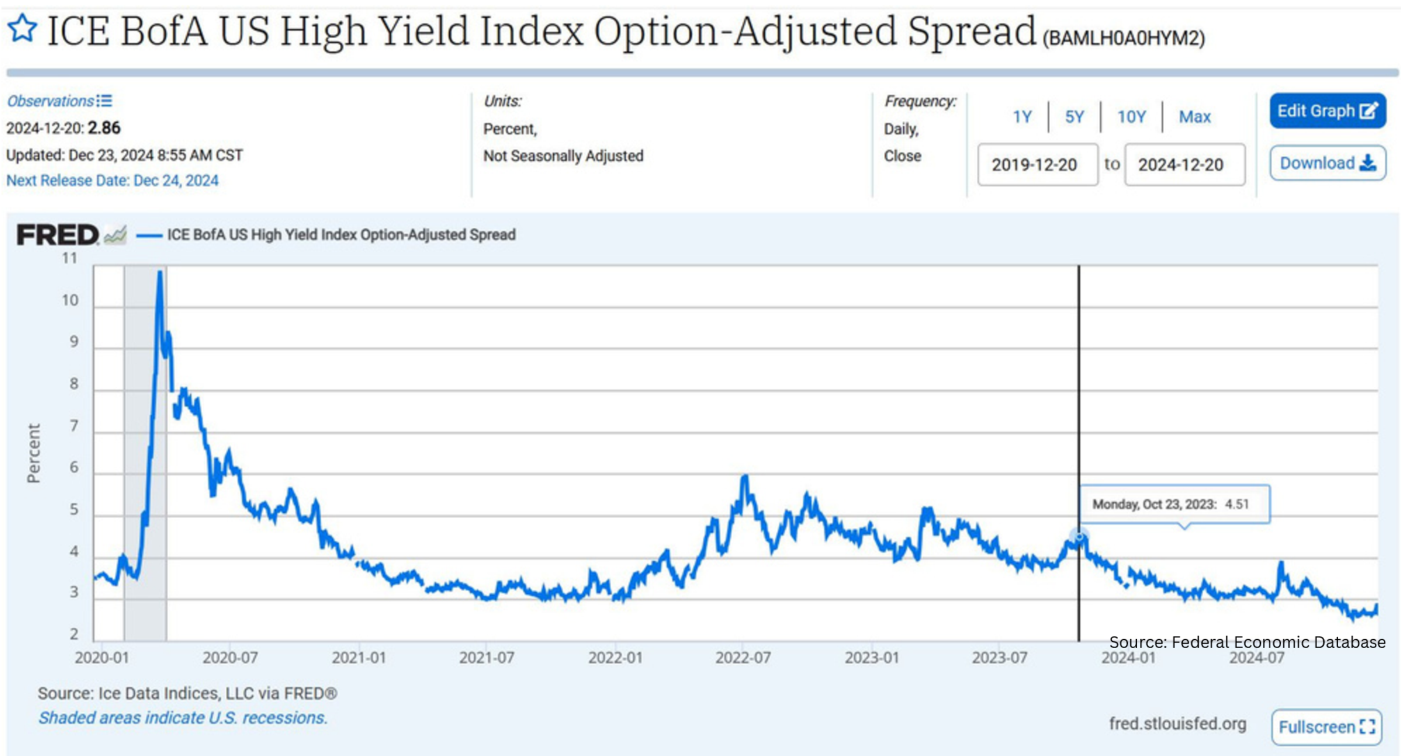
Credit spreads have remained abnormally tight over the last 12 months in both the investment grade and high yield corporate bond space. While we acknowledge that the economic back drop at the current time is stable. Corporate & high yield bond spreads are currently near their all-time lows. Meaning that any sort of economic surprises to the downside could create volatility in credit related investments.

Figure 4: Investment Grade Corporate Bond Spreads



The ICE BofA US Corporate Index Total Return Index tracks the performance of investment grade rated corporate bonds in the US. An option-adjusted spread compares the yield or return of a fixed-income product to the risk-free rate of return on the investment. In theory, debt obligations issued by the U.S. Department of the Treasury (bonds, notes and Treasury bills)

Figure 5: High Yield Corporate Bond Spreads

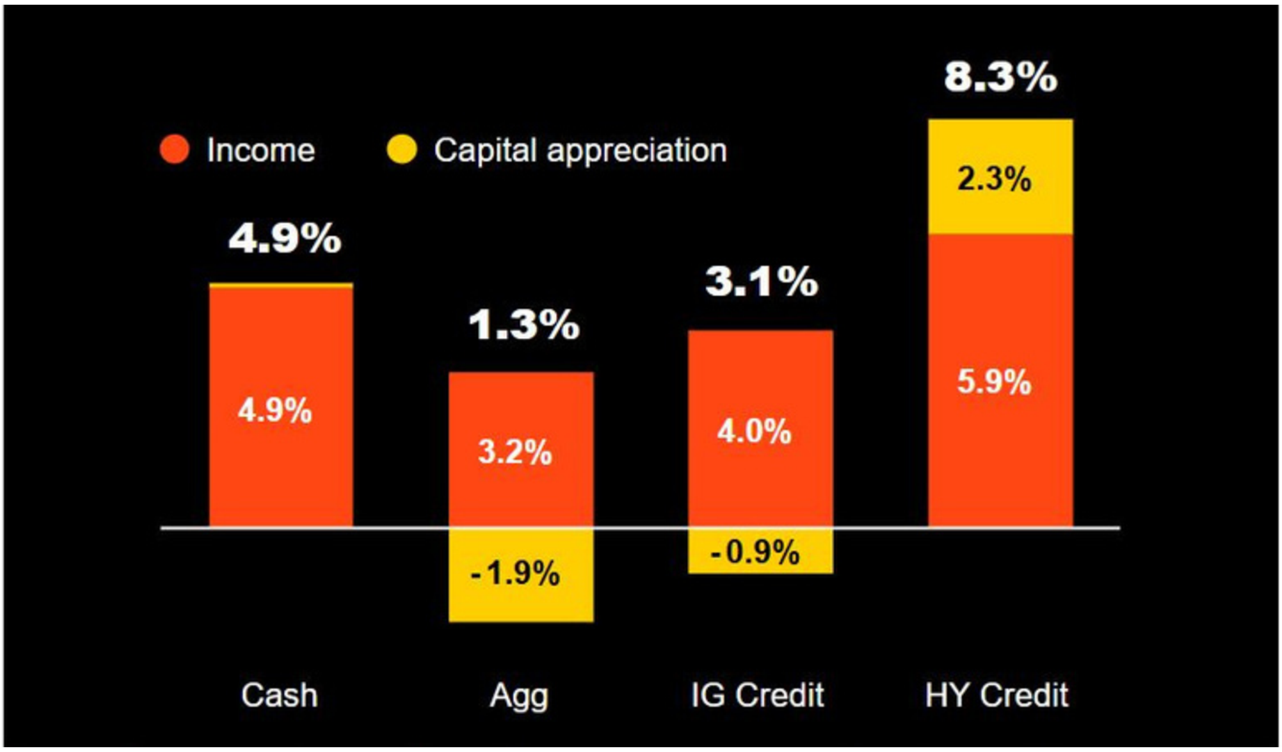


2025 FIXED INCOME OUTLOOK:

Whenever there is change, and whenever there is uncertainty, there is opportunity. Let's review a few opportunities in the fixed income space for 2025.

Cash / Money Market / Certificates of Deposit: Cash and alternatives like CDs and Money Market funds showed continued strength throughout 2024. Outperforming both the Aggregate Bond Index and Investment Grade Corporate Bonds.

Figure 6: 2024 Fixed Income Returns



Source: BlackRock as of 11/22/24. Cash defined as Bloomberg Treasury Floating Rate Bond Index, Agg as Bloomberg U.S. Aggregate Bond Index, IG Credit as ICE BofA US Corporate Index, and HY Credit as ICE BofA US High Yield Constrained Index.

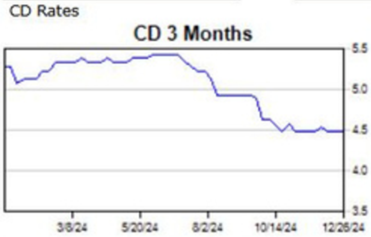
While I do not expect cash to have a follow up 5.00% return year, I do still think that there is ample opportunity for returns in the guaranteed space. With the recent normalization of the yield curve, investors can finally be rewarded for extending duration once again. There is still a window of opportunity where investors can begin to ladder CDs out for 5 years and guarantee 4.00% + rates of return.

Certificates of deposit (CDs) typically offer a fixed rate of return if held to maturity, are generally insured by the FDIC or another government agency, and may impose a penalty for early withdrawal. A CD ladder is an investing strategy in which you buy multiple certificates of deposit (CDs) with different maturity dates.

U.S. Treasury Rates | Municipal Bond Rates | Corporate Bond Rates | CD Rates

CD Rates

Last Updated: 12/24/24 14:00 ET



Maturity	Yield	Yesterday	Last Week	Last Month
3 Month	4.50	4.50	4.50	4.50
6 Month	4.30	4.30	4.35	4.50
9 Month	4.30	4.30	4.35	4.35
1 Year	4.15	4.15	4.25	4.30
2 Year	4.00	4.00	4.15	4.15
3 Year	4.05	4.05	4.10	4.15
5 Year	4.00	4.00	4.10	4.10

Source: ICE BondPoint, Inc.

2025 FIXED INCOME OUTLOOK:

Investment Grade Corporate Bonds: Investment grade corporate bonds were a laggard over the course of 2024, with interest rates rising towards the end of the year eroding price appreciation received from falling credit spreads. We prefer high quality investment grade corporate bonds in 2025. You can still achieve yields of 4.00% + with the potential for price appreciation if longer term interest rates begin to level off. This comes with significantly less credit risk than their high yield counterparts.

High Yield Corporate Bonds: High Yielding corporate bonds were among the best performers in 2024. They benefited from easing financial conditions and lower credit spreads. I am cautioning investors from allocating to much of their fixed income allocations to this space in 2025. While yields of 6.00% + are enticing, this should only be a small portion of your allocation as there is an ample amount of downside for these positions if we do see any resurgence in inflation, or slowdown in the U.S. economy.

US Treasury Bonds: US Treasury bonds are well know for their safety, being backed by the full faith of the US Government. Investors in US Treasuries have very minimal credit risk. This makes treasuries valuable during a slowdown in the US economy. Depending on which portion of the yield curve your are allocated towards, you could have varying return profiles.

Short Term Treasuries: Short Term Treasury bonds should have minimal volatility over the course of 2025, while still returning upwards of 4.00% yields for investors. I would expect price appreciation here to be limited, unless a slowdown in the US economy does begin to materialize.

Intermediate Term Treasuries: Intermediate term treasuries are going to be tied more closely to the 5 & 10 Year Treasury Yields. We believe the opportunity here is quite enticing with the 10 Year Yield currently near 4.60%. The risk / reward for intermediate treasury bonds is strong given where yields stand to end the year.

Long Term Treasuries: Long term US Treasuries have been a world of pain for investors over the last 5 years. We do not have any need to allocate towards this portion of the yield curve at this point in time, the volatility here can be immense and we feel that these positions would only truly shine during a recession, which is not our base case for 2025. We would positions treasury holdings in the short to intermediate part of the yield curve to start the year.

Summary: 2025 is set to be another great total return year for fixed income investors, we caution against reaching for yield in the high yield space at this time as there could be a better opportunity in this space sometime throughout the year. We continue to like the guaranteed side of the fixed income markets to generate yields, while we wait for a time when credit conditions begin to loosen from their current tight stance to begin to add high quality investment grade corporate bonds.

Stay Safe and Happy New Year!!

All indices are unmanaged, and investors cannot actually invest directly into an index. Unlike investments, indices do not incur management fees, charges, or expenses. Past performance does not guarantee future results.

CHANGES TO YOUR RETIREMENT ACCOUNTS IN 2025

BY JACOB WOOD

As we approach 2025, several significant changes are coming to retirement accounts in the U.S. These adjustments could impact how much you can save, when you need to start withdrawing funds, and how you plan for a secure financial future. If you're already contributing to a 401(k), IRA, or other retirement accounts, it's important to understand how these updates will affect your strategy moving forward. Here's a look at the key changes coming in 2025.

Contribution Limits

One of the most anticipated changes is the increase in contribution limits for retirement accounts. The IRS regularly adjusts these limits to keep pace with inflation, and 2025 will see important changes in the amounts you can contribute to tax-advantaged retirement accounts. The largest change you will notice is the new "Super Catch-up Contribution" now available in most employer sponsored plans. For more clarification on contribution limits please see the table on the next page.

- **Traditional & Roth IRA:** The contribution limit for IRA's will be $7,000 in 2025. For individuals age 50 and older the limit will be $8,000. These figures remain unchanged from 2024.

- **401(k), 403(b) & 457(b):** For employees under the age of 50 the annual contribution limit will be increasing from $23,000 to $23,500. Employees aged 50+ will receive a $7,500 catch up contribution bringing their total limit to $31,000 annually. Lastly, Any employee age 60-63 will receive a super catch-up contribution of $3,750. This brings your total contribution limit to $34,750 for those 4 years.

- **Simple IRA:** In 2025 simple IRA plans will also be imposing the new super catch up contribution rule, just with slightly different limits. The total deferral amount also varies depending on weather the plan has more than 25 employees.

    - **Simple IRA 1-25 employees:** The standard contribution limit for participants under the age of 50 will be $17,600. Participants who are 50 and older will receive a catch up contribution of $3,850 bringing their annual limit to $21,450. Lastly, Any employee age 60-63 will receive a super catch-up contribution of $1,400. This brings your total contribution limit to $22,850 for those 4 years.

    - **Simple IRA 26+ employees:** The standard contribution limit for participants under the age of 50 will be increasing from $16,000 to $16,500. Participants who are 50 and older will receive a catch up contribution of $3,500 bringing their annual limit to $20,000. Lastly, Any employee age 60-63 will receive a super catch-up contribution of $1,750. This brings your total contribution limit to $21,750 for those 4 years.

CHANGES TO YOUR RETIREMENT ACCOUNTS IN 2025 - CONT'D

- **SEP IRA:** Lesser of 25% of W-2 pay or $70,000

Age	Traditonal & Roth IRA	401(k), 403(b) & 457(b)	Simple IRA 1-25 employees	Simple IRA 26+ employees
<50	$7,000	$23,500	$17,600	$16,500
50 - 59	$8,000	$31,000	$21,450	$20,000
60 - 63	$8,000	$34,750	$22,850	$21,750
>63	$8,000	$31,000	$21,450	$20,000

Required Minimum Distributions (RMDs)
There will be no notable changes with Required Minimum Distributions (RMDs) heading into 2025. RMDs are the minimum amounts you must withdraw from retirement accounts like IRAs and 401(k)s once you reach a certain age. As of 2023, the RMD age is 73, thanks to the SECURE Act 2.0, up from 72. Going forward, the RMD age will increase to 75 in 2033. The amount of the RMD is based on your account balance and life expectancy. Failure to take the required distribution can result in a 25% penalty (reduced to 10% if corrected within 2 years).

Access to Emergency Savings
In 2025, retirement plans will allow participants to access up to $1,000 for emergency expenses without penalty, though this amount can only be withdrawn once per year. If the withdrawal is repaid within three years, it won't affect future emergency withdrawals, otherwise you will not be able to take another emergency withdrawal.

As we move into 2025, these updates to retirement accounts bring new opportunities for savers to boost their retirement savings. With higher contribution limits and the introduction of the Super Catch-up Contribution, many individuals will have more room to grow their nest eggs. The increased access to emergency savings offers additional flexibility, allowing for greater financial security in times of need.

As always, if you have any questions or would like something explained in further detail, please do not hesitate to contacts us here at the office.

Happy New Year and Go Bills!

Jacob Wood - Wealth Manager

ROB SWANKE MARKET COMMENTARY

Q3 2024 Earnings: Santa Delivered, but Markets Expect More in 2025

When kids are young, they don't ask for much—maybe a toy car or a new puzzle will keep them happy. But as they get older, the requests always seem to get bigger. Those toys and puzzles become more complicated video games, LEGO, or designer clothes and are invariably something we, the adults, never had as kids.

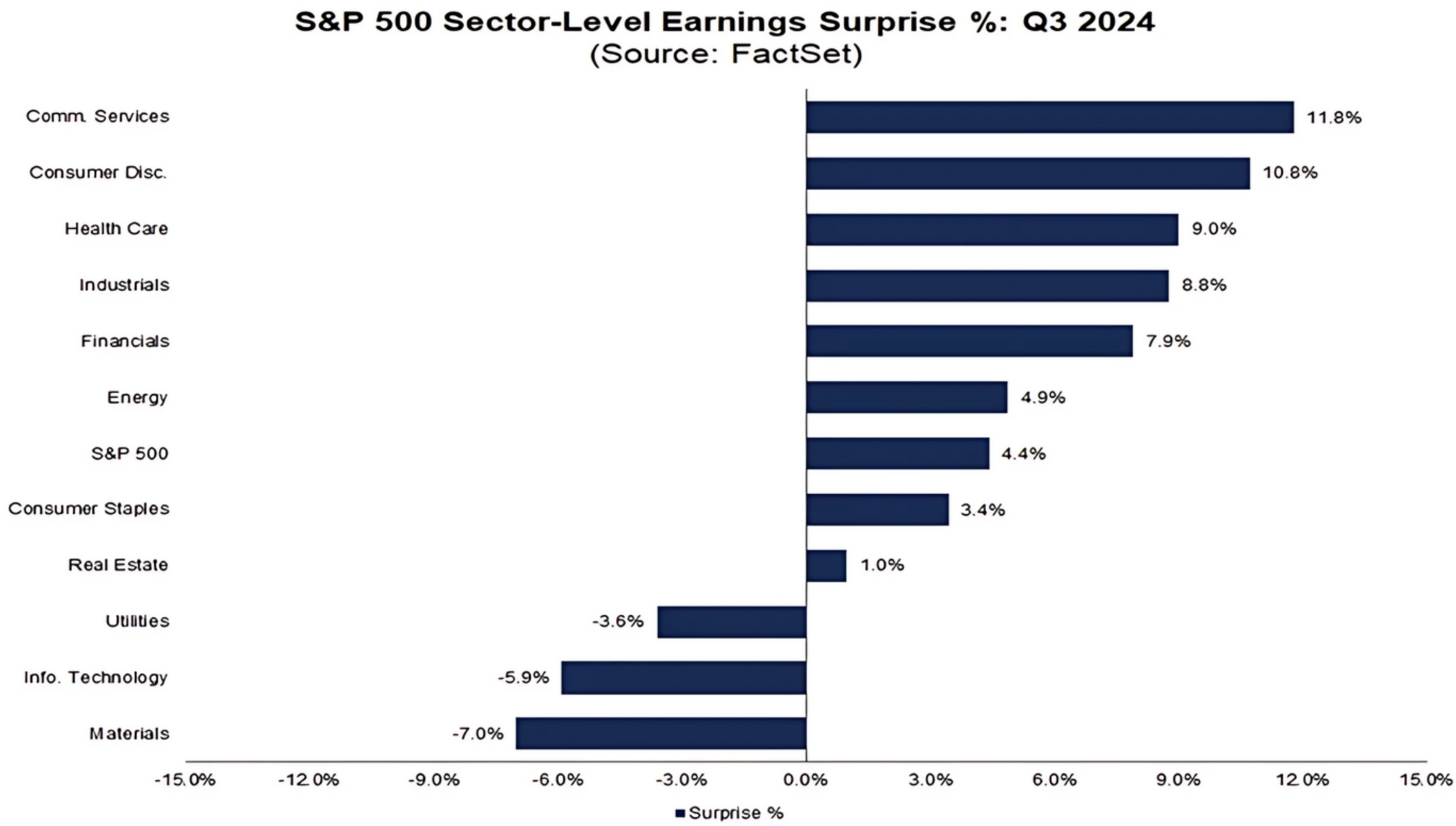
The markets weren't asking for much in the third quarter, so the 5.9 percent earnings growth we received delivered all that was asked for: It was above the 4.2 percent analysts were expecting when we entered earnings season. The "Magnificent Seven," which includes Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia, and Tesla, produced nearly all the growth of the S&P 500 with 21 percent growth for the quarter—above the 19 percent that was expected going into earnings season. This result is in spite of the fact that Apple reported earnings of $0.97 per share versus the expectation of $1.60 per share due to a $10.2 billion charge related to the impact of an adverse ruling in Europe regarding tax payments. The rest of the index had a really low bar, with an expected earnings decline of 1 percent that they managed to beat with growth of 1 percent.

Markets rewarded earnings beats, delivering an average price increase of 1.6 percent from the two days before reporting earnings to the two days after, which is above the 5-year average price increase of 1 percent. On the other hand, high valuations contributed to an average price decrease of 3.1 percent when companies missed earnings, which was above the 5-year average decline of 2.3 percent. As we move into 2025, we expect high valuations will continue to place greater importance on not only beating earnings but also delivering solid guidance to continue to see price increases.

2024 Midyear Outlook: Slower Growth Ahead for U.S. Economy? - Cont'd

IA Look Inside Santa's Bag

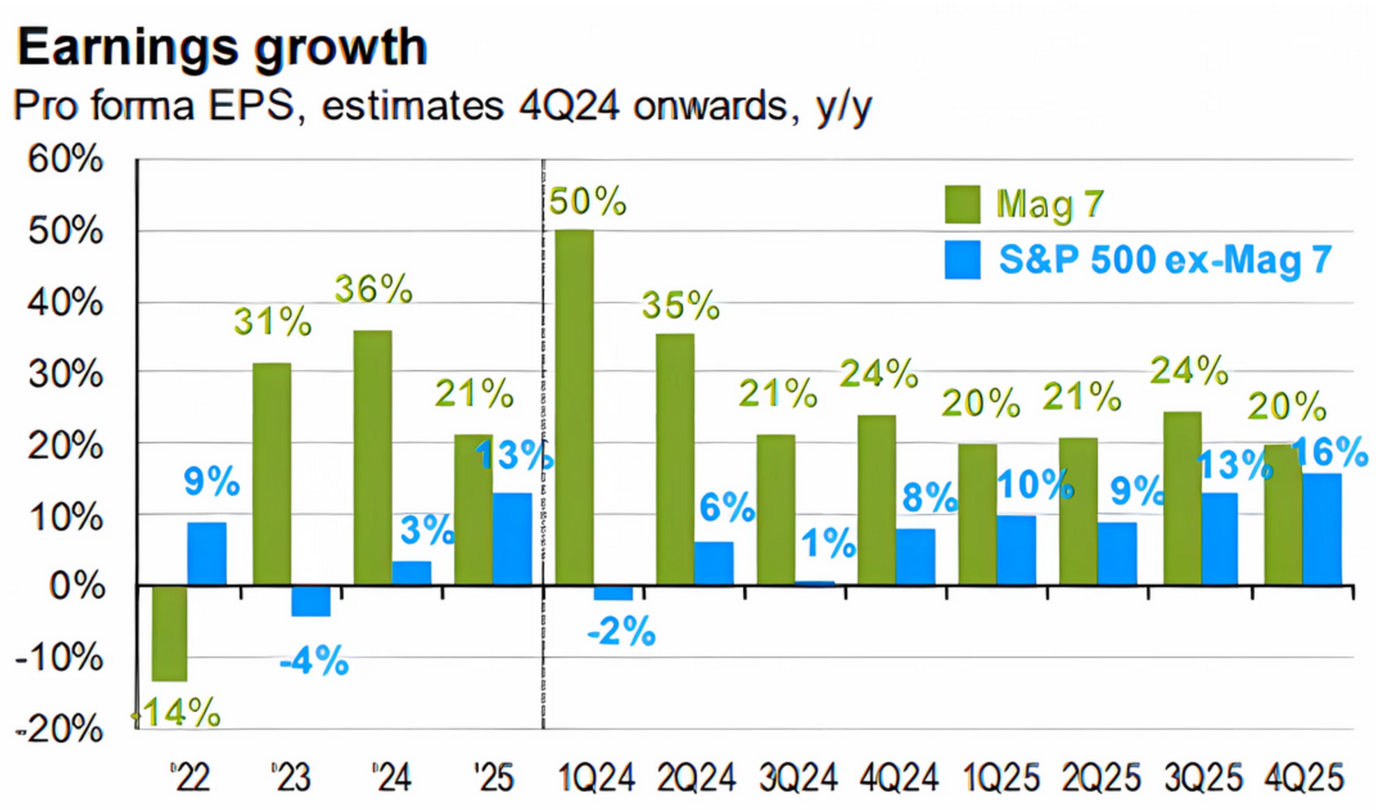
When we look at the presents Santa delivered, the communications sector delivered the biggest gift, with a positive earnings surprise of 11.8 percent. This included a range of companies that beat estimates, including Take-Two Interactive, Fox Corporation, Alphabet, Meta, and Electronic Arts. Consumer discretionary also delivered 10.8 percent earnings beats, with a broad range of companies beating earnings, including Garmin, Nike, Hasbro, Deckers, and Amazon.com. Health care, industrial, and financial sectors rounded out the best performers relative to expectations. The materials and tech sectors received "coal" during the quarter, with the aforementioned Apple weighing heavily on the tech sector.



We entered the quarter waiting to see if the rest of the index outside of the Magnificent Seven could close the earnings growth gap. Still, it was the largest companies that continued to provide the engine for growth in the U.S. During the quarter, analysts lowered estimates for the future in line with historical averages but projected that those companies would continue providing the lion's share of U.S. growth. Fourth-quarter estimates have the Magnificent Seven seeing 24 percent growth versus the rest of the index at 8 percent. They expect a similar story in 2025, with 21 percent growth for the Magnificent Seven and 13 percent for the rest of the index.

While it may be healthy to see a broadening of growth throughout the economy, given the heavy weight of the Magnificent Seven in the index, the markets will likely rely on growth in those companies in the near future.

2024 Midyear Outlook: Slower Growth Ahead for U.S. Economy? - Cont'd



How High Can Expectations Go?

In the midst of a solid earnings season, we also had an election, which helped drive valuations above 22x forward earnings (levels we saw in 1998 and 2020). While both periods saw significant growth in the subsequent years, it is difficult to continue to satisfy high expectations, as we saw in both cases. If earnings continue to surprise to the upside, it could justify the current valuations, but we expect valuations to come down as growth expectations begin to level out.

Given the high growth expectations, we could see valuations come down while prices go up, which could be healthy for the market. Investors should also consider other parts of the market outside of large-cap growth companies. These companies are trading closer to historical averages, and a broadening of the market could benefit them.

Staying in the Present

As investors, it's important to recognize the positive fundamentals of the market while also being mindful that we don't get carried away with expectations for the future. For now, we're wishing everyone a great holiday season and to be grateful for all the gifts we've received.

Rob Swanke - Senior Investment Research Analyst, Commonwealth Financial Network

Happy New Year!

Wishing you a year filled with joy, prosperity, and success. Happy New Year!

www.buffalofinancial.com
4990 Transit Road
Depew, NY 14043
(716) 771-1888

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