ALTMAN
INVESTMENT MANAGEMENT

EQUITY STRATEGY FOCUS

APRIL, 2024

IN VIEW: Market Performance & Earnings

U.S. stocks appear to be exiting the optimistic wave that began in the 4th quarter of 2022. This follows over a year of strong performance for the popular benchmarks. The Fed's pivot in late 2023 to an easing bias has instilled investor confidence in a soft landing, and sparked a rally that has notably concentrated on what has been characterized as the Magnificent 7. Although not always on an even path, this rally included the participation in the broader market of stocks over the past several weeks. It's our view that the U.S. economy will continue to surprise on the upside in 2024.

Narrow corporate bond spreads and the overall equity market's elevated P/E multiple refute the notion that monetary policy has been excessively restrictive. The Fed's recent pivot signaling holding interest rates where they are, rather than cutting which was wildly anticipated, has reversed expectations that the disinflationary trend in CPI will persist. The recent easing of financial conditions has increased the odds that economic growth does not materially slow in the second half of the year. We maintain our view that aggressive rate cuts in 2024 coupled with further significant declines in bond yields from current levels is not the most likely outcome. The Fed recognizes that premature rate cuts could risk reigniting inflationary pressures down the road and force another leg up in bond yields. This scenario lays the ground work for a 'Goldilocks environment' for risk appetites to continue. Until inflation resurfaces and bond yields respond accordingly, equities should remain at the forefront of the preferred asset class, given the supportive economic and earnings outlook.

With financial conditions loosening and overall earnings growth expected to firm, the outlook for the average stock has improved and has allowed the market participants to broaden out. As we head into the second half of 2024, we favor sectors that have lagged while de-emphasizing those that are dominated by the "Magnificent 7". This narrow group of stocks could be ripe for profit-taking, as the Fed begins to pivot its current restrictive stance and supports the case for greater economic sensitivity. In this environment, we continue to overemphasize the more cyclical sectors such as the Energy and Banking group, and deemphasize Communication Services and Technology.

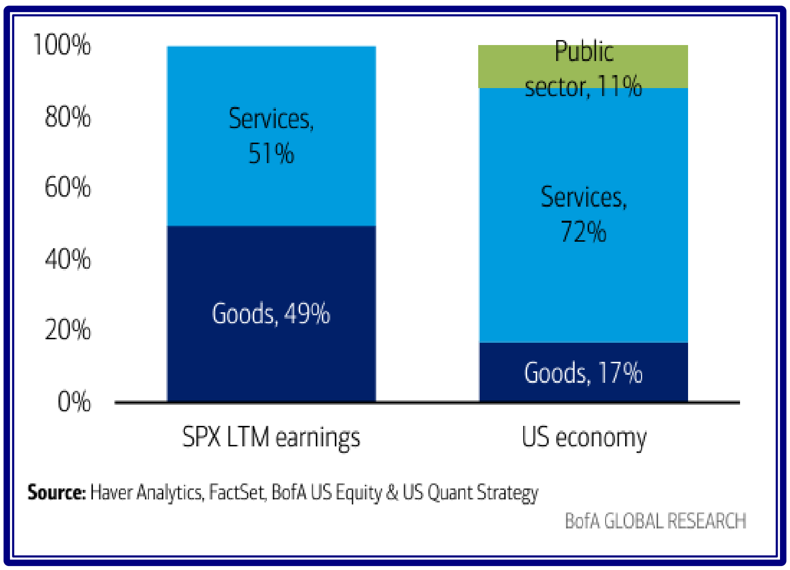
Comm Serv	Energy	Info Tech	Financials	Industrials	S&P 500 Index	Materials	Health Care	Cons Staples	Cons Disc	Utilities	Real Estate
15.8%	13.9%	12.7%	12.5%	11.0%	10.5%	9.0%	8.9%	7.5%	5.0%	4.6%	-0.6%

Source: Bloomberg and Altman Investment Management, LLC

We saw a confirmation of this strategy as Energy, Financials and Industrials all led the markets higher in Q1. The AIM composite performed in line with the Russell 1000 Value index for the quarter and outperformed the S&P 500 equally weighted index. The AIM composite narrowed the relative return gap this year against the S&P 500 capital weighted benchmark, trailing the index by less than 1.9%. Weak performance in mega cap shares of Apple and Tesla, along with less than stellar results in Alphabet, finally gave way to plentiful growth prospects in the broader market.

We are currently in the midst of peak earnings seasons for Q1 reporting. With approximately 41% companies having reported thus far, earnings growth is strongest in Media and Entertainment, Insurance and Technology sectors. The weakest areas being Energy, Basic Materials and Transportation. Earnings and revenue overall have posted surprises of 7% and 1.2% above expectations, respectively. Both trending above pre-covid averages. Revenue and earnings growth appear to have bottomed in 2023, as analysts look to a shift back towards consumer goods demand. Goods and manufacturing account for nearly half of S&P earnings. Its representation in U.S. GDP is much smaller, so any movement in consumption favoring goods bodes well for for earings growth to outpace GDP growth.

Shift in Demand Back to Goods Favors Earnings Growth



Source: Bank of America Global Research:
*Estimate for Goods vs. Services exposure of S&P 500 based on industry breakout of 2023 earnings vs. % goods/services for US economy (based on gross value added by industry, 2023)

As year-over-year real sales growth improves, companies can rely upon fixed costs over variable costs to support ongoing business operations which leads to better margins. The Fed's ability to manage inflation pressures without creating a recession is crucial to keeping demand momentum.

We expect the broadening of the market to continue in the months to come. The Mega Cap 8 stocks accounted for over 60% of earnings growth, but growth in this segment is anticipated to decelerate. On the other hand, earnings growth outside of this group are accelerating and should be the primary driver of earnings going forward. Consensus estimates, according to Yardeni Research, are calling for 9.4% earnings growth this year and 14.3% in 2025. The economist highlights correlations with Coincident Economic Indicators, now at a record high, as indications of strong operating earnings. Additionally, positive forward earnings trends are generating optimism.

CLOSE-UP: Equity Sector Overview

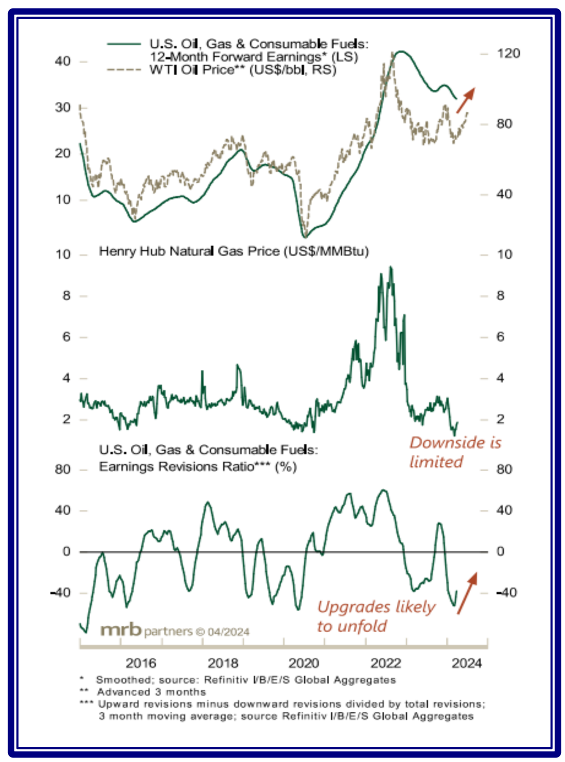
Energy Sector: Overweight

Crude oil prices have already rebounded over $80 a barrel on tighter supplies and escalating tensions between Israel and Iran. There is further support for higher oil prices as demand, driven by improving global trade and manufacturing, is set to outpace supply this year. The supply growth in non-OPEC countries is offset partially by OPEC production cuts and weather-related supply outages. In addition, energy stocks should benefit as better-than-expected global growth should allow oil prices to firm in 2024.

The cycle of negative earnings revisions since oil prices peaked in 2022 is unwinding, as profits begin to reflect the upward turn in West Texas Crude prices. This leaves the door open for future earnings surprises. During 2023, market leaders such as COP and XOM, reported one of the most profitable years in over a decade. Only 2022 was a stronger year as oil prices rebounded to over $120 mostly from pent-up demand coming out of the economic shutdown. Higher oil prices enable companies to raise production and increase dividends to shareholders. The oil, gas and consumable fuel group trades at a 43% discount P/E multiple to the market. Our overweight investment thesis is further supported by generous dividends available within this sector.

Risks to Investment Thesis: OPEC regions have excess capacity. Should supplies from these regions increase, it could limit the upside to oil prices. MRB Partners suggests this is unlikely due to OPECs preference for high oil prices in order to finance government spending. This could become more of a concern as prices climb closer to $100 - but any adjustments to supplies should be gradual.

Oil Prices Point to a Reversal in Downward Trend in Forward Earnings



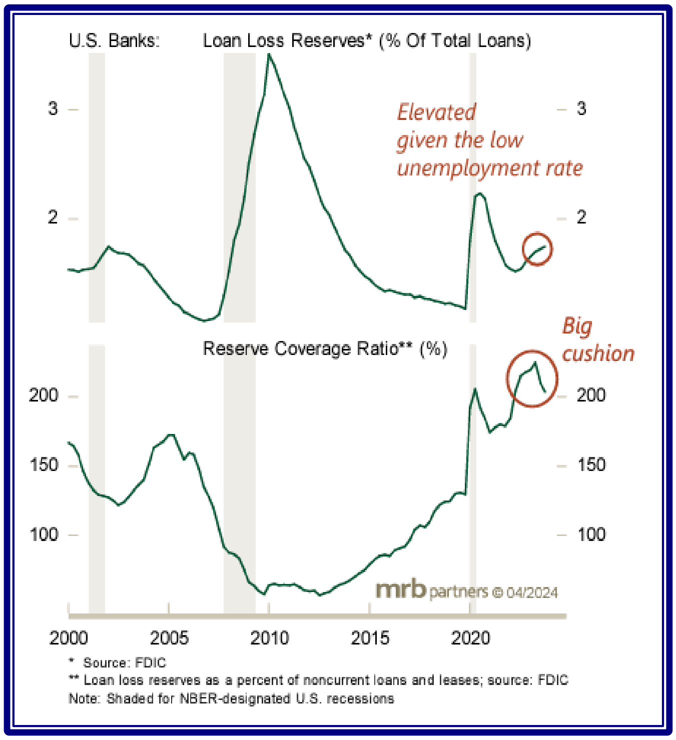
Source: MRB Partners

Banking Sector: Overweight

Banking stocks have only just begun to recover from fears that aggressive Fed tightening would force the economy into a recession. Isolated banking failures in the beginning half of 2023 further exacerbated caution surrounding the potential for a credit crunch, which ultimately turned out to be unwarranted. The U.S. economy proved to be more resilient supported by consumer spending, a robust labor market, and moderating inflation. Banks have since bottomed in October of last year and are now one of the top performing sectors to date.

Forward earnings growth is at an inflection point and about to turn positive which should extend recent outperformance. The uptick since October was primarily multiple-driven. However, restored sentiment in favor of the economic cycle coupled with benign credit quality could drive stocks higher. Earning momentum could see support from repricing of low yield loans, lower funding costs, and loan growth spurred by improving business confidence. Many banks including Bank of America, Citigroup and Regions Financial beat consensus revenues this quarter in trading and investment banking, indicating a rebound in capital markets is on the horizon. Conservative Net Interest Income guidance also allows for upside surprises.

Bank Reserves in Strong Position



Source: MRB Partners

The Federal Reserve's evolving bias towards easing that signals fewer rate cuts this year is another positive for the industry. Renewed expectations for a soft landing create a better environment for bank balance sheets by lowering the risk for credit losses. Assets at banks tend to reprice at a faster rate than liabilities expanding net interest incomes. Analysts will likely continue to revise estimates as visibility on the Fed rate policy evolves. Any revisions reflecting fewer rate cuts on the horizon is supportive of net interest margins. Credit quality also improved significantly since the financial crisis leaving banks with sounder balance sheets. The percent of reserves covered by bank assets (reserve ratio) has climbed to over 200%, while loan loss reserves as a percentage of total loans is higher than pre-pandemic levels.

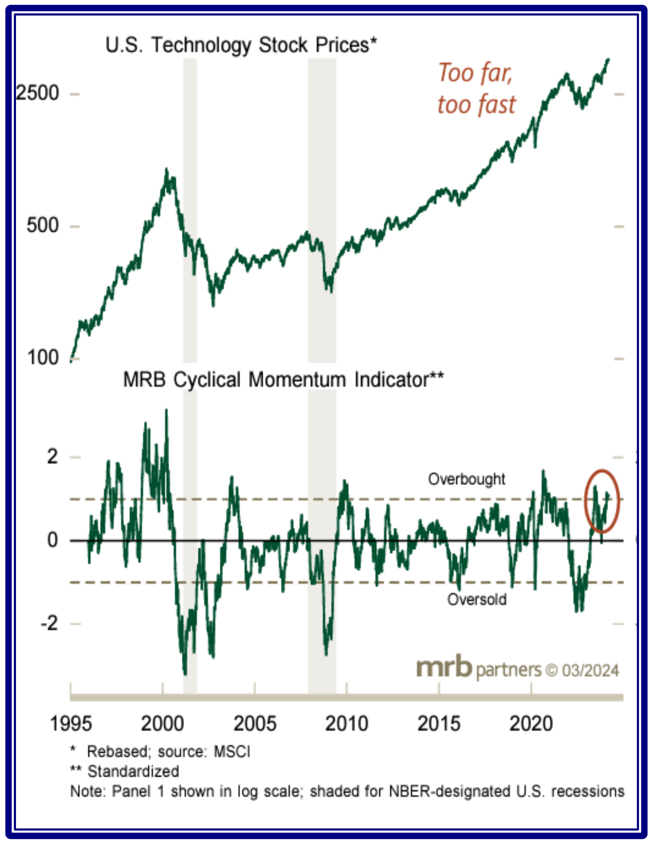
Risks to Investment Thesis: Banks are awaiting new capital requirements from the international consortium of regulators as part of the last phase of Basel III, an agreement to improve banking sector practices post the financial crisis. For now, this puts banks in a capital preservation mode, but overall, these requirements should help shore up capital efficiencies at banks. Additionally, should economic growth weaken substantially, loan growth and higher funding costs could become a problem. Average loan growth continues to trend lower, partially offset by higher deposit volumes.

Technology Sector: Underweight

According to Gartner, a leading provider of research and consulting, global IT spending is expected to rise 8% in 2024 with the fastest growth coming from software. As companies gear up to incorporate AI solutions into existing products and services, spending growth in data center systems is expected to more than double. Cloud providers have been driving growth in this area thus far and enterprise software is likely to follow suit and increase spending further supporting growth. Software and semiconductors are direct beneficiaries of continued growth. IT services is also expected to post a significant jump over the prior year.

After rebounding ~ 68% since January 2023, Technology shares are expensive and arguably overbought. The oversized representation of the sector within the S&P 500 index is a signal that shares are vulnerable to unfavorable market developments. Technology shares bounced on the initial shift in Fed verbiage indicating a series of rate cuts were on the table for mid-2024, adding to tailwinds from artificial intelligence that were already driving the sector. Shares are trading at a 34% premium to the S&P 500 on a forward P/E basis. Coupled with broadening earnings momentum, the market is susceptible to a shift in leadership. Up to this point, leadership within the sector has been dominated by a few mega cap stocks with 60% of the sector dominated by just 3 companies, Apple, Nvidia, and Microsoft. Sector exposure alongside industry and stock selection are key.

U.S. Technology Stocks are Overbought



Source: MRB Partners

The Technology sector is underweighted within the AIM composite, based upon elevated valuations relative to the S&P 500 benchmark index. This strategy reduces the risks associated with high expectations that are currently priced into the Technology sector. Investment selections in companies such as Oracle, Applied Materials, Intel and Microsoft give the portfolio exposure to growth areas like AI, personal computing, and software at reasonable prices.

For example, Microsoft (MSFT) is represented in the portfolio, but has a relative underweight position. MSFT's Intelligent Cloud revenues, along with More Personal Computing are primary drivers of revenue. Momentum in Azure, MSFTs AI and cloud-scale data solutions, should continue to fuel growth. Being a direct beneficiary of AI, MSFT's is expanding its leadership opportunities beyond cloud computing. Applied Materials (AMAT), is another core holding and is also a beneficiary of AI demand. The company is diversified across multiple AI enabling technologies. AMATs large scale and expanding market share make it a direct beneficiary of growing chip demand. It maintains a robust free cash flow position, enabling dividend growth and share buybacks.

Risks to Investment Thesis: Continued outperformance of a few select mega cap tech stocks could perpetuate relative outperformance of the Technology sector. Highly valued sectors such as Technology would benefit should bond yields decline more than anticipated by year end.
