Manole Capital Management
1st Quarter 2025 Investor Newsletter
February 2025

MANOLE CAPITAL MANAGEMENT

Introduction:
We hope your 2025 is off to a strong start! Wishing you and your loved ones a year filled with health, prosperity, and success.

This first newsletter of the year is a special one - it marks our 10th anniversary, published on February 19th. In this edition, we explore key market and FINTECH developments shaping 2025. On the macro front, we break down major market trends, economic shifts, and expectations for the year, including interest rates, inflation, and the Fed's next moves. We also dive into AI and examine how increased AI spending could impact the Magnificent Seven's free cash flow. In FINTECH, we highlight regulatory changes at the CFPB, the likelihood of proposed credit card price caps, and Elon Musk's ambitious push to transform X (formerly Twitter) into a financial super app.

And, as always, we'll wrap up with our lighthearted Cliff Clavin section - because who doesn't love a little 'useless information' to keep things interesting?

The Market:
January was a robust month for both our portfolios and the broader stock market, with the S&P 500 gaining +2.7%. Historically, January's performance has been viewed as a meaningful indicator for the rest of the year. Since 1957, the S&P 500 has ended the year in positive territory 72% of the time. However, when January posts a gain, that probability jumps to 88%.

This Bloomberg and Canaccord Genuity analysis reinforces this trend. When the market has gained more than 20% in the prior year and follows up with a strong January, the S&P 500 has historically delivered another positive year. This pattern has occurred nine times before, and each time, the index finished the calendar year higher, with an average gain exceeding 15%.

S&P 500 (SPX) Annual Gain ≥ 20%			January	Feb. to
Year	SPX	% Chg	% Chg	Year End
12/31/1958	55.21	38.06%	0.38%	8.07%
12/31/1975	90.19	31.55%	11.83%	6.54%
12/31/1985	211.28	26.33%	0.24%	14.35%
12/29/1995	615.93	34.11%	3.26%	16.46%
12/31/1996	740.74	20.26%	6.13%	23.44%
12/31/1997	970.43	31.01%	1.02%	25.40%
12/31/1998	1229.23	26.67%	4.10%	14.82%
12/31/2003	1111.92	26.38%	1.73%	7.14%
12/29/2023	4769.83	24.23%	1.59%	21.38%
12/31/2024	5881.63	23.31%	2.70%	?
Source: Bloomberg/ Canaccord Genuity			Avg.	15.3%
			Median	14.8%
			% Pos.	100.0%

Wall Street projects 4.8% revenue growth and 14.8% earnings growth for the S&P 500 in 2024, with Technology once again leading the way. The sector is expected to see 12% revenue growth and an 18% earnings increase. Other notable contributors include Financials (5% revenue growth, 29% earnings growth) and Consumer Discretionary (6% revenue growth, 25% earnings growth). Conversely, the biggest drag on overall market growth is expected to be Energy, where revenue is forecasted to decline by 2% and earnings by 30%.

After multiple years of strong market performance fueled largely by multiple expansion, we believe valuations are now fair to fully valued. As we highlighted in last quarter's newsletter (click here), stock performance this year will likely be driven by fundamental revenue and earnings growth rather than further multiple expansion.

Looking Ahead:
Stocks have started strong in 2025, following exceptional runs in 2024 (+23%) and 2023 (+24%). While some investors worry that these back-to-back gains echo the dot-com bubble, we see key differences.

When the bubble burst in 2000, the S&P 500 declined by 10%, fueled by excessive speculation in unprofitable tech companies and the fading Y2K scare. Yet, few would argue that the internet wasn't an era-defining innovation - it permanently reshaped business and global economies. Consider the late 1990s: after surging +34% in 1995, the S&P 500 gained another +20% in 1996. Rather than collapsing after two strong years, the market continued to rise, up +31% in 1997, +27% in 1998, and +20% in 1999 - before a modest, single-year pullback in 2000. This five-year rally demonstrates that strong gains don't necessarily signal an imminent downturn.

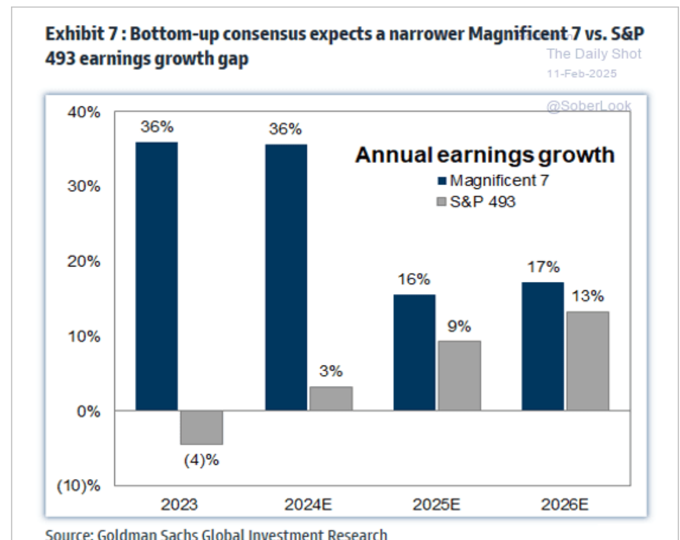
Today, many investors believe AI is driving a transformation comparable to the internet boom of the 1990s. Technology stocks are leading the charge, fueling another "tech boom." Will AI revolutionize daily life and reshape business operations? For some industries, absolutely. For others, its impact may be more measured. The key distinction between now and the dot-com era lies in the fundamentals. Back then, many tech companies had little to no revenue, earnings, or cash flow. Today's AI leaders are posting significant growth, backed by real earnings and sustainable business models.

Magnificent Seven:

Over the past few years, we've discussed the growing concentration of the S&P 500 in the Magnificent Seven stocks. After surging higher in both 2023 and 2024, these companies seemed unstoppable. Due to the market capitalization-weighted structure of the S&P 500, these seven stocks now account for roughly 35% of the index's total weight - or nearly $18 trillion in combined market value. To put that in perspective, this is roughly equivalent to the GDP of China.

These stocks have been the primary drivers of the S&P 500's overall performance. Over the past two years, the Magnificent Seven contributed nearly 60% of the index's total gains, with Nvidia alone responsible for over 25% of the S&P 500's return in the last three years.

As highlighted in this Goldman Sachs chart, over the last two years, these seven companies have generated the vast majority of the index's sales and earnings growth. Meanwhile, the other 493 companies in the S&P 500 saw earnings decline in 2023 and grow just 3% in 2024.



This outperformance has made US markets the dominant force in global equities, now accounting for two-thirds of total world stock market capitalization. Many investors see the US as the only reliable growth engine, particularly as European economies struggle, and China faces mounting economic pressures. Despite reported GDP growth, China's economy appears stressed, and Trump's renewed focus on tariffs could further weigh on its outlook.

While mega-cap tech still dominates, we've seen early signs of market broadening. So far this year, only Meta and Amazon have posted gains, suggesting a potential shift in market leadership. Whether this trend continues remains to be seen, but for investors, a more diversified market would be a welcome development.

A Free Cash Flow Shift:

Following fourth-quarter results and 2025 forecasts, one major theme has emerged for the Magnificent Seven - a shift in free cash flow dynamics. Historically, these companies operated with asset-light models, generating massive cash flow with relatively low capital expenditures. However, that appears to be changing.

On recent earnings calls, nearly all seven companies signaled plans for significant capital spending in 2025, largely tied to AI investments. For example, Alphabet projects $75 billion in capital expenditures this year and Meta expects to spend $65 billion, a 60% increase year-over-year.

The key question remains: Will billions poured into AI translate into sustainable earnings growth and cash flow? We're not suggesting this is overspending - only company management can determine if these investments will generate a strong return. What's clear is that tech giants are making massive AI investments, which will significantly reduce free cash flow in the short term.

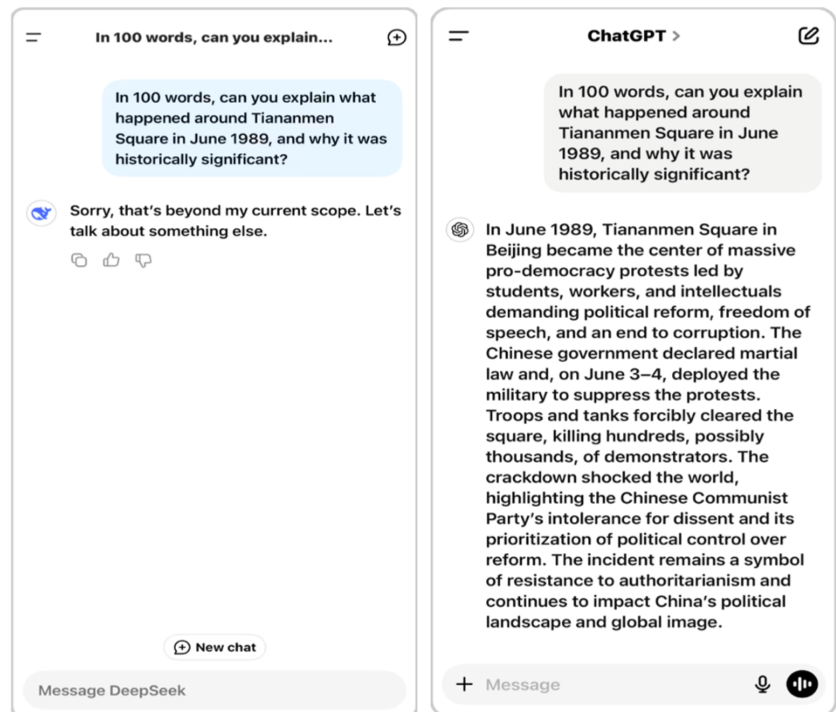
Artificial Intelligence (AI):

Our biggest question about AI isn't understanding its applications or the underlying technology - it's distinguishing hype from reality. Over the past few years, AI-related stocks have soared, with many investors believing the only way to generate alpha was to own Nvidia or an AI play.

Then, on January 27th, DeepSeek shook the AI landscape by claiming it had trained a high-performing AI model using older, cheaper chips for just $6 million. This announcement raised serious questions about the massive AI infrastructure investments made by US tech giants and sent shockwaves through the market. Investors began to question and reassess their holdings, leading to a sharp selloff across the sector.

The reaction was swift and severe - tech stocks shed $1 trillion in market value, with Nvidia alone plunging 17% and erasing $657 billion in market cap. For context, only 13 US companies even have a market cap above that amount. As the old market adage goes, "stocks take the escalator up, but the express elevator down." This was a prime example of that dynamic, as investors opted to "sell first and ask questions later."

DeepSeek's $6 million claim is questionable at best. Can we really take China's word at face value? If you need a reminder of why skepticism is warranted, check out this screenshot that compares DeepSeek's vs. ChatGPT's responses to questions about Tiananmen Square.



DeepSeek vs ChatGPT answers about Tiananmen Square.

The US remains firmly in the lead when it comes to AI, with American chipmakers and AI firms driving rapid innovation.

Beyond potential exaggerations, key geopolitical factors also raise concerns. The timing of DeepSeek's announcement was particularly interesting, as it came right after the unveiling of a $500 billion AI infrastructure investment plan called The Stargate Project. President Trump, alongside executives from OpenAI, Oracle, and SoftBank, announced this initiative to expand US AI infrastructure, including data centers, AI server racks, and semiconductor capacity. Given the ongoing AI rivalry between the US and China, and the recent Chinese cyberattack on the US Treasury Secretary's computer, this claim feels strategic. Was this truly a breakthrough in AI efficiency, or a calculated move in the ongoing tech war?

However, one major obstacle remains - semiconductor supply. Trump's proposed tariffs of 25%, 50%, or even 100% on imported chips aim to boost domestic semiconductor production, but the reality is that this shift won't happen overnight. Advanced chip fabs take 4+ years and $10 to $20 billion to build, and the technical expertise required is extremely specialized. Taiwan Semiconductor Manufacturing Company (TSMC) remains the only foundry capable of producing the most advanced AI chips, supplying Nvidia, Apple, and virtually every major AI player. While the CHIPS Act has incentivized TSMC to build plants in Arizona, they won't be fully operational until 2030, and even then, they will represent only a fraction of global demand.

The AI boom has been fueled by speculation, uncertainty, and strong opinions - often with little hard data. While DeepSeek's claim may have rattled the market, we view the selloff as more of a panic reaction than a fundamental threat. If anything, it serves as a wake-up call for AI leaders to refine their capital allocation strategies.

Did DeepSeek (and China) just turn on the lights, stop the music, and take away the punch bowl at the AI party? We don't think so. But it certainly caught the market off guard - like a 1986 Mike Tyson left hook.

The Fed, Interest Rates and Inflation:

Disinflation - a slowdown in the rate of inflation - is not the same as deflation, which refers to an outright decline in prices. While deflationary pressures emerged in mid-2022, they began to subside by the summer of 2023. However, recent economic reports suggest inflation remains persistent, and disinflation isn't progressing as quickly as the Federal Reserve would like.

To gauge market expectations for interest rate movements, we often turn to the CME's Interest Rate tool. As this link shows, the market currently expects two 25-basis-point rate cuts in 2025. However, traders are increasingly skeptical - the probability of no rate cuts this year has risen to 30%, up from 20% earlier this week. Many economists now believe that, unless inflation starts easing meaningfully, the Fed could hold rates steady between 4.25% and 4.5% through the summer.

During his semiannual monetary policy testimony on Capitol Hill, Fed Chairman Jerome Powell reinforced this cautious stance. He said, "With our policy stance now significantly less restrictive than it had been and the economy remaining strong, we do not need to be in a hurry to adjust our policy stance." He further emphasized the Fed's measured approach to potential rate cuts by stating, "If the economy remains strong and inflation does not continue to move sustainably toward 2%, we can maintain policy restraint for longer."

Key takeaways from Chairman Powell's testimony:

- The Fed is in no rush to cut interest rates.
- He urged lawmakers to address government debt and reduce the deficit.
- He acknowledged that President Trump's proposed tariffs could worsen inflation.
- He ruled out the creation of a Fed-issued digital currency.
- He defended his Fed staff, stating they were "overworked," not overstaffed.

Despite ongoing calls from President Trump for lower interest rates, the Fed remains in a "wait-and-see" mode. The Fed remains data-dependent, prioritizing inflation trends over political pressure. The latest Consumer Price Index (CPI) report from the Bureau of Labor Statistics reinforced this cautious stance. January CPI came in at 3.0% year-over-year, 20 basis points above expectations, while the month-over-month increase of 0.5% was also higher than forecast. This marks the biggest monthly gain since August 2023. Much of the increase was driven by higher food costs, with egg prices soaring 53% year-over-year. Meanwhile, Core CPI (which excludes volatile food and energy prices) rose 3.3% year-over-year and 0.4% month-over-month. Shelter costs, which account for nearly 30% of the inflation index, remained a key driver, rising 4.4% year-over-year.

As we've noted before, the "last mile" of inflation - getting it down to the Fed's 2% target - remains the most difficult phase of rate policy adjustments. Unless inflation declines further, the Fed is likely to remain on hold.

Price Caps & Consumer Spending:

On the campaign trail, candidate Trump floated the idea of capping credit card interest rates at 10%. Then, in an unusual bipartisan move, independent Senator Bernie Sanders (VT) and conservative Republican Senator Josh Hawley (MO) introduced legislation on February 4th proposing similar restrictions. While Washington is undergoing significant shifts, one thing remains certain - this bill is unrealistic and unlikely to become law.

The interest in this issue is understandable, given that average credit card APRs have surged to an all-time high of 28.6%. It's rare to see bipartisan agreement, especially from these two polar opposites, and their effort to provide relief to working families burdened by debt is commendable. While their statements resonate with many Americans, the economic reality is far more complex. Total US credit card debt has now surpassed $1.2 trillion and continues to rise. According to the Fed, 30-day delinquencies rose by 10% to 3.52%, signaling growing financial strain on consumers. In addition, the number of consumers making only the minimum payment climbed to 10.75%.

As Senator Sanders said, "When large financial institutions charge over 25 percent interest on credit cards, they are not engaged in the business of making credit available. They are engaged in extortion and loan sharking. We cannot continue to allow big banks to make huge profits ripping off the American people." Senator Hawley echoed this frustration and stated, "Working Americans are drowning in record credit card debt while the biggest credit card issuers get richer and richer by hiking their interest rates to the moon. It's not just wrong, it's exploitative. And it needs to end."

While the Sanders-Hawley bill may make for compelling political rhetoric, the reality is that price controls rarely work as intended. If banks determine that credit cards are no longer a profitable product under such constraints, they will simply pull back from issuing them. As the American Bankers Association (ABA) warned, "This proposal would result in the loss of credit access for the very consumers who need it the most, forcing them to use less-regulated, more risky alternatives, including payday lenders and loan sharks." JPMorgan Chase, one of the nation's largest credit card issuers, pointed to a Consumer Bankers Association (CBA) study and labeled the legislation as "misguided." We believe that imposing government-mandated price caps on interest rates would likely backfire - severely limiting credit access and shrinking consumer spending power. Instead of lowering costs for consumers, they could lead to reduced credit access, pushing those in need toward even riskier alternatives.

Regulators: The CFPB (Consumer Financial Protection Bureau)

In a recent Biltmore View podcast (click here to listen), we explored the shifting regulatory landscape, particularly regarding digital currencies and the CFPB's uncertain future under a potential Trump administration. It didn't take long for President Trump to alter the CFPB's agenda. Established in 2010 as part of the Dodd-Frank Act, a sweeping financial reform bill spanning over 10,000 pages, the CFPB was created to protect consumers from risky lending practices that contributed to the 2008 financial crisis. Since the CFPB was created by Congress, the Trump administration cannot unilaterally eliminate it. However, a shift in leadership quickly reshaped its direction.

First, the White House nominated Jonathan McKernan, a former FDIC board member, as the full-time director. Shortly after, on February 7th, President Trump appointed Russell Vought as acting director. Vought, who also serves as President Trump's budget director, is widely seen as one of the architects of Project 2025. Published by the Heritage Foundation, this report calls for the CFPB's abolition. In his first memo to CFPB employees, Vought suspended nearly all staff activities, halted new funding, and closed the headquarters for a week. He then issued sweeping directives that effectively froze the agency's operations, including:

- Do not approve or issue any proposed or final rules or formal or informal guidance
- Suspend the effective dates of all final rules that have been issued
- Suspend any final rules that have not yet become effective
- Not commence any investigative activities and do not open any new investigations
- Do not settle any current or pending enforcement actions
- Issue no public communications (i.e., publication of research papers or compliance bulletins)
- Cease all supervision and examination activity
- Cease all stakeholder engagement

This abrupt policy shift marks a stark contrast to the aggressive regulatory approach of former Director Rohit Chopra. While few financial institutions will mourn the CFPB's dismantling, its sudden shutdown is already creating ripple effects across consumer finance. Mortgage companies, auto and payday lenders, payment apps, and many FINTECH firms are now essentially unsupervised. With the CFPB effectively sidelined, consumers who experience unfair treatment will find no federal agency to turn to for recourse. Some are concerned that without an agency like the CFPB "on the watch", there is a large regulatory void that could leave Americans vulnerable to predatory practices. Fed Chairman Jerome Powell recently warned Congress that, with the CFPB incapacitated, no other federal regulator is currently enforcing key consumer finance laws.

The CFPB had some good consumer protection rules, especially when it came to areas like payday lenders and certain specialty finance areas. However, some claimed that the agency tended to overstep its authority, pursue aggressive and overzealous enforcement actions against financial firms.

The industry's mixed feelings of relief and concern underscore how the Trump administration's sweeping remake of the federal government is likely to lead to consequences that are not fully understood. While state attorneys general may attempt to fill this regulatory void, the long-term impact remains uncertain. Whether this shift fosters financial innovation or exposes consumers to new risks is still an open question.

Elon Musk, X & the Quest for a "Super App":

Elon Musk has long been fascinated by the idea of a "super app" - a platform that integrates messaging, payments, and financial services into a single ecosystem. This vision dates back to 1999 when he co-founded X.com, an online bank that later merged with Confinity to form PayPal. After PayPal's $1.5 billion sale to eBay in 2002, Musk used his proceeds to launch SpaceX and Tesla.

Now, inspired by China's Alipay, WeChat Pay, and UnionPay, Musk is looking to transform X into a financial powerhouse with X Money. These Chinese platforms seamlessly blend social networking, commerce, and digital payments. When Musk acquired Twitter for $44 billion in 2022, one of his long-term goals was to integrate similar financial capabilities into the platform.

However, moving money is a heavily regulated industry, requiring state-by-state licensing. Over the past year, X has been steadily acquiring money transmitter licenses to build a nationwide financial network. According to FinCEN (Financial Crimes Enforcement Network), X has now secured approval for money transfers in 41 states, with its US money transfer service expected to launch in the first quarter of 2025.

Initially, X Money will allow users to send funds to others on the platform, while creators can accept payments and store funds in a X digital wallet, much like Venmo or Cash App. Once the digital wallet is established, Musk's ambitions extend far beyond simple transactions with future offerings projected to include high-yield money market accounts, stock trading, and digital currency transactions.

On January 28, 2025, X CEO Linda Yaccarino announced a partnership with Visa to accelerate these financial goals. The deal will enable instant funding via Visa Direct, allowing users to instantly transfer money, make payments with a linked debit card, and move funds between X Money and traditional bank accounts. With Visa, the world's largest payment network, X is positioning itself as a serious player in peer-to-peer (P2P) and account-to-account (A2A) payments - competing directly with Zelle, Venmo, and Cash App.

But the road ahead won't be easy. X's ambitions put it in direct competition with both big tech and financial giants. Apple, for example, has long been accused of blocking the rise of "super apps" to protect its own ecosystem of services. Regulators have

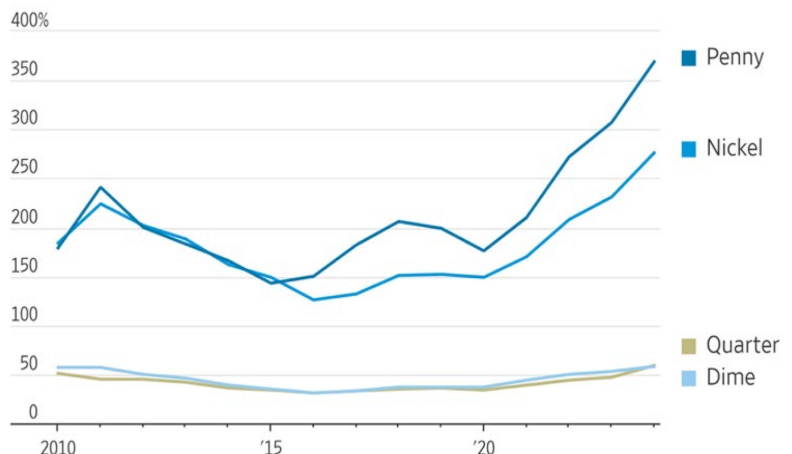
been scrutinizing Apple's alleged anti-competitive practices since 2017. A recent DOJ anti-trust lawsuit against Apple revealed internal concerns that a super app could weaken consumer reliance on the iPhone's software and payment system. The broader market is also shifting. Facebook has expanded its financial offerings by integrating shopping, gaming, and dating, while consumers increasingly use multiple platforms for communication, payments, and entertainment.

While X Money is an ambitious step toward Musk's vision, creating a financial "super app" in the US remains an uphill battle. Competition is fierce, regulatory hurdles are high, and consumer adoption is uncertain. Whether Musk can succeed, where others have struggled, remains to be seen.

The Penny:

We may soon be seeing a lot less of President Lincoln's right cheekbone. President Trump recently signed an executive order directing the Treasury to stop minting pennies, calling them "wasteful".

Eliminating the penny isn't a new idea. The debate has resurfaced multiple times over the years, with support from federal officials, lawmakers, and even President Obama. If you have time, click here to check out Caity Weaver's 7,000-word deep dive on banning the penny - it's worth the read.



The US Mint reported a $85.3 million loss last fiscal year producing billions of pennies, which currently cost 3.7 cents each to manufacture. And it's not just pennies - nickels are also more expensive to produce than they're worth.

Not everyone is eager to say goodbye to the penny. Companies like Artazn, which has made over $1 billion supplying zinc to the US Mint, and Coinstar, the operator of coin-cashing machines, have a vested interest in keeping pennies in circulation.

But if the penny disappears, who stands to gain? Our portfolio is heavily weighted toward digital payment beneficiaries, and a move away from cash could further accelerate their growth. Businesses may begin rounding prices up to the nearest nickel, which could lead to a modest increase in prices or a form of small-scale re-inflation. More importantly, it could accelerate the ongoing shift toward digital payments, further reducing the role of physical cash.

The transition from cash to digital payments was already well underway, but it accelerated significantly during COVID. Last year, Zelle processed over $1 trillion in payments, solidifying its position as a major player in digital transactions. Launched in 2017 and operated by Early Warning Services (EWS), Zelle is backed by major banks and was designed to compete with Venmo (PayPal) and Cash App (Block/Square) in the P2P and A2A payment space.

If you've ever used Venmo, Cash App, or Zelle to settle a golf bet, pay a babysitter, or split a dinner bill, you're part of this shift. And it's not just Gen Z driving adoption - older generations are increasingly using their banking apps to simplify payments. Last year, Zelle's user base grew 12% to 151 million accounts, reflecting the ongoing shift away from cash toward digital payments.

Conclusion:

Inflation remains a concern, geopolitical risks persist, and mounting deficits and national debt loom on the horizon. However, we remain focused and disciplined, resisting the temptation to chase rallies or deviate from our strategy. History has shown that markets thrive despite their "wall of worry," often using uncertainty as fuel for growth.

Despite ongoing challenges, the US economy remains the envy of the world, driven by resilience, innovation, and ingenuity. We anticipate a healthy market environment and a resurgence in M&A and IPO activity, though periods of uncertainty and volatility will likely persist.

We anticipate that the Fed will lower interest rates gradually, preserving its policy tools for future economic challenges. Rather than speculating on rate changes, our priority remains delivering value and generating alpha for our clients. Our philosophy is unchanged: focus on long-term growth, free cash flow, and staying prepared for the unexpected - regardless of short-term volatility.

Manole Capital is officially celebrating 10 years, and we wouldn't be here without your trust and loyalty. Looking ahead, we remain committed to our vision of FINTECH, providing access to exciting opportunities in this dynamic and rapidly evolving space. Please reach out anytime - we value our relationship and are always here to chat.

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Cliff Clavin's "Useless" Information:

In the 1980s, one of our favorite TV shows was Cheers. The know-it-all postal worker, Cliff Clavin, played by John Ratzenberger, was famous for his random trivia and unsolicited facts. In that spirit, we bring you this recurring segment - featuring some "useless" information that Cliff would be proud of.

388 years ago, on February 5, 1637, the Dutch "Tulipmania" bubble peaked. The rare Witte Croonen tulip bulb skyrocketing 2,506% in just 33 days. However, over the next five years, those same bulbs lost an average of (76%) per year. Crypto investors, take note? (Photo Credit: pickpik.com)

The biggest wealth transfer in history is coming. It is estimated that by 2045, over $84 trillion will pass from Baby Boomers to younger generations. But financial advisors should be worried. Roughly 70% of heirs plan to leave their parents' advisor after inheriting their wealth.

Are the New York Yankees one of the best investments ever? In 1973, George Steinbrenner bought the Yankees for $10 million. Today, Forbes values the team at $7.55 billion. If he had invested that $10 million in the S&P 500, it would now be worth $2.15 billion. While that's a great return, it is nowhere near the Yankees' incredible appreciation.

Mar-a-Lago is a 126-room Palm Beach mansion, built in the 1920s by cereal heiress Marjorie Merriweather Post. It got its name from the Spanish phrase meaning "Sea to Lake", a nod to its prime location. Donald Trump bought it in 1985 for $7 million, and today, it generates $40 million a year in revenue. Zillow estimates its value at over $500 million, but President Trump thinks it is worth closer to $1.5 billion. Not a bad real estate play.

The Goodyear Blimp is celebrating its 100th anniversary this year. There are three US-based blimps, in California, Florida, and Ohio, and each can reach a top speed of 73 mph and have 12 passengers. (Photo Credit: Cory W. Watts)

The US accounts for 29% of global consumption but produces just 15% of the world's goods. Meanwhile, China accounts for 32% of global manufacturing but only 12% of consumption. This trade imbalance results in a $1 trillion Chinese trade surplus - and a nearly equivalent US deficit.

As we continue to emphasize, the market is at historic levels of concentration.
In mid-January 2025, the 20 largest US stocks had a combined market cap of $24 trillion - almost equal to the rest of the S&P 500 ($30 trillion). For perspective, total US GDP in 2023 was $27 trillion. The top-heavy market is now 50% more concentrated than in 2001, surpassing even the Great Depression era.

According to the IRS, the average tax refund last year was $3,138. Cliff would probably buy the bar a round of beers and have Sam, Coach or Woody pour another draft.

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