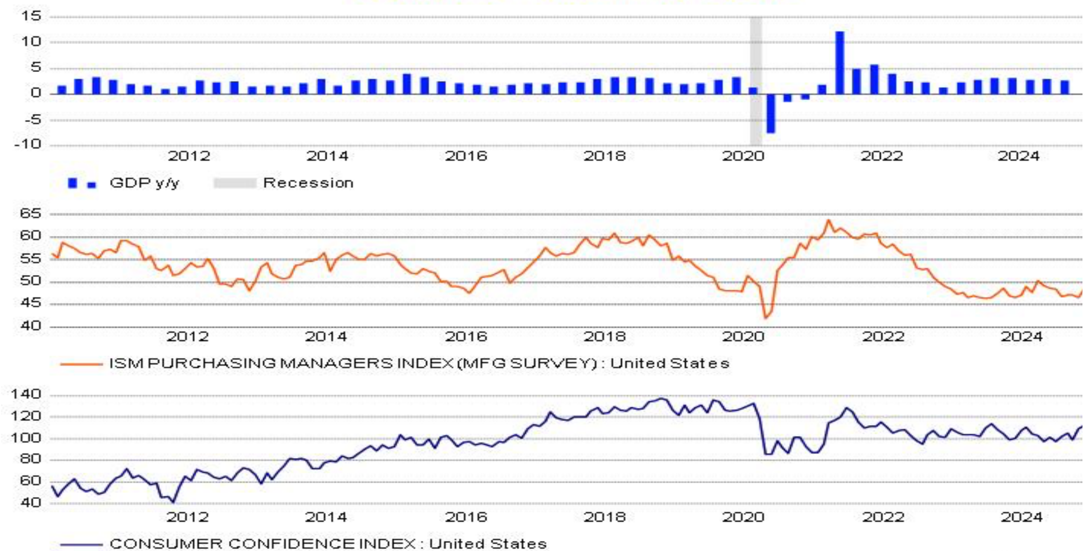
i2i CAPITAL MANAGEMENT

The Outlook for 2025 – More of the Same with a Trump Twist

As it stands, we expect a lot of the next 12 months to largely be an elongation of the positive trends and themes we have been seeing over the last 12 months. There are always areas to pick on but for the most part the US economy is being handed off to the new administration on a solid footing with good momentum. Further, much of where the bright spots in the US economy are currently, tend to align with the new administrations' goals. Specifically, we are referring to a lot of the infrastructure and onshoring trends already in progress and that still have runway. We have a hard time seeing a scenario where the government benefits a whole lot from getting in the way of this momentum and might even expect them to add a bit of gas to 'the fire'. Of course, this gas might be a 'good' thing in the short-term but will be a risk to watch and consider over time.

Economic Backdrop



As of January 9, 2025

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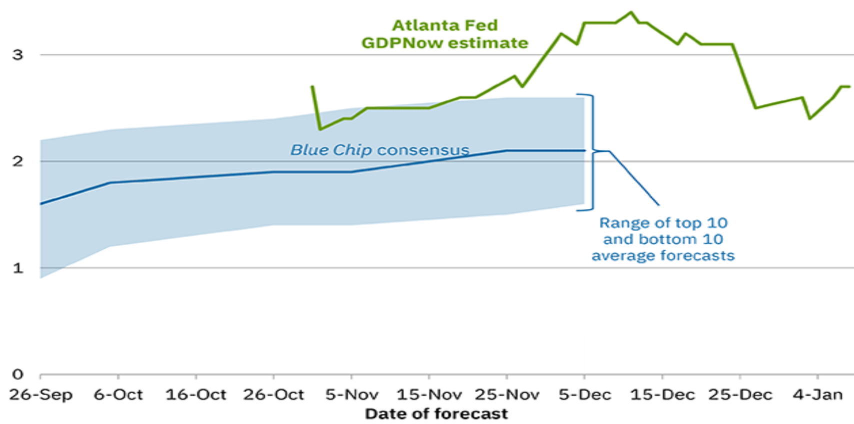
GDP remains stable and positive which is what you want to see. Outsized GDP growth is nice in theory, but it tends to lead to problems we have seen in past years such as inflation and renewed concerns over when the 'party' ends and a recession comes. In contrast, a nice steady, positive GDP growth cadence is something that can be sustainable and allows for businesses to plan for the future compared to thinking about more short-term risks if the growth picture is at polar ends of the spectrum. This positive GDP picture is further supported by the Atlanta Feds forward quarterly GDP estimate which is tracking between 2% and 3%.



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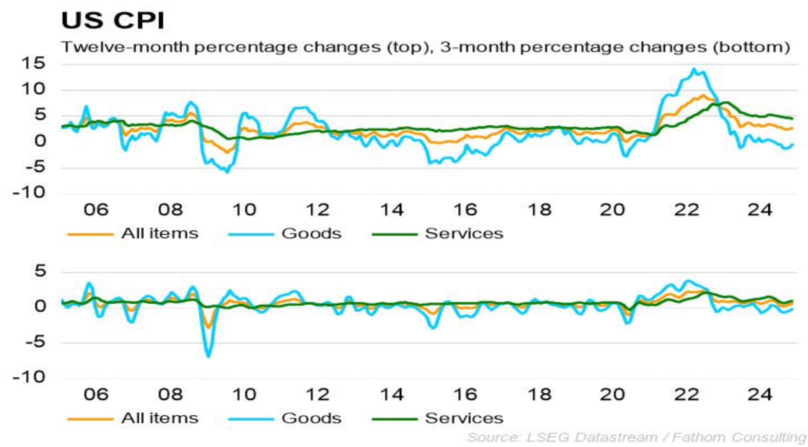
The below unemployment rate chart speaks for itself to a large degree but is another feather in the cap of the 'good economy' that sets markets up for a good year.

As of January 9, 2025

Continuing the trend of a healthy economy being handed off to a new administration, it is becoming ever more clear that inflation for the time being has quelled and we are normalizing back to long-term averages. One of the risks we expect over the next 12 months is that at some point there will be an inflation scare that will largely be proven to be investors wrongly extrapolating a few short-term data points into perpetuity. There is a potential that certain forces or policies lead to a reignition of inflation but we think these fears will likely be best to fade because markets don't like inflation and the incoming administration likes it when 'markets go up' and policies are likely to be adjusted to ensure that the government does not get in its own way on some of these strong footings it is on already.



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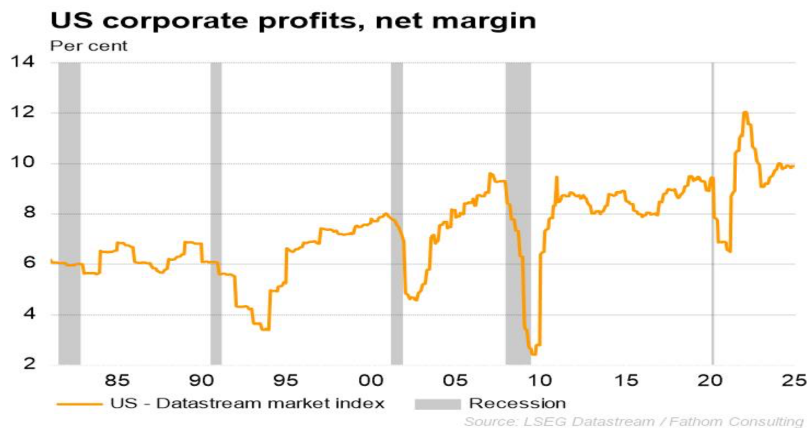
This might be the more interesting chart for a bit of a view on the economic backdrop. First, corporations are clearly doing ok and over time, profit margins continue to creep higher. Yes, margins can be short-term volatile in nature but the overall trend is clear. For years, the narrative has been that margins are a mean-reverting series and in turn will need to revert back to some long-term average. Well, going back as far as the early 80's, this has clearly not been the case and we do not really see a good reason as to why one should expect margins to revert back to some level we saw back in the early 80's. For some further optimism on profit margins, potential of lower taxes and even some cost efficiencies thanks to AI technologies, one can see a scenario where these margins tick sustainably higher over the medium term.



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Valuations

Valuations at the market level can always be fickle. Investors have probably viewed valuations as being ‘expensive’ for a large part of the last ten years, only to see those same markets produce above average returns over that period. This point isn’t to say that valuation should be ignored rather that they aren’t overly helpful as a timing tool but at least can potentially be used to help an investor gauge how aggressive they should be or better yet, where they should be more aggressive.

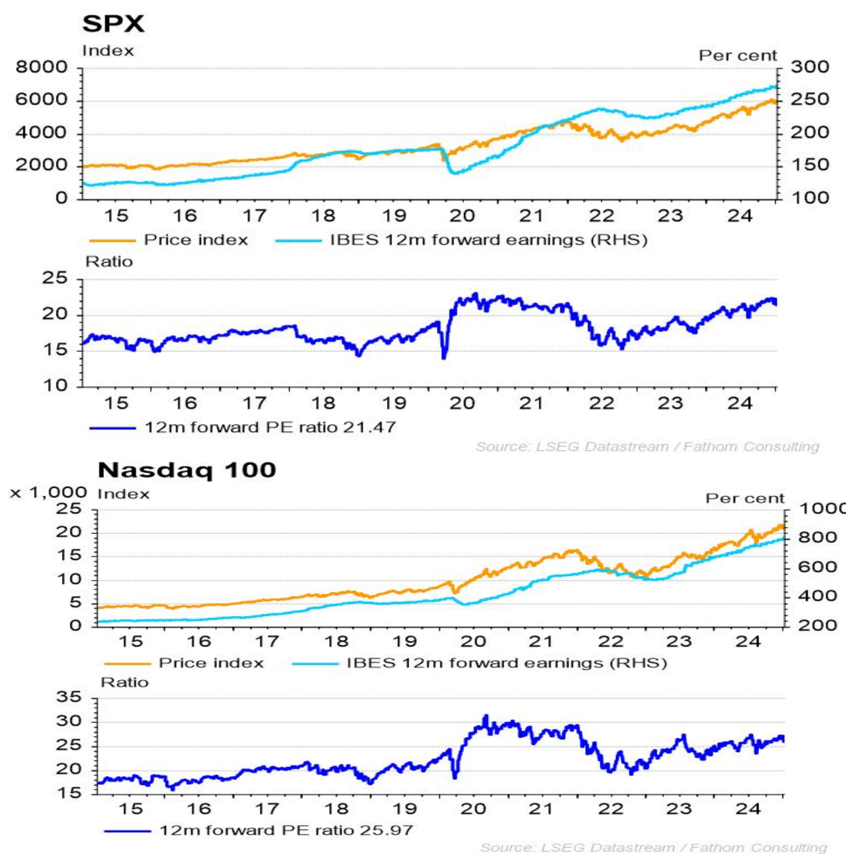
As we walk through some of these valuation charts, no one will be surprised to hear that large-caps are at best ‘richly valued’. This is how it should be. Things look pretty good and higher valuations should be rewarded to these markets. You don’t have to like or agree with the premium valuations, but we also don’t think they are overly concerning for a few reasons:

- Margins are near record highs and continue their march higher per our previous margin chart highlighted above.
- These indices are skewed to some of the largest and most profitable companies we have seen in the world and through history, in turn biasing valuations higher versus historical periods. Comparing valuations of the markets today is not exactly an apples-to-apples comparison of the markets in the 80’s.
    - The top 10 companies make up over 35% of the S&P 500 market-cap compared to 7% in the S&P 600 small-cap index.
- The economy is on solid footing.
- There are arguably few ‘obvious’ risks facing markets at this point in time, particularly relative to the last three years of tumult.
- Interest rates have/are coming down which adds a further tailwind to markets.

- Incoming government will more than likely look to institute policies that lean more toward being positive for equity markets, whether or not those policies play out as one expects (if they ever do!).

This is our long-winded way of saying that yes large-cap valuations are getting stretched, but in this environment and given market composition, they probably should be. Of course, the issue here is that it might not leave much room for error and the large-cap indices are increasingly becoming an implicit bet on less than ten companies.

Looking at large-cap valuations, we think the takeaway here is that investors might have some success in this space but at the margins, there are probably ‘easier’ or more reliable places to generate returns in the medium term. This is where the small and mid-cap markets enter the picture.



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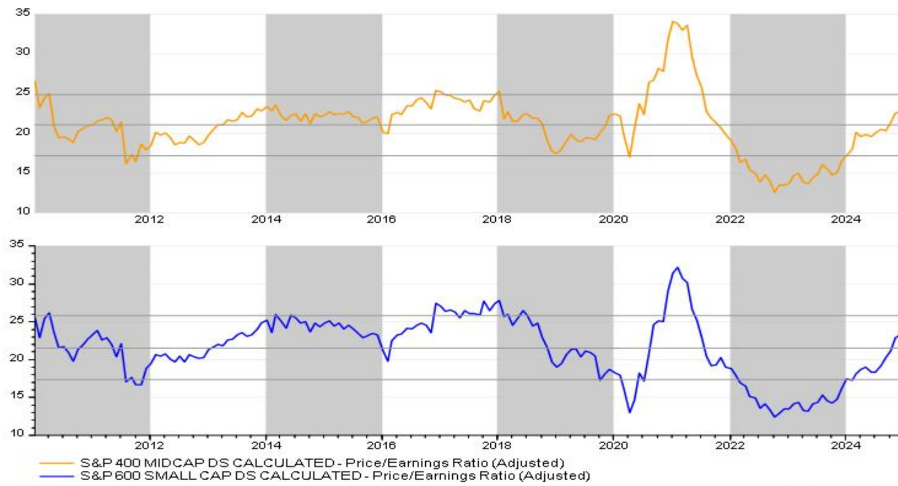
As can be seen in the below chart with the mid and small-cap valuations, it is a bit of a different story compared to their larger-cap brethren.



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Finally, viewing SMID-Caps relative to large-caps, it is clear that the spread between large cap valuations and SMID-Cap remains around 30-year highs. As investors look at their portfolios in 2025 and where they should be investing the marginal dollar, they are faced with a large-cap market that has had a stellar run over the past decade but is on the high side of valuations and to a large extent dependent on a handful of very large companies. This is compared to the SMID-Cap market with better growth prospects, cheaper absolute valuations, an extreme discount relative to large-caps, and that is roughly flat when you zoom out three years. In our minds, where money is going to flow to seems fairly obvious and it becomes more of a question of when or how gradual the rotation into the smaller-cap space occurs versus if it will occur.

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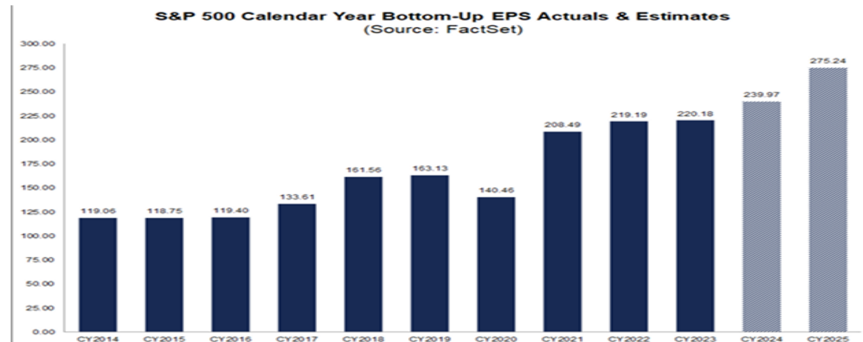
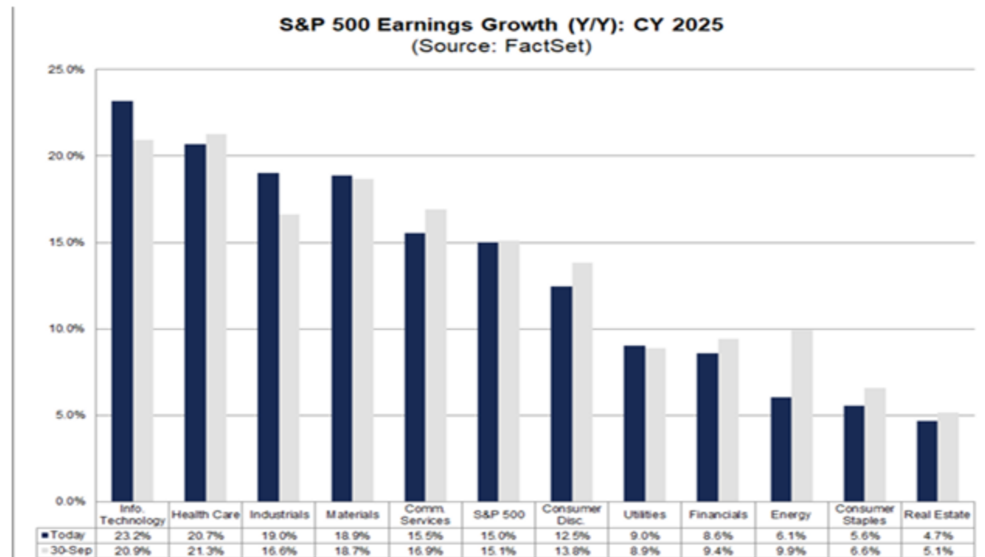
Earnings

Drilling a bit deeper into the company level, we also see that 2025 is looking good on an earnings basis. According to FactSet, earnings for the S&P 500 are expected to grow in the range of 14% with IT, Healthcare, and Industrials leading the way in that growth, in the range of 16% to 20%. These are three industries we tend to tilt the portfolio more toward as well, alongside Consumer Discretionary.

Bottom-Up EPS Estimates: Current & Historical

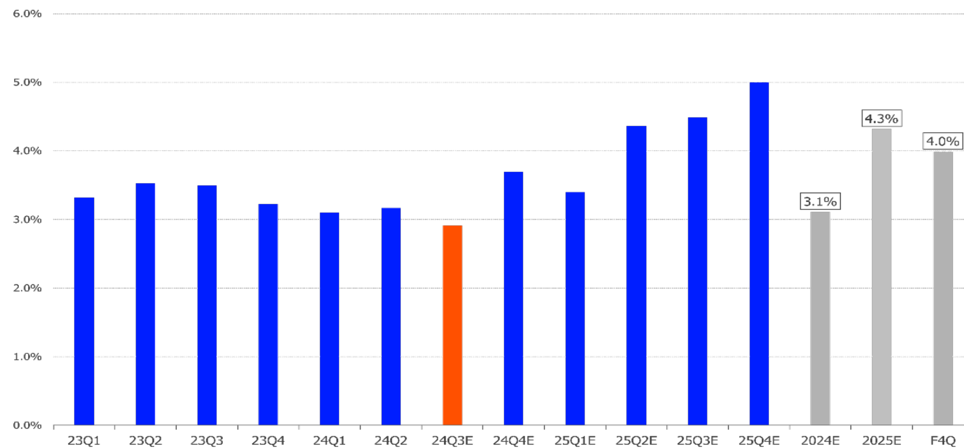


CY 2025: Growth



	Info. Technology	Health Care	Industrials	Materials	Comm. Services	S&P 500	Consumer Disc.	Utilities	Financials	Energy	Consumer Staples	Real Estate
Today	23.2%	20.7%	19.0%	18.9%	15.5%	15.0%	12.5%	9.0%	8.6%	6.1%	5.6%	4.7%
30-Sep	20.9%	21.3%	16.6%	18.7%	16.9%	15.1%	13.8%	8.9%	9.4%	9.9%	6.6%	5.1%

There are also indications that net profit margins are expected to expand for the Russell 2000, rising from 3.1% in 2024 to an expected level of 4.3% in 2025 according to LSEG.



The earnings picture is yet another feather in the cap for what looks like a strong economy heading into 2025. This strength likely provides a bit of room for 'error' at the government policy level but also should mean that things are pretty good as they stand and no one will (or should) be overly eager to 'kill the goose that lays the golden eggs'.

We think it is pretty difficult to be pessimistic on the outlook for 2025 as we see it now. The US economy and companies are on solid footing in most respects, the risks of the past few years are shadows of what they were, and valuations are justified and even attractive depending on where you look. There will always be some ebbs and flows to deal with in markets but we are excited to see what 2025 holds.

Specific Themes for 2025

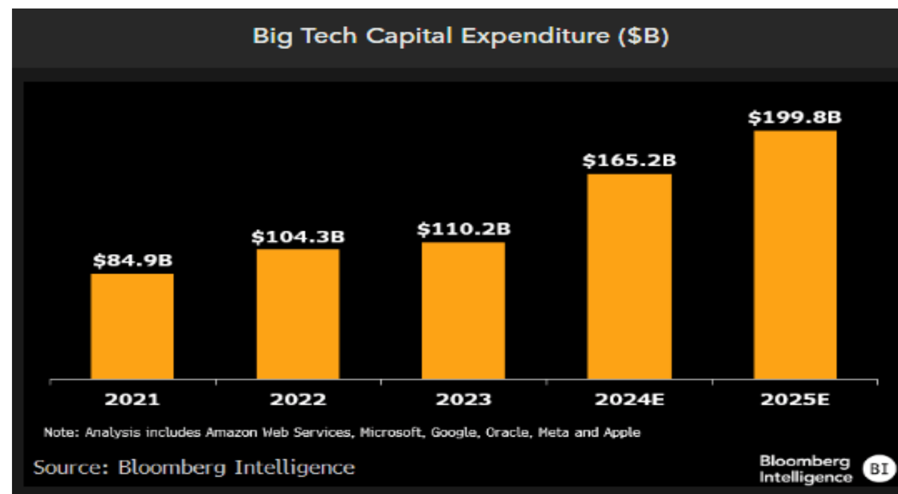
Infrastructure/Onshoring

This has been a trend and theme since COVID but given that many industrial-style projects take time to get shovels in the ground in the first place, it is a trend whose impact on the economy has really just begun to be felt over this last year. As these projects and various government programs continue to roll out and gain steam, we expect this trend to continue with its current momentum. Adding in a new administration that appears to be even more interested in reshoring and more of an 'America First' approach, we expect to see these trends to at least continue if not become an increased theme for the next year. The continuation of this trend should also bode well for the economy as a whole, as investment and growth in the industrial sector typically has a higher multiplier effect across the economy compared to other industries.

A Pivotal Year for AI

It is hard to believe that AI is still a new trend given how quickly it has proliferated. The last year largely consisted of large tech companies laying the groundwork for

the future of AI. Most of the large tech players viewed this space as an existential area that if they did not win in, they at least need to be competitive in. This story is not done yet. While big tech is expected to have spent $165 billion on cap-ex in 2024, this number is expected to increase to just shy of $200 billion in 2025. For some context, this level of annual investment is equivalent to the market-cap of roughly the 60th largest company in the S&P 500, an index of the largest companies in the US! Perhaps more stark, this level of annual investment exceeds the market-cap of the Royal Bank of Canada!



This level of investment is a bit of a double-edged sword because it cannot keep up forever, nor does anyone expect it to either. Given some of the massive capital expenditure into AI and the runway companies have been given to allow them to build out their infrastructure, we do think that by the end of 2025, companies will need to start showing returns or at least a roadmap to the returns from these AI investments and along with it, markets will want to begin seeing some monetizable business verticals coming out of this.

In turn, we expect that in the second half of the year, all eyes will be on AI. We don't think the outcome will be binary but this coming year will likely offer some clarity on how this industry will unfold over the long-term and whether the spending and investment into the space will continue its upward momentum or begin to normalize.

Rotation to SMID-Caps, Finally!?

We have touched on this point already but whether it is a big rush of assets into the small and mid-cap space or if it is a bubbling but consistent rebalancing from large to small, we expect the rotation into small and mid-cap stocks to be a tailwind for most of 2025. Small and mid-caps are cheaper, growing faster, should benefit from incoming policies to a greater degree, and should also benefit from lower rates. With a more normalized environment and a bit of what looks like a consistent operating environment for the last year or so, we expect small and mid-sized companies to once again have their feet on solid ground and be ready, able,

and willing to play a bit more offense opposed to what has felt more like a defensive stance for the last couple of years. Finally, with a bit of a phantom selloff for SMID-caps in the last month of the year on no clear material events/news, we think it only increases the chances/probability of small and mid-caps having a good 2025 calendar year.

Trump Twists

We expect 2025 to be filled with what we are calling 'Trump Twists'. These are headlines that markets react to and over extrapolate their impact. While this also means a bit of extra volatility, we expect these events to provide opportunities for a nimble investor and is a theme that we think will offer opportunity through 2025. They are likely to offer opportunities where fundamentally strong companies present attractive entry prices for a new position or attractive prices with which to add to current positions. On the other side, it also likely presents some opportunities to exit positions over the year where markets are maybe pulling forward too much good news.

While not every Trump Twist will be investable, or a space we would necessarily want to invest, it will more than likely open doors to areas or investments that we would like to enter but are just not quite 'there yet' for some reason (typically valuation). Being nimble but not reacting to the first headline that comes across ones' screen should be a recipe for success.

We also expect these Twists to provide a bit more opportunity on the short side. Over the last year, being too aggressive on the short side would have impeded returns and staying more conservative on the short side proved to be the right decision. However, over the last three months, some areas of the markets, particularly lower quality ones, have seen stellar runs which we think sets up some opportunities on the short side of the portfolio as well. Further, just like Trump Twists offering opportunities on the long side, we think it will also offer opportunities on the short side where investors overreact to news flow, creating hard to justify price moves in some stocks.

2024 Hits and Misses

Going ever more granular, we now want to review a few investments we made that worked out well and a few that worked out less well.

Miss 1: Aspen Aerogels (ASPN)

Aspen was a frustrating situation because management actually executed on what they said they would do and the thesis unfolded as expected. However, a few too many unknowns started to build which simply led to too much uncertainty overhanging the shares.

Aspen produces aerogels that are used on the batteries for electric vehicles. The material is lighter weight and management is of the view that it acts as a better insulation/barrier than other competing materials. The light weight is important for mileage and being more effective at preventing battery overheating (thermal runaway) is obviously important from a safety perspective. The company also already had multiple OEM contracts in hand with GM being their largest customer. The opportunity was catalyst rich with a few OEM's waiting in the wings to sign contracts, conservative guidance offering ample room for 'beat and raise' quarters, a new plant to be built out greatly increasing capacity and in turn growth that was going to be financed by a low-cost loan from the government. Ironically, most if not all of these catalysts were lining up and being executed on and while the fundamental thesis was playing out, too many high-level questions were piling up, negating any positive news flow.

First, GM announced changes to their battery platform (Ultium) which was not necessarily a negative to ASPN but did add some uncertainty/questions. Next the political climate shifted with concern around support for EVs and a removal of an EV subsidy at the consumer level added to concerns. Even though one of the largest backers of the incoming administration owns an EV company, investors have become concerned over the future of EVs! Finally, after the positive news of the loan was announced, the company then went and did an equity issue which took any steam out of the shares. While many of these issues did not have clear or quantifiable impacts versus the news the company was executing on, there were enough question marks that we viewed the risks as piling too high on one side and we exited the position. Often, when more nebulous risks start to build, it only takes small, often inconsequential, pieces of news to take a stock materially lower as investors throw in the towel. In fairness, ASPN may very well be a name we return to in the New Year but a bit more clarity is needed on a few fronts here.

Miss 2: Vertex Inc (VERX)

For this one, we are going to do that thing everyone does in interviews where they turn weaknesses into strengths.

Vertex is a tax solution provider that has success with larger companies that have more complex tax situations and boasts having over 60% of Fortune 500 companies as their customers. The company is growing, has very sticky revenues and is able to sell new services to large, beholden customers. VERX has gross margins in the 60% range that are trending higher and helps to solve difficult problems around tax that are also critical for a business to get right.

We owned this company prior to 2024 but after a good run we decided to exit the position due to a valuation that was expanding. There was also some insider selling that was raising questions for us at the time. Of course, most likely know how the story goes. While we sold at a gain, the stock continued to run. We often find that some of our biggest regrets are simply selling. More often than not, if you

have done the work, the company is growing, the balance sheet is high quality, and the management team does what they say, selling is a mistake.

So how do we flip this to a strength? What we did get right here is that we re-entered the shares (albeit at higher prices) and the company continues to perform well. Psychologically, it is quite difficult to re-enter a position at higher prices once you have sold, but often this is the right decision to make. The stock doesn't know or care when you bought or sold the shares and it has no bearing on the company prospects. Only the investor themself cares about their past decisions, even though they should not really let it impact the investment decision making process. We built a position in VERX again at around the $35 to $37 range and shares now sit at the $55 level as we write this. So, at least we were able to right our wrongs and still generate a healthy return in a relatively short amount of time with potential for those returns to continue to compound.

Hit 1: Axon Enterprises

Axon might be one of our biggest hits in the portfolio on outright return but also on position sizing as well. We began purchasing shares in the $120 range with shares now in the $560 range as we write this and was sitting at our largest weighting at roughly 8%, a level that we have trimmed back by the time you are reading this. While looking at a longer-term chart of the shares, it looks like it was a pretty easy ride to the recent highs. However, longer-term charts of big winners tend to hide or smooth out the bumps in share prices along the way. In fact, the fund held through a nearly 55% drawdown in share price of AXON, reaching the $80 range, to climb its way up to current levels.

We were recently discussing that 55% drawdown as we were reviewing our holdings and the interesting thing about it was that there was actually no real reason for such a substantial drawdown. Everything that has led to where the company (and stock) is today, was already in place when it saw that 55% decline. They were expanding internationally. They were growing and upselling within their current customer base. Many of the software services with sticky and higher margins that are seeing so much success were already selling at that time, albeit a far smaller part of the total pie. While there is more certainty 'today', all of the pieces of the puzzle were not just in place but already gaining traction. Axon is a great example of why thinking long-term and focusing on the fundamentals is so important. In the short-term, stocks of all shapes and sizes can fluctuate due to items unrelated to the stock, company or even sector that they operate in and those fluctuations can take time to be digested. 12 months is a very short time in the investing world but it can feel like an eternity, especially when the investment is moving contrary to expectations. Having a bit of a point of reference in the form of fundamentals helps an investor get through tougher periods while providing patience.

Looking forward, we remain optimistic on AXON's outlook. They continue to execute in an impressive manner and have essentially become the defense

company of police forces across the world. Their move into AI and utilizing it to help officers write reports more efficiently (a part of the job most don't particularly enjoy) is one of the first clear or discrete real world end-use cases we have seen for AI from public companies and offers yet another growth vertical for the company. With that said, the company is now trading at over 18 times sales, is up just shy of 150% in a single year and over 700% over five years. While past performance does not indicate future returns one way or another, given the large run it has had coupled with a material step up in the valuation, we have materially trimmed the position down in the New Year. It might be a name we add back to if better entry opportunities present themselves but for the time being we think taking some profits in our largest position is prudent.

Hit 2: Sezzle (SEZL)

We think Sezzle is an interesting name to highlight as it was a big winner in a short timeframe but is also a bit of a different type of investment we will make from time to time. An important point to keep in mind is that while we are highlighting this position, we no longer hold this in the fund at the time of writing. While it is no longer a holding, it is a good example of some types of more nimble investments we will make from time to time.

As most of our investors know, we like momentum. We like momentum even more if it is coming from a low valuation, indicating that there might be a shift occurring in how the company is valued by markets. When these occur, there can be plenty of runway for fundamental and share price growth as the valuation expands to a level that better reflects the situation at hand on top of growing fundamentals. Essentially, you get two major levers driving the stock price higher if it works. We like momentum and value combinations even more if it is a smaller company that is not really in the public 'psyche'. It is intriguing if a mega-cap stock is hitting new highs, but when a company that no one seems to know or talk about continues to hit new highs, that is a signal worth paying attention to. Sezzle ticked a lot of those boxes alongside more stock specific items such as big upside surprises in earnings, a strong consumer that continued to spend, and benefitting from lower rates that offered a tailwind. Over a four-month holding period, the investment in Sezzle produced a total return of 98%.

One of the biggest struggles with the name was keeping the position size reasonable due to it growing so fast, a decision that proved prudent as we were able to actively trim/rebalance the position back down to lower weightings, making volatility in the name less of an issue prior to fully exiting the position and realizing a healthy return in a short period of time.

A lot worked out with this investment and quicker than we would have imagined and it should not be construed as a 'regular occurrence' in the portfolio (though we will certainly try to get more of these wins!) but we are highlighting it because it is a good example of one of our big wins in the year and also an example of more

of a short-term investment we will make from time to time that tends to be a bit more of a requirement in US small and mid-caps. We will make these investments where we feel the stock has become dislocated from reality. We find in the small and mid-cap space, these pop up far more frequently than in the large-cap space. When we view a risk/reward scenario as being tilted in our favour, we are happy to take that opportunity with the plan to exit the investment or at least aggressively trimming it down when we feel the stock catches back up with the actual fundamental story. Often these types of investments will be in sectors or industries that we are less interested in or with addressable market sizes that are more constrained. This is opposed to longer-term holdings that we expect to have a long-term and outsized runway for growth. Sezzle is a great example of one of those attractive risk/reward opportunities that we come across periodically.

- Ryan and Peter
Keep Moving Forward.
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