



Sound Income Strategies, Monthly Equity Update

October 31, 2023

Monthly Maxims

“October was always the least dependable of months, full of ghosts and shadows – Joy Fielding

“You make most of your money in a bear market, you just don’t realize it at the time.’ – Shelby Davis

Executive Summary

Macro: October was a risk-off month. Higher geopolitical risks and higher interest rates continued to pressure stocks and bonds, despite the favorable seasonal set up for a year-end rally. Stronger than expected GDP, retail sales, employment and inflation data all motivated the Fed to persist with its higher for longer interest rate rhetoric, which pushed rates to pre-financial crisis highs and was a pox on credit and economically sensitive industries. Higher rates also continued to shift consumption away from goods and into more services. These restrictive policies, on top of the US Government’s expanding budget deficit, general dysfunction in Washington and broadening global stresses were negative for risk assets. Globally, the newly reignited war in Israel, that is threatening to expand, greatly contributed to the risk-off mood and higher energy prices, which undermined the Fed’s inflation battle. These stresses, on top of the Russian invasion of the Ukraine, North Korean and Iranian activism to support it, and Chinese saber rattling versus Taiwan are painting a scenario where the risk for a catastrophic global error has risen.

Markets: Started strong, but fell soon after Hamas attacked Israel, killing over 1,000 people. The rise in global uncertainty and interest rates led to a flight from equities, especially dividend payers, which are underperforming meaningfully in 2023 for only the third time in the last 30 years, with the other two being the ‘99 tech bubble and early in the pandemic.

Portfolios: Our portfolios under-performed the S&P 500 in October as higher bond market yields led a flight from high dividend stocks to Gov’t bonds and cash. The S&P meanwhile was bolstered by a return to favoring technology names and the defensive segments of utilities and consumer staples, areas where we are underweight. In Dividend River, we exited the last portion of Truist to take advantage of an oversold condition in Xerox, which has a higher yield, and which will likely raise investor expectations in March, after their recapitalization is complete.

Part I: Macro Market Factors and Thoughts

Forget Halloween -- There Isn’t Anything Scariest Than War

Perhaps the most helpful exercises taught in school are the cause and effect diagrams that summarize how various changes in factors translate into real world effects for people. In economics, one of the common relationships is: “when risks rise, discount rates rise, which drives investment valuations

down.” This concatenation sounds more intuitive than the visual is of flashing CAPM and cash flow discount model equations. A similar cause and effect is, “when the Fed raises interest rates, investment prices fall.” We faced both in spades in October, but nothing blows out risk premiums like the uncertainty around war, where the risks go beyond just getting a lower return on principal. When there are half a dozen countries with nuclear ICBMs, people’s minds leap beyond wondering whether there will be a return of principal to wondering if it is game-over for everything we hold dear. Because existential threats in mathematical and psychological terms mean infinite risk, or everything and nothing scenarios, price swings can be sudden and massive. While the exact probabilities of being completely wiped-out are small and hard to calculate, as they rise, the negative leverage they have on outcomes and valuations is awesome. For example, \$1MM for a glass of water in the desert could be fair, or free penthouse apartments on Central Park West (which were available as late as 1991) can happen.

For the last 22 months, with Russia attacking Ukraine and China threatening Taiwan, the West has had bubbling anxieties about its Communist adversaries tilting the world order away from freedom, where we get to keep our lives, liberties and stuff, and towards despotism, where we could lose everything. Since both actors tend to be more rational than adventuresome, the bet that they (or we) would not risk WWII for small territorial changes has been the smart way to play. But recently two unexpected things happened on the way to assuming normalcy and rationality: 1) the Russians did not win right away, as expected. Rather than simply looking evil bombing civilians and wontonly theiving, they also appeared to be less competent at war than anyone thought. Then, 2) the US and its allies behaved differently than they have in the past too; they started giving the Ukrainians massive amounts of money and top shelf, high tech weapons to kill Russians with. We aren’t just handing a few dozen stingers to Afghanistani freedom fighters, like we did in the 1980s, we are giving platoons of Abrams tanks and F-16s to a trained army. Are we nuts? It is one thing to poke the bear, its another to hand your rifle to a hunter to take a shot at him. Suddenly, we started seeing flashbacks of the mistakes of 20th Century European history echoing into the 21st, with two very powerful foes acting recklessly. Not good.

Transparently, Russia’s grab for the Ukraine appears to be the next domino in Putin’s Hitler-like empire building campaign of gobbling up Europe one piece at a time. He started with bits of Russia’s former republics, which is just what what Hitler did when he got rolling in 1939. Not long after gaining power, Putin toppled Georgia and Belarus (kind of like what Hitler did when he annexed the Sudetenland and Austria) and took the cream of the Ukraine in 2014, similar to Hitler reclaiming the part of Poland taken from Germany at Versailles. Hence, many in Europe look at stopping or slowing Putin as being as essential to European and global stability, as stopping Hitler earlier in his campaign could have been.

Further, with so many alliances entangling participants, this episode has parallels with WWI, which ended up amplifying a random act of terrorism into a global conflagration, due to that era’s concatenation of alliances that led to dangerous chest-thumping that went awry. In 1914, all sides thought the others would withdraw, but no one did. No one is giving up here either. Instead, every side sought to gain advantage by upping the ante, which didn’t work. Amplifying the risk today is the problem that we have questionable leadership on all sides (an unwell KGB megalomaniac on one side and a doting bureaucrat on the other), which increases the likelihood of an error, one way or the other, and an over-reaction following it. So far, we seem to have been lucky, with the Russians and Chinese not visibly escalating, but the situation is far from resolved, and that anxiety percolated the markets in October.

Historically, Western proxy fighting the Communist powers has happened in bigger ways in Asia since WWII, versus the Chinese (Korea, Viet Nam), than against Russia because we held the perception that Russia was much more nuclear capable than the Chinese were. Still, even without the threat of nuclear war, we did not fare so well against the Chinese when their economy was tiny largely because their

troops were so plentiful and nearby. Now, the Chinese have the second biggest pile of cash in the world, significant natural resources, and the biggest army in the world. If they want Taiwan, we can't stop them and they know it. What they are more worried about is the Taiwanese blowing up their strategic semiconductor and manufacturing assets, should China attack. So, the Chinese are incrementally tunneling their way to Taiwan, angling for a softer takeover, if possible. This approach gives us a few years to replicate Taiwan semiconductor's capacity elsewhere, before that plan comes to fruition – so here the Biden Administration is doing something smart by helping to fund new fabs – though building them in Arizona, where water is scarce seems crazy. In the meantime, China is happy to sell the Russians military hardware and see us distracted from their gains in Asia and Africa.

At the same time that the risk of WWII went up in 2022 and 2023, global trade slowed, interest rates soared, and most stock prices fell. That reaction chain made sense, but now, out of the blue it seems, we just had the best GDP report we have seen in years. So, are things improving or getting worse?

The answer is both, as discussed below, which means more volatility ahead. However, before we go on, **it is important to remember that bad news, if temporary, is great news for long term investors**, because it pushes prices down, as hinted by the Shelby Davis quote above. Economic history is one of creation, destruction and rebirth. So long as the destruction part is not permanent, you can win the long term investment game by buying the dips. It is when we get caught up in the emotions of panic (sell low) or euphoria (don't sell high) than mistakes are made. To spin on Alec Badlwin's "always be closing" speech, we might say "always be investing," via dollar cost averaging.

Getting back to Europe, in response to this nearly direct confrontation with the West, which it cannot win alone, Russia reached out to China, North Korea, Iran, Syria, and everyone who might help them with weapons, or other forms of aid and said something to the effect of, "remember how we helped you fight the evil capitalists when you needed it? Well, now we need your help, however you can, because they are killing us and revealing our power is more limited than previously thought."

So, in response to Russia's out-reach, the West has been seeing more noise and threats by Russia's "axis of evil" satellite states, especially Iran, which likes to keep oil prices high with supply uncertainty, on top of everything else and Syria, which receives billions of aid from Russia in the form of rent for Russia's only Mediterranean naval base. With Iran sponsoring Muslim militant groups across the Middle East, including Hezbollah in Lebanon, Hamas in Gaza, and Palestinian Islamic Jihad (PIJ) in broader Palestine among a dozen others, it seemed like only a matter of time before one of them did something stupid to take the US, focus off of the genocide in the Ukraine and onto something else that the US media and the US Government tend to care about more, Israel.

That eventuality came in the form of the large, adroitly planned attack that killed over 1,000 civilians in Israel a few weeks ago, which remains a daily news story today. From the start, the coordination, radio silence and effectiveness of the attack exceeded anything that Hamas had tried before. This sophistication led US intelligence sources to deduce it was a state sponsored operation and that it will likely be followed by others. Hence, the risk-off mood, even three weeks later, is lingering.

Currently, we are in the reaction / escalation phase and already it is clear than the axis of evil has achieved some of their objectives: the US media attention has shifted 99% to Israel, the US is going to spend billions supporting Israel, some of which will be at the expense of helping the Ukraine, and Israel has been destabilized over in-fighting about culpability, and what the appropriate response might be. On top of that, the Saudi Arabian effort to recognize Israel with a cooperation pact have been scuttled. Considering that Iran is not fond of either party, this was a bonus win for them.

Recalling, Baron Rothschild's famous reaction to Napoleon's gains and losses, "the time to buy is when there is blood in the streets," we could not agree more. However, we must note that lower prices generally reward risk takers, so long as their capital resides in a safe place. I would be hesitant to buy assets in the Ukraine or Israel at present, but today there are war discounts pretty much everywhere. We are still bullish on America, but the profligacy of the Government could change that view in time.

Fed Spook Continued, Aided by Strong GDP, Inflation, Consumption and Jobs Data

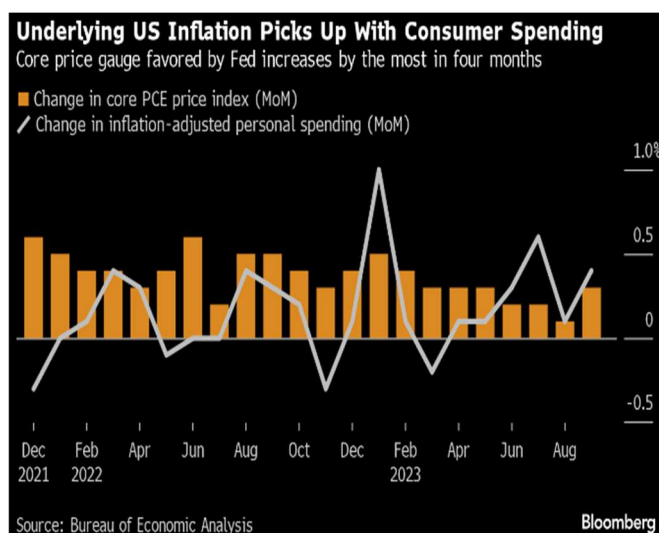
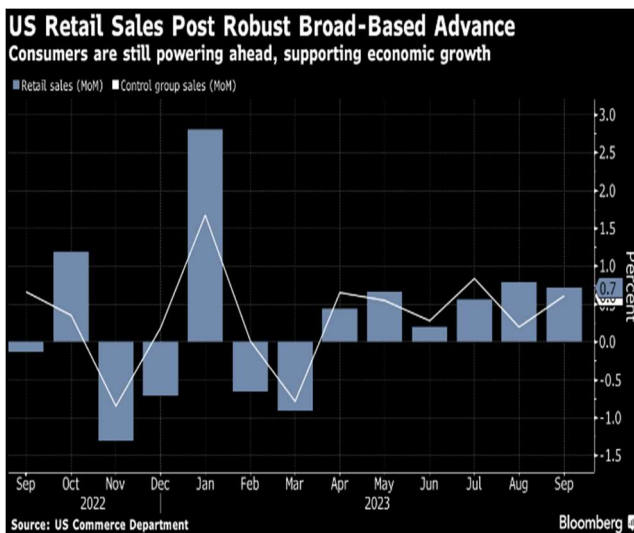
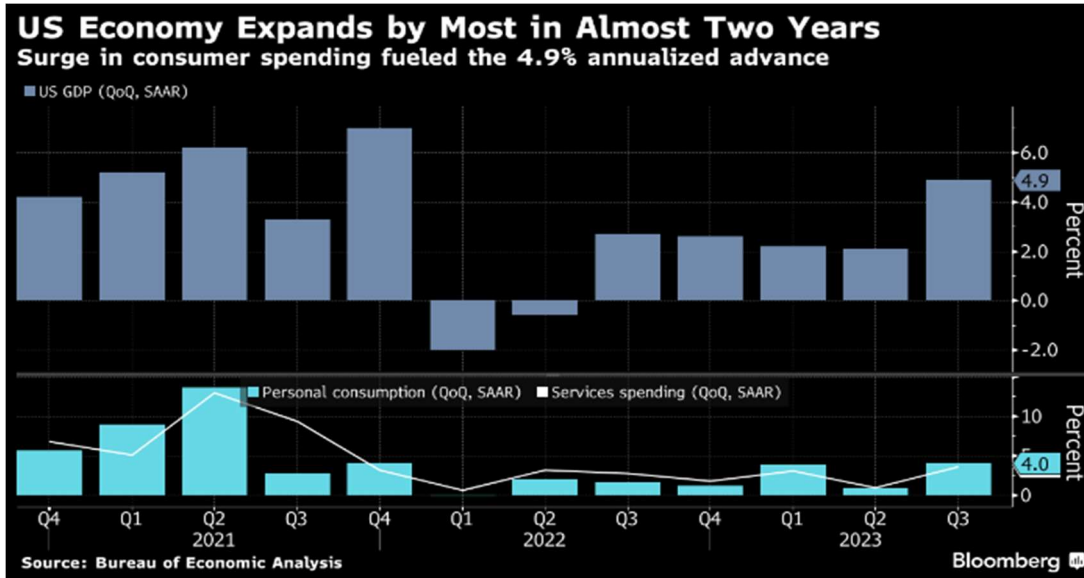
It's not fun to live in a world where good news is bad news, but that's where we have been and will continue to be until the Fed is clearly done raising rates. The Fed is not evil, though it can feel that way for retirees when stock and bond prices drop in response to their rate hikes, or to people who can't afford to buy homes at 8% mortgage rates, or to those who lose their jobs because the economy slows down and companies need to cut costs. These are some of the consequences of the Fed using the blunt tools of raising short term interest rates and bond market manipulation to fight inflation. While they are trying to sustain the value of the currency and saver's purchasing power, they are perversely at odds with the US Treasury Department and other parts of the executive and legislative branches, who have more collective power than the Fed to manipulate the economy. These branches both create and benefit from inflation, as they are the largest borrower in the world and the incumbents can point to their hand-outs as reasons for the beneficiaries to re-elect them next time around. This tension, and the inevitable lags between when the Fed does something and when the data captures it create the over-swinging pendulum phenomenon the Federal Reserve Board (FRB) is known for.

In its attempts to be less over-reaching this time around, the FRB has been slowing their pace of economic chemotherapy to give their prior "treatments" time to weaken the victim just the right amount to kill the inflation cancer and not wipe out the patient. With the legislative and executive branches of the USG continuing to print money, this is a tough act to pull off. Historically, the Fed has only stuck a soft landing 2/10 tries. However, the odds of them doing it this time around are better than average, because of the combination of pent-up demand and strong consumer and corporate balance sheets.

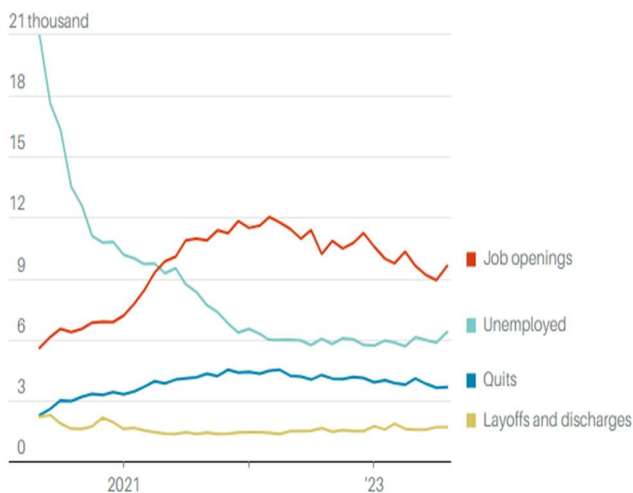
Confounding the Fed and investors, has been the inconsistency of the economic data, which has not only exhibited normal saw-toothed movements, but has also held up better for longer than in prior tightening cycles. For example consumer spending is still growing, as real incomes have risen, though its pace of growth is slowing down. Normally, at this time in tightening cycle, the evidence in the data would be more stark, but the combination of less variable rate debt on consumer and business balance sheets, and pent up demand, for things consumers could not do or buy during covid, and businesses need to add capacity, economic activity has remained stronger than expected.

Specifically, three sets of data have been delaying the long awaited Fed pivot from tightening to easing, and bolstered the higher for longer point of view: 1) GDP continues to exceed on the upside; 2) employment continues to hold up better than expected, and 3) the inflation data, while on a negative trajectory, continues to be higher in several measures than desired. These are captured in the illustrations below, and explain the Fed's "higher for longer" rate rhetoric.

Indicator	Actual	Estimate
GDP	+4.9%	+4.5%
Personal consumption	+4%	+4%
PCE price index, excl. food & energy	+2.4%	+2.5%



Since spring 2021, there have been more job openings than unemployed people looking for work.



An Example of When Bad News is Good News: Wage Growth Has Cooled

Despite the many headline grabbing strikes which have resulted in above inflationary wage concessions, in aggregate, wage growth has slowed down to below pre-pandemic levels. This spells good news at the Fed, as it shows evidence their efforts are slowing down the rate of inflation, and it is also good news for workers, who are still seeing wage gains above the target 2% rate. So, real income growth, but not as much as before.



And When Bad News is Bad: Mortgage Rates Hit 8%, a 23 Year High!

On the dark side, higher mortgage rates are having real consequences with buyers cancelling sales and furniture and homegoods companies cutting estimates.

According to Redfin, in September alone, 53,000 home purchase transactions were cancelled due to the rise in mortgage rates, which forced the buyers to back out. That was 16.3% of the homes that went to contract that month. This was the highest backout rate since October 2022, when the bail rate was 15.8%, as mortgage rates then hit 7%. In Florida, the cancellation rate in September was ~22%; in Atlanta it was 24.4%.



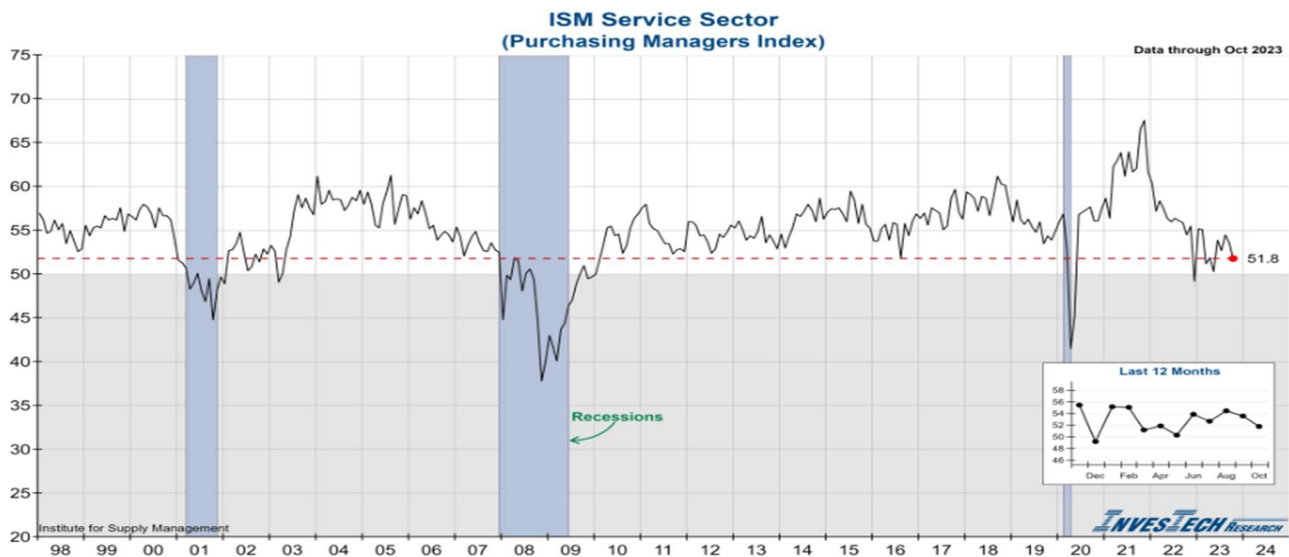
As an example of follow on sales, carpet titan Mohawk has cut its outlook each quarter since the Fed started raising rates and that stock is trading well below its pre-pandemic levels.

One Last Macro Data Set to Mind: ISM Trends

We have seen consumption shift from goods to services over the past year, and the normal patterns is the one or two down years in any data series sets up easier year over year comparisons for a rebound afterward, as illustrated in the ISM Purchasing Managers Index Manufacturing chart below, from 1948 through October 2023. Note that marks of 50+ indicate growth and below 50 contraction. From this chart, and the New Orders subcomponent shown below it, we seem to be at a nice inflection point after two declining years that mirrors similar bottoms before turning points in the past. This is a hopeful sign that a recession might be averted and growth is looming just around the corner.



Behind the data is the weight that manufacturing has become less than 15% of the US economy, so while it counts, it counts significantly less than services and that is why GDP has stayed positive, as the Services sector, while down, has remained in growth mode – though it is not flashing as clear a picture that it has bottomed as the Manufacturing data shows. Still, as the monthly sub-box in the chart shows, it too seems to have bottomed.



Despite All the Worrisome News and Data; We Are In the Season to Believe in Happy Endings

Like Linus and the Great Pumpkin, the whole peanut gallery is sitting around in the dark looking up for some magic signs of goodness and doubting, and between the rain drops, it is finding them. After all, every bull market needs a wall of worry to climb, and we have plenty of those. On top of that fable, we know that Santa is on his way, with his goody bag rally that pretty much happens every year, as there are a lot of over-sold tax loss names this year, which only amplifies the likelihood of a bounce. Further, Goldilocks has been getting more mentions in the news than even the Kardashians, with her “just right” bowl of economic goodness, thanks to the strong employment picture, and economic growth that has exceeded expectations. So, we have a lot of good things to be thankful for as we roll into November.

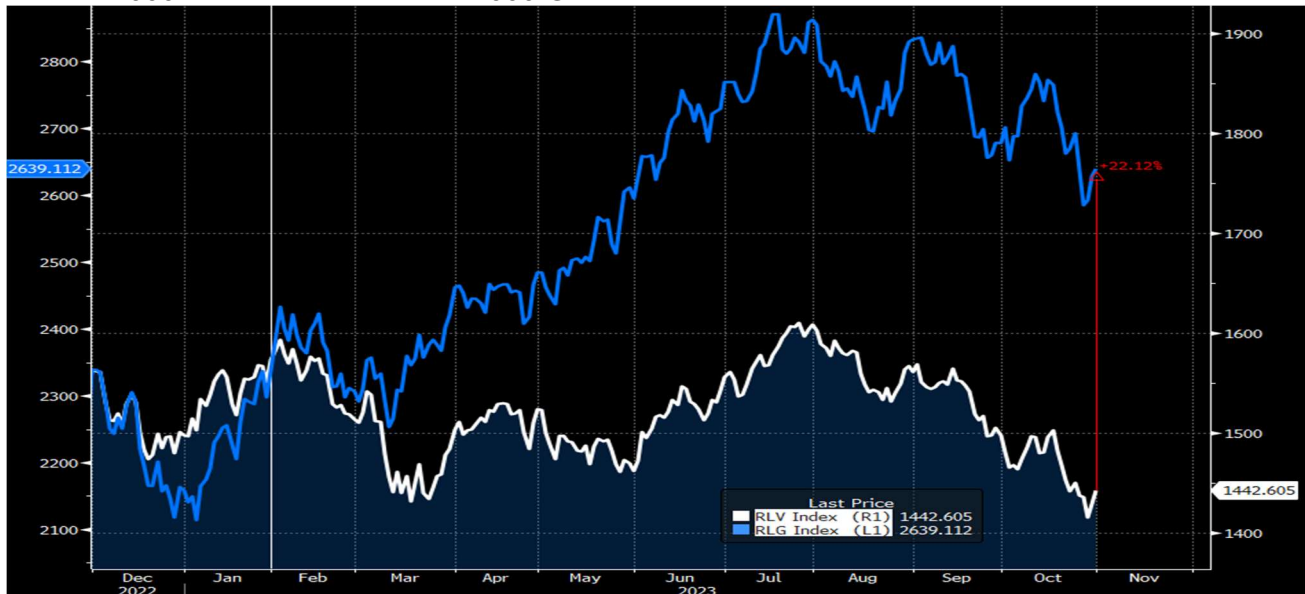
Yes, things can always go wrong, but as the historical economic dorsal fin chart so famously illustrates, the US economy has expanded 85% of the time and taken stocks up with it. So, if you have to make a long term bet, and you believe that history is a fair guide, the smart money bet would typically be to go long stocks from here and enjoy the magic of compounding your money. Maybe things are truly different this time around, but the track record of that bet is pretty low.

Part II: The Monthly US Equity Market Report

Growth Versus Value – Risk Off Led to Growth Win

As shown in the chart below, large cap tech / growth names have logged their best relative performance in many years in 2023. In fact, over the last 10 months, growth has out-performed value by 22%, its best spread since the dot.com era in 1999. As we have noted every month this year, while large cap growth has been this year’s best bet, their performance relative to value is still negative if you start the clock when the Fed started raising interest rates in Q1 last year, run it through the end of October. Typically, higher rates favor value stocks, but last year’s oversold condition in tech, plus the secular strength of the cloud and AI trends, and the uncertainty about cyclicals, financials and energy names (all value stalwarts) has contributed to the unusual growth surge. On top of this cyclical versus secular dynamic is the more typical scarcity dynamic, where the few things that are growing late in a business cycle typically see their multiples rise, whereas areas under pressure experience valuation multiple compressions. That has been uncharacteristically acute this year in consumer staple and healthcare names, which traditionally have seen their multiples rise when the fear of a recession lurks in the background, as it has since the Fed started lifting rates.

Russell 1000 Value Versus Russell 1000 Growth – Last 12 Months



On a total return basis in October, the total rates of return for the various benchmark were:

Russell 1000 Value (RLV)	(3.53%)	Russell 1000 Growth (RLG)	(1.42%)
S&P 500 (SPX)	(2.10%)	Dow Jones Industrial Average	(1.26%)
NASDAQ (CCMP)	(2.76%)	iShares Select Dividend ETF (DIVY)	(2.79%)
		Sound Equity Income ETF (DIVY)	(4.22%)

YTD, the total returns for the various benchmarks, **assuming reinvestment** has been:

Russell 1000 Value	(1.82%)	Russell 1000 Growth	+23.19%
S&P 500	+10.68%	Dow Jones Industrial Average	+1.44%
NASDAQ (CCMP)	+23.61%	iShares Select Dividend ETF (DIVY)	(10.62%)
		Sound Equity Income ETF (DIVY)	(4.90%)

As you can see in the table, our Dividend ETF uncharacteristically under-performed in October, as the risk-off trade and a few company outlook cuts at portfolio names torpedoed the results. (It has had a nice rebound in the first few days of November).

Just like we saw this year, with growth names coming back strongly after a horrid 2022, we believe that value and dividend names are setting up nicely for a relative rebound in late 2023 and 2024.

Dividends Being Dumped

One of the factors hurting our returns this year has been a flight from dividend paying stocks, as many risk averse investors have shifted capital to Treasury Bonds, with a 5% 20 year looking very attractive, relative to corporate bonds and stocks, or cash, also paying 5%, with the optionality of shifting that capital (albeit likely at higher prices and lower yields) back into riskier assets when the macro picture seems clearer. As Joe Rosenberg, the Chief Investment Strategist and Loews Corp was fond of saying, "one pays a high price for certainty," and as Warren Buffet frequently counsels "buy when others are fearful and sell when they are greedy."

Following up on the observations of these sage investors, the cutout below is from an interview with BMO's Chief Investment Strategist, who thinks the sell-off in high dividend paying stocks is a holiday gift that investors like us should capitalize on. Naturally, we agree and we suspect that you do too.

Don't Miss This Holiday Sale!

However BMO's Chief Investment Strategist Brian Belski argues that nearly "indiscriminate selling" of high dividend payers creates an entry point for investors. He offers three reasons that now could be an opportune time to scoop up some of these stocks.

For starters, history would suggest that their underperformance can't last long. Over the past three decades, "there have been only two periods where high dividend yielding stocks have performed worse relative to the S&P 500 on a year-over-year basis: the tech bubble and the pandemic," Belski writes. "According to our work, this type of abnormal underperformance has typically proved to be an inflection point historically."

In fact, five other times when dividend payers' relative underperformance was this dramatic over the past 30 years proved a good time to buy.

"These stocks tend to stage an impressive recovery following such levels," Belski writes. Over the past three decades, they on average have outperformed the S&P 500 by more than 20% on an annualized basis from trough to peak in relative year-over-year total returns for periods lasting nearly a year. These stocks go on to maintain above-average outperformance for nearly two years following the peak as well.

Monthly US Equity Market Report

10/31/2023

Fundamental, Technical, and Valuation Snapshots

Fundamentals: Tech still in drivers seat; Better than feared, due to employment & falling costs.

Trend Economy is growing, overall revisions are positive due to technology spending & falling costs.

(+)	Information Tech	AI demand, cost cutting, and BTE orders have lifted #s & outlooks.
(+)	Energy	Higher prices & costs, but big earnings misses at majors.
(+)	Consumer Discretionary	Revisions were strong away from hard goods.
(+)	Communications	Positive revisions for Internet Cos, Media, and Telecoms.
(+)	Financial Services	Higher NIMs, less than feared credit losses are offsetting higher costs.
(+)	Real Estate	Higher rents are marginally offsetting lower occupancy & higher rates.
(+)	Utilities	Outlook for a cooler winter & rising investments are lifting estimates.
(=)	Consumer Staples	Mixed bag: price & cost pressures slowing down, but volumes meak.
(-)	Industrials	UAW strike impacts, falling backlogs & orders are beginning to bite.
(-)	Materials	Strong dollar, falling prices and softening demand are nicking estimates.
(-)	Healthcare	Biden drug price policies, FX & soft volumes are reducing estimates.

	10/31/2023	Earnings Revisions			Performance (Total RoR)		
	Mix	3 Mo.	6 Mo.		MTD	QTD	YTD
S&P 500		2.1%	1.9%		-2.1%	-2.1%	10.7%
Communications	8.8%	4.8%	5.7%		-1.8%	-1.8%	37.9%
Consumer Discretionary	10.9%	4.8%	9.6%		-4.5%	-4.5%	20.9%
Consumer Staples	6.5%	0.0%	1.2%		-1.2%	-1.2%	-5.9%
Energy	4.8%	6.1%	-3.6%	Worst =>	-6.0%	-6.0%	-0.3%
Financial Services	11.2%	2.0%	1.5%		-2.5%	-2.5%	-4.1%
Healthcare	14.4%	Worst => -6.0%	-10.4%		-3.2%	-3.2%	-7.2%
Industrials	7.8%	-1.2%	1.2%		-2.9%	-2.9%	1.4%
Information Tech	27.1%	Best => 7.3%	13.6%		0.0%	0.0%	34.7%
Materials	2.8%	-2.4%	-6.4%		-3.2%	-3.2%	-0.7%
Real Estate	2.8%	1.0%	-0.9%		-2.8%	-2.8%	-8.2%
Utilities	3.0%	0.2%	-0.8%	Best =>	1.3%	1.3%	-13.3%

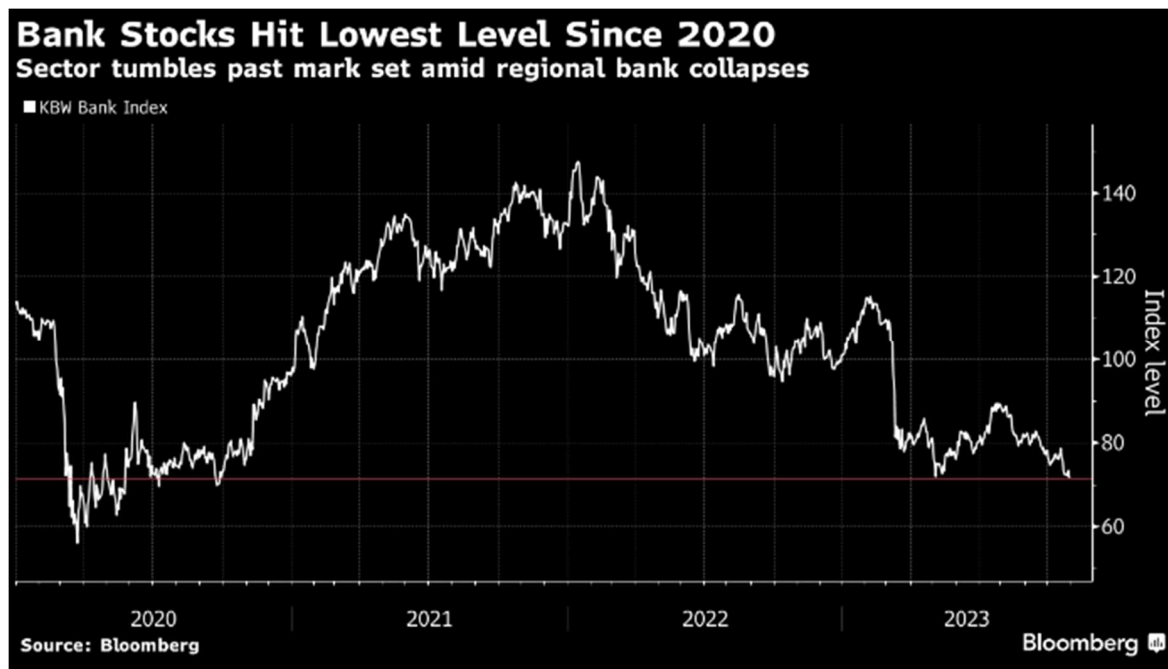
The only two places to hid in October were in Technology and Utilities, as they have a secular and weather stories (bad winter expected) that led capital to shift into them and away from the risks that the wars and the Fed presented to more cyclical areas.

On the downside, Energy prices remained firm, but cost driven earnings misses at the majors and cautious outlooks about the economics of their renewables efforts sent the shares lower pretty much up and down the energy stack. Because of the long term under-investment in Energy, created by the various governments anti-carbon policies, we expect energy stocks to be substantiatl FCF generators, and prices to continue to remain firm. However, we favor the processing and infrastructure plays because they have more stable dividends and less project risk.

One of the toughest areas for investors this year has been in consumer discretionary names. While the large up moves in Tesla and Amazon have the sector flashing the third best performance, the rest of the lot has been crushed, as traditional retailer and apparel names continued to cut estimates in October, at the same time that Amazon and boosted theirs. The negative trends have lapped a year already, which is longer than normal for a turn, but heading into the 2023 holiday season, the order

rates have been largely below prior years, even with tight inventories, which means that big holiday sales run is unlikely to happen.

Also hidden behind a trend of mostly positive revisions in financial company shares has been a resumption in the dive in banks, as concerns over deposit flight, slowly weakening credit trends and soft loan volumes, due to high interest rates are leading to a split decisions by analysts as to whether to jump in or bolt for safer pastures.



Tipping the scales in this debate last month was Jamie Dimon's revelation that he sold \$141MM of JPM stock. Everyone respects Jaimie's judgment, but did not sell-out, rather he diversified into cash, as the majority of his massive net worth is in JPM stock, even after the sale.

Technically Speaking – Most Technicals are Bunk, Akin to Newspaper Horoscopes

Last month, the technicals were neutral heading into the transition between the September dive and the typical year-end rally, but that smooth transition didn't happen because the Hamas attack put the markets in a risk-off mood. This month, the technicals started off bearish (according to the standard measures), because of the presumption that the negative October market action would continue, but we all know that the market's are oversold (more on that below) and were are entering the post-tax loss selling / Santa Claus rally, so all of the negativity seems to be yesterday's news.

A more positive technical picture comes from looking at the "double-barreled" oversold reading. According to Limelight Alpha Partners (a technical sell-side shop), when the percentage of stocks trading above their 200 day moving average gets really low, relative to the norm on the firms 1,600 stock universe, 91% of the time, a median ~28% rally occurs over the next nine months, and at the end of October the measure got hit. This has happened 22 times over the last ten years and every time the markets went up afterwards, they say. So, that measure and the 75% (made up estimate) likelihood that the Fed is done (which also has a good track record of preceding lower interest rates and a stock rally) bodes well for the coming months and year – presuming something unexpectedly negative does not happen, like another war. Here's to optimism!

Technical: Overall Bearish: ST Bearish, IT Neutral, LT Bearish.

Key Positive indicators: TDD, ST Fibs, IT Highs
Key Negative indicators: All EMAs, All MACDs, RSI, TDD, IT & LT Fibs, ST & LT Highs, Stochastics

(-) Trend 9/11 sectors closed down in October, leaving only 4/11 up YTD.
 (-) Fund Flows Down all month, as soon as the war in Israel broke out.

	Price	30 Day	50 Day	100 Day	200 Day	
(+) Golden Cross [50 dma > 200]	4,194	4,290	4,357	4,405	4,241	
(-) Price / Moving Average [4 / 4 are "< 1"]		0.98	0.96	0.95	0.99	
(-) Support Levels are further away	4,117	-1.8%	4,111	-2.0%	4,055	-3.3%
(+) Resistance levels gap after near mark	4,209	0.4%	4,306	2.7%	4,333	3.3%
(-) Volatility, (VIX)	Vix rose from 17.34 to 21.71, on war uncertainty before dropping to 18.14					
(-) Trading Volume	Year over year volume was down.					

Valuation: Positive vs. Bonds	PE		EPS		
	2023e	2024e	2022	2023e	2024e
Treas. yields rose, credit spreads narrowed					
'23 PE is 3.0 points > LTA	18.9	17.2	\$ 223.0	\$ 221.6	\$ 243.9
10 Year US Treasury: (1/r) = PE Equivalent	20.3	20.3	12%	-1%	10% = y/y %
10 Year BBB: (1/r) = PE Equivalent	15.1	15.1	'23 & '24 EPS est. FELL by 1% each in Oct		
Stocks are Cheap Relative to Bonds based on LT Spreads			Upside For Stocks Relative to Bonds		
10 Yr Treas.: LT Avg (1/r) relative to S&P PE	1.0	1.0	vs. 10 yr	7%	18%
10 Yr BBB: LT Avg (1/r) relative to S&P PE	0.7	0.7	vs. BBB	16%	27%
S&P 500 Earnings Yield (E/P)	5.28%	5.81%	<= Earnings yield is up / risk prem. Down		
10 Year US Treasury Yield (+35 bps in Oct)	4.92%	4.92%	10Y Tr. Downside to Parity -7%		
Spread (E/P minus 10 Yr. %)	0.36%	0.89%	<= PE fell, risk prem narrowed		
BBB narrowed vs. Treasuries, as rates rose 35 & 31 bps respectively					
10 year BBB Corporate Yield	6.62%	Norms	<- rose by 31 bps in October		
Yield Spread of S&P E/P minus BBB	-1.34%	-2.68%	BBB downside to normal SPX -16%		
Yield Spread of BBB minus 10 Yr T	1.70%	2.20%	BBB upside to LT Spread vs. T -7%		



Part III: Portfolio News and Changes

In October, we began in the quiet period and finished in the middle of earnings season, so we were able to do preliminary research on a lot of investment candidates, but we could not connect with too many companies to get our questions answered. That will change in November as Q3 earnings season winds down. The only notable portfolio change this month was that we sold the remaining piece of Truist out of the Dividend River portfolio to take advantage of an unusual sell-off in Xerox, following Carl Icahn's sale of his ~25% position back to Xerox and the company's guidance cut. The Street did not like either event, but the numbers told a different story than the stock price.

After the earnings call, we reached out to Xerox (XRX)'s management to check our math. It appeared that the company has been reducing its share count, overhead costs and debt faster than the secular decline in its core print services business, so EPS and FCF per share were rising. Hence, not only was the company's 8% dividend yield safe, but after the recapitalization to buy Icahn's shares was completed, it appeared the Xerox should have high single digit to low double digit EPS growth, after posting a 65% gain this year. For a stock trading at under 7X earnings and 4X FCF, we wanted to understand what we were missing. In other words, if the company survived for 4 years, investors would get all of their money back.

What we found out was that the restructuring costs, that trimmed the theoretical FCF in 2022 and 2023 to more pedestrian figures were lessening and management left enough cushion in their \$400MM FCF outlook (which works out to \$3.20 per share, or over a 25% FCF yield for a \$13 stock) to not only pay the dividend and reduce debt, but to buy back shares and expand its computer servicing business, that is growing by double digits. In March, the company intends to have an analyst day in NYC to update the guidance and report progress on all fronts, and talk about their planned exit from the equipment leasing business, which is profitable, but confuses investors to think that the operating company is more indebted than it really is. Management expects this exit to boost the company's valuation, and net it a lump of cash from the buyer.

Recall that XRX has one of the classic value trap attributes: its core business is in secular decline. We normally avoid melting ice cube businesses, but in this case we overlooked that major problem because its FCF was so high and because of our (so far incorrect) belief that when the pandemic ended, office workers would return to their former offices and print and copy with a similar frequency to how they did pre-pandemic. That simply has not happened as we thought. Similarly, we thought Carl Icahn's intent was to sell XRX to either Fuji Xerox or Hewlett Packard, as both had negotiated to buy the company. As it turns out, that belief was wrong too, as insiders told me that Icahn had blocked both deals because he had unrealistic expectations about what the business could be worth. Not that he is gone, they say, there is a chance that discussions could begin again, though management is not banking on that.

As for us, we would be happy if XRX went from trading at 4X prospective FCF to 7 or 8X, which is in line with where it has traded before. If we can collect an 8% yield and the stock can rise 75% to 100% over the next year, we would consider the bumpy ride we have been on to date to have been worth it. In the meantime, we expect XRX to rise sharply over the next two months, as tax selling abates and other investors go through the same conversations and mathematical exercises we have. As long as sales don't get worse than management's conservative guidance, we should see blue skies ahead.

Performance – Dreadful October

	October	YTD
Dividend River (est.)	(3.88%)	(4.02%)
Total Return Yield (est.)	(4.60%)	(3.91%)
DIVY NAV (Toroso)	(4.32%)	(5.15%)
DIVY Price (Toroso)	(4.22%)	(4.90%)

The combination of tax loss selling, interest rates spiking, a flight out of equities, especially dividend yielding names, and a few negative earnings revisions rendered out October performance to be worse than the broader & growthier indices. Technology stocks also had a bit of a comeback, thanks to some positive comments by chipmakers and cloud service providers on the ongoing strength of artificial intelligence driven demand. As has been the case all year, these higher multiple, no yield, or low yielding stocks don't fit our high yield mandate, so when they run, we are stuck on the sidelines.

As we wrote in last month's letter, we believe that once interest rates stop rising, the market's favoritism pendulum will gradually sway back towards a more central or balanced position, which should take dividend paying companies out of the penalty box they are now in. Already in the first few days of November, both the interest rate drop and a smart snap back in our names has happened. We look forward for more of that to continue, as well as the typical Santa Claus rally, which should favor our type of high yielding value names this year. Also, as earnings season winds down and companies will return our calls, we anticipate swapping into a few names that we don't own that have also been beaten up this year, in anticipation of capturing some rebounds.

As illustrated in the DIVY chart below, while the returns for high dividend value stocks have been weak in 2023, over the last few years they have been exceptional. While it would be ideal to win every quarter and every year, that is unrealistic, The good news is that we are almost through this give back period and we should end it with a big lead, as we enter a time when we should start winning again.



Characteristics – Cheaper Than the S&P 500, With Higher EPS Growth & Dividend Yield

Our portfolios are still 42% cheaper than the S&P 500 on a PE basis, with higher dividend yields and higher expected EPS growth rates, but lower weighted average sales growth expectations.

As of month-end, Dividend River was paying a 5.0% annual yield 2.9X that of the S&P 500, at 42% below its PE price, while the Total Return Yield was paying a 4.1% dividend, 2.4X the yield of the S&P 500, also at 42% below its PE price. Dividend River has a 2023e EPS growth forecast that is 9.2% above the S&P 500, while the Total Return portfolio is expected to grow EPS 10.6% above the benchmark. Also, their Betas are 0.7X the Index Beta, which means that they should go up and down

less than the S&P, based on the historical movement of their constituent shares. The EPS growth plus dividend lines in the tables below indicate our approximate expected forward total returns for both portfolios. These returns both exceed the S&P 500 outlook, based on consensus estimates.

Dividend River Portfolio Characteristics						Total Return Yield Portfolio Characteristics					
October 31, 2023						October 31, 2023					
SECTOR WEIGHTS	SIS	SPX	KEY METRICS *	SIS	SPX	SECTOR WEIGHTS	SIS	SPX	KEY METRICS *	SIS	SPX
Communications Services	8.0%	9.0%	Dividend Yield	5.0%	1.7%	Communications Services	9.4%	9.0%	Dividend Yield	4.1%	1.7%
Consumer Discretionary	7.1%	10.9%	2023e PE	11.2	19.3	Consumer Discretionary	9.6%	10.9%	2023e PE **	11.1	19.3
Consumer Staples	5.1%	7.2%	EV/ EBITDA	9.6	13.4	Consumer Staples	9.5%	7.2%	EV/ EBITDA	9.4	13.4
Energy	17.6%	4.5%	PB	4.1	4.0	Energy	12.6%	4.5%	PB	3.7	4.0
Financial Services	14.3%	12.2%	2023e Sales Growth	1.8%	4.2%	Financial Services	15.6%	12.2%	2023e Sales Growth	2.6%	4.2%
Healthcare	18.0%	13.0%	2023e EPS Growth	8.6%	-0.6%	Healthcare	10.1%	13.0%	2023e EPS Growth	11.2%	-0.6%
Industrials	2.8%	8.3%	BETA	0.7	1.0	Industrials	5.9%	8.3%	BETA	0.7	1.0
Information Technology	11.2%	27.8%	EPS Gr. + Div %	13.6%	1.2%	Information Technology	12.1%	27.8%	EPS Gr. + Div %	15.3%	1.2%
Materials	10.8%	2.4%				Materials	15.2%	2.4%			
Real Estate	0.0%	2.3%				Real Estate	0.0%	2.3%			
Utilities	5.1%	2.4%				Utilities	0.0%	2.4%			
Totals	100.0%	100.0%				Totals	100.0%	100.0%			

Undoubtedly, October was a Tough Month, but We Survived it

As we enter November, the Fed has indicated a rate pause, supported by with weaker-than-expected job numbers and the yield curve has accordingly moved lower. So far, this shift has propelled stocks and bonds to gap higher, especially value and yield stocks like ours. While a few good days does not make a trend, this movement and the end of the main tax loss selling period are directionally two factors that we have been looking forward to for a few months now. With the war breaking out in October, perhaps the typical turning point was delayed by a couple of weeks, but it was not eliminated.

The sledding since January has been tough, some of the toughest for dividend value investors in years, but we made it through. Despite the weak total return figures relative to the S&P 500, we are pleased that the portfolios have been able to generate strong yields, which our clients need, and we are also pleased to find the table reset for better returns in the months ahead, despite the slowing economy.

As always, we are extremely grateful for the trust that you have placed in us, and the partnership we have in pursuing our common goal of taking care our clients, in all types of markets.

Thank you again for your faith in us, and for all that you do.

Gratefully yours,

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