

CROWELL WEEDON ASSET MANAGEMENT
MONTECITO INVESTMENT PORTFOLIOS

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Dear Fellow Investors,

Capgemini's wealth management report revealed some interesting findings. Last year saw growth in high-net worth individual wealth and in the overall number of high-net worth individuals. Further, there is a massive trend taking shape that will see an unprecedented amount of wealth (over \$80 trillion) transferred to Gen X, Millennials, and Gen Z in what is collectively referred to as Next-gen investors. While we're rarely fans of generalizing complex issues, we do believe there is some potential value and insights to be had when thinking through this topic from a high-level perspective.

In general, the majority of assets we manage are typically owned by individuals with some years of wisdom under their belts. These individuals likely fall into the Silent or Baby Boom generations. Their children or grandchildren likely fall into this Next-gen category. To state the obvious, times have changed. What was considered common and preferred by one generation might now feel foreign and uncomfortable by another. Given this unprecedented wealth transfer starting to take place, we believe now is a great time to have conversations that can help bridge this generational divide to ensure that the values, discipline, and work ethic that created the wealth can be passed on for generations to come.

For this to be successful, we must confront the hard truth that Next-gens face challenges unique to preserving wealth. They are a generation that is wired differently and perhaps unwired is a better way to put it. They became familiar with technology at a young age and are now seemingly born with it in their hands. This technology gives them access to a world that can seem foreign to older generations. Next-gens expect things to be instant, convenient, simple, and accessible from anywhere. They prefer communicating via digital channels and might find a text more meaningful than a phone call. Their attention span is shorter when dealing with things that older generations embraced. It's why we've seen baseball shorten their games, the rise of watching shorts, clips, and highlights, and binge-worthy TV series explode in popularity. News, entertainment, and commerce have evolved to keep pace and stay relevant with these consumers. However, Next-gens' attention can be held if your product can provide those dopamine hits to keep them engaged; just look at the popularity of Netflix, TikTok, YouTube, Meta, and Roblox as proof. This has led to the gamification of everything, amplifying the entertainment factor by giving you the ability to bet on sports, props, politics, and even in markets with zero-day-to-expiration option "investments." Next-gens embrace an entirely new "asset class" in crypto that can see new tokens created almost instantly and trading occurs 24/7. With mobile technology strapped to their wrists, stuffed in their pockets, and shoved in their ears, the world competes for their attention and encourages them to take action.

Herein lies the problem. Taking constant action is at direct odds with building and maintaining wealth. Being a successful investor is difficult because it requires patience and the proper temperament to keep your emotions in check. These traits are virtually impossible to develop when algorithmic precision fills your mind with sensationalized takes, emotional triggers, and blurred lines between entertainment and news. This urge to act coupled with frictionless trading has led to the average holding period of a stock

now being measured in months as opposed to years. Not surprisingly, the average DIY investor's return falls woefully short.

Capgemini's report further revealed that 72% of Next-gens believe achieving above-average returns is no longer feasible by relying solely on traditional stocks and bonds. Not surprisingly, 81% of Next-gens plan to switch from their parents' wealth management firm within one to two years after receiving their inheritance. The most common reasons cited included a lack of services available on their preferred digital channels, the unavailability of alternative investments such as private equity and crypto, and inadequate value-added services which included estate planning, medical care, education advisory, and cybersecurity services. D.A. Davidson certainly realizes the importance of exceeding client expectations. It's worth noting that our firm makes continual investments to improve our digital tools like the client website and app, offers unique services such as our own trust department, has recently launched a securities-based lending product, offers Medicare guidance via our partnership with Chapter, and has a growing line-up of alternatives that includes 1031 exchanges, opportunity zones, venture capital, private credit, and direct indexing. DA Davidson certainly understands the importance of offering products and services to meet our clients' needs.

While the expanding capabilities are essential to remain competitive, we do find Next-gens' belief that they can't earn great returns from traditional stock and bond portfolios as troubling. Their screen time most likely amplifies their belief that they need to do something, and do something different. The reality is, they most likely can earn attractive returns if they exercise patience and do not sell out of long-term investment strategies because they're reacting with short-term emotion. In our opinion, the U.S. stock market has been and will remain an incredible place to build long-term wealth. We believe this generational divide in beliefs can be bridged if we have some open discussions and education centered around a few core principles:

- Treat investing like starting your own business. You need a well prepared and thought-out business plan (your investment thesis) summarizing key points and rationale for making an investment decision.
- If you were to start your own business, odds are you wouldn't be asking for an appraisal every day, week, month, or even year. The value of your business will be realized over the long-term. The same holds true for stocks. Although stock prices change constantly, value takes time to be realized.
- While you can buy and sell a stake in a business instantaneously and in some cases free of cost, you shouldn't. This lack of friction has put the focus on stock price and not what the company actually does.
- The "experts" filling your feeds with content about investment advice are almost certainly the wrong people to follow. The right people to follow typically write shareholder letters, possibly books, may now be transitioning into podcasts, and you'll most likely find their advice boring.
- Investing in the stock market is a get-rich-slow scheme. It takes time for companies to make investments to deliver future returns.
- Investing, although exciting, will earn its greatest return when implemented in a very boring manner. Seek out, own, and hold great companies for the longest amount of time possible.

While Next-gens face challenges, they are not insurmountable. Fortunately, Next-gens assign the highest value towards receiving tailored investment advice. Rest assured, the custom portfolios we build and

manage for clients operate from these core principles. The approach might seem old-school, but that's most likely a very good thing.

FORECASTS

As we're halfway through 2025, let's check in on our forecasts for the year. Our forecasts from the beginning of the year are in **bold** with current updates in *italics*.

Economy: modestly higher with GDP eclipsing \$30 trillion by the end of the 3rd quarter. *Through Q1, GDP was \$29.96 trillion, up from the \$29.72 trillion in Q4 2024. Growth of the economy continues with no recession occurring. However, as forecast, the rate of growth has slowed, and we see it remaining this way through the end of the year.*

S&P 500: up modestly to a range of 6,200 to 6,400 in a bit of a "breather" year for stocks. *Halfway through 2025 and so far it's been eventful. Trade / tariff uncertainty resulted in the NASDAQ declining 27% from its December 2024 peak and the S&P 500 falling 21% from its February 2025 peak. While eventful, in many respects this year has been no different than many prior years with volatility, corrections and recoveries being part of the pathway. As of this writing markets are back to all-time highs with the S&P 500 just above 6,100. We continue to see better earnings with some multiple compression leaving our forecast range well within reason.*

Oil prices: will spend most of the year somewhere around \$65 - \$70 per barrel. *Oil briefly dropped below \$60/barrel in spring of this year. We felt this was too low and actually seized the opportunity to add Chevron into portfolios. Prices have since recovered to the lower end of our range which some might find surprising given the unrest in the Middle East. With markets perhaps focused more on the shift in sentiment towards domestic production, we remain comfortable with our forecast for the remainder of the year.*

Commercial real estate: the FTSE NAREIT All REIT Index rises again, in line with inflation (3 to 3.5%) and yields (4 to 5%), for a total return of 7 to 9%. *Long-term interest rates have the greatest impact on capitalization rates and, therefore, the value of commercial real estate. Year-to-date, rates are very close to where they started the year and not surprisingly, so too is the FTSE NAREIT All REIT Index. With inflation tame and therefore rental increases also being tame, we remain comfortable in our total return forecast of 7 to 9% for the year.*

Residential real estate: a more subdued environment than years past with the Case-Shiller Index rising very modestly, if at all. *Through the end of April, the Case Shiller index is up 0.2%. Certainly a much more moderate rate of growth than in years past.*

Inflation: 3% to 3.5% inflation – similar to what we saw in 2024. *The most recent inflation reading came in at 2.4%, which was lower than just about every forecast, including our own. Tariffs remain the wildcard as to whether they prove to be inflationary or not. While we think the rate may bump up a bit in the second half of the year, we are pleasantly surprised that inflation remains benign.*

Short-term rates: a good chance the Fed Funds rate is 3.5% to 4% by year-end. *The Federal Reserve has shown amazing restraint in lowering interest rates even in the face of immense political pressure. With the stated intent of keeping inflation in check, they remain on pause, waiting to see the full extent of higher*

tariffs on prices. We think the deflationary impacts of technology will continue to counter the tariffs/taxes on goods and eventually the Federal Reserve will begin to lower rates by year-end.

Long-term rates: the 10-year yield maintains its historic average of approximately 4.5%. *The tariff / trade uncertainty drove yields up briefly, but they've since settled around the 4.5% level for much of the year. We remain of the opinion that a 4.5% cost of long-term capital is appropriate for a growing economy.*

We will leave the "Fun Forecasts" and progress on the "Long-term forecasts" for discussion in the annual letter.

As always, we welcome your feedback and would love to talk about these and other topics that may be important to you. We thank you for your continued confidence and the opportunity to manage your investments. We take very seriously our responsibility. ***Montecito Investment Portfolio's Mission: To provide diversified, disciplined, long-term investment solutions, service, and guidance to help our clients achieve and maintain their "Financial Independence."***

Sincerely,

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Disclaimers

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Real estate investments may be subject to a higher degree of market risk because of concentration in a specific industry, sector or geographical sector. Real estate investments may be subject to risks including but not limited to declines in the value of real estate, risks related to general and economic conditions, changes in the value of the underlying property owned by the trust and defaults by borrower.

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.

The Standard & Poor's 500 Index is a capitalization weighted index comprised of 500 widely-held stocks on US stock exchanges. Companies included in the index are selected by the S&P Index Committee, a team of analysts & economists at Standard & Poor's.

S&P 500 Total Return Index is a measure of the price movement of The Standard & Poor's 500 index and including the dividends paid by the companies in the index.

S&P Case Shiller Index – a group of indexes that tracks changes in home prices throughout the United States. CaseShiller produces indexes representing certain metropolitan statistical areas as well as a national index.

GDP – the monetary value of all the finished goods & services produced within a country's borders in a specific time period.

The MSCI US REIT Total Return Index is an index that broadly represents the price and income movement of the equity REIT universe in the United States. The Index represents approximately 85% of the US REIT universe.

The Barclay's Aggregate Bond Index – includes government securities, mortgage-backed securities, asset-backed securities and corporate securities to simulate the universe of bonds in the market. The maturities of the bonds in the index are more than one year.

P/E Ratio is a valuation ratio of the company's current share price compared to its per-share earnings.

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<http://www.cwam.dadavidsonfa.com/Our-Commentary.4.htm>