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Sound Income Strategies
Monthly Equity Newsletter

Sound Income Strategies, Monthly Equity Update **October 31, 2024**

Monthly Maxims

"We do not have government by the majority. We have government by the majority who participate."
- Thomas Jefferson

"In allocating capital, activity does not correlate with achievement. In the fields of investments and acquisitions, frenetic behavior is often counter-productive." – Warren Buffet

Executive Summary

Macro: October began with a surge of optimism and ended with waves of despair, as mixed economic data reduced confidence that the Fed would cut rates as aggressively as hoped. At the same time, many company outlooks expressed in Q3 earnings calls have been less sanguine than expected. Of equal importance, the US Presidential election takes place on Tuesday, November 5th and both polarizing candidates are even heading down the home stretch, which has added to the market's uncertainty. With each party's tax and economic policies so disparate, the securities of those industries with the most to gain or lose based on the outcomes have been bouncing around. With all of these shifts taking place, interest rates backed up, which sent most stocks and bonds lower.

Markets: Stocks and bonds began the month surging on falling rates and economic optimism but ran out of gas after the economic data suggested the Fed would be less aggressive than hoped going forward. Still, spreads tightened as the outlook remains positive for credit.

Portfolios: The Sound Income portfolios fell in October, as higher rates pressured cyclical names and disappointing results or outlooks in a select few drove share prices lower. Trade-wise, in Dividend River, we sold Unilever, which was approaching its price target to buy Citizens Financial Group (CFG), a regional bank that is set to benefit from improving lending activity and expensive rate swaps rolling off. So far, this trade has worked out favorably.

Part I: Macro Factors and Thoughts

October Roll-Over – Good Data Spooks Fed Bets

Propelled by a brisk gust of rate cut optimism to start the month, investor sentiment was over the moon with the specter of an economy that was aging gracefully. Fears of a recession had been dispelled by the soothing words of an attentive Fed that had shifted its focus from fighting inflation (Mandate #1), to preserving jobs (mandate #2). So long as the data cooperated, "we would be in like Flint." But, the data did not cooperate.

After a week of bliss, the trouble started. The September jobs report included another decline in the unemployment rate. This data was paired with one of the highest monthly payroll addition numbers of the year. While this good news helped to ease fears that the labor market was rapidly deteriorating, it took a lot of the mustard off of the case that the Fed had to cut rates aggressively to save the (fairly healthy) labor market, and by extension, investors from inflated expectations.

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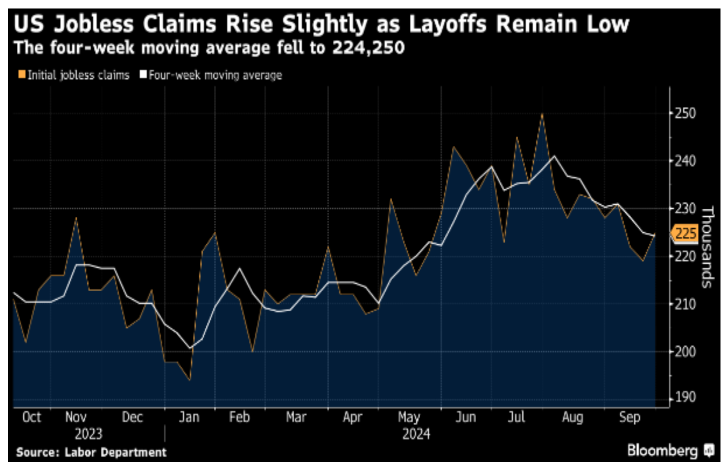
Then, the latest Consumer Price Index (CPI) report came out and showed core prices increased more than expected. This hot CPI report was soon followed by a warm Producer Price Index (PPI) study that told a similar story, with core prices increasing 2.8%, compared to Wall Street's expectations for a 2.6% increase. These data, along with hot housing turnover and price increase figures got strategists' attention. As noted by Eric Wallerstein of Yardeni Research in a Yahoo Finance article below.

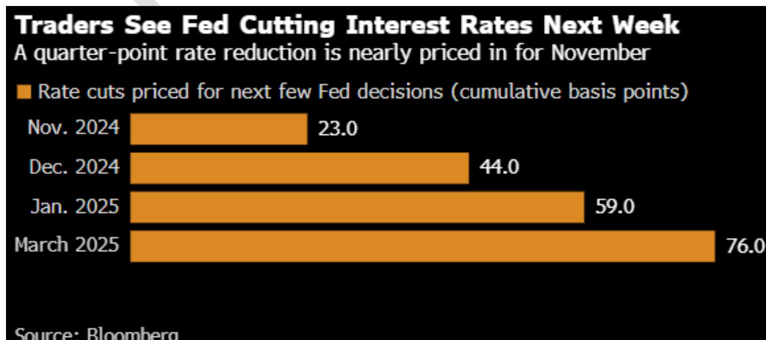
"As long as inflation isn't getting towards 2% so dramatically and there's no crisis that unfolds in the labor market, which I don't foresee, I don't think there's anything that gives the Fed reason to cut further this year."

Yikes! This "no cuts" forecast sent trembles across Wall Street, which sent bond yields higher and security prices lower. The better-than-expected Q3 GDP report did not help matters much either.



It all happened so fast. Right after the Fed inspired investors last month with its surprisingly large 50 bps cut, it was starting to look like Lucy pulled the Football, and maybe the prospect of a Goldilocks-managed landing was gone. This change in perspective has weighed on everything. So now the scary question is, how is the Fed going to react to this batch of better-than-expected data? To help mortals grapple with this recurring question, the CME Group kindly shares its "Fed Watch tracker that extrapolates the probabilities implied in futures and options bets for their embedded assumptions for Fed Funds rates and actions. Bloomberg also derives this data with a similar methodology.

As shown in the illustration below, traders still expect a 25-bps cut at the next meeting, but after that, confidence has fallen. The CME calculates a 25-bps cut to have a 98% probability of occurring. What comes after that will be more tied to what the Fed says at the post-election meeting, and subsequent data. Note that while the Fed says that it is data dependent, sometimes the data they focus on shifts unexpectedly, and there are many cases where politics have played a role, like last month, when 17 Senators asked the Fed for a 75-bps cut, even though the Fed and its defenders claim it is apolitical.



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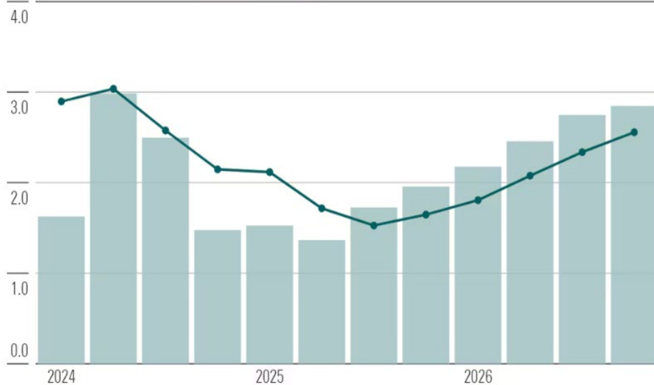
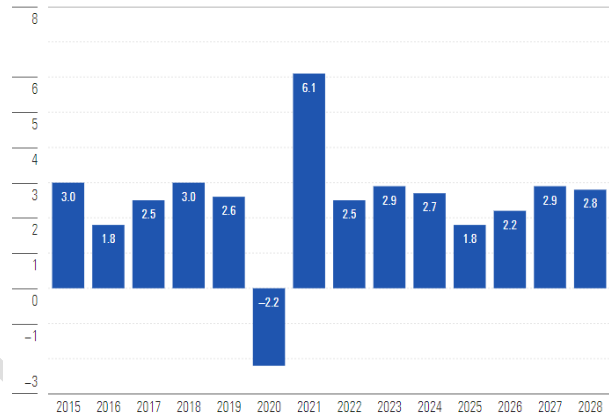
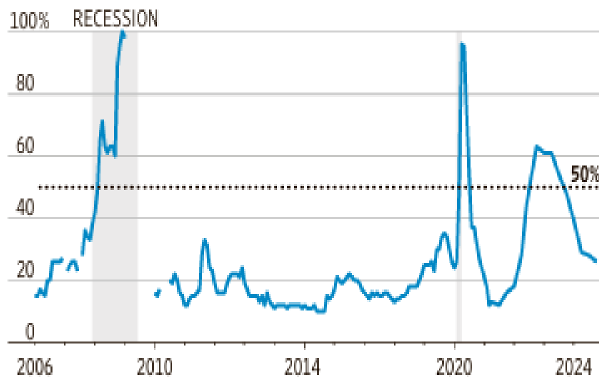
“It’s the Economy Stupid”, James Carville

You know all of that incremental deficit spending the Biden Administration has been engaging in? Well, it has definitely helped to keep the economy rolling -- along with being inflationary. Also, the capital spending that has picked up to rebuild the capacity destroyed by the covid shutdown policies has also helped to keep the economy moving. You can see these outcomes in the four years of positive post-pandemic GDP growth shown below and the expectations for four more years of positive GDP growth forecast by the US BEA, regardless of who wins the White House in November – though usually, such a bright outlook favors the incumbents. [Printing money works until the bill comes due].

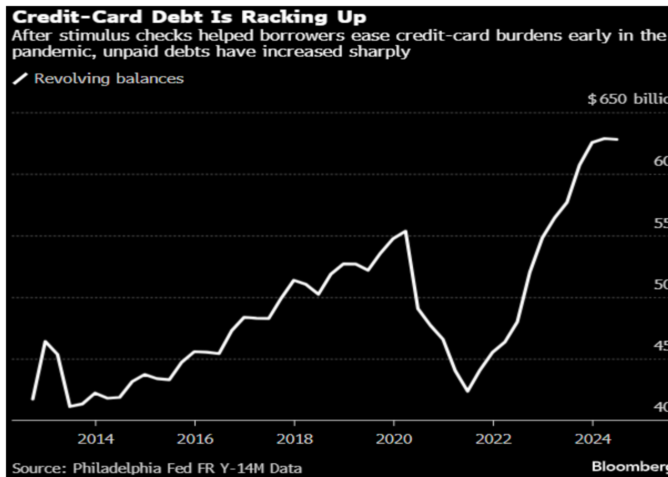


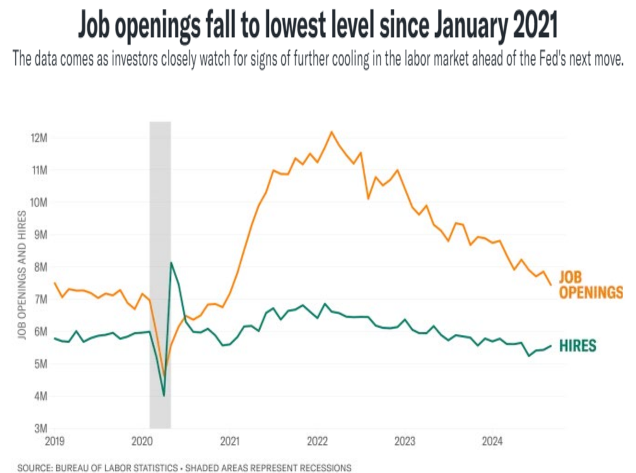




You can also see in the drop in the WSJ probability of a recession chart and incremental pickup in the PMI outlook for the services economy graph that the outlook for the US economy is trending a little better than it feels. While consumers in the middle and low end are tapped out, with savings rates at five-year lows, borrowing rising, (see below) and shoplifting too, businesses and the top quartile of the economy are still functioning reasonably well. So far, consumers have been able to service their debts better than historical trends. The Fed is watching this data closely for signs of a breakdown.

The other data series that the Fed Governors keep talking about is the ratio between job openings and hires. Both are trending lower, as shown below. These trends give support to the case for continuing to lower rates, but the pace could be slower than expected. Job creation, like many economic things, trend steadily until the unpredictable breaking point, akin to the proverbial straw that breaks the camel’s back. Once the break occurs, it costs 10X as much effort to undo the damage than it would have taken to avoid it. Powell knows this risk, so it is better to cut rates early than too late.





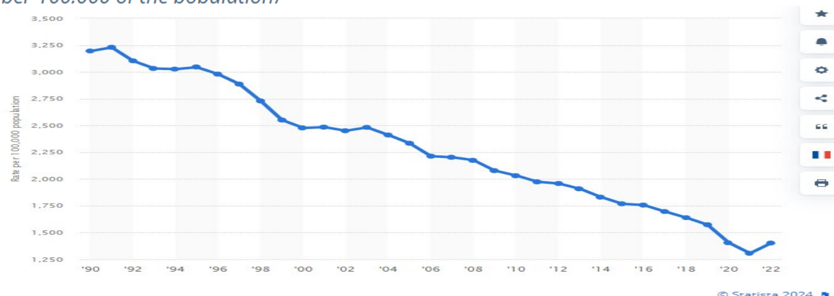
The US Has A Shoplifting Epidemic – But The Police Data Don't Show It

According to police records, 1.4% of the US population was found guilty of petty larceny in 2022, up from 1.3% the prior year – that's nothing, right? Well, the increase in caught thieves is nothing to get excited about, but the reality of what is happening in America is quite different.

In 2024, a LendingTree survey found that 5% of American adult consumers admitted to having shoplifted in the past year and 25% admitted to having shoplifted at one time or another. [How much higher would the figures have been if teens had been counted?] While these figures may not be exact, they are large and highlight a growth in lawlessness in the US that appears to have accelerated after the pandemic and the defund the police "movement" led to a relaxation in the policing of petty crimes.

The Statistica chart below shows that prior to 2020 reported theft rates were on a 30-year decline, before bouncing in 2020 and heading up thereafter. However, the steady decline in reported larceny before 2020 was not because people had become more honest, but rather because retailers have gradually stopped reporting thefts to the police, who have done little to stop it.

In the latest National Retail Federation study, "shrink" (missing goods) rose 10% in 2023 over 2022, with many retailers saying "shrink" has reached all-time highs on earnings calls. As exhibited by the increasing use of security measures and store closures in pharmacies, unless the actual trend in shoplifting stops, retailers will either have to close stores where shoplifting is extreme, which is basically in the inner cities, or raise prices enough to offset the losses due to shrink and the costs for higher security measures needed to reduce it. These higher costs make retailers' products even more expensive than online alternatives, which encourages shoppers to buy more online. The decline in retail then, leads thieves to pray more on the remaining stores or get into the habit of stealing packages from doorstops, where the risk of getting caught is higher. [Get a doorbell camera ASAP!]



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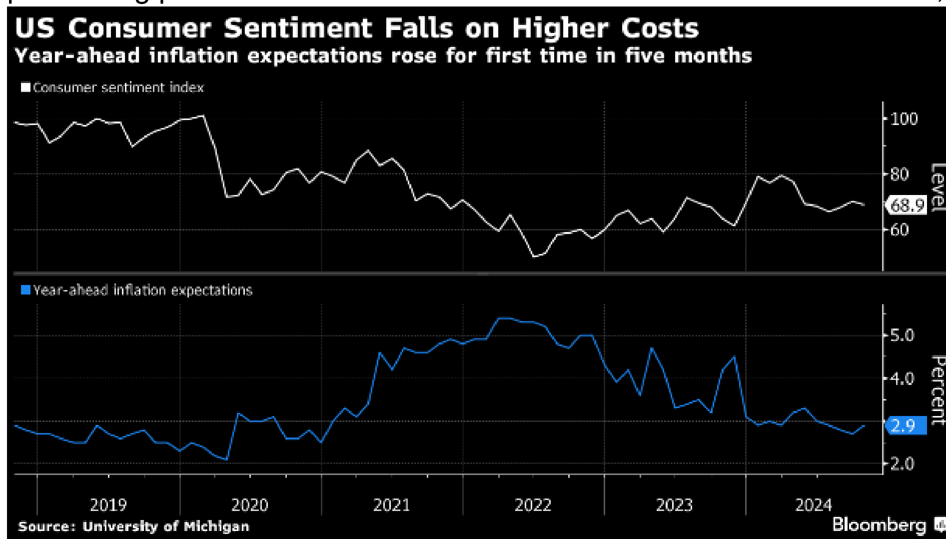
Sentiment Slipped at Precisely the Wrong Time

Consumer sentiment has been trending higher over the last two years, with an inverse relationship to inflation (see chart below). When inflation spikes, consumers intuitively understand that their purchasing power and wealth have declined and vice versa. Last month, sentiment fell.



The important result of this awareness is that consumer spending tracks sentiment, and as we head into the all-important holiday shopping season, retailers and businesses of all flavors want consumer sentiment to be rising. The Fed is aware of this condition too, and that has contributed to their delay on cutting rates until inflation appeared to be unequivocally contained, though maybe not fully yet.

The Unkind Calendar

Thanksgiving this year falls on the last weekend of November, which gives holiday shoppers less time during "panic season" to buy whatever they will buy before Christmas than normal. On one retail call, the CEO said the 17 business days is the shortest on record between Thanksgiving and Christmas. Over the last ten years, data have shown that last-minute shoppers have tended to buy more via physical stores than online, which creates inventory challenges and often sell-out conditions in stores that ultimately have led to lower-than-expected sales. Those who like to buy online have a dilemma too, as next-day deliveries become impossible for the overburdened shippers of the world, the closer one gets to the holiday of choice. The net of these puts and takes is that the calendar, along with the stretched consumer and election anxiety suggest this holiday season could be disappointing. It also suggests to last-minute shoppers (like me) that we better get out there early this year if there is something special one of your giftees wants, as it might not be available by mid-December.

Benign Winter Energy Outlook From the EIA = Bright Spot for Consumers

After two warmer-than-normal winters that led to some oversupply conditions in the spring energy markets, this winter is forecast to be marginally colder, but adequately supplied, barring an unexpected disaster, such as all-out war in the middle east. Accordingly, in its widely-read Winter Fuels Outlook report, the Energy Information Administration is forecasting nearly flat year-over-year winter heating bills, with natural gas fuel prices higher and heating oil prices lower. These forecasts assume that there won't be any change in the US energy policies next year, which might be off.

The Election – Too Close to Call

Most polls reveal the bias of the pollsters, with Harris ahead in some and Trump in others. The stock market predictor, which has predicted correctly for the incumbent party in 12 of the last 15 elections

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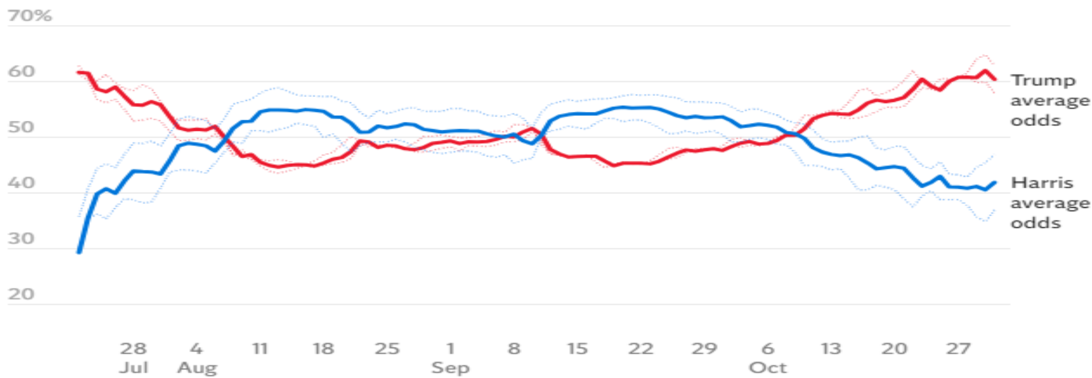
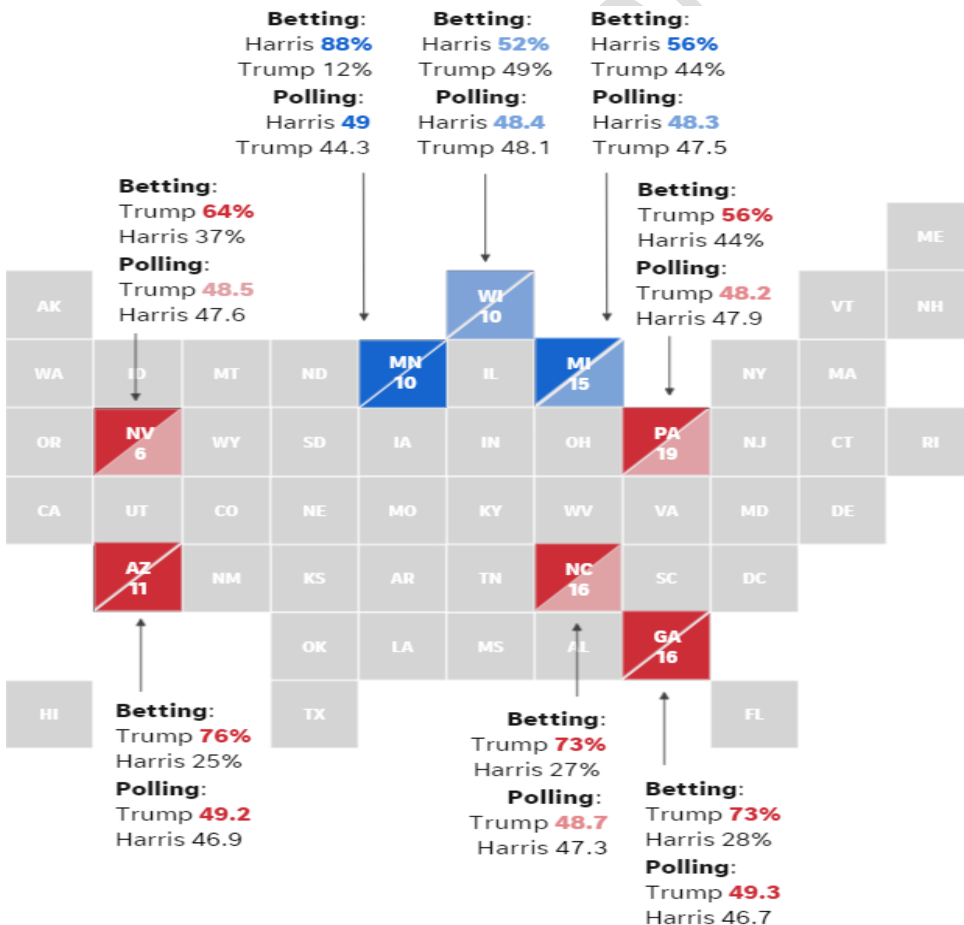
(see break out below) favors Harris, while the betting markets, which have been correct about 93% of the time since 1868 favor Trump (they also favored Hillary in 2016 and were wrong). The swing state tea leaves are also very close, with Harris clearly ahead in MN, WI and MI, with 35 electoral votes, while Trump, as of Friday morning, ahead in NV, AZ, PA, NC and GA, with 68 votes (see chart below.) If these bear out, it will be Trump by a whisker, but the Democratic party's ground game is legendary, pulling homeless people out of shelters and filling in mail in ballots for the elderly (or deceased in Chicago), so the winner is still anybody's guess, though it is not a guess to forecast the bitterness of the losing side's extremists. If only all of the imbalanced people who promised to leave the US after their side lost in prior elections actually did, maybe we'd all have less polarizing rhetoric today.



Betting odds above are for who will win the US presidential election, via platforms Betfair and PredictIt, aggregated.
Chart: Alicja Hagopian • Source: Betfair/PredictIt average odds



What we can say for certain is that:

1) whomever wins should be cognizant that they won't have a mandate, with half the people voting against them, and
2) the best we can hope for is a divided government to ensure that is the case. On that score, the Republicans are expected to gain a few seats in the Senate, but the House, where spending bills originate, could go Blue, so there is more risk for fiscal imprudence than ideal.

In particular, both candidates' fiscal policies need work to become viable, as spending endlessly and only taxing one's enemies sound great on the campaign trail, but they are deeply divisive and counter-productive when the day after comes. Along these lines, there needs to be some serious work done to cut spending and the deficits, no matter who wins. So, write to your Congressmen; make your voice heard. It may lead to nothing, but at least you will know that you took an active role and advocated for what you want, rather than leave you fate up the the wisdom of strangers.

When the silly season ends, we can only hope that cooler heads will prevail, but this outcome should have a more solid foundation than just "hope". Appointments matter and neither Trump nor Biden got as many of them right as desired the last two times around. We need more pragmatic people in those seats this time. But, just as hope is not a viable strategy, neither is spending a lot of time worrying about what we cannot control, after pulling those levers. So, vote early, vote often, see what happens, and then deal with it. Our desired candidates may lose or win, but either way, we have to make the best of what comes next and seek opportunities, wherever they may be hiding.

<u>The S&P 500 Has Been an Excellent Election Predictor, but Not Perfect</u>

Since, 1928, the incumbent party has held onto the White House in 12 out of 15 elections when the S&P 500 rose during the 3 month period prior to the election, which is an 83% correlation. We can't say causation, although it is likely to have been a factor. Notably, the stock market rebound in late 2020 did not correlate for a win for Trump versus Biden, nor did it save Carter against Reagan in 1980.

Along these lines, many Republicans have questioned if the Fed's 50 bps cut in September, in light of the strong labor market and positive revision to GDP, was done to give the Democrats a boost leading up to the election. This questioning is fueled by the fact that it came right after a quorum of Democratic Senators approached the Fed with a plea for 75 -- after polls showed they were lagging, on top of relatively strong economic data that made a double cut seem unnecessary, and out of consensus. Maybe Trump saying that he didn't think a fully independent Fed was such a good idea played a roll too? Such conspiratorial allegations may or may not have any basis in reality, but they are now part of the historical record. The politicians said what they said, the fat cut happened, stocks are up, and usually that's a win for the incumbents - but not always.

<u>No Surprise Here: Poll Suggests That Financial Planners Have a Conservative Bias & Want Gridlock!</u>

Financial Planning Magazine frequently surveys planners and investors for insights, so naturally, they did not want to let the golden opportunity of asking their readership who they wanted to win the election and what the key issues were. With sample sizes of less than 1,000 and no clear balancing efforts indicated, one could say that their polling methods have a lot to be desired. Nonetheless, It is worth reading the whole story online, but for those who don't wish to do so, you might want to take in the following cut-outs from their findings, which are probably not far off from what our Sound Income Advisors might say – based on what they have shared with me.

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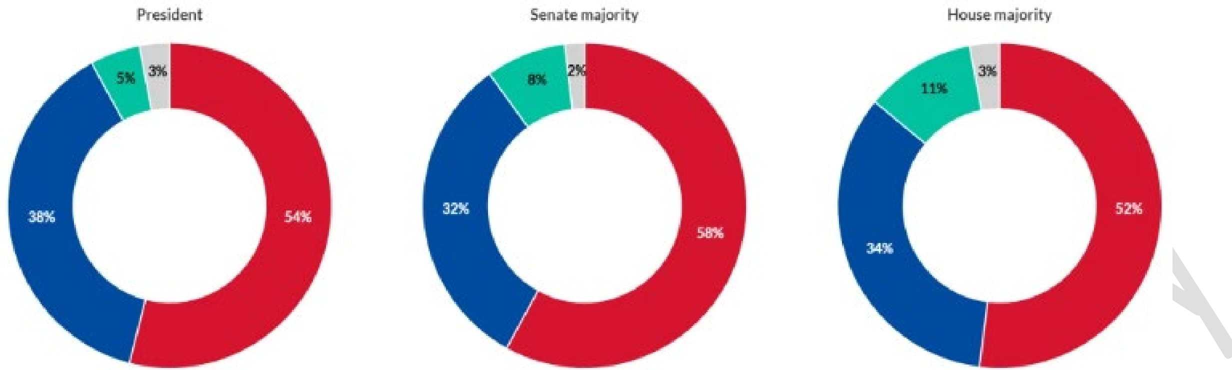
Which one of the following possible outcomes to this election cycle do you believe would be best for the country OVERALL?

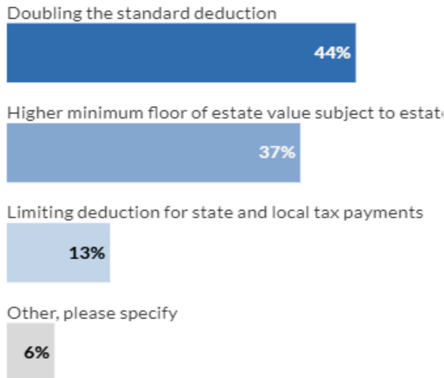
Republican | Democrat | No difference | Prefer not to say



Source: Election Survey Fall 2024, Financial Planning
Total 213

Which expiring provision of the Tax Cuts and Jobs Act of 2017 will be the most impactful for your clients and advisory practice if it doesn't get extended past 2025?

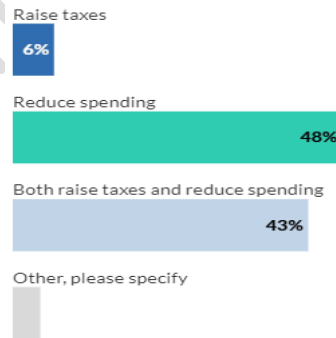
RIA not affiliated with BD



Source: Election Survey Fall 2024, Financial Planning
Total 213

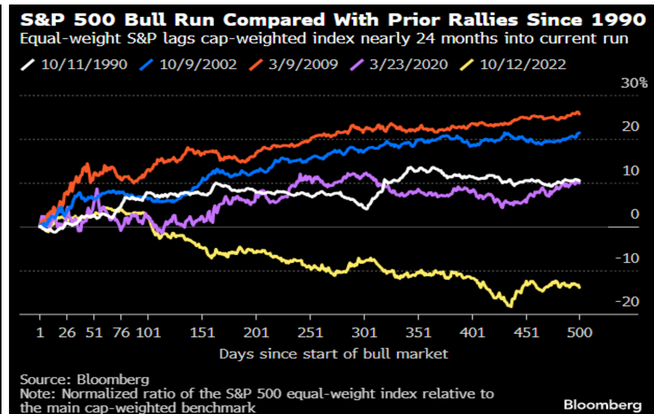
Which action do you think is the most important action the next White House and Congress should take in order to balance the federal budget deficit and reduce national debt?

RIA not affiliated with BD



Source: Election Survey Fall 2024, Financial Planning
Total 213

Part II: The Monthly US Equity Market Report



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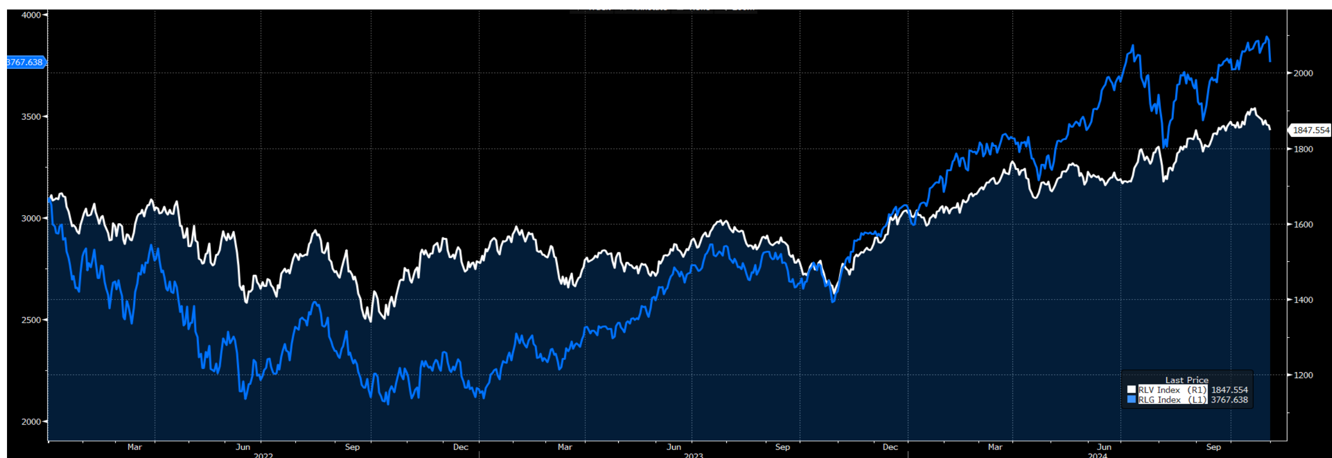
October was spookier in the markets than desired, with the backup in rates killing the cyclical, small-cap and value run that was getting started. We also so more volatility in the large-cap tech names, but there was enough good news in Tesla's, Nvidia's, Amazon's, and even Google's blowout commentary to offset the slowdowns in Microsoft and Apple.

As the chart above to the right highlights, we are still in a narrow market, where the average stock has more greatly trailed the Magnificent 7 and large-cap leadership than any other bull run before it. Hence, it still sucks to be anywhere but in this hot momentum trade, if you are going to be benchmarked to an index, because they are being taken to new heights by the same narrow subset that fundamental, high dividend value investors like us, by mandate, cannot buy. However, we could have bought more utilities and financials, which have soared in the last few months, and will likely continue to rise, if the rate cuts and expansion plans continue as expected.

Russell 1000 Value Versus Russell 1000 Growth – Last 34 Months



Growth is winning again, but cracks in the growth rates for the Magnificent names have been showing up – though technology and related names still lead the market higher in October. Again, DIVY underperformed DVY because it has a lower weighing in the financial sector which has been a top-performing sector in recent months. We are gradually repositioning, to be more rate-sensitive.

<u>October Returns</u>

Russell 1000 Value (RLV)	(1.10%)	Russell 1000 Growth (RLG)	(0.33%)
S&P 500 (SPX)	(0.91%)	Dow Jones Ind'l Average (INDU)	(1.26%)
S&P 500 Equal Weight (SPW)	(1.63%)	iShares Select Dividend ETF (DVY)	(0.24%)
NASDAQ (CCMP)	(0.49%)	Sound Equity Income ETF (DIVY)	(2.20%)

<u>Estimates Are Coming Down.</u>

While the lagging figures shown in the fundamental table below still show positive revisions for the overall market, thanks to technology and related sales growth, shorter-term measures are falling, as evidenced by the back-to-back monthly declines in Q4 and FY 2024 EPS estimates reported in September and October. The economy is still "growing but slowing." The revisions reflect a decline in unit demand, due to higher prices.

Indeed, not only are consumer products and services prices high, but security prices are high too, with buyers anticipating lower discount rates and an eventual reacceleration caused by lower interest rates, which essentially lowers the cost of everything. The only problem is, these falling rates are going to take some time (typically six months) before their positive effects noticeably bear fruit. In the meantime, security prices are high and insiders have stepped back from buying, as shown below.

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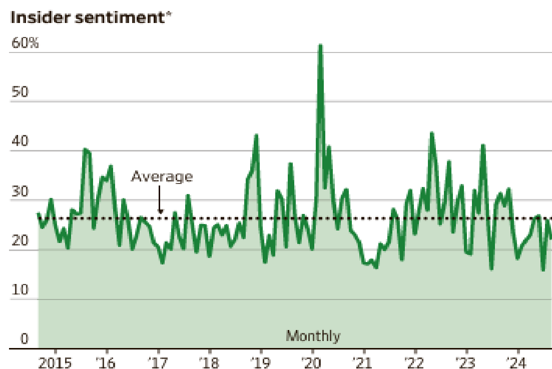

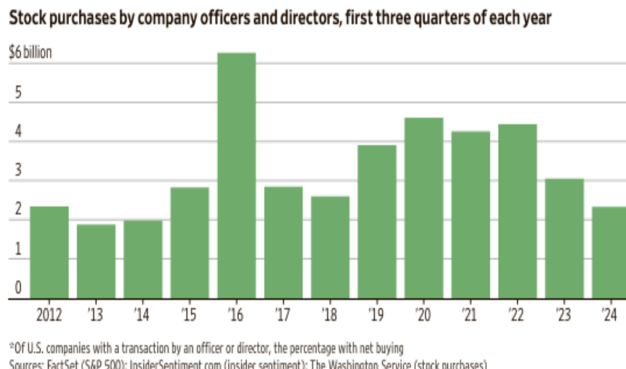

*Of U.S. companies with a transaction by an officer or director, the percentage with net buying
Sources: FactSet (S&P 500); InsiderSentiment.com (insider sentiment); The Washington Service (stock purchases)

Monthly US Equity Market Report

Fundamental, Technical, and Valuation Snapshots

10/31/2024

Fundamentals: Cyclicals weakening, tech, financials, Internet, Tesla rising.

Trends: AI demand remains strong, but the economic slowdown is real, rate cut expectations down.

	Sector	Comment
(+)	Information Tech	AI and related demand for servers and chips continues to be strong.
(+)	Consumer Discretionary	Low end slowdown is ongoing. GM & Tesla are up, all other autos down.
(+)	Communications	Internet firms are thriving, while AT&T & Verizon have beaten estimates.
(+)	Financial Services	NIM pressure, but outlooks up on trading, deals & rising loan expectations.
(+)	Real Estate	Rising rents, falling rates & occupancy creep are all helping on the margin.
(+)	Utilities	Rising capacity investments & lower rate outlook are lifting estimates.
(--)	Consumer Staples	Consumers continue to trade down to private label, volumes are light.
(--)	Healthcare	Lower pricing & utilization have offset obesity drug & pricing boosts.
(--)	Materials	Prices, costs & volumes down, but China stimulus has lifted outlook.
(--)	Industrials	High interest rates, strong dollar & weak exports are overcoming stimulus.
(--)	Energy	Prices & margins have fallen on slowing demand and growing production.

	10/31/2024		Earnings Revisions			Performance (Total RoR)		
	Mix		**3 Mo.**	**6 Mo.**		**MTD**	**QTD**	**YTD**
S&P 500			**0.6%**	**1.8%**		**-0.9%**	**-0.9%**	**20.8%**
Communications	9.4%		2.7%	6.1%		3.6%	3.6%	31.3%
Consumer Discretionary	10.4%		3.6%	4.7%		0.3%	0.3%	12.1%
Consumer Staples	6.2%		-0.5%	0.8%		-2.7%	-2.7%	15.4%
Energy	3.3%	Worst =>	-9.9%	-16.1%		0.1%	0.1%	9.2%
Financial Services	12.9%		1.3%	3.4%	Best =>	3.9%	3.9%	25.2%
Healthcare	11.1%		-1.1%	-2.9%	Worst =>	-3.8%	-3.8%	9.1%
Industrials	8.4%		-3.8%	-5.8%		-0.2%	-0.2%	18.6%
Information Tech	31.6%	Best =>	4.6%	10.8%		2.7%	2.7%	29.0%
Materials	2.1%		-2.6%	-3.6%		-2.0%	-2.0%	10.2%
Real Estate	2.2%		1.1%	1.8%		-1.6%	-1.6%	10.6%
Utilities	2.4%		0.3%	0.7%		-2.1%	-2.1%	29.3%

Utilities Have Got Game!

As the YTD sector performance table above shows, the S&P 500 Utility sector is now the second best-performing sector in the index YTD, after decades of lagging. Sure, falling rates have suddenly helped the market's bond proxy regain a pulse, but actually the story is much better than that. Suddenly, utilities are an AI, data center story, on top of being an EV migration story. The electrification of everything needs critical components to come to life. Even if wind, solar, and other renewables are going to displace fossil fuels gradually over time, the world needs power plants, transmission wires, and a grid, and these things all below to that highly regulated, slow-moving Utility sector.

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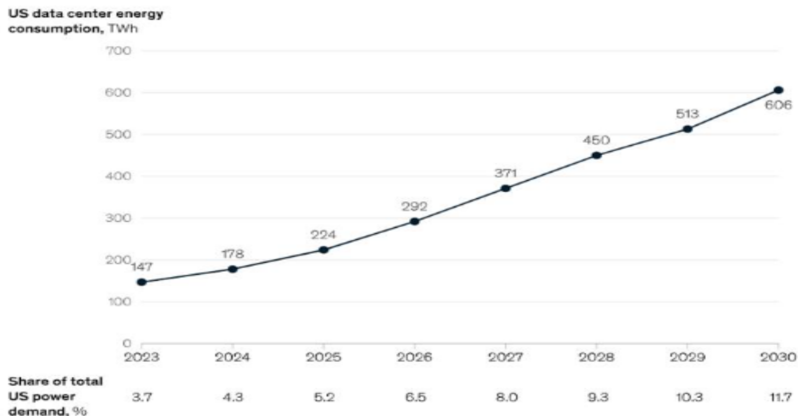
As the chart below suggests, US power demand is set to double every four years and that will only happen if the Utilities start building today, as it takes two to ten years for these projects.



Source: McKinsey & Company

While the forecast for growing demand is undeniable, the challenge is getting regulators to let the utilities charge customers today to build the infrastructure needed for tomorrow. In a political climate where consumers are already tapped out by inflation, getting these increases has been difficult, which is an nice way of saying that regulators are not letting the utilities raise rates as fast as costs have been rising, in general, so while EPS are rising, the ROEs have been slowly falling. Nonetheless, barring a war, this rising demand seems more bankable today than at any time in the last 20 years, where increasing efficient electrical motors and LED lighting dimmed the growth for electrical demand. Thanks to the explosion in data center and AI demand, the future for utilities is now brigher than ever.

Technicals: Overall Neutral: ST Bearish, IT Neutral, LT Bullish, per StockTA.com

Key Positive indicators:		IT EMA, IT & LT MACD, IT & LT Fibonaccis, ST Lows, IT Trends, Stochastics					
Key Negative indicators:		ST EMA, ST MACD, RSI, TDD, ST Fibs, All Highs, IT, LT Lows, IT, LT Trends					
(-)	Trend	6/11 sectors declined on lower outlooks for 2025 & less Fed cut optimism.					
(-)	Fund Flows	Began the month positively & turned sharply netative over last two weeks.					
		Price	**30 Day**	**50 Day**	**100 Day**	**200 Day**	
(+)	Golden Cross [50 dma > 200]	5,705	5,778	5,699	5,589	5,354	
(+)	Price / Moving Average [3 / 4 are "> 1"]		0.99	1.00	1.02	1.07	
(+)	Support Levels are Plentiful	5,681	-0.4%	5,640	-1.1%	5,585	-2.1%
(+)	Only Two Resistance Points	5,771	1.1%	5,869	2.9%		
(--)	Volatility, (VIX)	VIX rose by 6.43 to 23.16 as rate cut expectations & fwd outlooks fell.					
(--)	Trading Volume	Volume rose as the selloff picked up steam towards month end.					

As indicated in the Technical's data box above, the market is showing signs of fatigue that suggest it will need some incremental good news in order to move higher. [Positive Fed commentary about further cuts would help, for example]. Accordingly, we expect volatility to remain high, with earnings coming in a bit lighter than expected, election uncertainty, and geopolitical risks still at heightened levels.

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Valuation: Neutral vs. Bonds	PE		EPS			
Yields rose, spreads narrowed.	**2023**	**2024e**	**2022**	**2023**	**2024e**	
'24 PE is ~7.6 points > LTA	25.8	23.6	$ 224.4	$ 221.3	$ 241.9	<= est fell
10 Year US Treasury: (1/r) = PE Equivalent	23.4	23.4	13%	-1%	9%	= *y/y %*
10 Year BBB: (1/r) = PE Equivalent	18.7	18.7	'2024 EPS est. fell slightly in Oct.			
Stocks are close to FMV 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	-9%	-1%	Warning
10 Yr BBB: LT Avg (1/r) relative to S&P PE	0.7	0.7	vs. BBB	5%	15%	
S&P 500 Earnings Yield (E/P)	3.88%	4.24%	<= Earnings yield down; risk premium up			
10 Year US Treasury Yield (+50 bps in Oct.)	4.28%	4.28%	10Y Tr. Downside to Parity			0%
Spread (E/P minus 10 Yr. %)	**-0.40%**	**-0.04%**	**<= PE fell, risk tightened by 38 bps**			
BBB narrowed vs. Treasuries, as rates rose 50 and 44 bps respectively						
10 year BBB Corporate Yield (+44 bps in Oct.)	5.34%	**Norms**	<- Rose by 44 bps in October			
Yield Spread of S&P E/P minus BBB	-1.46%	-2.68%	BBB downside to nomal SPX			-24%
Yield Spread of BBB minus 10 Yr T	1.06%	2.20%	BBB upside to LT Spread vs. T			-18%

For the first time since 2008, stocks are neutral versus bonds, with the 10-Year Treasury offering a higher yield than the S&P 500, while the gap to BBB is the narrowest it has been versus its long-term average. The is still some room for stocks to rise relative to BBBs, but only ~15%.

This over-bought condition is rare heading into a rate-cutting episode and it sets up an interesting battle, rates need to fall further and earnings improve more than currently forecast to generate further gains in the markets, yet, the historical record suggests more gains should follow, and even where, as illustrated below.

S&P 500 Bull Market Annual Returns

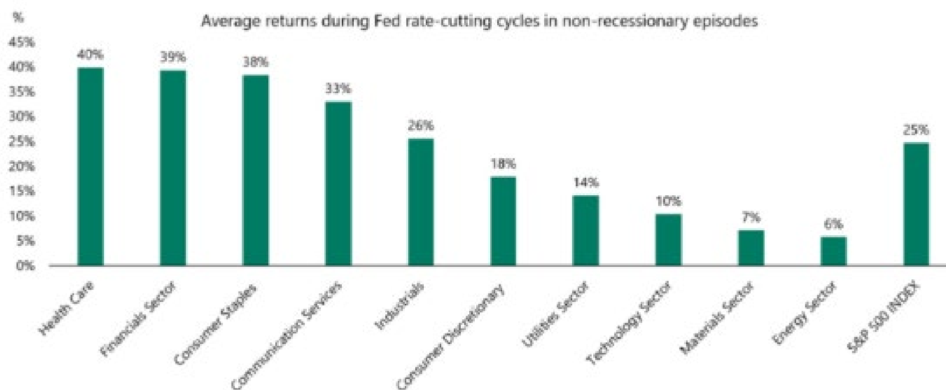
Bull Market		Full-Year S&P 500 Price Changes											Prior Bear
Start	End	Yr. 1	Yr. 2	Yr. 3	Yr. 4	Yr. 5	Yr. 6	Yr. 7	Yr. 8	Yr. 9	Yr. 10	Yr. 11	Recovery
5/17/47	6/15/48	19%	X										57%
6/13/49	8/2/56	42%	12%	13%	-2%	20%	39%	17%	X				1031%
10/22/57	12/12/61	31%	10%	-5%	28%	X							313%
6/26/62	2/9/66	33%	17%	2%	X								205%
10/7/66	11/29/68	33%	7%	X									169%
5/26/70	1/11/73	44%	11%	X									130%
10/3/74	11/28/80	38%	21%	-7%	6%	7%	18%	X					135%
8/12/82	8/25/87	58%	2%	13%	30%	37%	X						615%
12/4/87	7/16/90	21%	29%	X									129%
10/11/90	3/24/00	29%	6%	14%	1%	24%	21%	38%	2%	36%			1676%
10/9/02	10/9/07	34%	8%	7%	13%	16%	X						105%
3/9/09	2/19/20*	69%	16%	4%	13%	21%	11%	-4%	19%	18%	-2%	23%	305%
3/23/20	1/3/22	75%	X										223%
10/12/22	10/7/24	22%	32%										152%
Averages		39.1%	14.2%	5.2%	12.7%	20.8%	22.1%	16.9%	10.3%	26.7%	-1.6%	23.4%	375%

Source: CFRA, S&P Global. Past performance is no guarantee of future results. *Within 20 days of a complete year.

Source: CFRA

If the past were a perfect guide to the future, we'd simply load up on healthcare, financials, staples, and communications stocks, and crush the index. Certainly, the Internet-based

communications stocks and the financials are performing according to script. The rest of it is off the reservation so far, with valuations higher than we have ever seen, with margins still near all-time highs, and the country not being in a recession. So this time is different, by a wide margin and there aren't any North Star roadmaps to follow.



Part III: Portfolio News and Changes

We have been doing a lot of work on utilities and financials over the last two months, but getting questions answered during the quiet period slowed us down, as did the melt-up in both areas where we were working. Nonetheless, we did add Citizen's First to Dividend River and funded it by selling Unilever (U), which has been a good stock for us this year

Citizen's Financial Group (CFG)
Providence, RI based CFG is an $18.5B market cap regional bank that pays a 4.1% dividend and trades at 13X 2024 and 10X 2025 EPS estimates, with 20% to 30% EPS growth expected over each of the next several years – after reporting a 1/3 decline in earnings over the last two. It trades at 0.8X PB and 1.25X PTB, both ~20% discounts to peers. If CFG's management delivers the consensus expectations, which mathematically seem reasonable, the stock could yield a 100% rate of return over the next three years.

The drivers for the bank's high expected growth rate going forward include expansion of its private bank/wealth management division, which has been bolstered by 8 acquisition over the last 3 years (including HSBC's NY offices and hiring 150 people from First Republic in 2023/24), improvements in its general banking and lending franchises, and most importantly, and the rolling off of underwater swaps and hedges that have been undermining CFG's NIM over the last few years by 25 bps, On the downside, near-term net interest margin compressing and credit losses are expected to be headwinds that abate as rates fall and the yield curve normalizes.

On the private back side, the group reached profitability in Q3, as deposits and lending grew, helped by improved integration of the acquired personnel. These costs savings are expected to grow further in the quarters ahead as management seeks to drive its efficiency ratio lower. On the swap side, because the benefits are not expected to accrue until halfway into 2025, the Street seems to be overlooking the flip from them being a headwind into being a tailwind. As we don't mind waiting six months while being paid a 4% yield, for the magic to start, we have an advantage over more short-term focused investors.

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Looking ahead, the management expects its NIM to rise from 2.77% in Q3'24 to ~3.33% by Q4'27, with Fed Funds in the 3% to 3.5% range, this is better than most banks with more than half of the gain coming from the swap unwinding, beginning in 2H'25.

Performance (non-GIPSs)	Q1	Q2	Q3	October	YTD
Dividend River (est.)	+4.82%	(5.79%)	+8.17%	(1.93%)	+ 4.91%
Total Return Yield (est.)	+9.49%	(4.28%)	+7.67%	(2.13%)	+10.67%
DIVY NAV (Toroso)	+4.94%	(5.72%)	+8.22%	(2.18%)	+ 4.32%
DIVY Price (Toroso)	+5.10%	(5.67%)	+8.41%	(2.20%)	+ 4.48%

Characteristics – Still Cheaper Than the S&P 500, With Lower Betas and Higher Yields

Our portfolios are ~50% cheaper than the S&P 500 on a 2024e PE basis, with higher dividend yields and similar EPS growth expectations. YTD, our performance has lagged the technology-weighed indices because our high-yield mandates have prevented us from investing in the expensive, low or no-yield growth stocks have lifted the S&P and NASDAQ higher, thanks to their positive sales momentum and strong fundamentals. As we saw at the end of October and during parts of September and August, these high multiple stocks have started to falter, as their growth rates have slowed, which has pressured their valuation multiples at times. Our stocks too have been volatile too, due to uneven near-term results, but as short-term rates gradually come down, their relative prospects and performance should rise, especially the higher-yielding names, as yields become scarce the further the Fed goes with its easy cycle.

Dividend River Porfolio Characteristics

October 31, 2024

SECTOR WEIGHTS	SIS	SPX	KEY METRICS *	SIS	SPX
Communications Services	10.7%	9.4%	Dividend Yield	4.6%	1.3%
Consumer Discretionary	6.3%	10.4%	2024e PE	11.9	23.8
Consumer Staples	6.0%	6.4%	EV/ EBITDA	13.4	16.6
Energy	14.6%	3.4%	PB	4.5	5.1
Financial Services	17.2%	13.0%	2024e Sales Growth	3.5%	4.9%
Healthcare	17.6%	11.2%	2024e EPS Growth	10.2%	9.3%
Industrials	0.0%	8.5%	BETA	0.7	1.0
Information Technology	9.1%	31.0%	EPS Gr. + Div %	14.8%	10.7%
Materials	13.0%	2.1%			
Real Estate	0.0%	2.3%	* Based on Bloomberg consensus data.		
Utilities	5.5%	2.4%			
Totals	100.0%	100.0%			

Total Return Yield Porfolio Characteristics

October 31, 2024

SECTOR WEIGHTS	SIS	SPX	KEY METRICS *	SIS	SPX
Communications Services	8.5%	9.4%	Dividend Yield	3.5%	1.3%
Consumer Discretionary	9.7%	10.4%	2024e PE **	11.5	23.6
Consumer Staples	9.5%	6.2%	EV/ EBITDA	13.1	16.6
Energy	11.5%	3.3%	PB	5.5	5.1
Financial Services	18.3%	12.9%	2024e Sales Growth	1.3%	4.9%
Healthcare	12.9%	11.1%	2024e EPS Growth	10.2%	9.3%
Industrials	6.3%	8.4%	BETA	0.8	1.0
Information Technology	10.5%	31.6%	EPS Gr. + Div %	13.7%	10.7%
Materials	12.7%	2.1%			
Real Estate	0.0%	2.2%	* Based on Bloomberg consensus data.		
Utilities	0.0%	2.4%	** excludes WDC		
Totals	100.0%	100.0%			

As of October 31st, Dividend River was paying a 4.6% dividend yield, >3.4X that of the S&P 500 at 50% below its 2024e PE price, while the Total Return Yield was paying a 3.5% dividend, 2.7X the yield of the S&P 500, at 51% below its PE price. Dividend River has an 10.2% weighted average 2024e EPS growth forecast that is 90 bps above the S&P 500, while the Total Return portfolio is also expected to grow EPS 10.2%, 90 bps above the popular benchmark. With Betas at 0.7 & 0.8X the Index, both portfolios should be less volatile than the S&P, based on the historical movements of their constituent shares.

The EPS growth plus dividend lines in the tables below indicate that our expected total returns for both portfolios should exceed those of the S&P 500 in 2024, if multiples didn't change – but they have changed, with the S&P 500's multiple expanding. These figures suggest that the Dividend River total return could be 13.4% versus 10.7% for the index, while the Total Return Yield portfolio could be 13.7%, which is 3.0% above the S&P 500. These estimates are based on consensus EPSe, and assume that the relative valuation multiples remain the same.

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While stock prices are generally based on discounted future cash flows that look beyond the current year, the simple CY EPS growth + dividend yield heuristic has proven to be an accurate guide over time, and suggests our portfolios should perform relatively better than they have YTD.

Looking Ahead

With the election uncertainty soon to be passed and interest rates falling around the world we still expect the global economy to improve from here, despite the challenges of the rising deficit, wars, inflation and social discontent.

We are in an awkward transition period, with security valuation levels fairly high, by historical standards, but no great alternatives to stocks and bonds to preserve and grow wealth.

As we frequently remind ourselves, timing the market tends to be a precarious, value-destroying endeavor, so we tend to stick with the plan, and pay attention to the disconfirming information along the way. We are not blind to the need to make adjustments, but equally aware of the costs to bouncing around.

In the beginning, middle, and end, markets seek efficiency and equilibriums, which gives us faith that our low expectation, low valuation, and high dividend-paying strategies will continue to work more often than they fail, even though the past year has been relatively disconfirming, to say the least in Dividend River. Total Return Yield has been better, as it usually is, but if rates come down as expected, both of our relatively high-yielding portfolios should become hot tickets again, as they will have what everyone wants, money to spend when the alternatives are increasingly hard to find..

As always, we remain extremely grateful for your partnership and support. May your candidates win and you all have heartfelt Thanksgiving celebrations.

Gratefully yours,

Eric

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Investment Advisory Services offered through Sound Income Strategies, LLC, an SEC Registered Investment Advisory Firm.