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Sound Income Strategies
Monthly Equity Newsletter

Sound Income Strategies, Monthly Equity Update **November 30, 2024**

Monthly Maxims

"A vote is like a rifle; its usefulness depends upon the character of the user." - Theodore Roosevelt.

"The economy is not sending any signals that we need to be in a hurry to lower rates." - Jerome Powell.

Executive Summary

Macro: In November, there was a palpable pivot in global sentiment, as the unexpected Republican sweep in the US elections inspired a wave of economic optimism that has overcome concerns about slowing economic growth and rising Federal deficits. Investors are particularly optimistic about the Trump administration's deregulatory, lower tax rate, and global peace intentions. The expected benefits of these initiatives are believed to be strong enough to overcome the negative outlook revisions that many cyclical companies have given in their post-Q3 earnings calls, a pull-back in rate-cutting urgency by the Fed, and the prospect of a global tariff war, which the incoming President has threatening to impose on trading partners that have not stuck to prior agreements, to the detriment of US firms.

Markets: Stocks reacted to these events more favorably than bonds, as rates dropped only marginally in November, in response to concerns that lower taxes will mean higher Federal budget deficits and a less aggressive Fed will mean higher short-term rates for longer.

Portfolios: The Sound Income equity portfolios rose ~4% this month, as lower rates and pro-cyclical optimism lifted all sectors. We were very active in repositioning both equity strategies. Focusing on new names, in Dividend River, we sold Entergy (ETR), which had exceeded its price target, and replaced it with Evergy (EVRG), a cheaper utility, with a similar data center rate-base growth catalyst. In Total Return Yield, we sold Kenvue, which was approaching its price target, to buy Nomad Foods (NOMD), the leading frozen foods company in Europe that is benefiting from the growing adoption of frozen meals. We sold the shares of MAGN spun out of Berry Plastics, and reinvested the proceeds into Pfizer (PFE), which seems under-appreciated. We also exited Baxter (BAX) after its weak Q3 results and unresponsiveness in addressing our questions. We redeployed those proceeds into Sanofi ADR shares (SNY), which offer an attractive yield and above-average EPS growth.

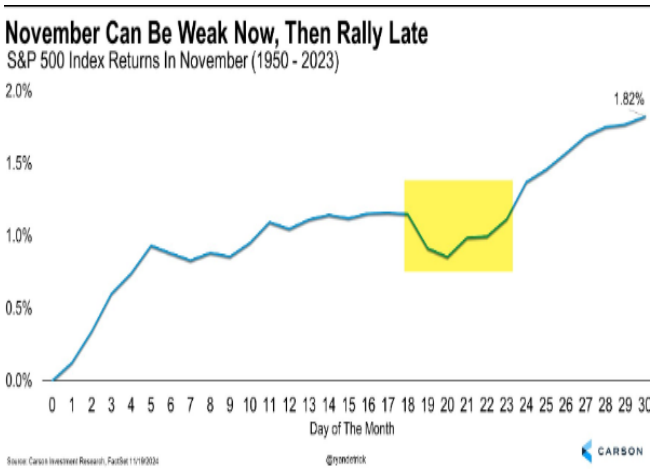
Part I: Macro Factors and Thoughts

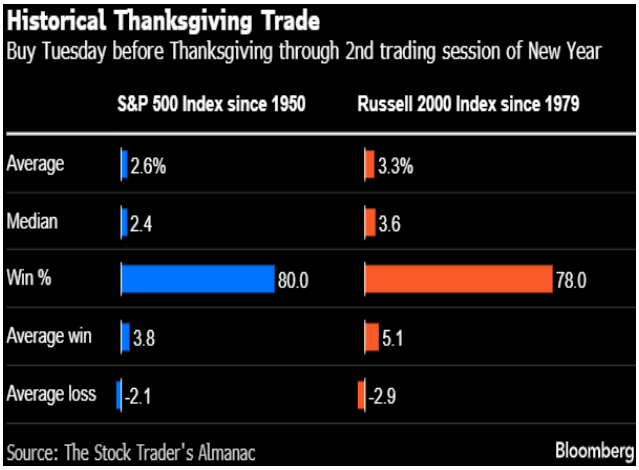
November's Market Action Did Not Disappoint Investors – Though it Did Shock and Awe Folks

November has consistently been one of the best performing months of the year and December is no slouch either. This year, the return in the S&P 500 was more than triple its historical average 1.8% gain (see charts below), as the surprising Republican sweep ushered in a wave of optimism about "change we can believe in" that hasn't happened in a long time. The long and short of it (or should we say the

long and “short covering” in response to it) is that the prospect for lower taxes and lower regulatory burdens very likely means faster and more economic growth than what the Biden administration and its Harris extension were offering, and greater personal wealth accumulation.

The markets did not need a room full of Nobel laureates to reach these conclusions, but to validate these expectations, the Administration and the American people will need a few eggs to crack open sunny side up when they fall, which will take some luck as well as skill on the part those manning the apparatus, many of whom are first-time operators.





Now, these expectations don’t come without clear risks and unintended consequences either, as Trump’s use of high Tariff rhetoric as a cudgel to beat recalcitrant foreign administrations into adhering with prior trade agreements could easily backfire and lead to a global trade war, or his promises of lower taxes lead to a ballooning of the Federal budget deficit, which might raise long-term rates, instead of lowering them, or his stimulating faster economic growth might bring inflation roaring back with it.

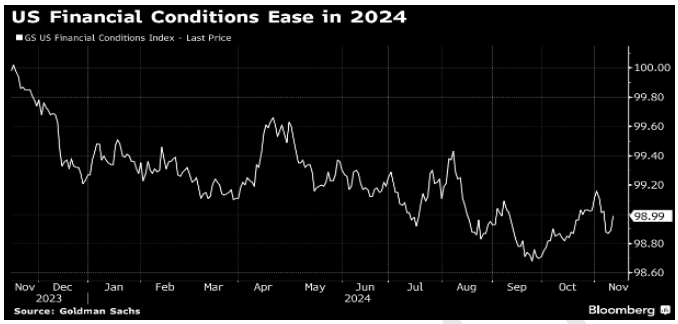
These risks are all real, but for now, the bloom is on the rose, and the big picture positives have emotionally outweighed the negatives. The voters and the markets have spoken, and while not perfect, so far, they like what they are seeing. We hope this wave of optimism and promise continues, and the reality turns out to be as good or better than expected – though the bar is high.

In the meantime, we are not out of the woods yet, with regards to global problems and slowing growth at home. As indicated below, the road to Nirvana is not smooth, but with bumps come opportunities.

Fed Plots to Deliver a Slower Rate Descent, As the Economy Hums Hotter Than Expected

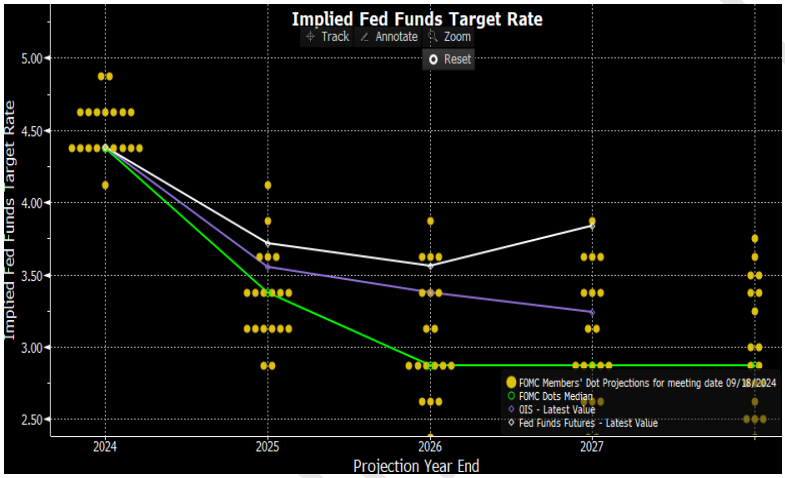
Real consumer spending picked up in October, as financial conditions eased, which is normally great news and consistent with a Fed cutting cycle, but Core PCE also picked up in October, as forecast, rising 0.3% M/M and 2.8% Y/Y, well above the Fed’s 2% (too low) target. The good news was that the annual PCE as calculated in September came in at 2.1%, down 20 bps from August and 80 bps year over year.

Metric	Actual	Estimate
PCE price index (MoM)	+0.2%	+0.2%
Core PCE price index (MoM)	+0.3%	+0.3%
PCE price index (YoY)	+2.3%	+2.3%
Core PCE price index (YoY)	+2.8%	+2.8%
Real consumer spending (MoM)	+0.1%	+0.2%



Still, the implication is that the Fed should slow down its pace of cutting interest rates -- despite its view that policy remains more constrictive than desired, as risks to the labor market have risen, because inflation is not going gently into the night, even after showing real progress over the past two years.

This signal is a problem for Chairman Powell, who really does not want to play the Grinch for Christmas, but the data keep telling him that he's been perhaps a little too generous recently, just as the cracks in the financial system told him he might have been too harsh when he got started raising rates. The quote at the top of this letter reveals that he intends to move slower with cutting rates going forward reflective of his current data dependent thinking on the topic. No one can be perfect when guessing, but the direction is still lower, albeit at a slower pace than before. Instead of reaching 3% by Q3 2025, as the Fed's estimates suggest, the futures market is now implying 3.6% by year-end, as shown in the chart below.



This gradual drop implies that the middle of the yield curve will be inverted for longer, which will extend the refinancing distress in the fixed income markets, and help keep rates overall higher for longer, which will slow down capital spending, versus prior estimates. As you can see in the charts below, another effect of these conditions is rising bond volatility and rising expectations for investment grade bond down-grades, as firms have increasingly fewer lower rate refinancing options before their current debts mature.

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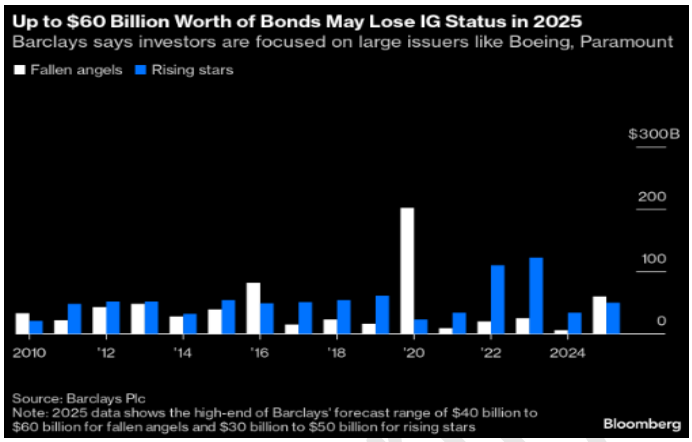
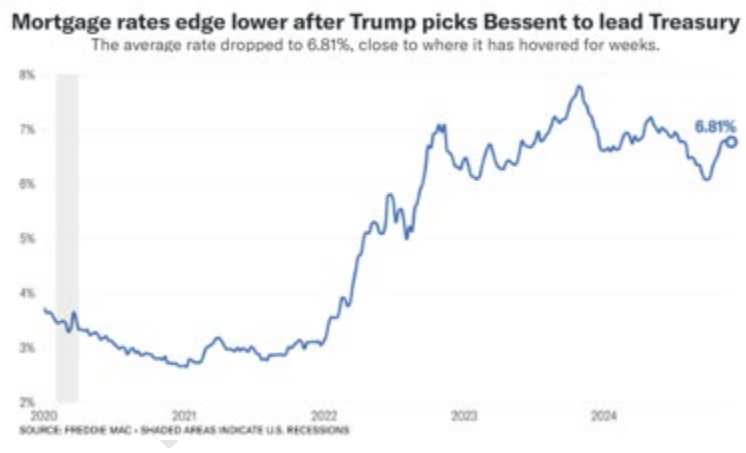
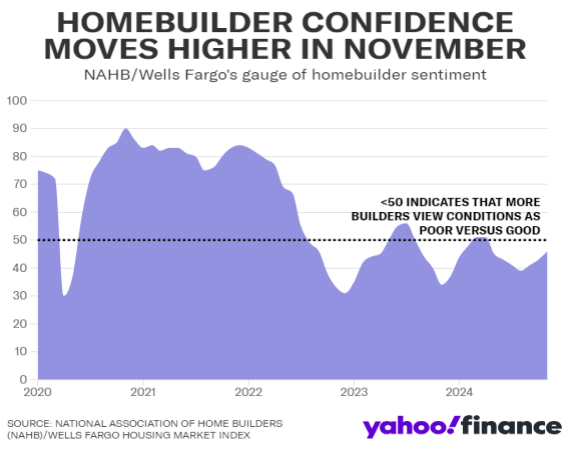


As far as the December 18th meeting goes, the swaps market is pricing in a 60% probability of a 25 basis point cut, but the torrent of data coming between now and then, including PMIs, JOLTS, Non-farm payrolls and mortgage applications are significant enough to potentially flip the probability of a cut to near zero, if things come in stronger than expected. The futures market is nervous and after a big run in November, some retracement in both stocks and bonds leading up to the meeting seems likely.

Mortgages Rates are Important – And the Backup in Rates is a Problem That Won't End Soon

As reported in Bloomberg, "Before Donald Trump's election, Redfin projected mortgage rates would average 6.1% in 2025. But three days after the election, they revised their estimate upward to 6.8% – basically unchanged from today's levels." The implication is that Trump's tax cut proposals and the resulting deficit growth would keep rates higher, however, we also got higher inflation data at the same time, so the entire backup is not due to the market's reaction to Trump. A week later, after Trump nominated Scott Bessent to lead the Treasury Department, mortgage rates began moving lower, as noted below. Nonetheless, the housing market needs them to move down another 150 basis points to ignite the housing market, by unlocking homeowners trapped in their homes by low-rate mortgages. This meaningful rate drop forecast is not yet on the horizon for 2025 or even 2026.





As the chart of the right implies, while homebuilder confidence rose with the election results and improving economic data, conditions for homebuilders continue to be poor, with affordability at its worst level in decades. To solve this challenge, the administration will have to offer more than cheap Federal lands, as discussed in the campaign. What would help is a mechanism for homeowners to keep their existing loans, and re-assign them to new properties. If the FDIC, Fed, and Fannie / Freddie could work out the necessary details to make that happen, they would truly have something that could help everyone. While not a novel idea, we will send this suggestion to the Fed and Treasury anyway.

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A Brief Note on DOGE and the Deficit.

Elon Musk and Vivek Ramaswamy are two bright guys who have pulled rabbits out of their hats before, but cutting $2T out of the Federal Budget via their newly created Department of Government Efficiency (DOGE) will require them to coordinate with Congress and across party lines in ways only witnessed before during times of war. It is possible, but unlikely to show progress in the near term, if at all.

	Oct-24	Dec-19
National Defense	18.38%	20.29%
Net Interest	18.30%	10.74%
Medicare	19.16%	18.96%
Income Security	14.11%	14.81%
Social Security	30.33%	30.29%
TOTAL	100.29%	95.09%

As the illustrations above imply, the ideal path to lowering the deficit would be a combination of raising revenues and cutting expenses, but with the administration committed to tax cuts, the need to cut expenses has become twice as critical to realizing this stretch goal. However, with so many non-discretionary expenses built into the budget, there simply isn't $2T of discretionary fat to cut, without taking out some meat along with it.

As shown above, the net interest cost is the fastest growing budget item. Hence, quantitatively lowering interest rates (again) could go a long way to artificially solving the growth in the deficit problem in the short run. However, in the long run, structural changes are necessary, with cuts in Social Security, Medicare and Defense being the fattest targets of what is left – that is if it all can't be rung from the system by adopting best practices efficiency gains, which both men have suggested is possible – though unquantified at present. So, we remain skeptical of the goal, and still are relying on the data we have seen, which show that unless revenues can be raised, benefits will have to be cut.

As we have suggested before, tariffs seem like a clumsy mechanism to export this burden and raise revenues, but a value-added tax, akin to what all of the European countries have in place, could work at raising revenues, without putting US corporations at a competitive disadvantage to their global peers, the way a higher corporate tax rate would. The question is, who has the ability to sell this idea to the American people, without a crisis forcing their hand? It most likely will not be anyone associated with DOGE or the current administration, but with Trump not seeking re-election in 2028, maybe that forecast will change too.

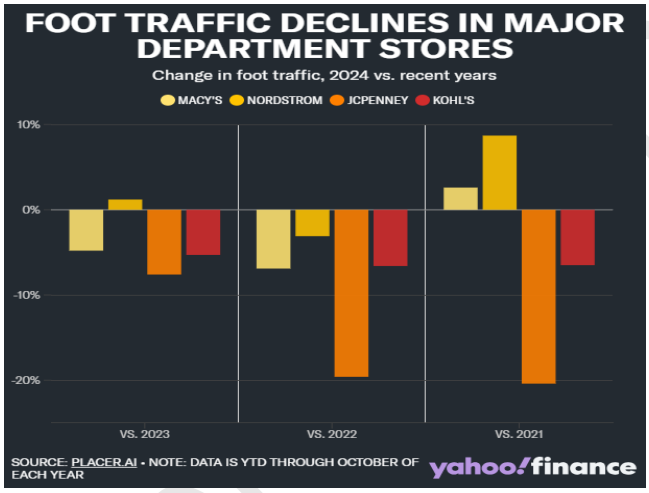
Christmas Cheer is Not Yet Clear

As we discussed in last month's letter, while consumer spending has risen a bit lately, which is good news, the shorter-than-normal window between Thanksgiving and Christmas this year is likely to stress retailers and consumers, who traditionally rely on five full weeks of shopping before the big day, but now have less than four. This tigher window will help online retailers at first, and Amazon and Walmart are doing just fine online, but in the last week before Christmas, they won't be able to deliver on time, leaving givers with sub-optimal choices. The net result could be more gift cards being given and clearance discounting later, which seems very likely to hurt already distressed retailers.

Partially offsetting this unusual seasonality, last week, the good people in the Baird equity research department overlayed the generally strong October US Bureau of Economic Analysis Income and Outlays report -- which showed that October personal income was +0.6% M/M (+5.3% Y/Y), due to strong wage growth, while PCE was +0.4% (+5.4% Y/Y) – hence positive nominal income growth, but no real income growth, after a couple of months of it, with retail channel data they track regularly. They found that over the past month, soft-lines spending (apparel) modestly decelerated, though spending on discretionary "things" overall picked up, benefiting from improvements in big ticket items. Retailer commentary was generally constructive regarding late-October/early-November trends – despite the risk of a crunch. The net of these observations seems to be that no one is panicking yet, and the consumer has been gliding forward, with lower-end consumers still cutting back (per multiple retailers) and the high-end spending. Even with a Trump sentiment bump, these responses are not overly encouraging for retail results as we close in on the big day, but they are not dire either.

As shown in the charts below, department stores have been severely hurt over the past 15 years by the growth in online sales. This trend was amplified during the covid shurtdown crisis and it continues today.

Hence, even if the consumer sees a resumption in net income growth in the months ahead, while broadlines retailers may beat reduced expectations, any target that assumes a return to prior year levels is likely going to be missed. These trends explain our extreme reluctance to dip our toes into stores like Macy's or Kohls, even though their valuation metrics are tempting, including the potential repurposing value of their real estate, which might be worth more than the store's themselves.



Something to Be Thankful For, from the 11/24/24 WSJ

According to the Wall Street Journal, the average cost of a classic Thanksgiving feast for 10 people—from the turkey to the pumpkin pie—has dropped 5% from last year.

This year's cost is $58.08, down from $61.17 last year, and down 9% from $64.05 in 2022, according to the American Farm Bureau Federation's 39th annual Thanksgiving dinner survey. It adds up to about $5.81 a person in 2024.

Of the 11 items on the Farm Bureau's menu, seven cost less than last year: turkey, sweet potatoes, frozen peas, a vegetable tray of carrots and celery, pumpkin pie mix, pie crusts, and whole milk. Only four menu items—dinner rolls, fresh cranberries, whipping cream, and cubed stuffing—cost more.

Notice that the study excluded cheeses, fresh produce, nuts, drinks, napkins, and other items that most holiday meals include. In checking this study against my receipts, it appears that my pre-Thanksgiving shopping experience cost over 25% more than it did last year, to feed 11 people and the total grocery store tally was nearly $400, not $58. Just the turkey, fresh cranberries, cheddar cheese, and stuffing ingredients (sausage, chestnuts, celery, broth, croutons) at Stop and Shop exceeded $58, so maybe the study was done at a Piggly Wiggly in Arkansas or assumed tiny portions, was completely made up. I am curious if other people tracked their expenses and found prices to be higher or lower.

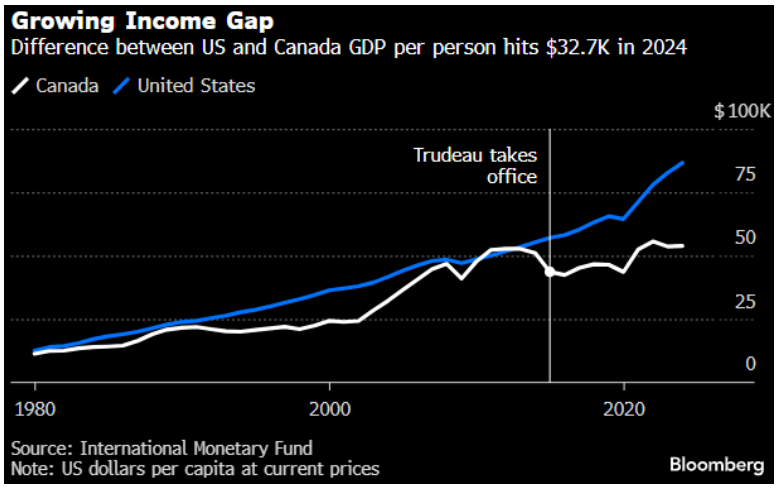
Peace In the Middle East – Great for Humanity, But Not So for Oil Prices

As if the energy markets did not have enough problems with electric cars and a glut of oil on the markets, with Russia is funding its war effort by shipping all it can to China, now, with Israel and Hezbollah promising to de-escallate their conflict with a cease-fire, the risk premium for oil fell a little bit last week, which weighed on oil prices and the price of oil company stocks.

As the chart below shows, oil prices started falling 2 days in advance of when the actual Lebanon cease-fire began, on Wednesday, November 27th, at 4 AM.

Eh, Canada?

The IMF GDP comparison chart below illustrates that it has been much better for the average person financially to live in the USA over the last five years, with its diversified economy, rather than to have lived in Trudeu's Canada, which is still largely natural resource-based, during a time when the world has turned its back on on so many natural resources in a political quest to decarbonize energy.



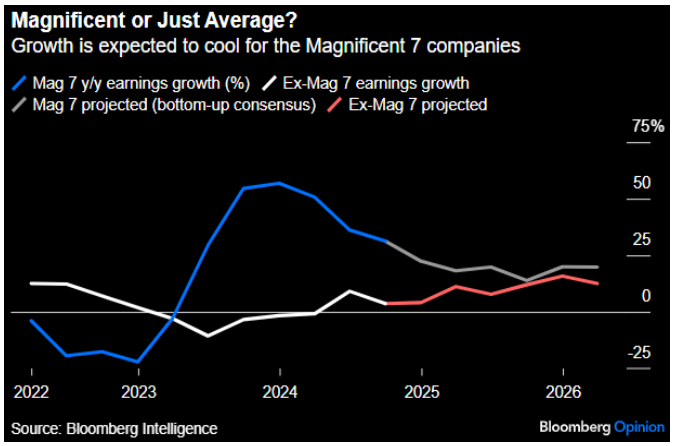
This chart also correlates with data that shows that US Government spending per GDP, which has been much higher than Canadian spending per GDP in recent years, seems to have helped to sustain US GDP growth, in US dollar terms better than the relatively smaller Canadian alternative.

In practical terms, this chart suggests that Americans, who had a similar GDP per household to their northern neighbors in 2017 are 60% wealthier than them. If the average Canadian knew this fact, we might have a border problem on both sides of the country. While this risk seems less likely, Justin Trudeau would very likely be shown the door, if this story gets picked up where it would count the most.

Part II: The Monthly US Equity Market Report

The Republican sweep predictably goosed financial stocks on deregulation optimism, which should increase M&A activity across all industries, and crypto-exposed stocks, as the Trump team has expressed open acceptance of the digital assets in contravention to the prior administration's scrutiny. Along with crypto, Tesla surged on the belief that Elon musk's coziness with the incoming POTUS and quasi-cabinet position as the co-head of the Department of Government Efficiency (DOGE) will let him tilt the tables in favor of Tesla in the auto industry.

Despite the surge in Financial and Utility stocks that are often bastions of value investors, Growth outperformed value again in November, even with slowing growth rates for the Magnificent names.

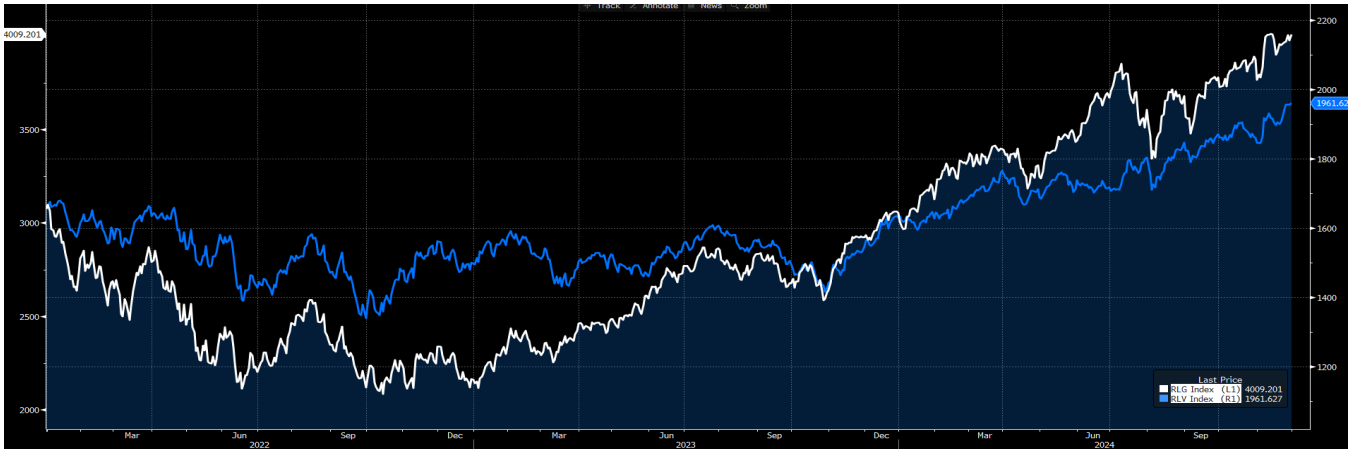


Healthcare was the biggest surprise drag this month, as the announcement that Trump nominated Robert Kennedy Junior to become the Secretary of the Department of Health and Human Services sank

most drug stocks, as he has been critical of the industry in his rhetoric throughout his career. This hurt GARP investors, like us, who felt that healthcare stocks might do better under a Republican administration that would likely impose fewer price pressures on the industries than we have seen under Democratic administrations. With a lifetime Democrat, who has been critical of the industry potentially at the helm of the Health Department, there are many concerns about what he might do if appointed, however, the history of such strong moves in reaction to appointments suggests that they will come back, once the shock wears off and it becomes clear that less will change than feared.

As noted in Baird's weekly research, following RFK, Jr's nomination, the "top 50 pharma stocks lost $180B (4%) in market cap from Wednesday-Friday. This move, relative to prevailing P/S valuations, implies ~$37B in at-risk revenues as market discounts implications of RFK cabinet appointment. To say what this means for our coverage is difficult at this point, though the size of moves – particularly in VEEV/PHR – is hard to reconcile with (the analysis) outlined below. We have seen that quickly discounting unknown risks can yield buying opportunities (see bank stocks in 2023); worth watching biopharma in this context, while acknowledging that political element adds risks."

Russell 1000 Value Versus Russell 1000 Growth – Last 35 Months



November Returns			
Russell 1000 Value (RLV)	+6.38%	Russell 1000 Growth (RLG)	+6.49%
S&P 500 (SPX)	+5.87%	Dow Jones Ind'l Average (INDU)	+7.74%
S&P 500 Equal Weight (SPW)	+6.42%	iShares Select Dividend ETF (DVY)	+6.43%
NASDAQ (CCMP)	+6.30%	Sound Equity Income ETF (DIVY)	+4.27%

Again, DIVY underperformed DVY because, a) it has a 10% and 20% lower weightings in the top performing financial and utility sectors respectively than DVY and b) it has a 13% higher weighting in healthcare, which has been lagging.

Sometimes being consciously different than a peer or index is a strategy to game relative performance. In our case, we are not actively competing with indices or benchmarks, but rather focused on assembling diversified, high-yielding portfolios that should perform well over time, and under various market conditions. However, in narrow markets, or those where select sectors greatly outperform others, this balanced strategy runs the risk of relative under-performance, just as it can lead to outperformance when a large concentration elsewhere goes down disproportionately.

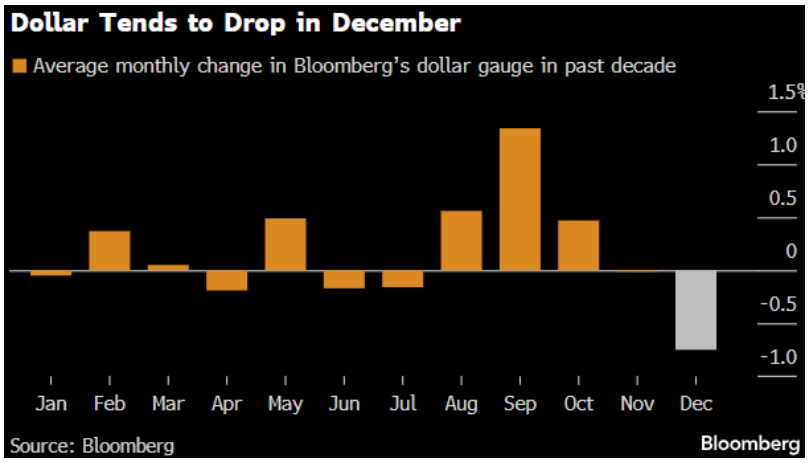
Guidance Continued to Come Down in Q3 Reports - But Seasonal Factors Suggest A Strong YE Finish

As shown in the Monthly Market Report table below, there were more sectors with negative earnings revisions than those with positive revisions for the past three months. We saw more of these pull-backs in company guidance during the Q3 reporting season than we saw following Q2, indicative of softening

demand. However, we also saw a few green shoots of improvement in select consumer names, where pent-up demand led to higher sales. One notable win was in Walmart, which raised its outlook, in contrast to the Dollar Stores and Target, which cut expectations. Also, GM reported strong sales demand, while Stellantis, Ford, and Volkswagen reported weakening demand.

On the ugly list, as shown in the table below, Energy and Materials company sales softened due to weak pricing and consumption. The strong dollar and talk of large tariffs being imposed against Canada, Mexico and China are not helping these sectors either, as they only portend higher costs to consumers, which means lower quantities sold. Both management teams and analysts are forecasting the prospects of lower demand, which is nicking estimates and chipping away at sentiment. Improving peace prospects in the Middle East are not helping energy prices either. While, the tardiness of rates to come down is delaying the benefits that falling interest rates could have on housing and materials demand for large financed projects.

Seasonality, however, bodes well for both ongoing stock price strength, as falling temperatures tend to lift energy prices, and a falling dollar, which benefits from a dip in imports towards year-end, also helps company sales. This soft-dollar tendency is illustrated in the Bloomberg chart below



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Monthly US Equity Market Report *11/30/2024*

Fundamental, Technical, and Valuation Snapshots

Fundamentals: inflecting as short-term revisions are mostly negative, but optimism is rising.

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

(+)	Information Tech	AI and related demand for servers and chips continues to be strong.
(+)	Communications	Nearly everything is clicking, except Match, Paramount and Warner Bros.
(+)	Financial Services	Estimates rising on steepening curve & deregulation optimism.
(+)	Utilities	Falling yields and AI demand story have lifted stocks and EPS estimates.
(--)	Real Estate	Sentiment is turning up, while fundamentals are OK, despite revisions.
(--)	Consumer Staples	Very mixed. Dollar stores & most foods down, groceries & tobacco up
(--)	Consumer Discretionary	Nike, Ulta, MGM, Lulu & select auto names are down, but most est. rising.
(--)	Healthcare	RFK, jr fears have hit stocks, along with lower reimbursement rates.
(--)	Materials	Prices, costs & volumes down, but China stimulus has lifted outlook.
(--)	Industrials	Stocks are up on rising sentiment, despite falling short-term estimates.
(--)	Energy	Prices down on slowing demand, growing production & cease fire.

	11/30/2024		Earnings Revisions			Performance (Total RoR)		
	Mix		3 Mo.	6 Mo.		MTD	QTD	YTD
S&P 500			0.6%	0.9%		5.9%	4.9%	28.1%
Communications	9.2%		4.1%	2.6%		3.1%	5.1%	35.4%
Consumer Discretionary	11.2%		-1.0%	2.3%	Best =>	13.3%	11.6%	27.1%
Consumer Staples	6.3%		-0.8%	-0.1%		4.7%	1.8%	20.9%
Energy	3.4%	Worst =>	-8.4%	-15.7%		6.9%	7.8%	16.8%
Financial Services	13.5%		0.5%	1.9%		10.3%	13.2%	38.1%
Healthcare	10.5%		-1.0%	-2.3%	Worst =>	0.3%	-4.4%	9.4%
Industrials	8.6%		-5.8%	-6.8%		7.5%	6.1%	27.5%
Information Tech	30.6%	Best =>	6.3%	10.9%		4.7%	3.6%	35.0%
Materials	2.0%		-4.6%	-7.6%		1.6%	-1.9%	12.0%
Real Estate	2.2%		-0.3%	-1.0%		4.1%	0.7%	15.1%
Utilities	2.4%		0.1%	0.3%		3.7%	2.6%	34.1%

Technicals: Overall Bullish: ST, IT & LT are all bullish, per StockTA.com

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

(+)	Trend	11/11 sectors rose on new administration & lower rate 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]	6,032	5,892	5,839	5,677	5,455	
(+)	Price / Moving Average [4 / 4 are "> 1"]		1.02	1.03	1.06	1.11	
(+)	Support Levels are Plentiful	5,998	-0.6%	5,968	-1.1%	5,930	-1.7%
(+)	No Resistance Points						
(+)	Volatility, (VIX)	VIX fell by 9.65 to 13.51 on outlook optimism.					
(+)	Trading Volume	Volume rose as the meltup picked up steam.					

Financials Have Taken the Lead from Technology & Utilities

After suffering two mini-crises, in both 2023 and 2024 as a result of the Fed's most aggressive overnight rate hiking program in history, the regional banks have come back in the second half of 2024 to lead the Financial sector to market leadership, with the triple benefits of: a) real consumer income growth, which

has lessened the credit strain normally seen late in a business cycle, b) a change in the Fed's policy from raising rates to cutting rates, and c) the light-switch flip from an administration that was the most anti-M&A consolidation in the nation's history to one which promises to be the most accommodating.

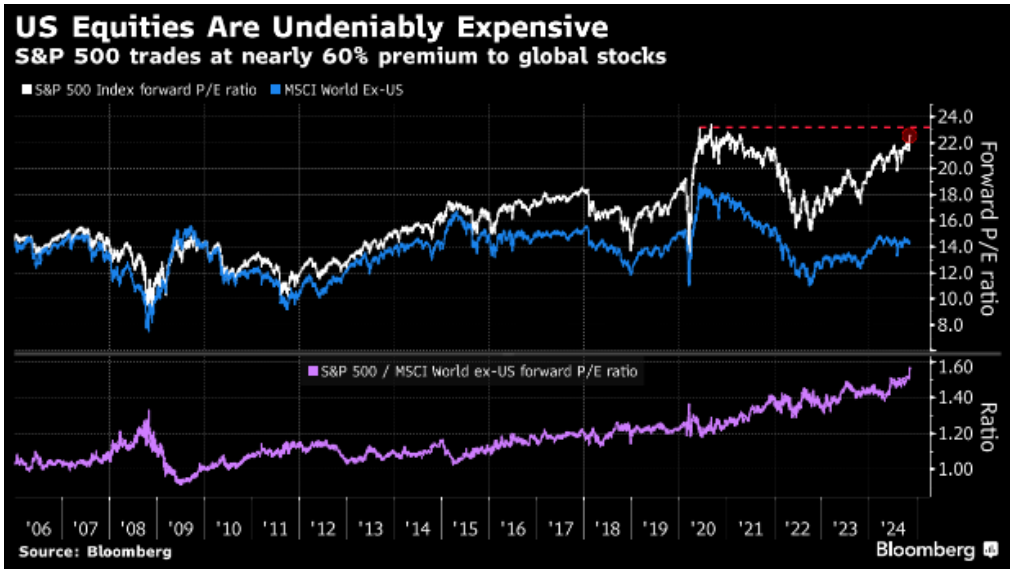
The industry almost could not have written a better film script – except that mortgage rates are still too high to kick-start housing and its follow-on consumption. We need a few more Fed cuts and more clarity from the new administration on taxes, cost-cutting, and tariffs before we see mortgage rates materially shift down, though they have dropped from peak levels this month on Bessent's nomination.

Technically

In November, the market went from neutral to nearly 100% bullish. However, the valuation jump that came with the post-election surge also flipped stocks from being priced relatively normally, in terms of earnings yield spreads versus Treasuries and BBB corporates, to being expensive versus Treasuries. In the past, this flip was a warning sign that stocks had gotten ahead of themselves.

This time, with margins and utilization rates still fairly high, it will be harder for the economy to grow fast enough to justify the current equity prices without industries adding capacity. That need to expand will likely put a strain on interest rates later in 2025, if demand picks up. Equally, if demand picks up ahead of capacity, inflation will rise and the Fed will never see its 2% target, and may raise rates again.

Extending the comparison of US stock valuations beyond comparing to historical spreads, US stocks look rich compared to global equities, even more so than they always do, as shown below.



This US premium in stocks is not surprising, however. Just as there is regularly a flight to safety in US Treasuries when there are conflicts and sovereign risks abroad, there is a similar flight to US equities when there is greater uncertainty abroad than at home. With the war in Europe, the Middle East, and Chinese growth slowing, the US markets seem like a safe haven too, plus, they have consistently outgrown European stocks, and been less volatile than Asian stocks. With feeble governments in faster-growing Africa and South America, including now a new leftist leader in Mexico, it makes sense that more global investors are flocking to US stocks than elsewhere.

This preference could change, if Trump can in fact help to end the war in Ukraine and get the Chinese and the Iranians to behave better, but until those hopes become reality, the US stock and bond markets look like the safest places to park capital.

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Valuation: Rich vs. Treasuries	PE		EPS			
Yields fell, spreads widened.	2023	2024e	2022	2023	2024e	
'24 PE is ~8.9 points > LTA	27.3	24.9	$ 224.4	$ 221.2	$ 242.3	<= est +
10 Year US Treasury: (1/r) = PE Equivalent	24.0	24.0	13%	-1%	10%	= *y/y %*
10 Year BBB: (1/r) = PE Equivalent	18.9	18.9	'2024 EPS est. rose by 1% in Nov.			
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	-12%	-4%	Warning
10 Yr BBB: LT Avg (1/r) relative to S&P PE	0.7	0.7	vs. BBB	0%	10%	
S&P 500 Earnings Yield (E/P)	3.67%	4.02%	<= Earnings yield down; risk premium up			
10 Year US Treasury Yield (-11 bps in Nov.)	4.17%	4.17%	10Y Tr. Downside to Parity			1%
Spread (E/P minus 10 Yr. %)	**-0.50%**	**-0.15%**	**<= PE fell, risk tightened by 38 bps**			
BBB widened vs. Treasuries, as rates fell 5 and 11 bps respectively						
10 year BBB Corporate Yield (-5 bps in Nov.)	5.29%	**Norms**	<- Fell by 4 bps in November			
Yield Spread of S&P E/P minus BBB	-1.62%	-2.68%	BBB downside to nomal SPX			-25%
Yield Spread of BBB minus 10 Yr T	1.12%	2.20%	BBB upside to LT Spread vs. T			-17%

With stock prices high, the expected returns for next year are generally below average, but still positive. In fact, some strategists are trotting out the bull market cycle argument to justify their expectations for low returns next year, as shown in the BMO / Yahoo chart below – with next year being the third year in the current bull market. We find these arguments both reasonable and flimsy. It is reasonable to expect high prices to precede lower returns, but it is less reasonable to compare the current economic conditions to normal business or market cycles simply because the factors driving this cycle have been vastly different than those at any time other than the post-WWII period.

Right now, we do not have a surplus of idle productive capacity, which is what normally precedes a cyclical slowdown. We do have too much capital, some of which is chasing foolish things, but that is only because companies have been restricted in pursuing M&A, and otherwise have been disciplined with their capital. If there is a need to expand global capacity to meet demand, such as there is for housing in the US, then we could see enough of a pickup in economic activity to send equity prices higher than simply up 5% next year. Certainly, value stocks and cyclical stocks, outside of those that have already run up, have plenty of scope to see their earnings and valuations rise more than 5%, even if the mega-cap tech names that have driven the indices take a breather. This is more in line with what we expect:

perhaps softer mega-cap-led index results and better value performance. Sure, this outlook is talking our book, but it also seems reasonable, if the markets are still equilibrium-seeking arbitrage engines.

A key factor still supporting the markets is the enormous amount of cash sitting on the sidelines, earning 4% now, down from 5% 9 months ago, soon to be earning just 3.5%. As rates fall, a large portion of this cash will move elsewhere.

Bloomberg 11/14/2024: ***"For the first time, US money-market funds have more than $7 trillion in assets under management, a milestone for an industry that's skyrocketed in popularity among investors, thanks to lofty and dependable yields. Even after the Fed cut its benchmark rate by half a point in September and a quarter point this month, they remain popular for their yields. So far this year, more than $700 billion has flooded into the funds according to one estimate."***

Part III: Portfolio News and Changes

November was a busy month of trading for us, with a lot of weight shifting in both strategies, due to valuation / price changes, and shifts in outlook. We have more work to do to get things where we want them to be for the start of 2025, but the run-up in the market has taken many targets out of range, and tax loss selling has weighed on some of the names we would like to replace. An emotional trader acts quickly, but often suboptimally. We endeavor to be disciplined, based on valuation and evidence.

Usually, this discipline works to our advantage, though sometimes, we have held dogs too long, or missed opportunities by not jumping on prospects before finishing the work. Again, the errors avoided have more than justified the missed opportunities, but it is human nature to be haunted by mistakes and critics more than reminded of successes.

Below are short summaries of the new names added to the portfolios in November.

<u>Evergy (EVRG) – Dividend River / DIVY</u>
Kansas City, MO-based Evergy is a $14.5B market cap electric utility serving Kansas and Missouri that pays a 4.2% dividend and trades at 16.5X 2024 and 15.9X 2025 EPS estimates, with 5% to 10% EPS growth expected over each of the next several years. Helping this growth rate is a new law that will allow the utility to file rate hike requests more expeditiously. Evergy's current PE multiples are ~15% to 20% below its peers, based on estimates <u>before</u> two data center development projects that are in their planning stages have been factored into forward earnings. If these projects are approved as estimated, they would add another 5% to EVRG's annual EPS growth rate. The combination of EVRG's baseline discount and the prospect of these new projects, which several analysts have told us they expect to happen, could lift EVRG's price by 25% in the next year. This gain, plus the dividend and natural EPS growth suggests 30% to 40% total return over the next one to two years, which is attractive, considering how expensive the market is right now.

<u>Nomad Foods (NOMD) – Total Return Yield</u>
Great Britain-based Nomad Foods is a $3B US market cap frozen food company serving Western Europe, with the top brands and market share for frozen foods in the region. NOMD currently trades at 9.9X 2024 and 9X 2025 estimated EPS, and it pays a 3.3% annual dividend. Earnings are expected to grow at 9% per year for the foreseeable future, which is above most branded packaged food companies. Like the US, one of its leading brands is Birdseye, but unlike US-based frozen foods, most of Nomad's foods are healthy, lower-cost alternatives to fresh meals, that are still gaining adoption by European consumers. Hence, the frozen category is gaining meal share and that phenomenon, as well as a gradual broadening of its offering to be more complete meals, versus singular dishes, is leading analysts to forecast above industry-leading growth in the years to come.

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We believe that Nomad will likely be acquired by a larger European or global branded food peer company, on account of its low valuation, superior growth, and market-leading brands – not to mention attractive 30% gross and 15% EBIT margins, for a food company. Whether via an acquisition, or gradual appreciation of the company's fundamental performance, we believe that Nomad will trade back up to over $30 per share, where it was in 2021, up 67% from where it is today, if it trades back in line with peer company multiples. This gain and the 3% dividend suggest that Nomad could return up to 70% to investors in the next two years if management can continue to execute its secular growth story and gain attention through such a performance. Even if the multiple does not expand, as we expect it to, if the company can realize 9% price appreciation, in line with EPS growth, and continue to pay out a 3.2% dividend, we will not be sad about the outcome.

Sanofi ADR (SNY) – Total Return Yield

Paris, France-based Sanofi is a $123B market cap pharmaceutical giant. It has a broad portfolio of therapeutic franchises, led by its Dupixent (immunology) drug, that continues to win label expansion, including promising trials for COPD, which has the potential to add a billion dollars to Sanofi's sales, if it earns approval for this condition. Other key drugs are Lantus (insulin), Kevzara (interleukin inhibitor blocker), and Lemtrada (CD52 monoclonal antibodies). Supporting the company's growth, recent launches of Altuviiio (hemophilia) and Beyfortus (RSV monoclonal antibody for infants) are doing well.

Like many pharmaceutical stocks, Sanofi has seen its price fall ~20% from recent highs on account of the RFK, Jr. nomination to lead the US Department of Health and Human Services, as he has been a long-time critic of the healthcare industry, in particular as a trial attorney, an out-spoken critic of vaccines, and a person who has suggested prohibiting drug companies from advertising their products to the public. These positions have led people to fear that negative changes could come to the industry, which will reduce profits. While bad outcomes could materialize, if RFK, Jr. is approved by the Senate, if he is not approved, or if these anxieties prove to be unfounded, then Sanofi could quickly rebound.

Currently, Sanofi trades at 12.1X 2024 and 10.8X 2025 estimated EPS, and it pays a 4.2% dividend yield. The company is expected to grow its EPS by 12% in 2025 and 8% in 2026. These PE multiples are ~10% discount to peers, for similar growth.

Like its peers, Sanofi is planning to separate its consumer business (Opella) from its branded drugs, which has the potential to unlock value, as these consumer franchises are currently trading at high teens PE ratios, which is 25% to 30% above the mid-teens or lower multiples for branded drug companies.

The combination of Sanofi's earnings growth, its above-market dividend yield, in a falling rate environment, the potential for a re-expansion of its multiple if the RFK, Jr. concerns don't materialize, on top of the potential value unlocked by separating the consumer products from the branded drug business all suggest that Sanofi's stock price should move higher if the company executes on its plans. We estimate the total pre-tax return over the next two years should range from +20% to +50%. However, if RFK, Jr. or the Trump administration do harm to the drug industry by changing US policies adversely, or if the company does not execute its plans, then the stock could decline. With 20% of a setback already priced in, however, we believer there is a reasonable margin of safety guarding against these unknowns.

Performance (non-GIPSs)	**Q1**	**Q2**	**Q3**	**Nov.**	**YTD**
Dividend River (est.)	+4.82%	(5.79%)	+8.17%	+3.77%	+ 8.86%
Total Return Yield (est.)	+9.49%	(4.28%)	+7.67%	+3.58%	+14.63%
DIVY Price (Bloomberg)	+5.10%	(5.67%)	+8.41%	+4.27%	+ 8.95%
DIVY NAV (Toroso)	+4.94%	(5.72%)	+8.22%	+4.09%	+ 8.59%

Characteristics – Cheaper Than the S&P 500, With Similar Growth, Lower Betas & Higher Yields

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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 behind the technology-weighed indices because our high-yield mandates have prevented us from investing in the expensive, low or no-yield growth stocks that have lifted the S&P and NASDAQ higher. Over the last few months, these high multiple stocks have started to falter, as their growth rates have slowed, which has pressured their valuation multiples at times, but YTD they are still up massively. Our stocks have been volatile too, but their prospects should brighten as short-term rates fall, lifting the attractiveness of their dividends, and the economy picks up, raising cyclical shares.

Dividend River Porfolio Characteristics

November 30, 2024

SECTOR WEIGHTS	SIS	SPX
Communications Services	10.7%	9.2%
Consumer Discretionary	6.6%	11.2%
Consumer Staples	6.8%	6.3%
Energy	13.7%	3.4%
Financial Services	18.1%	13.5%
Healthcare	16.2%	10.5%
Industrials	0.0%	8.6%
Information Technology	9.6%	30.6%
Materials	12.6%	2.0%
Real Estate	0.0%	2.2%
Utilities	5.6%	2.4%
Totals	100.0%	100.0%

KEY METRICS *	SIS	SPX
Dividend Yield	4.5%	1.3%
2024e PE	12.4	24.9
EV/ EBITDA	11.9	16.8
PB	4.3	5.2
2024e Sales Growth	2.3%	5.0%
2024e EPS Growth	8.5%	9.5%
BETA	0.7	1.0
EPS Gr. + Div %	13.0%	10.8%

* Based on Bloomberg consensus data.

Total Return Yield Porfolio Characteristics

November 30, 2024

SECTOR WEIGHTS	SIS	SPX
Communications Services	8.0%	9.2%
Consumer Discretionary	9.8%	11.2%
Consumer Staples	9.8%	6.3%
Energy	11.6%	3.4%
Financial Services	19.5%	13.5%
Healthcare	12.7%	10.5%
Industrials	5.7%	8.6%
Information Technology	10.4%	30.6%
Materials	12.5%	2.0%
Real Estate	0.0%	2.2%
Utilities	0.0%	2.4%
Totals	100.0%	100.0%

KEY METRICS *	SIS	SPX
Dividend Yield	3.5%	1.3%
2024e PE **	11.8	24.9
EV/ EBITDA	11.7	16.8
PB	5.1	5.2
2024e Sales Growth	0.6%	5.0%
2024e EPS Growth	10.0%	9.5%
BETA	0.7	1.0
EPS Gr. + Div %	13.6%	10.8%

* Based on Bloomberg consensus data.

** excludes WDC

As of November 30th, Dividend River was paying a 4.5% dividend yield, 3.5X 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 53% below its PE price. Dividend River has an 8.5% weighted average 2024e EPS growth forecast that is 1% below the S&P 500, while the Total Return portfolio is also expected to grow EPS by 10.0%, 50 bps above the popular benchmark. With Betas at 0.7X 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 13.0% versus 10.8% for the index, while the Total Return Yield portfolio could be 13.6%, 2.8% above the S&P 500. These estimates are based on consensus EPS estimates and assume that the relative valuation multiples remain the same.

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 it suggests that our portfolios should perform relatively better than they have YTD.

Looking Ahead

With the election results helping to lift US stock indices to all-time highs, there is likely to be more volatility in the year ahead than we saw in November, despite improving prospects for world peace and economic growth, thanks to the new administration's pro-business biases and falling interest rates and inflation. This expected pick-up in volatility is more due to the market pricing in more incremental good news than bad, and the history of news being less skewed to the upside than what seems to be priced in today.

The US economic growth rate is still positive, but slowing, and inflation is still slowing, but the aggregate level of prices remains oppressive to consumers who face sticker shock every time they go to a grocery store or look at real estate listings.

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Nonetheless, real progress appears to be being made in wealth creation and there are still shortages of goods and services that the world would like to buy if it could afford to do so, so there will be ongoing investing and growth.

With the economy and stock markets gradually broadening out, and bond yields slowly falling, the relative merits of our portfolios should continue to rise. After a very challenging year for high dividend value stocks, relative to no dividend growth stocks, we welcome this broadening out and look forward to better days ahead.

Thank you for your partnership and friendship on this journey. We appreciate all that you are doing for your clients and pray that you and yours will enjoy all of the warmth, joy and magic that the holiday season can provide.

Equitably yours,

Eric

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