



January 2025

**Annual Investor Letter – 2025 - The Year of the Donald.**

Dear Fellow Investor,

I am delighted to present the annual letter to investors of the BayFort Capital Global Leaders Portfolio. The year, 2024 commenced amid concerns of a potential recession, yet it ultimately emerged as a year of exceptional stock market returns. By steadfastly adhering to our investment philosophy – focusing on companies characterized by innovation, robust fundamentals, strong leadership, and an unwavering commitment to long-term value creation – we successfully navigated market volatility and delivered outstanding returns with low volatility. This letter will primarily focus on the macroeconomic factors that will impact 2025. We will share a more in-depth, portfolio-specific annual letter in the first week of February.

Net Returns, INR (Dec. 31, 2024)	1 Month	YTD	1 Year	2 Years	Inception* Annualized	Inception* Cumulative
BayFort Capital Global Leaders Advisory Portfolio (INR)	-1.55%	32.58%	32.58%	38.55%	31.01%	96.44%
S&P 500 (INR)	-1.06%	28.67%	28.67%	26.02%	23.44%	69.29%
NIFTY 50 (INR)	-2.02%	8.80%	8.80%	14.28%	17.56%	49.84%

\* Annualized (CAGR) Since Inception on July 1, 2022

As stock market participants analyze the flurry of tweets from Donald Trump, we believe there will be no drastic measures that could harm the stock markets. Instead, we expect a gradual implementation of tariffs and other policies over the next few years. One of the most critical legislative priorities for Trump will likely be preventing the expiration of the tax cuts he enacted, which are set to sunset in 2025. Addressing this issue is time-sensitive and will require Trump to invest significant political capital to maintain the current tax regime for corporate America.

Current indications suggest this legislative effort could be resolved by May 2025. Once the extension of tax cuts is secured, Trump may have limited political capital remaining for advancing other parts of his agenda, potentially slowing the progress of additional legislative measures. The administration’s first major test will come in May 2025, with the effort to extend these tax cuts—a move that could significantly influence the economic and market landscape for the remainder of the year.

We hold a constructive view on the market's trajectory in 2025. A significant portion of macroeconomic risks are currently embedded in market expectations. We anticipate an improvement in market sentiment as these risks are contained or resolved over the course of the year.

The risks facing the market in 2025 can be broadly categorized as follows:

- **Inflation Risk:** Some market participants contend that a 3% inflation rate is the new normal and unlikely to return to the Fed's 2% target in the near term. Even in this scenario, we do not see significant risk for 2025, as this expectation is already factored into market pricing, with the U.S. 10-year Treasury yield trading at a spread of 160-170 basis points to the anticipated 3% rate. However, we believe inflation could decline further toward the Fed's 2% target. The U.S. Inflation index, the most widely tracked inflation measure, consists of 40% goods and 60% services. Over the next 6 to 12 months, we will examine how these components, along with gains in U.S. labor productivity, are likely to create a deflationary trend.
  - **Goods Inflation (40% of Inflation Index):** The Goods component of the Inflation Index, constituting 40% of the index, has been experiencing deflation for over a year. The appreciation of the US Dollar against major currencies, ranging from 5% to 7%, is expected to exert further downward pressure on US Goods inflation. Moreover, the sustained period of subdued commodity prices suggests that Goods inflation may remain deflationary throughout 2025, contributing to a downward pull on the overall inflation index.
  - **Services Inflation (60% of Inflation Index):** The Services component, comprising 60% of the Inflation Index, has been a primary driver of recent inflationary pressures. Notably, Rents and Auto Insurance have been significant contributors. Auto insurance companies have experienced a surge in profit margins to cyclical peaks, suggesting limited further upward pressure on this component of Services inflation. Historically, Rents have exhibited a lagged response to market conditions, declining as annual leases expire. This trend is evident in recent inflation data, where month-over-month rent increases have moderated from approximately 0.6% last year to the current 0.2% range. Concurrently, rental vacancy rates have gradually increased, approaching cyclical highs of around 7%. Given these signs of easing pressure from both Rents and Auto Insurance, we anticipate a cooling trend in Services inflation over the coming months.
  - **Productivity:** There is a growing market consensus that AI will significantly boost productivity within the U.S. labor force. The key question remains the extent of this impact, as AI continues to advance at an extraordinary pace. Given the substantial capital expenditures in the tech sector, it is likely that we will witness a paradigm shift in productivity. Such increases in productivity are inherently deflationary and could play a critical role in driving inflation toward the Fed's 2% target range.
  - **Employment Data:** Approximately half of all jobs created in the past year have been in the government sector. However, with the Department of Government Efficiency (DOGE), led by Elon Musk, focusing on reducing the size of the government, new job creation in this sector is expected to decline significantly. This reduction in government hiring is likely to exert additional downward pressure on inflation.



- **Interest Rate Risk:** Following the December Fed conference, widely seen as a pivot from dovish to hawkish, 10-year Treasury yields have increased to the 4.5-4.8% range. We believe that all negative news has already been priced into market expectations. Unless inflation data for January and February surprises to the upside (which we view as highly unlikely), interest rates could trend lower from current levels, providing additional support for the stock market.
- **Fed's Hawkish Tone:** In recent months, non-farm payroll data has consistently exceeded analyst forecasts. However, with the Trump administration's emphasis on the Department of Government Efficiency (DOGE), led by Elon Musk, the government's contribution to job creation is expected to decrease significantly. Over the past year, more than 50% of all new jobs were in the government sector. As this trend shifts, non-farm payroll growth is likely to lose momentum and could even decline. If inflation remains under control, as discussed earlier, this slowdown in job creation could prompt the Fed to pivot from its hawkish stance back to a more dovish approach, which will be very bullish for the equity markets.

In conclusion, 2025 presents a promising landscape for stock market investors, as several macroeconomic risks appear to be contained or even poised to improve over the coming months. The potential extension of corporate tax cuts by May 2025 would provide a significant boost to corporate America, enhancing investor confidence and stabilizing market conditions. Meanwhile, inflation trends, declining services inflation, and increased productivity fueled by advancements in AI are expected to create a deflationary environment that supports market growth.

Additionally, interest rates are likely to remain stable or decline further, providing a favorable backdrop for equity investments. As government-driven job creation slows and the Fed potentially pivots to a more dovish stance, market sentiment should further improve.

In closing, I wish you a prosperous and fulfilling New Year. We are grateful for your continued support, which has been invaluable to us. Thank you.

Yours Sincerely,

Ketul Sakhpara  
BayFort Capital