FOR INTERNAL USE ONLY

Sound Income Strategies Monthly Equity Newsletter

Sound Income Strategies, Monthly Equity Update **January 31, 2025**

Monthly Maxims

"In investing, what is comfortable is rarely profitable." — Robert Arnott

"The individual investor should act consistently as an investor and not as a speculator." – Ben Graham.

For Internal Use Only

Executive Summary

Macro: In January, Government data and company earnings reports indicated that the US economy grew by ~5% nominally in Q4, with similar gains expected in 2025. While there is concern that the President's tariff proposals will be inflationary, it presently appears that more CEOs are optimistic that the Administration's deregulatory and lower tax initiatives will be more positive for their businesses than those who think that the tariffs will be negative. The press has mostly taken the opposite view, but stocks rose nonetheless, helped by generally better-than-expected earnings reports, an increase in deal activity, stable labor markets, and the quick resolution of the dockworkers' strike. As expected, the Fed held interest rates firm, with Powell indicating that there was a balance between inflation and employment concerns that warranted a pause in lowering the discount rate. At the long end of the curve, interest rates remain elevated, due to concerns about the Federal deficit and the low likelihood that the Fed will make more than one or two rate cuts this year.

Markets: January saw a rise in volatility and a change in leadership as news leaked out that Chinese A.I. search tool DeepSeek could perform generative A.I. queries at lower costs, with less sophisticated equipment, than the latest Western chipsets. The technology that DeepSeek uses has not been verified, but the prospects of the story being true knocked billions off Nvidia and its AI hardware peers' market caps. Ironically, this hit came right after they soared when Meta and Microsoft revealed 2025 capital investment plans that indicated much higher spending in 2025 than in 2024. The money that rushed out of technology shares spread into previously lagging sectors of the market, like healthcare and staples.

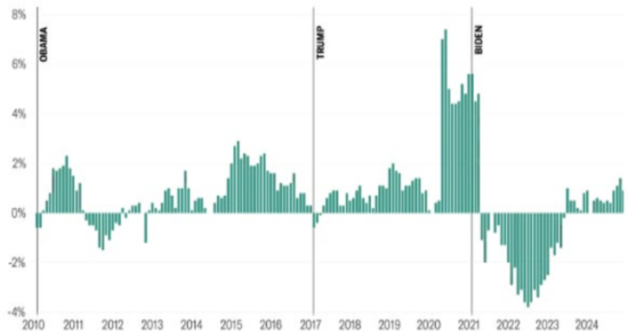
Portfolios: The Sound Income equity portfolios outperformed the S&P 500 in January, as mostly good earnings reports, a rebound in value names, and the drop in technology helped our relative results. In Dividend River, we sold our position in Edison International (EIX), after it appeared that the California courts were going to try to find evidence that they were responsible for the recent wildfires, even though none of the company's sensors indicated that was the case. We also exited Walgreens after the US Government and the State of Illinois filed redundant suits to the previously settled opioid dispensing cases, which killed the prospects for the company completing its takeout deal with Sycamore partners. We replaced Edison with Eversource (ES), an East Coast utility that is restructuring. We also added a 1% position in Wendy's and a 2% weight in Pepsi, after they traded down to multi-year lows on volume concerns.

FOR INTERNAL USE ONLY

Part I: Macro Factors and Thoughts

Earnings Growth Optimism Lifted Shares in January, Despite High Prices & Political Uncertainty

As illustrated below, US corporate earnings growth, outside of A.I., has been weak for the last few years due to rising costs, rising interest rates, and soft volumes. These issues were made worse by the Biden Administration's heavy increase in regulatory oversight, often with Executive Orders, including Lina Khan's anti-M&A policies, its plans for material tax increases, and its wealth redistribution efforts. These policies reduced executives' propensity to invest in large-scale capacity expansions, (as captured by the decline in the capital/employment ratio from the Spring '23 onward) on concerns that net attractive returns on investment might be too hard to come by to bank on – unless the Government offered some kind of sweetener to nudge progress. Hence, we saw more share repurchases than usual (which Biden then taxed) and an under-investment in industrial capital projects, which delayed the pace of rebuilding what was destroyed during the COVID-19 shutdown period.



Slide above from Yahoo Finance, 1/21/25.

However, in 2025, coincident with the Trump team promising to unwind as much of the anti-business regulation actions as possible and sustain the current tax regime for as long as possible, there is more optimism that US corporate earnings and capital investment will see a pick up in growth this year, against easier comparisons, aided by falling interest rates. Altogether, S&P 500 EPS are expected to grow in 2025 by ~14%, or ~8%, excluding the Magnificent 7 names, their best jump in 4 years.

This outlook is not a certainty, as currently high interest rates continue to sap consumers' purchasing activity and housing turnover. Also, there is broad anxiety over how much the new administration's policies might upset the status quo and the price of goods. For example, heavy investments have been made to decarbonize the economy, due to Government mandates, yet now some of the incentives and rules promoting that shift are set to be eliminated. Similarly, Trump's nominee to be the Secretary of Health and Human Services, RFK, Jr., has made comments about processed foods and vaccines that could be significantly disruptive to those industries should he be confirmed and change the rules governing food and healthcare programs. Whenever there are significant changes underfoot, uncertainty freezes decision-making, until the facts are settled. This response alone could upset the rosy forecasts for this year, if uncertainty lingers for too long – perhaps just as much as what a validation of the DeepSeek low-cost AI could mean for tech spending in the second half of 2025.

Trump's Tariff Troubles

The biggest flies in the ointment for the US economy so far this year are the growth in the Federal Deficit, Trump's unpredictable nature and the uncertainty over how the world will react to his tactic of

For Internal Use Only

imposing tariffs on trade partners to coerce them into adopting more US-friendly trade practices and behaviors, and to incentivize US companies to redomicile production to the higher cost US.

Historically, coercive actions have been met with as much retaliation as cooperation, but when Trump imposed tariffs on China in his last term, the Chinese did not retaliate, so those tariffs helped to shift US trade dependence away from China – though it increased China's influence elsewhere. The President seems to be relying on the success of that precedent in his efforts this time around. Certainly, tariff threats got Colombia and Venezuela to take back their refugees this month – at the cost of stirring the "we hate Gringos" rhetoric South of the border, so the President has notched a couple of victories in his belt so far with weaker nations, as beating up on weaklings is easy. Gaining advantages from taxing the US's biggest trade partners, Canada, Mexico, and China will be more challenging.

Trump has claimed that imposing 25% tariffs on Canada and Mexico and 10% on Chinese goods should raise US Government revenues enough to keep US tax rates low (though some trade zones and goods are excluded – and Canadian Oil will be taxed at 10%). This trade-off, and the economic boom that will come from US companies re-shoring activity will be more beneficial to the US, he believes, than the harm that will come from higher prices here or lower sales of US goods abroad, when they hit us back with tariffs on US goods. We shall have to see what really happens. Our belief is that Trump will adjust his position to be less onerous if he gets some concessions from the other countries that show some supplication to the US, but we have not seen any indications of that yet.

Already, the Mexican and Canadian premiers have asked their ministers for positive and negative responses to the tariff plans. As expected, the rhetoric out of Ottawa and Mexico City has been wholly defiant, with Canada proposing a 25% tariff on US consumer imports and Mexico considering the same. As articulated daily in the press, most economists disagree with the President's "net win" assessment and highlight the risk of a trade war, reminiscent of the Hawley-Smoot tariffs that amplified the severity of the Great Depression. However, most economists are not skilled negotiators, where the gray areas are more valuable in a negotiation than elements that are black and white.

We are not keen on this game, which has us reassessing how our holdings might fare versus alternatives, in a retaliatory scenario. Nothing would be safe if the world melts down in a global trade war, but utilities would be the safest, followed by ammunition and gold. Since the latter two don't have yields, though they do pay other dividends, we are mindful of playing both defense and offense -- that is to invest when others are fearful as much as to dive into a bunker when the bombs start falling.

Clearly, US executives, whose companies have built meaningful capacity in China, Mexico, and Canada to take advantage of their lower all-in costs, are not thrilled about these actions – though they are publicly playing nice with the administration by saying they can work around whatever changes happen. Unequivocally, the tariff adventure will be disruptive, and it is not clear that the benefits outweigh the costs. Hence, when it became clear on the last day in January that Trump really was going to impose these Tariffs on February 1st, which was not fully expected, US stocks dropped, as they should have.

The questions foreign leaders and US investors are left with include:

a) What does the US President really want?
b) What is the most beneficial response for each party, considering this change?
c) What might be the effects of these tariffs on prices and trade flows and how long might they remain in place?

For Internal Use Only

FOR INTERNAL USE ONLY

There are myriad tariff regimes in the world already and life has gone on without the sky falling, but few changes as large and sudden as these have taken place without there being short-term negative consequences. The uncertainty over the outcomes from these actions are likely to delay executives' willingness to make capital investments until there is more clarity on what will come. Hence, some of the benefits of deregulation are likely to be lost, for as long as this tariff threat game persists.

It is perfectly reasonable for Trump to point out how much our allies and adversaries have taken advantage of the US over time, such as with Government subsidies for their companies, unequal regulations, beggar thy neighbor tax policies, underfunding NATO, charging high fees to use assets we built for their benefit, passing costly environmental laws that tax the US, but not others, etc. However, demanding sudden changes to right these wrongs in the first weeks of his administration seems like too much to ask for at once. While we have not seen any formal polls on this subject, anecdotally, it seems that most American citizens agree we should stick up for ourselves more, but they would like to see more diplomacy than threats, and the administration to publicly offer solutions that are win-win for its partners, while lessening the US's role as a global patsy, instead of solely shaking a stick at everyone.

A Growing but Slowing Economy

The US economy continued to grow in Q4, however, the real US GDP estimate reported on 1/30/25 fell short of consensus, while personal consumption exceeded expectations, due to increased EV and hybrid car buying.

Indicator	Actual	Estimate
GDP	+2.3%	+2.6%
Personal consumption	+4.2%	+3.2%
PCE price index, excl. food, energy	+2.5%	+2.5%

More concerning to us than the GDP miss was the decline in backlogs and increase in inventories reported in the December ISM Services report. "The ISM® Services Backlog of Orders Index contracted in December for the fifth month in a row and the seventh time in 2024. The reading of 44.3% is 2.8% < the 47.1% reported in November." This measure indicates that purchasing managers expected the economy to continue to slow, even after the election results.

The ISM "inventory sentiment" was also positive but softening. As reported in its release, "The ISM® Services Inventory Sentiment Index grew for the 20th consecutive month in December… The index registered 53.4%, a decrease of 1.2% from November's figure of 54.6%. This reading indicates that respondents feel their inventories are too high when correlated to industry levels."

However, these measures were somewhat balanced by a surge in positive sentiment in the Philadelphia Fed survey for manufacturing shown below.

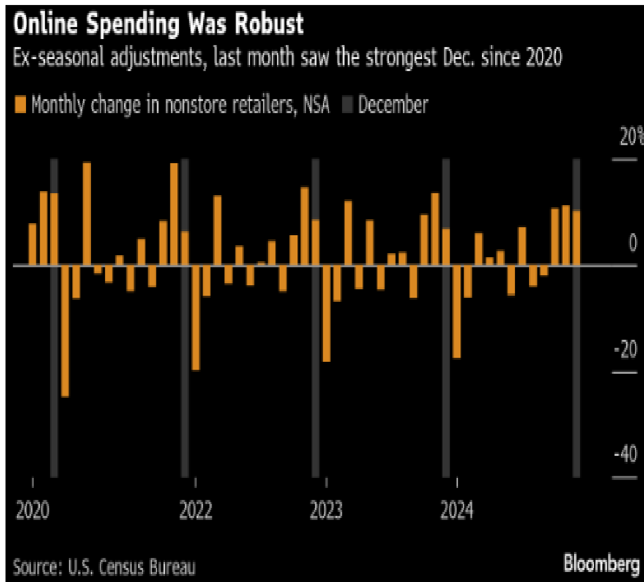
The net of these measures suggests a healthy environment of cautious optimism to us.

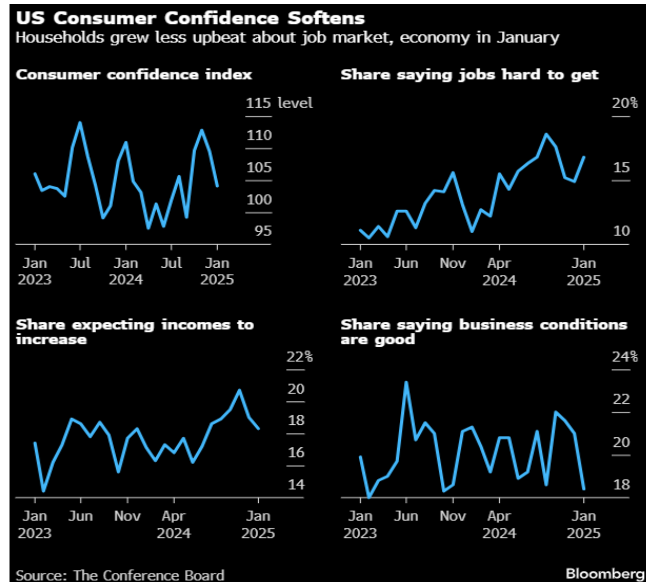
Consumer's Spent, But Confidence Dipped in December / January, As Unemployment Rose

As illustrated below, consumers ramped up their online spending in December, encouraged by the shortened Holiday selling season in inhospitable weather throughout much of the US. More importantly, consumer confidence fell a bit, as wage gains and job growth slowed. We expect these trends to continue until companies start investing more, after Q1.

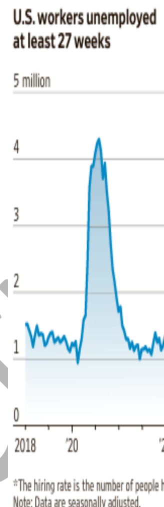
For Internal Use Only

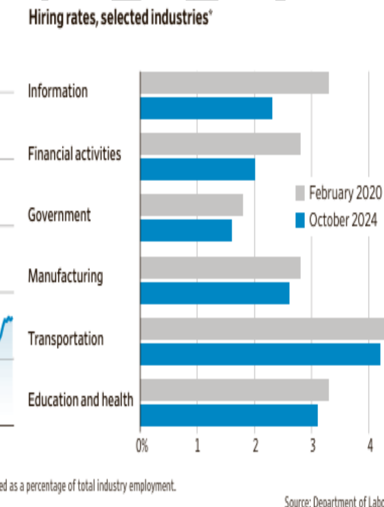
FOR INTERNAL USE ONLY

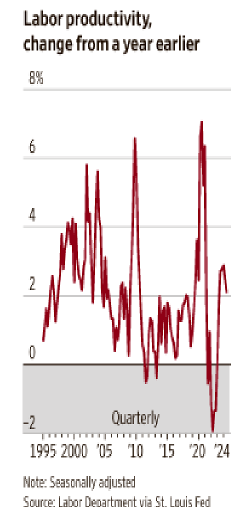




Jobs – Unemployment Slowly Rising – But Productivity & Wage Growth Still Positive





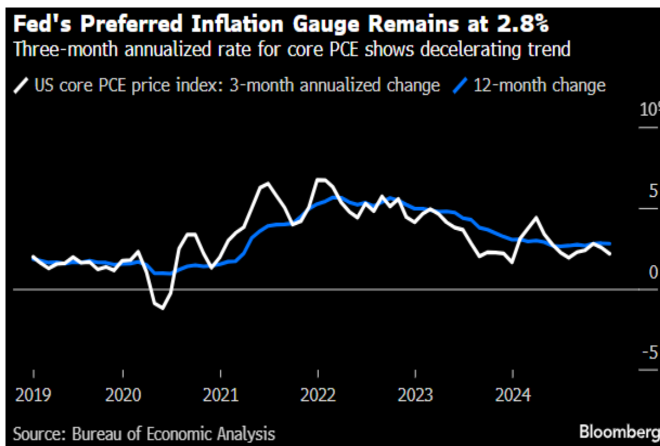


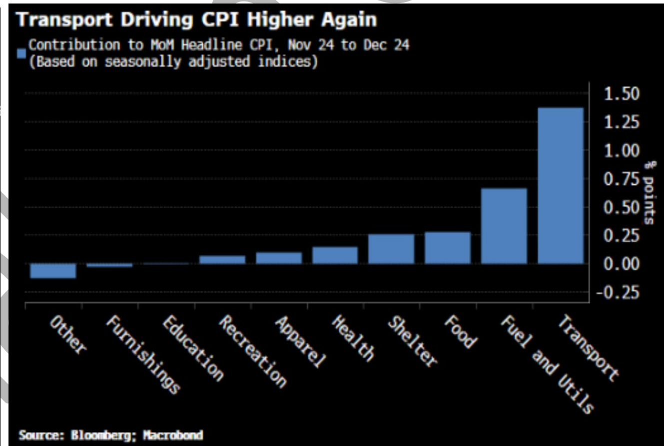
FOR INTERNAL USE ONLY

For a data-dependent Fed that has not driven inflation down to its target, these slowly moving unemployment and job growth figures are ideal, as they do not force the Fed to lower rates and focus on job creation, rather than price stability. While rising, unemployment remains near record lows, and the job openings data are still above pre-pandemic levels. In fact, the recent waft of deportations of illegal aliens may drive an increase in job postings and wage pressures that could allow the Fed to stay on hold for much longer than the current dot plots project.

Inflation & the Fed -- Inflation Lives, But There Is Hope For Further Declines!

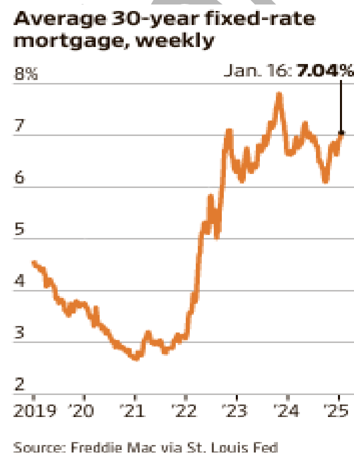
The January 7th ISM services report showed that inflation picked up in December which suggested the Fed was done with cutting rates for the time being. “The Prices Index registered 64.4% in December, a 6.2% increase from November’s reading of 58.2%. This month’s reading is the first time the index has registered over 60 percent since January (2024).“ This data was supported by the December PCE report that came out on 1/31/25. On a month-over-month basis, core PCE rose 0.2%, which was faster than the 0.1% measure for November. The annual and monthly figures were in line with expectations. However, on a three-month annualized basis, the core PCE advanced 2.2% in Q4, the least since July. So, while inflation reaccelerated in Q4, the longer-term trend is still lower, for now.

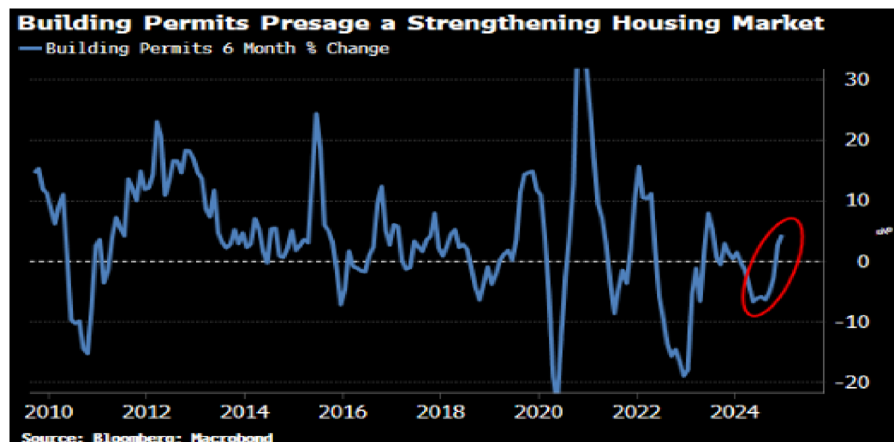




Housing & Permits

US mortgage rates continue to hover near two-year highs, yet new housing activity showed signs of rising with a more than seasonal increase in permits. This data is incrementally positive for cyclical stocks, like chemicals, for which housing is a key end market. However, existing home sales are still trapped by homeowners with low-rate loans who cannot afford the payment hike for a move. Mortgage portability could solve this issue, but it is not yet part of the agenda.

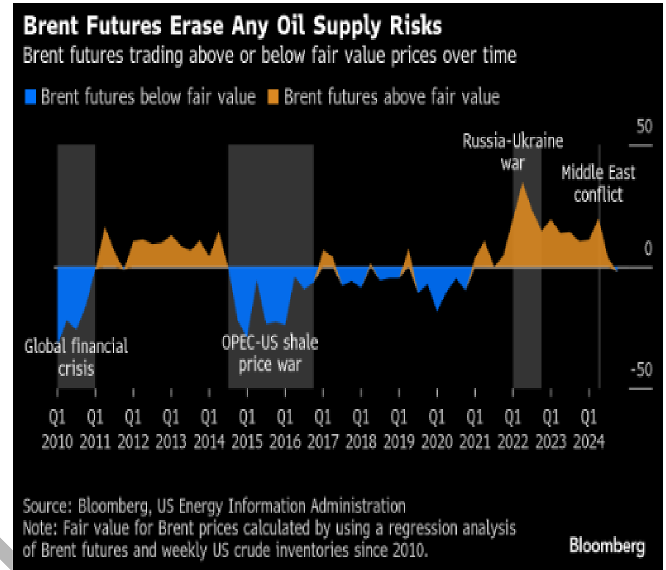




FOR INTERNAL USE ONLY

The Oil Yo-Yo

With the Chinese and European economies growing slowly, EVs reducing demand for traditional fuels, and the US shale production remaining higher than domestic demand, oil prices would likely be heading lower, if not for the global conflicts and production constraints voluntarily put in place by OPEC. As the chart below shows, the Brent futures premium due to the conflicts is nearly gone, now that there is a peace accord in Israel and at least some discussion of peace negotiations in the Ukraine. This is a scary spot for oil producers, and lower prices mean lower cash flows. This is an example of why we prefer tolling companies rather than commodity plays. Ironically, natural gas demand continues to rise, so all the news is not bad in the energy patch, and our holding Baker Hughes is making a killing right now, not selling oil field equipment so much as it is selling components to increase global LNG capacity. "The future Benjamin, is NatGas."

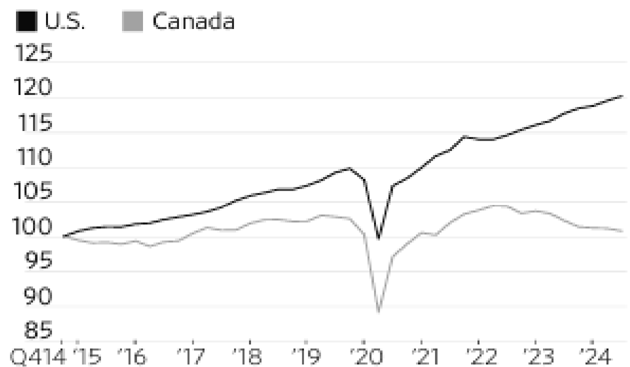


Oh, Canada!

Over the course of his nine painful years as Prime Minister, Justin Trudeau's Progressive agenda led to a noticeable relative decline in Canadians' financial well-being versus those of their Southern neighbor. As shown below, American GDP per capita increased by 20% over his tenure, while Canada's did not move at all.

Largely to blame for this dip in Canadian wealth was Trudeau's decision to decarbonize Canada and demonize fossil fuels. While this view was consistent with the fashion of his party, it was inconsistent with the fabric of his nation, as Canada is a country that largely makes its living off of exporting petrochemicals, minerals, and agricultural products that rely on carbon-based fertilizers to grow.

While raw materials still remain Canada's biggest industrial category, Ottowa's war on Energy and Green socialism under Trudeau cost Canadians so much welfare that he was unceremoniously diminished and nudged out, after nine years of power. It is not clear who will come next, but most likely that the Prime Minister will treat his golden geese better than the last one did, and hopefully the new person will also play nicer to people who disagree with him or her than Trudeau, who froze the bank accounts of those who opposed his draconian Covid-19 lockdown policies, for example.

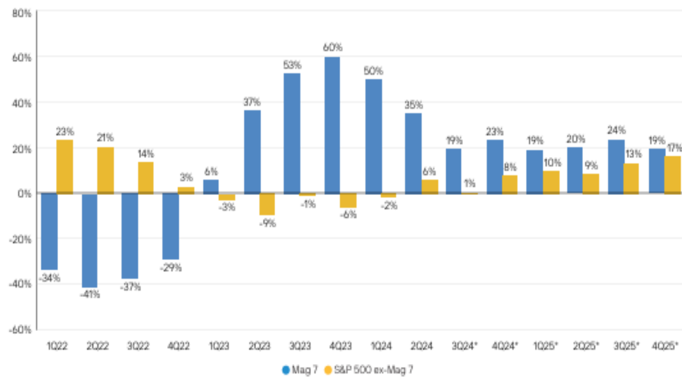


For Internal Us

FOR INTERNAL USE ONLY

Part II: The Monthly US Equity Market Report

As discussed above, stocks rose in January, led by value and cyclical names, on the back of mostly favorable earnings reports, optimism about the Trump de-regulatory actions and tax proposals, and an on again off again cooling of investors' overweight in AI technology names, which have dominated the markets for the last two years. As shown in the LHS JPM chart below, this surge in technology names was led by their relatively strong sales and earnings growth profile, compared to everything else in 2023 and 2024. However, with everything else forecast to finally start growing earnings again in 2025, and with them trading far below the Magnificent 7 names, it doesn't take much to shake investor's confidence in the AI trend and to seek cheaper names. We got a vivid example of this skittishness on January 26th, when the DeepSeek news hit the tape. The RHS shows growing cyclical expectations.



Russell 1000 Value Versus Russell 1000 Growth – Last 37 Months

Finally, value stocks outperformed their growth peers, led by healthcare, industrials, materials, financial services, and utility names. More significant than the positive trades in these mostly cyclical areas was the pullback in AI names, as Chinese AI startup DeepSeek was able to match the effectiveness of its Western peers, presumably with older technology at a substantially lower cost. These claims have not yet been verified, but if they are true, this leap in performance will likely accelerate AI adoption and lower capex. Unless this claim is disproven, we expect AI orders to slow, as companies seek to get the most bang for their dollar, rather than over-order, as they have been, on the fear of being left out.

FOR INTERNAL USE ONLY

January Returns

Russell 1000 Value (RLV)	+4.63%	Russell 1000 Growth (RLG)	+1.97%
S&P 500 (SPX)	+2.78%	Dow Jones Ind'l Average (INDU)	+4.78%
S&P 500 Equal Weight (SPW)	+3.50%	iShares Select Dividend ETF (DVY)	+2.64%
NASDAQ (CCMP)	+1.66%	Sound Equity Income ETF (DIVY)	+2.78%

My Kingdom for a Benchmark

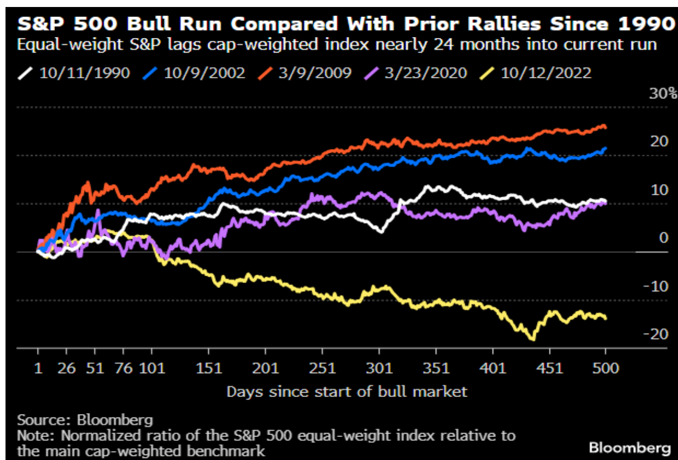
The last two years have been brutal for high dividend value investors, because it is human nature for people to think that if the S&P 500 and NASDAQ were up 20%+ each year, then it is reasonable for them to expect similar returns from their portfolios, even if they sought out considerably less risk, as is appropriate for folks in or near retirement status. Hence, the illogic goes, any investor that captured lower returns than the S&P 500 must be a moron, or they should at least switch up what they are doing.

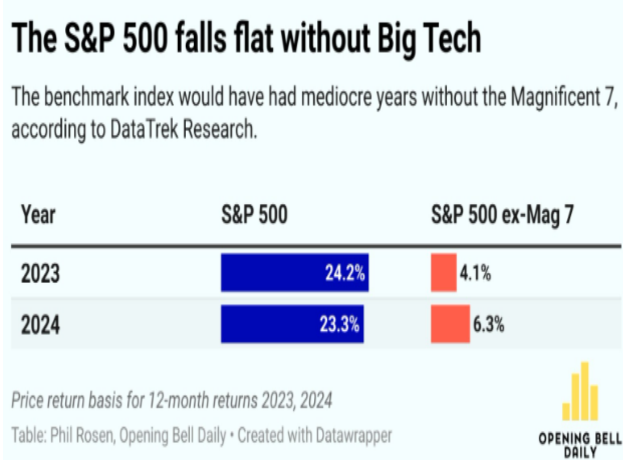
This kind of thinking is not only misguided, because it conflates all forms of equity investing as one, and assumes low-risk, lower-reward portfolios should do as well as high-risk portfolios, but it is dangerous, as performance chasing is a proven path to sub-par returns, for those who get in late.

Fortunately, most of our advisors are smart enough, informed enough, and articulate enough to be able to explain why this expectation is not realistic for their clients who have selected lower-risk, and higher-yielding vehicles, like ours. But, not everyone gets it on the first try, so we will rehash some helpful facts.

The LHS chart below illustrates with the yellow line that the last two years, in which mega-cap growth names dominated the performance of the markets were unprecedented. Usually, the equal-weighted S&P 500 has outperformed the cap-weighted index, but this was not the case in 2023 and 2024. Further, the RHS illustration shows that over the last two years, if you take out the contribution from the Magnificent 7 names from the S&P 500, the returns would have been just 4% to 6%, not 23% to 24%. Yet, the average investor does not realize that, nor do some advisors, based on the emails they send me.

Once folks are shown the breakdown of what led the market-cap-weighted indices to outperform everything else, it should be clear that it is unreasonable to expect that portfolios like our Dividend River and Total Return Yield portfolios, which have mandates that preclude us from investing in those type of no-yield and high-multiple stocks, should miraculously match them performance-wise, during such a period. Yet, some of the letters we get from advisors show that not only do some of the clients not get it, but some of the advisors don't get it either.





The S&P 500 falls flat without Big Tech

The benchmark index would have had mediocre years without the Magnificent 7, according to DataTrek Research.

Year	S&P 500	S&P 500 ex-Mag 7
2023	24.2%	4.1%
2024	23.3%	6.3%

Price return basis for 12-month returns 2023, 2024

Table: Phil Rosen, Opening Bell Daily • Created with Datawrapper

OPENING BELL DAILY

Also, everyone knows we freely allow our advisors and their clients to invest beyond our high-yield, low-beta equity portfolios, for those who can handle more risk -- which has a downside, as well as the upside.

We even have a Mag-7 chaser for those who want to play along. However, we created our core equity portfolios to fill a void in the market, for clients that want to capture higher qualified dividend yields than those that are normally available, with our low Beta funds, which are suitable for retirees, who have less tolerance for volatility than younger folks, who can replenish their tanks during drawdowns.

Unfortunately, we have also created a bad benchmark problem of leading advisors to compare our performance to the S&P 500 because we have used the S&P as a basis for comparison for valuation, yield, and sector weights. We have used the S&P as a characteristic benchmark because there is so much data and broad familiarity with it – NOT because it is a basis for comparison for expected returns. Yet, that is what it has become. This comparison unfortunately undermines the significantly lower risk and return expectations that should come from higher-yielding, lower-priced portfolios like ours, in part because we out-performed the S&P 500 for two and a half years before we started trailing it in 2023.

Indeed, not only does the S&P 500 have significantly lower yields and higher PE valuations than our portfolios, but it is overly concentrated in information technology, with a 30% GICs weighting. Further, if one adds back Amazon, Google, Meta, and Tesla, among other mischaracterized names, the technology weighting of the S&P 500 would be over 40%. Our maximum industry exposure, for risk mitigation purposes, is 25%, and the highest we have ever gone is 20% in financial services. The risk of the S&P's concentration shows up when Technology under-performs, the way it did in 2022, when the index fell 20%, while our portfolios held up.

The next most cited benchmark is the Russell 1000 value (RLV) index, which at least is spiritually closer to what we do than the S&P 500, NASDAQ, or even DJIA. However, the Russell 1000 Value Index also trades at a 50% higher PE, at 19.7X, than our funds, and pays a 2% dividend yield, about half of our funds' average. Also, sector-wise, the RLV is led by Financials, which make up 21% of the index, and Industrials, which make up 18.7%. This weight is higher than ours because industrial names are expensive and low-yielding now. It also holds 5% in REITs, which are not allowed in our funds. Hence, this benchmark too is not really a good basis for comparison for our funds either.

In fact, the REIT, BDP, MLP, and tobacco exclusions, that make our funds unique, make it difficult to find comparisons. An ideal benchmark for us would be an equal-weighted, custom list of stocks that meet our investable criteria. Unfortunately, there isn't an off-the-shelf model that finds our criteria.

One broadly-owned diversified ETF that people look at versus our funds is the iShares Select Dividend ETF (DVY), which is the closest ETF to our funds that we have found, though it too is different. DVY holds over 25% in Utilities and over 5% in tobacco names, which makes it riskier than ours, and its yield is ~3.5%, similar to Total Return Yield, but with lower long-term performance.

The S&P 500 High Dividend Index, which measures the performance and characteristics of the 80 highest-yielding companies within the S&P 500, on an equal-weighted basis comes the closest, but it too is heavily weighted in unqualified dividend payers, like REITs (22.75%) and MLPs (4.5%). It is also more heavily weighted in Utilities (17.2%) than we would ever be. Because of the REIT overweight, the fund's average PE is 31X, nearly 3X ours, but the dividend yield has ranged between 4 and 5%, so it is close. The ETF that matches this index is called the SPDR Portfolio S&P 500 High Div ETF (SPYD).

Similarly, the Dow Jones US Select Dividend Index (DJDVY) a 100 stock portfolio with the highest dividend payers that have a payout ratio of 60% or less, is 29% made out of Utility names, 28% financials, and it includes Philip Morris too. It pays a 4% yield and has a 14X PE.

Well-informed advisors can explain what makes our funds unique for their clients, but the price of that uniqueness, along with higher yields, and lower risks, is differentiated performance. Clients don't mind that when it is better, and they got fatter yields to boot, but when they see somebody with a better-

FOR INTERNAL USE ONLY

returning mousetrap, FOMO sets in, and there isn't enough oxygen in the world to tell somebody that lower risk and lower returns are better, when their friend doubled his wad on Nvidia, and he didn't.

Monthly US Equity Market Report *1/31/2025*

Fundamental, Technical, and Valuation Snapshots

Fundamentals: Still growing but slowing. Rate backup is hurting lending and cap goods.

Trends: AI demand is solid, but low end consumer & weak industrial are concerns.

	Sector	Comment
(+)	Healthcare	Rising prices & some reimbursement relief have lifted eEPS and shares.
(+)	Communications	Netflix, Google & Meta strength are overshadowing old media concerns.
(+)	Industrials	Mixed: data center & infrastructure demand is outpacing trad'l activity.
(+)	Materials	Green shoots in chemicals, but China & construction softness remain.
(+)	Financial Services	Estimates rising on steepening curve & deregulation optimism.
(+)	Utilities	AI demand has lifted stocks and EPS est., but rates have been a seesaw.
(+)	Real Estate	Back to work orders are helping sentiment, while high mortage rates bite.
(+)	Consumer Discretionary	Tesla and Amazon have lifted the sector. The rest has been mixed.
(+)	Information Tech	AI and related demand for servers and chips continues to be strong.
(+)	Energy	Soft demand for oil & global uncertainty are disrupting industry profits.
(+)	Consumer Staples	Cum. price increases have dulled consumer appetites and hit volumes.

	1/31/2025		Earnings Revisions			Performance (Total RoR)		
	Mix		**3 Mo.**	**6 Mo.**		**MTD**	**QTD**	**YTD**
S&P 500			**9.2%**	**9.3%**		**2.8%**	**2.8%**	**2.8%**
Communications	10.1%		16.8%	15.0%	Best =>	9.1%	9.1%	9.1%
Consumer Discretionary	11.8%		7.3%	9.5%		4.4%	4.4%	4.4%
Consumer Staples	6.1%	Worst =>	1.2%	0.6%		2.0%	2.0%	2.0%
Energy	3.2%		1.6%	-8.6%		2.1%	2.1%	2.1%
Financial Services	13.8%		9.1%	10.5%		6.5%	6.5%	6.5%
Healthcare	10.4%	Best =>	18.6%	17.7%		6.8%	6.8%	6.8%
Industrials	8.3%		14.6%	8.9%		5.0%	5.0%	5.0%
Information Tech	30.0%		4.1%	8.6%	Worst =>	-2.9%	-2.9%	-2.9%
Materials	1.9%		9.5%	5.4%		5.6%	5.6%	5.6%
Real Estate	2.0%		7.6%	7.9%		1.8%	1.8%	1.8%
Utilities	2.2%		9.1%	9.4%		2.9%	2.9%	2.9%

As illustrated with the pink performance bar on the RHS of the table above, the Technology sector was the worst performer in the S&P 500 in January for the first time in two years. Hopefully, we shall see more of that, due to green shoots of growth elsewhere, but the biggest story on the page is the jump in earnings expectations and strong performance of healthcare. As you may recall, Healthcare was the second worst performing sector last year, on negative pricing and poor reimbursements, as the Biden administration began directly negotiating drug prices for Medicare. Also, the hyper-growth story of GLP-1 agonists, like Ozempic, sucked the oxygen out of everything else in the sector, but suddenly, in the last month, the pharmaceutical companies pushed through ~4% price increases that are expected to stick, and a raft of phase II and phase III drugs are poised to launch in the next 18 months, in contrast to the off-patent losses of the last two years. Altogether, RFK, Jr. risks aside, and Healthcare stocks have a new lease on life. Right behind them, Communications (Netflix, Meta, Google) saw very positive revisions, and that led the market higher, while industrials and materials saw some signs of life, on falling costs and green shoots for improving demand in the second half of 2025.

Right now, the strong dollar and high rates are creating problems for materials and export companies, as the EU and other Central banks are lowering rates, while the Fed is on hold. The new tariffs are

also a concerns. However, if these lower rates beget their historical effects of deflation on capital, Europe, Asia, and Latin America should see more growth, which will help the US too.
On this topic, we see constant pokes that now is the time to invest in emerging market stocks, as lower rates should stimulate them more than the US. This argument is rational, but the US always benefits from a flight to safety more than it is valued based on stable expected values. In this light, if we see global stability improve, then EM stocks should start performing better. Otherwise, in a risky world, even though they are expensive, US stocks and bonds seem like a better haven than anywhere else.

.

Technicals: Overall Neutral: ST is neutral; IT & LT are net bullish, per StockTA.com

Key Positive indicators: All EMS, All Fibs, RSI, IT MACD, ST & IT Highs, IT & LT Lows, LT Trends
Key Negative indicators: ST & LT MACD, TDD, LT Highs, ST Lows, ST & IT Trends, Stochastics

(+)	Trend	10/11 sectors rose on strong GDP and deregulation / M&A optimism					
(--)	Fund Flows	January started strong, but went negative mid-month.					
		Price	**30 Day**	**50 Day**	**100 Day**	**200 Day**	
(+)	Golden Cross [50 dma > 200]	6,041	5,971	5,990	5,881	5,630	
(+)	Price / Moving Average [4 / 4 are "> 1"]		1.01	1.01	1.03	1.07	
(+)	Support Levels (scope for gaps)	6,007	-0.6%	5,929	-1.9%	5,808	-3.8%
(+)	Resistance Points	6,084	0.7%	6,205	2.7%		
(+)	Volatility, (VIX)	VIX fell by 0.92 on earnings optimsm					
(+)	Trading Volume	Volume was higher y/y, as most stocks rebounded in January.					

The US market technicals have been bouncing back and forth between neutral and bullish ever since the Fed indicated its pivot in late 2023 from tightening to holding rates steady, to eventually easing. The problem is that the money printing by the US Government undermined the Fed and kept markets more aloft than expected, so we had all kinds of leading indicators calling for a recession that never happened and prices moving higher when fundamentals were deteriorating. Bad news became good news for prices and vice versa. Today, there is still enough excess liquidity to support US stock prices, though they seem to be falling.

On the bright side, the rise in volatility during this back-and-forth 18-month period is that the ebullient market sentiment indicators, such as the put-call parity spread of the AII sentiment survey are no longer overly skewed to the bullish side of their ranges.

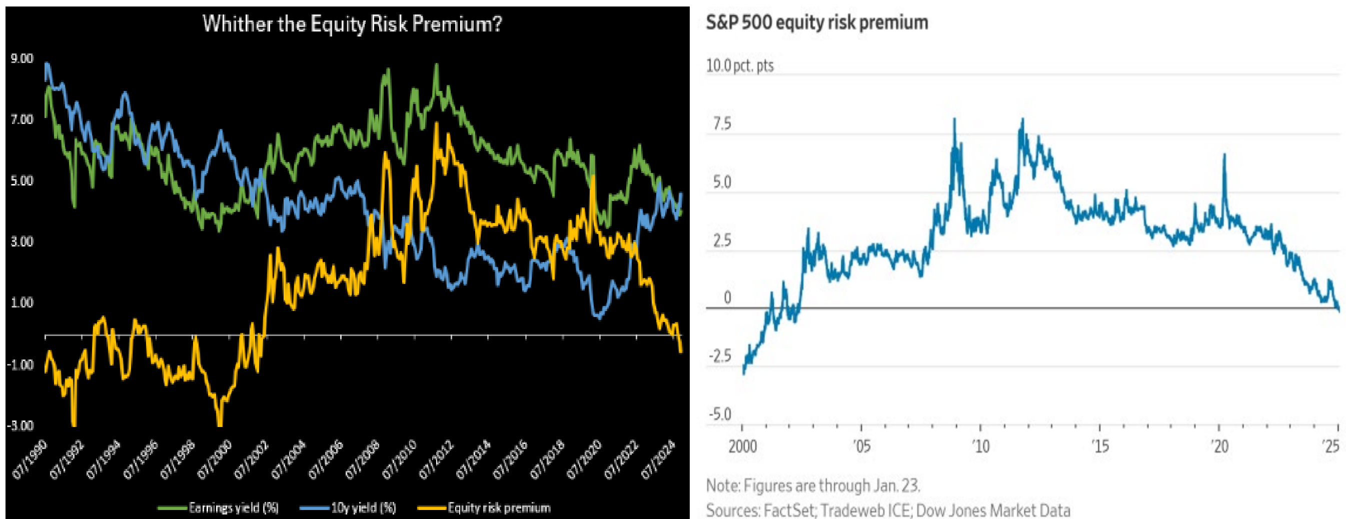
The dark side, however, remains the extreme valuations in the market leadership, and the fact that prices are close to their all-time highs, just as greater uncertainty is entering the picture. Hence, the neutral

technicals are unhelpful because they reflect the confusion of the tape, more than insights into what the smart money is doing, versus the crowd noise, or larger wave trends that seem durable.

Risk Premium Problem

One of the downsides for technology shares leading the S&P 500 to new highs, in valuation, is that it sends the not-completely-true signal to investors that stocks are expensive overall, versus bonds, and that the equity risk premium has evaporated. This signal is true for the mega-cap technology names, but for the average stock in the market, the equity risk premium is still alive and well. Most people don't know that, however, because the stats and charts, as shown below, are based on the market cap-weighted index, not the equal-weighted index.

Similarly, with the S&P being deemed as the proxy for the broader market, even though it no longer is representative, many reporters and strategists are saying now is the time to get out of stocks and load up on bonds. There may be some truth to that, with rates backed up and earnings expectations high, but for small-cap and value names, their discounts to the S&P 500, similar to bonds, are at attractive levels.



Valuation: Rich vs. Treasuries	PE		EPS			
Yields fell slightly, spreads stayed about flat.	2023	2024e	2022	2023	2024e	
'24 PE is ~9 points > LTA	27.3	25.5	$ 224.4	$ 221.6	$ 237.0	<= est -
10 Year US Treasury: (1/r) = PE Equivalent	22.0	22.0	13%	-1%	7%	= *y/y %*
10 Year BBB: (1/r) = PE Equivalent	18.3	18.3	'2024 EPS est. fell by ~1% in Jan.			
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	-19%	-14%	Warning
10 Yr BBB: LT Avg (1/r) relative to S&P PE	0.7	0.7	vs. BBB	-3%	4%	
S&P 500 Earnings Yield (E/P)	3.67%	3.92%	<= Earnings yield up; risk prem up more			
10 Year US Treasury Yield (-3 bps in Jan.)	4.54%	4.54%	10Y Tr. Downside to Parity			5%
Spread (E/P minus 10 Yr. %)	**-0.87%**	**-0.62%**	**<= PE fell, T-spread favors bonds.**			
BBB narrowed vs. Treasuries, as rose 40 and 21 bps respectively						
10-year BBB Corporate Yield (-3 bps in Jan.)	5.47%	**Norms**	<- Fell by 3 bps in January			
Yield Spread of S&P E/P minus BBB	-1.80%	-2.68%	BBB downside to nomal SPX			-23%
Yield Spread of BBB minus 10 Yr T Tight =>	0.93%	2.20%	BBB upside to LT Spread vs. T			-19%

Part III: Portfolio News and Changes

For Internal Use Only

In January, we did some trading in Dividend River, but nothing of note in Total Return Yield. In Dividend River, we exited Edison International (EIX) in response to growing evidence that the State of California was looking to pin as much blame for the devastating wildfires on EIX as it could, even though the sensor evidence from EIX's equipment in the areas where the fires broke out indicated that they did not start or contribute to the fires. Nonetheless, because these events caused billions of dollars of damage in California, and there is a $21B fund set up to protect the utilities in the case of firesuits, it made EIX a fat target for people to sue them and claim that falling utility wires and other equipment led to their homes burning down, even without hard evidence. Going along with the plaintiffs, the California courts were demanding that EIX not remove equipment in fire zones, in case they were to be needed as evidence, which was delaying the company's ability to restore power to its customers. Seeing that it was going to take years for the legal smoke to clear from this debacle, and with the California Governor having ambitions about running for President on the Democratic ticket, we could foresee him throwing a corporation under the bus to lock in a few votes, so we decided to get out. If the State was more supportive of the company and the courts relied on the evidence from the sensors, we would likely have stayed in, as the cash flow should be there to pay the dividend, and the rate base was growing. However, anytime a company gets on the other side of an activist state or attorney general, it has tended to be bad news for shareholders.

For similar reasons, we exited our painfully frustrating 1% position in Walgreens Boots Alliance (WBA), after the Biden Administration and the state of Illinois went back to the well to re-sue Walgreens for dispensing opioid prescriptions that they allege "WBA staff should have known were inappropriately written," after the company had settled all prior suits, including with IL, for ~$5.5B. The legal logic for the suits was flimsy the first time around, as there were no laws in place that required a pharmacy to second-guess doctors' scripts for patients with trauma prescribing pain medicine, yet everyone who was targeted settled the suits because the penalty for losing was bankruptcy. With this new variant of the same suit re-emerging, even with the first settlement terms suggesting the State could not re-litigate, we didn't want to stick around for another fleecing – most importantly, because the risk of it happening basically killed the chance that Sycamore would complete its take private efforts under favorable terms for shareholders, which kept us in the game as long as we were. Our clients had already suffered too much with WBA and all of its surprises, so had no interest in sticking around for more pain ahead. The tiny positions were not going to move the needle either way, so there was no reason to hold on.

We also trimmed AT&T and IBM, which have done well, rising ~50% over the last year, and are now trading at the high end of their valuation ranges.

With the proceeds from these sales, we added 3 new positions, with below-average size stating weights, to give us scope to buy more if they or the market dips. These were Eversource (ES) 2%, Pepsi (PEP) 2%and Wendy's (WEN) 1%.

<u>Eversource (ES) – Dividend River / DIVY</u>

Springfield, MA-based Eversource Energy is a ~$21B market cap global public utility holding company that provides electrical service to 2.7MM customers in Connecticut, New Hampshire, and Western Massachusetts. It also distributes nature cases in Connecticut and is the largest energy delivery company in New England. Its key brands include: Public Service Company of New Hampshire, The Connecticut Light & Power Company, NSTAR Electric Company, and Yankee Gas. It currently trades at ~12.6X 2024e EPS and 12.0X 2025 estimates, which is 4 multiple points, or 25% below peers. ES pays a 5.2% dividend yield, which is ~20% higher than peers. These discounts are due to uncertainty caused by the company's restructuring efforts that have been completed on paper, but not fully executed in real life.

Over the last two years, ES's stock price declined from ~$95 per share to $$54, as it restructured to exit the offshore wind business, which was less economically viable than expected, and it prepared to sell its

water utility to pay down debt. It has also suffered from failed attempts to raise its base power rates in Connecticut, where the regulator has driven down the utility's in-state ROE. ES's restructuring actions are nearly completed and today, ES is more of a traditional rate-based utility, that will soon have much less debt and business clarity than it had through its transition. By the end of 2025, all of the transactions and payments are expected to be completed.

Assuming that ES can grow its EPS by 5% per year, as expected, and it pays a 5% dividend, investors should get a decent 10% rate of return. However, if ES's PE multiple closes half the gap between itself and peers, to trade at 14X forward earnings, that would add another 15% to the return. If we take a 3-year horizon that would be ~15% annual return over each of the next three years, which would be just fine for us.

The downside risks for ES are rising rates, which would depress all utilities. Higher than expected true ups, in its windfarm sales, and Connecticut not letting future rate increases go through, due to rising costs, which would squeeze margins further. On this last point, there have been some notes that suggest that Connecticut will not continue to pressure utilities, as they recognize that the higher costs are a real problem, and further investment is needed to upgrade the state's infrastructure. In that case, ES could benefit from a growing rate base, as well as a smoother regulatory path going forward.

PepsiCo (PEP) – Dividend River / DIVY

Purchase, NY-based PepsiCo (PEP) is a $206B market cap global snack food and beverage company. With about 55% of its sales in North America and 45% elsewhere. It currently trades at 17.6X 2025 estimated EPS, which is ~20% below its long-term average, and pays a 3.6% dividend yield. The stock has traded down by ~20% over the last six months as Pepsi's sales and earnings outlook have come down in response to higher food prices weighing on consumer's spending for full-priced branded snacks and soft drinks. At the same time as consumer demand is being hurt by rising prices, the company's margins have been pressured by rising costs and FX pressures from the strong dollar, which has reduced repatriated sales. The result is 5% to 7% expected EPS growth over each of the next few years, down from 10% to 13% annual growth beforehand.

In light of Pepsi's growing international business and strong global demand, we think that once consumers' purchasing power recovers worldwide, which is expected to be in two years, Pepsi's earnings growth and PE multiple should reflate to normal levels. In the meantime, the combination of the company's dividend and EPS growth should yield 10% pretax returns to shareholders. So, similar to ES, if the 20% multiple compression (25% upside going the other way) is recaptured over the next two or three years, the total return should be ~20% per year, which is quite nice for a blue chip firm.

On the downside, if the current trend of consumer economizing continues and increased global tariffs exacerbate that situation, PEP likely not have any EPS growth for a year. However, PEP is already trading at its lowest PE in the last ten years. So, it seems unlikely to fall more than 10% lower (in response to 7% lost EPS growth), as investors tend to view it as a "bunker stock," i.e. a place to hide in times of trouble. However, another 10% drop would not be out of the norm, and we should add to the position, should such a dip occur, if the reason is more consumer economizing and not something more permanent, like a ban on selling sodas and snacks in schools.

Wendy's (WEN) – Dividend River / DIVY

Dublin, OH-based Wendy's (WEN) is the #2 hamburger chain in the US after McDonald's, with over 6,000 restaurants that are 95% franchised. It also has over 1,200 stores in over 30 foreign countries, where there is more opportunity for growth than in the US. WEN currently has a $3B market cap, is trading at 14.3X 2025 EPS estimates, and pays a 7% dividend yield.

For Internal Use Only

The stock has declined from over $20 per share to below $15 per share in the last year on a slowdown in sales and earnings growth, as competition from premium alternatives like Shake Shack in the burger category, and growth in non-burger alternatives, like Chipotle and Chic-Fil-A have taken share. Also, with consumers feeling the cumulative effect of several years of high inflation are cutting back some on fast food, which has hurt Wendy's more than some peers, due to its slightly higher prices for better quality food positioning. To combat the competitive and cost threats, WEN has been adjusting its menu, closing underperforming US stores, and slowing down its overseas growth rate.

Also, the firm which is known for its superior quality food, and unique menu features, such as the 127 flavor Coke freestyle soda machine, is experimenting with new menu items, like a nacho sandwich, Italian Mozzarella sandwich, a Mushroom Bacon Cheeseburger, and new Frosty (milkshake) flavors, like a Pumpkin Spice in the fall and a "Thin Mint" variety that is planned to be launched with the Girl Scouts in February. While none of these new flavor experiments have taken the world by storm, just yet, they are beginning to rekindle some of the lost buzz around the brand.

Looking ahead, as Wendy's net store count begins growing again in the second half of 2025 and some of these new menu items gain traction, we anticipate that EPS can start growing again, which should help to reinflate the stock price. Helping matters in the current quarter, the #1 burger chain, McDonalds had an e coli bacteria problem that drove some customers away, hopefully into the waiting arms of Wendy's.

Looking at the numbers, WEN is only expected to capture 4% EPS growth in 2025, but with the restructuring complete, the outlook is for double-digit growth thereafter. A 7% dividend and 4% EPS growth would be an 11% return, but getting back to double-digit growth in 2026 would likely re-inflate WEN's multiple from 14.3X to 20X, which is below its historical average of 27X. 20X 1.17 - $23.80 per share, which would be a 58% price gain in two years, before counting the 7% per year dividend.

On the downside, WEN has been losing market share to new competitors and they need to solve this problem. Further, the dividend, while safe because D&A is substantially higher than capex, still consumes most of the company's reported EPS, which is a red flag. WEN does not need to cut the dividend to meet its obligations, but if the company's performance were to deteriorate, this could happen. We only took a 1% position in WEN because of these factors, but anticipate buying more after the company reports Q4 results if they answer our questions satisfactorily.

Performance (non-GIPSs)	**Q1**	**Q2**	**Q3**	**Q4**	**2024**	**1/31/25 YTD**
Dividend River (est.)	+4.82%	(5.79%)	+8.17%	(3.06%)	+3.70%	+3.09%
Total Return Yield (est.)	+9.49%	(4.28%)	+7.67%	(4.97%)	+7.46%	+4.25%
DIVY TRA (Bloomberg)	+5.10%	(5.67%)	+8.41%	(3.36%)	+2.66%	+2.78%
DIVY NAV (Toroso)	+4.94%	(5.72%)	+8.22%	(3.18%)	+2.66%	+2.81%

Characteristics – Cheaper Than the S&P 500, With Higher EPS Growth, Lower Betas & Higher Yields
Our portfolios are >50% cheaper than the S&P 500 on a 2024e PE basis, with higher dividend yields and EPS growth expectations.

For Internal Use Only

Dividend River Porfolio Characteristics
January 31, 2025

SECTOR WEIGHTS	SIS	SPX
Communications Services	9.8%	10.1%
Consumer Discretionary	7.5%	11.8%
Consumer Staples	7.6%	6.1%
Energy	13.3%	3.2%
Financial Services	18.8%	13.8%
Healthcare	14.0%	10.4%
Industrials	2.7%	8.3%
Information Technology	9.8%	30.0%
Materials	11.5%	1.9%
Real Estate	0.0%	2.0%
Utilities	5.0%	2.2%
Totals	100.0%	100.0%

KEY METRICS *	SIS	SPX
Dividend Yield	4.6%	1.3%
2024e PE	11.9	25.5
EV/ EBITDA	12.0	17.1
PB	4.6	5.3
2024e Sales Growth	4.3%	4.5%
2024e EPS Growth	9.5%	6.9%
BETA	0.7	1.0
EPS Gr. + Div %	14.1%	8.2%

* Based on Bloomberg consensus data.

Total Return Yield Porfolio Characteristics
January 31, 2025

SECTOR WEIGHTS	SIS	SPX
Communications Services	7.6%	10.1%
Consumer Discretionary	9.9%	11.8%
Consumer Staples	9.2%	6.1%
Energy	12.0%	3.2%
Financial Services	20.1%	13.8%
Healthcare	13.2%	10.4%
Industrials	5.5%	8.3%
Information Technology	10.9%	30.0%
Materials	11.6%	1.9%
Real Estate	0.0%	2.0%
Utilities	0.0%	2.2%
Totals	100.0%	100.0%

KEY METRICS *	SIS	SPX
Dividend Yield	3.6%	1.3%
2024e PE	11.3	25.5
EV/ EBITDA	11.5	17.1
PB	5.1	5.3
2024e Sales Growth	1.5%	4.5%
2024e EPS Growth	11.3%	6.9%
BETA	0.8	1.0
EPS Gr. + Div %	14.9%	8.2%

* Based on Bloomberg consensus data.

As of January 31st, Dividend River was paying a 4.6% dividend yield, 3.6X that of the S&P 500 at 53% below its 2024e PE price, while the Total Return Yield was paying a 3.6% dividend, 2.8X the yield of the S&P 500, at 56% below its PE price. Dividend River has a 9.5% weighted average 2024e EPS growth forecast that is 2.6% above the S&P 500, while the Total Return portfolio is expected to grow EPS by 11.3%, 4.4% above the popular benchmark. With Betas at 0.7X and 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 above indicate that our expected total returns for both portfolios should have exceeded those of the S&P 500 in 2024 if multiples didn't change – but they have changed, as multiples expanded for the benchmark. 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. On this basis, we think it is fair to project a positive, better than S&P 500 return for our portfolios this year, as we did last year – though that did not bear out as well as we expected.

Looking Ahead

We are grateful to be off to a positive start in 2025 and to be able to work with so many dedicated and thoughtful advisors, who place their clients' interests above their own.

May this new year find you and your families well. It is always an honor to serve you.

Gratefully yours,

Eric

Eric Beyrich, CFA, CFP
Equity Portfolio Manager, Co-CIO
Sound Income Strategies
914-263-5800

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