ALTMAN
INVESTMENT MANAGEMENT

EQUITY STRATEGY FOCUS

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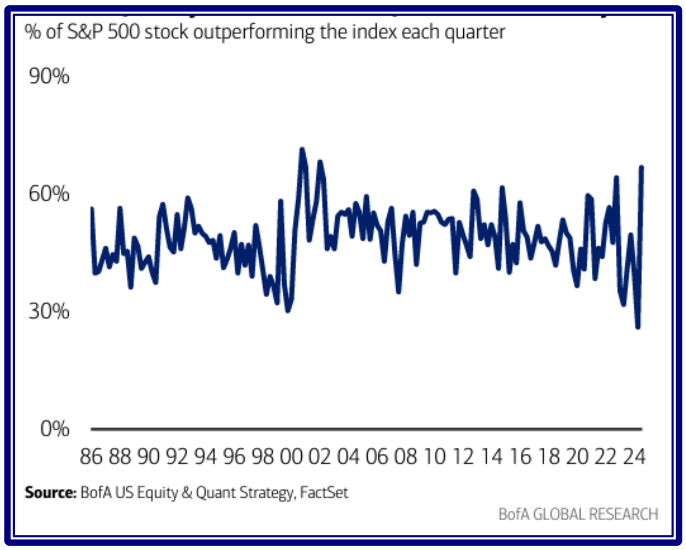
IN VIEW: Market Performance & Earnings

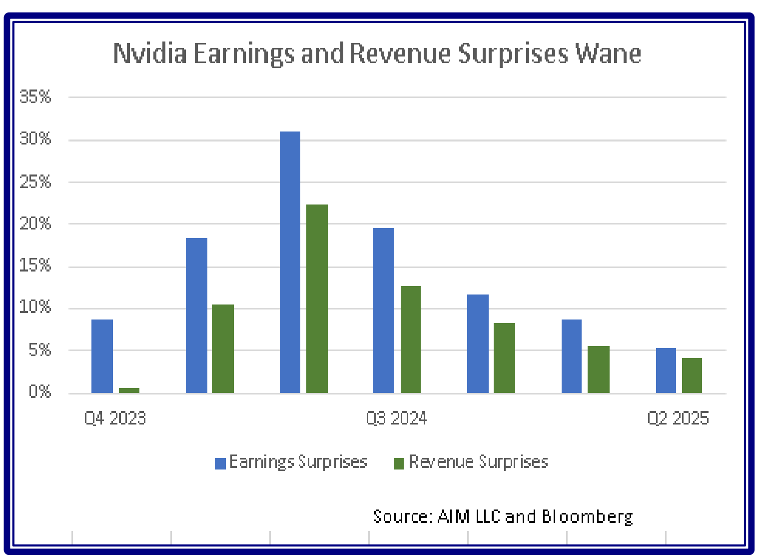
September's strong employment report is reflecting healthy corporate profits. Against a backdrop of balance sheet strength, this is a net positive for payrolls. We suspect the modest uptick in unemployment in recent months is simply normalizing off post pandemic lows. Capex (capital expenditure) is now near historical lows relative to corporate profits and should respond well to rising margins and CEO optimism.

The Stock Market is Broadening



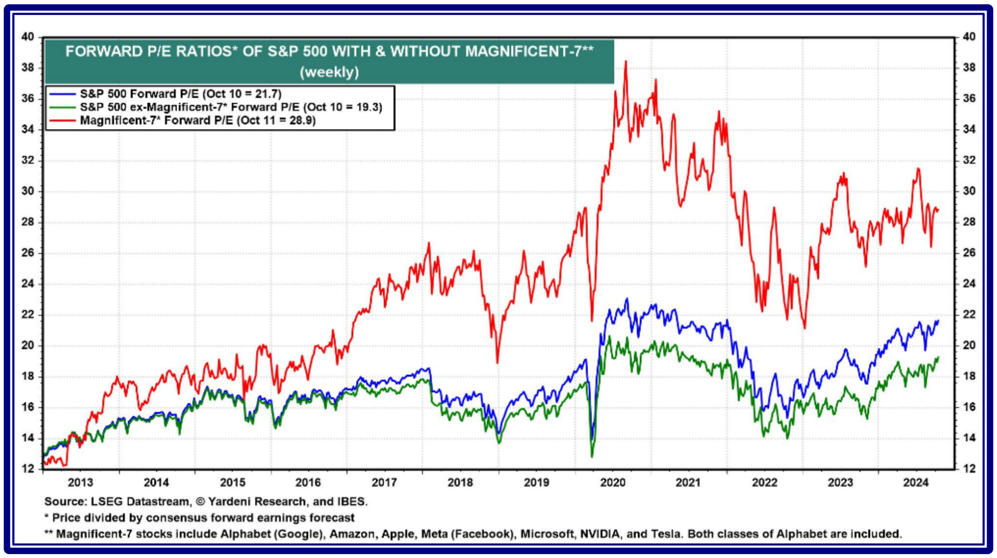
Fundamentally, the market continues to look expensive and is largely skewed towards a few select stocks. We expect the market will broaden out as appreciation for growth outside of the Mega Cap 7 is realized. Q3 earnings for the S&P 500 benchmark grew at a rate of 12.7% year-over-year, compared to only 8.2% the prior quarter; while Healthcare and Financials outpaced Technology. The narrowing earnings gap between a few select mega cap AI stocks and the rest of the market is why market breadth has already begun to broaden, with 67% of stocks outpacing the S&P 500 index in Q3.

The hype over AI may be near peak levels, as questions mount over ballooning capex spend and the undetermined timeline for the commoditization of such efforts. Goldman Sachs estimates mega cap tech stocks to spend $215 and $250 billion in AI expenditures in this year and next year respectively. Stocks are trading on that momentum for now, but there will come a time when the promise of productivity gains will not be enough and investors will require more qualification. Several of the high-flying AI leaders already have suffered ~20% pull back or more during the summer months. Most have rebounded but it shows their vulnerability for a second time in just one year. It's getting more difficult for Nvidia to deliver upside surprises, something to which the market has become accustomed. Since Q2 2024, the daily % change following Nvidia's earnings announcement has averaged only 3.3%, versus the 3-year post-earning average of 8.1%.



The current bull market is on its second year, as the economy continues to defy recession calls. The economy is demonstrating resiliency, as inflation is reigned in without triggering a recession.

Corporate earnings grew on the back of strong consumer strength, lower borrowing costs, robust balance sheets, and productivity. The lack of stock market participation from the broader market shows an underappreciation for earnings growth outside a few select stocks. In fact, the earnings growth gap between Technology, Communication Services and Consumer Discretionary sectors and the rest of the market has been narrowing for the last 4 quarters. The S&P 500 index however, is still heavily skewed towards Mega Cap 7 stocks. These stocks still represent 29% of the index market cap. The overall multiple of the index is 21.7x earnings vs. 19.3x earnings when those same stocks are excluded. Consensus earnings call for 9.4% growth this year and 14% for 2025.



The U.S. market has benefited this year from rising forward earnings expectations and resultant higher valuations (P/E ratios). Consensus has forward earnings rising 11% with P/E ratios providing an 8% boost to stock prices, according to MRB Research. U.S. consensus estimates for S&P 500 firms' operating earnings is $275 for 2025 and $308 in 2026. These estimates assume that Trump will quickly lower the corporate tax rate from 21% to 15% coupled with deregulation, and faster productivity growth. This will in turn push profit margins to record highs of 13.9% and 14.9%, for 2025 and 2026 respectively, according to Yardeni Research. This rosy forecast assumes that the conflict between Russia and Ukraine as well as the Middle East are resolved sooner rather than later.

Let's review how past markets have performed under the two main political parties. The results may surprise some who believe that the market favors one result over the other. In fact, going back to Jimmy Carter the return of the S&P 500 index was mostly consistent - despite the winning party - with the exception of George W. Bush's whose term began following the tech bubble that burst in early 2000. Throughout the next decade, the S&P 500 returned -1% per year on average. Regardless of the recent election result, the path of inflation and the rising national debt will likely play a prominent role in determining the level of business investment and economic growth.

S&P 500® Annualized Total Return by Presidential Term*

President	Return
Carter	12.0%
Reagan	15.1%
Bush 1	14.6%
Clinton	17.5%
Bush 2	-4.5%
Obama	16.3%
Trump	16.3%
Biden**	12.9%

Source: Richard Bernstein Advisors LLC, Bloomberg Finance L.P.
*Presidential Term measured by Inauguration dates.
**Biden returns are calculated through 8/31/2024.

Regarding the U.S. debt crisis, the markets are now assuming better economic growth will boost federal government revenues. It suggests the new administration will succeed in slowing the growth of federal spending, allowing GDP to keep pace with the mounting U.S. debt burden. Valuation multiples are historically, high especially for the Large Cap growth stocks.

However, multiples could remain elevated if investors believe that earnings can grow faster for longer because a recession is less likely in the foreseeable future. Despite tight monetary policy during 2022 and 2024, a U.S. recession never materialized. Suffice it to say that markets could be overly bullish at this juncture, so our emphasis remains on securities that aren't priced to perfection.

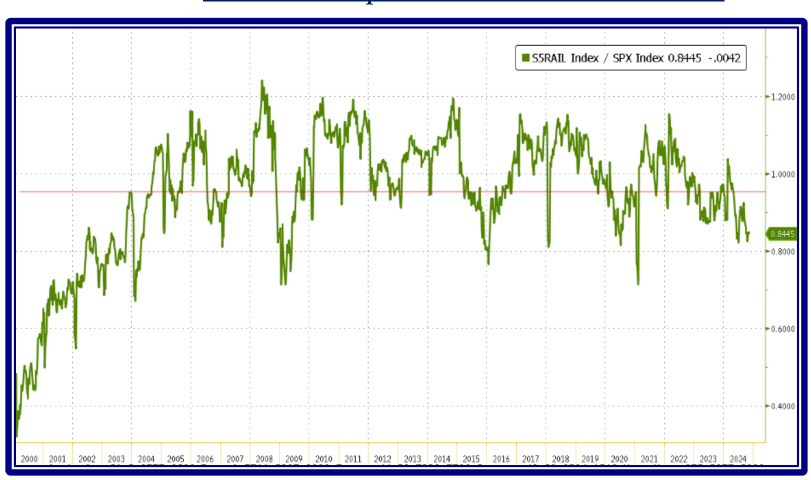
CLOSE-UP: Equity Sector Overview

In September, we decided to exit our position in Marathon Oil (MRO). The sale reduced an overweight position in Oil & Gas Exploration and Production while maintaining an overweight in Energy. Conoco Phillips, a current holding, is set to close its merger deal with MRO by the end of the year. The combined company creates the third largest producer in the lower 48 regions. The trend in merger and acquisitions within the industry highlights the competitive advantage gained by expanding production capabilities. COP's low cost of production with a break-even of $32 and significant cash flow keeps COP underleveraged and supports dividend security.

China's stimulus measures are lifting demand estimates for oil - plus an additional fiscal package is slated to be discussed at the next committee meeting of China's legislature next month, according to the Wall Street Journal. Coupled with tensions in the Middle East, any absence of a ceasefire between Isreal and Iran threatens oil supplies putting upward pressure on oil prices. On the other hand, the Saudis have indicated that they intend to increase oil supply into yearend, potentially putting additional downward pressure on oil prices, clouding oil price stability in the near term. Longer term, inflation and interest rates are likely to trend higher and underscore Energy as a good hedge position, as long as the world/U.S. continues to avert a recession.

We invested the proceeds from MRO to increase our positions in McDonald's (MCD) and CSX Corporation (CSX). MCD has several growth drivers that include value perception enhancements through its pricing initiatives. New menu items are coming up through its innovative pipeline to meet evolving demand. Digital transformation and loyalty programs are already improving same store sales through international soft product launches. We believe the pull back in shares from the recent E. coli outbreak may weigh on shares in the near term until the entirety of the scope is identified. Thus far, the contamination appears to be linked to a single supplier rather than improper internal health and safety practices. A similar incident at Wendy's in 2022 tells us that if early containment efforts are successful, it should limit long term impacts on sales. It's too early to tell at this juncture and we will continue to monitor the situation as new data is revealed.

Rails are Cheap Relative to the S&P 500 Index



CSX came in above analysts' estimates for Q3 with overall strong execution. EPS came in up 12% year over year on cost disciplines and efficiencies, while revenues grew 1%. Network velocity was maintained despite weather related challenges. Lower diesel and natural gas prices impacted volumes but were at least partially offset by new business generation. CSX is one of the largest U.S. rails with a diverse revenue stream through coal, merchandise and intermodal shipments. Rails are trading at a 16% discount to the S&P

500 index and a 22% discount to the Industrial sector on a forward price to earnings basis. CSX specifically is the cheapest member of the rail industry.

A recovery in cyclicals looks promising as CSX looks to capture volume growth over the next several years, by investing in industrial development, improved reliability, increased connectivity and expanding capacities to drive conversions to rails. Risks include demand for coal resulting from a broad shift to alternative energy sources that could limit profitability from lower volumes. However, lower coal prices could also mean reduced transportation costs that could help offset weaker volumes. Plus, the incoming administration makes substantial efforts towards clean energy less likely.

It may be premature to provide a conclusion as to which sectors and industries would be positively or negatively impacted by the Trump presidency. Of course, sector trends are impacted by a host of other factors such as the underlying earnings outlook, valuations, and economic prospects that more typically overwhelm the impact of politics. One could argue that Trump's more aggressive stance on regulations and immigration policy as compared to the Biden administration could tighten the supply of labor and push up wages and costs. Construction, retail, leisure and hospitality, and agriculture are all industries that are highly dependent upon this labor pool. Of course, a plan to impose tariffs universally on imported goods could negatively impact both retailers who outsource merchandise and manufacturers who are reliant upon imported inputs. Companies with exposure to the Chinese market are vulnerable to retaliatory measures. Lastly, the defense industry is likely to be viewed more positively as Trump supports strengthening U.S. military capabilities. Investors may also conclude that Trump would be most favorable to the Financial sector, especially banks and brokerages.

Lower corporate tax rates in the past have been favorable for small, capitalized stocks that tend to have more leveraged balance sheets. Deregulation and M&A activity as well as insulation from trade tariffs also tend to favor the smaller companies. However, participation in this group is not without risk. Should aggregate earnings not materialize it would put significant upward pressure on bond yields causing the Fed to turn more hawkish.

SUMMARY:

We anticipate the extreme concentration in the market over the long-term will broaden out. Earnings growth and valuations for the market in its entirety are underappreciated relative to a few select mega cap stocks. We continue to assert that in the long run, valuations matter and as the earnings gap narrows further, market leadership will expand beyond the AI dominant areas within Technology, Communication Services and Consumer Discretionary sectors.

As we enter 2025, we continue to de-emphasize this small group of dominant technology companies that have traded up more than 65% cumulatively over the past 24 months. Equity market valuations that have been reliable barometers of market excesses in the past are near all-time highs. With private and public debt at unprecedented levels and parts of the world embattled in conflict one can't help but recognize the disconnect. Clearly, it's a time for investors to be vigilant in order to retain stock market profits. Therefore, we continue to emphasize banking to capitalize on improving interest rate spreads, healthcare for free cash flows, and energy for yield.

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No gross performance returns that are referenced that are calculated after brokerage commissions but before investment counsel fees are presented without the comparable net performance figures after both commissions, investment counseling fees and other custodial charges. The net counseling fees are the actual average counseling fee calculated across all the portfolios included in the composite. All performance figures are presented on a time-weighted total return basis and assume all income is reinvested. The investment advisory fees are disclosed in Part II-A of the Investment Form ADV. Some clients may benefit from available discounting in the management fee schedule associated with the overall size of the portfolio. Management fees will reduce overall returns to the client.

The composites were created in 2001 and the inception dates start on August 17th, 2001.The composites include only discretionary fee-paying accounts managed in the strategies, and additional information associated with the composites are available such as: dispersion in individual portfolio results as well as the % of the firms AUM in the strategy. All performance calculations are presented within the GIPS® guidelines of the CFA Institute. The CFA institute does not endorse or promote this organization nor does it warrant the accuracy of the content herein.

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