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SPECIAL REPORT:

2024 STOCK MARKET OUTLOOK - Q3 UPDATE

the Prudent Speculator
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KEY TAKEAWAYS

- **Still Bullish on Value** - Returns in 2024 have been solid, but inexpensively priced stocks provide their owners more peaceful slumber in a chaotic world.
- **Where to Invest in '24 and Beyond** - We offer eight investment themes with more than 50 individual stock ideas for your portfolio.
- **48th Year of TPS** - Patience and discipline are the hallmarks of our time-tested approach.

Mark Twain said, "Get your facts first, and then you can distort them as much as you please," but the American humorist didn't realize that some folks would skip getting the facts! After all, in a *Wall Street Journal* Editorial titled The Economy Is Good. Why Don't People Know It?, noted American Economist and former vice chair of the Federal Reserve Alan S. Blinder wrote: "A Harris poll conducted a few weeks ago for the *Guardian* found that 49% of Americans believe that unemployment is at a 50-year high, 72% think inflation is increasing, and 56% think the U.S. is in a recession. Not one of these propositions is remotely true. That same poll even found that 49% think the S&P 500 stock market index is down for the year."

We realize that we are operating in a highly polarized political climate and that polls sometimes tell us more about the pollsters than anything else, while only 2,119 adults were surveyed. Still, the responses are shocking, and it would seem that our oft-cited Vannevar Bush quotation, "Fear cannot be banished, but it can be calm and without panic; it can be mitigated by reason and evaluation," is today more valuable than ever.

Indeed, with attention spans short and media outlets often biased in their coverage, keeping emotions in check seemingly has never been more difficult. This is why week after week we produce numerous charts focused on the current state of affairs and provide historical evidence for what has happened previously when similar events have occurred or comparable statistics have been registered. As Mr. Twain said, "History doesn't repeat, but it often rhymes," so we take great comfort that the admonition that the secret to success in stocks is not to get scared out of them is well substantiated.

That is not meant to suggest that equities will constantly prove rewarding as 5% declines in the Russell 3000 Value index (R3KV) have happened three times per year on average, 10% corrections have hit every 11 months on average and 20% Bear Markets have taken place every 2.9 years. On the flip slide, advances, rallies and Bull Markets have come with similar frequency AND the magnitude of the gains has dwarfed the losses, so much so that Value stocks, as segmented by Professors Eugene F. Fama and Kenneth R. French, have gained 13.8% per annum since the launch of *The Prudent Speculator* in 1977.

There are no guarantees that the past is prologue, but we note that despite June ending in the red, the R3KV returned 6.6% in the first half of 2024, almost exactly the historical two-quarter norm. True, the grass was greener on the Growth side of the fence, but it was

also a whole lot worse for Small Caps, which knocked the average stock in the broad-based Russell 3000 index into the red for the full six months.

Not surprisingly, we always encourage investors to look beyond the headlines as the stock market, meaning the broad-based indexes, had a very good first half of the year, but the market of stocks lagged far behind. Incredibly, the proverbial monkey throwing darts would just as likely have picked a loser as a winner so far in 2024.

Happily, returns this year for our disciplined approach of buying and patiently harvesting inexpensively priced stocks have topped the Value benchmarks. More importantly, we think the basket of stocks we own remain undervalued, while we expect the economy to continue to show OK growth, corporate profits to expand and dividend payouts to rise. Of course, we have been singing this song for more than 47 years, but it has never gone out of tune, for those who have a long-term time horizon.

There have been some scary trips south along the way, but Value stocks have turned in terrific long-term returns, despite slowdowns in the economy, questions about the timing of Fed rate cuts, elevated inflation readings, conflicts around the world, contentious elections and any of the other worries, factual or not, troubling investors today.

WHEN THE MARKET HOLDS A SALE, WE LIKE TO GO SHOPPING

With the major market averages up smartly through the first six months of the year but the average stock in the red, there has been a dispersion of returns. Some may find it disconcerting that the rising tide has failed to lift all boats, but we think the current dynamic has made it much easier to cash in chips on fairly valued stocks and reinvest the proceeds into undervalued names. After all, the objective of most investors is to sell high and buy low, and we have long preferred to buy stocks that have (temporarily, we believe) gone on sale.

Believe it or not, the shares of quite a few prominent companies have lost altitude this year. Stocks we find attractive today include investment management services heavyweight **Blackrock (BLK)**, entertainment giant **Comcast (CMCSA)**, farm-equipment titan **Deere (DE)**, home-improvement retailer **Lowe's (LOW)** and major appliance maker **Whirlpool (WHR)**.

There also are lesser-known names in the mark-down aisle. These include chemical producer **Celanese (CE)**, Dallas-based regional bank **Comerica (CMA)**, electronic manufacturing services provider **Jabil (JBL)**, open-air, grocery-anchored REIT **Kimco Realty (KIM)**, and automotive service industry tool and equipment maker **Snap-on (SNA)**.

YELLING FIRE IN A CROWDED THEATRE

In March 2023, the lightning-quick collapse of two prominent institutions in Silicon Valley Bank and Signature Bank after uninsured depositors fled en masse was followed by the demise of European financial behemoth Credit Suisse and prominent California lender First Republic. Even though the collapses began in the Regional Bank corner of the wider Financials sector, acute worries rippled through the entire system. Fortunately, the threatened mass exodus of depositors has failed to materialize and subsequent regulatory bank stress tests came and went without issue.

The ordeal's impact on stock prices has been uneven. The S&P Regional Bank index dropped more than 7% in 2023, while the S&P 500 Diversified Financials index gained 15%. It has been a similar story in 2024, with the Regional Bank gauge falling 4.6% and the Diversified Financials benchmark climbing 6.4%. Concerns remain about net interest margins, commercial real estate defaults and shrinking loan volumes, but we think there should be much more enthusiasm for healthy Regional Banks offering superb risk-reward profiles with rich dividend yields.

Though one wouldn't necessarily guess given the drubbing in 2023, we like **PNC Financial (PNC)** for its history of good risk management and it boasts a broadly diversified loan book, solid capital ratios and strong credit quality. We also like Cincinnati-based **Fifth Third Bancorp (FITB)** and its avoidance of held-to-maturity securities plus the diversity of its fee-generating businesses that includes payments, investment banking, wealth management and mortgages.

Looking at bigger banks, it's hard not to like **JPMorgan Chase (JPM)**, as its fortress balance sheet provides a stable keel to go along with an ability to generate profits in varied environments. A statistically deeper bargain, trading at a huge discount to tangible book value, we are liking the turnaround efforts underway at globally diverse **Citigroup (C)** under CEO Jane Fraser. We also think **Goldman Sachs (GS)** stands out with its well-known financial prowess that has helped maintain immense profitability despite weathering multiple strategic shifts in recent years.

Also in the Financials sector, shares of debt-neutral and tech-oriented **PayPal (PYPL)** have fallen 80% since 2021 as investors folded their hands and created what we think is a great opportunity to pick up an undervalued stock. We expect PayPal's new leader, Alex Chriss from Intuit, will be able to reinvigorate the company, build some of PayPal's sub-brands like Venmo and improve returns for shareholders.

HEALTH CARE (TEMPORARILY) IN THE SICK BAY

A shift in investor attention away from safer stocks, worries about government price controls or question marks about medical cost ratios have made for frequent up-and-down gyrations among health care companies over the last couple of years. Despite long-term demographic trends broadly supportive of continued growth and solid earnings, investors oscillated between spooked and confident, at least as reflected by the S&P 500 Health Care index standing today not too far above where it was priced 18 months ago.

True, more modest growth potential today might suggest lower valuation metrics are warranted than in years past. However, in an environment where Utility stocks trade for P/E ratios in the mid-teens, we believe that Big Pharma stocks like **Pfizer (PFE)** and **Bristol-Myers Squibb (BMY)** as well as biotech giants **Amgen (AMGN)** and **Gilead Sciences (GILD)**, all of which boast Utility-like yields, deserve significantly more love.

Looking at managed-care, industry giant UnitedHealth's disclosure that costs were on the rise due to an increase in pandemic-delayed surgeries among older adults has created a great entry point in stocks like **Elevance Health (ELV)** and **CVS Health (CVS)**, each of which trades for significantly lower multiples of earnings.

With the pandemic-related slowdown in voluntary procedures largely in the past, hip and knee orthopedic implant king **Zimmer Biomet (ZBH)** has encountered a new purported headwind: GLP-1 drugs (such as Ozempic), which have the potential to make a major dent in global obesity rates. The thinking is that lower Body Mass Indexes (BMI) will result in fewer joint-related surgeries. ZBH CEO Ivan Tornos claims the opposite is true as lower rates of obesity will actually be a boon for Zimmer considering that damaged cartilage, osteoarthritis and other joint issues are usually irreversible. Moreover, Mr. Tornos says some doctors are uncomfortable operating on patients with BMIs above 30 or 40 (depending on location), so more folks with lower BMIs could mean more Zimmer device usage.

ELECTRIC CARS WILL ARRIVE, EVENTUALLY

Significant hurdles remain for electric vehicles before the transition can be considered a success, but sales of the segment are still growing and manufacturers like **General Motors (GM)** and **Volkswagen (VWAPY)** have been working on paths to full EV product lines for most of their personal vehicle sub-brands. With deep discounts, government support and plenty of marketing, electric vehicle adoption has been a story of hits and misses. Tesla has found the sweet spot in balancing technology and performance, but its rapid price adjustments to meet sales targets have caused chaos for other EV carmakers.

We continue to believe the attractiveness of combustion vehicles will slowly wane over the coming decades. For many folks, that still leaves room for several conventional or hybrid cars before the eventual switch. Volkswagen made inroads on its EV program following the catastrophic 'Dieselgate' emissions scandal, but has struggled more recently to make its software tick, though a recent $5 billion tie-up with EV maker Rivian offers great promise. GM has had a few false starts, but management has been busy rewarding shareholders with massive stock repurchase programs, while continuing to invest heavily in R&D. Both companies remain very profitable, with substantial cash

flow from traditional vehicles providing the fuel for their electric aspirations to go along with single-digit P/E ratios.

A star in our portfolios between 2019 and 2022, mining giant **Albemarle (ALB)** shares have been thumped over the past 18 months as lithium prices plunged. Still, we think EV battery demand should surge through the end of the decade with data published by the International Energy Agency predicting that 350 million electric cars will be on the road by 2030, up from 26 million last year. For those looking for inexpensive EV exposure, we think ALB is a great choice, especially as we have seen interest from the major auto makers in entering into longer-term supply contracts and even taking ownership stakes in lithium producers.

DINOSAUR JUICE FOR PORTFOLIOS

The Electric Vehicle boom does not mean conventional energy businesses are dead men walking, especially as more than two thirds of U.S. energy is consumed by a sector other than transportation. The opposite, we think, as lower investment in conventional sources and solid demand should support energy prices for the foreseeable future. Layering on the massive upheaval in the energy markets from the war in Ukraine and frequent geopolitical spats over production levels and challenges finding new low-cost wells, we expect a flattening-demand environment with tightening supply will result in higher prices overall, and therefore enhanced profitability for the likes of exploration and production companies **Civitas Resources (CIVI)** and **EOG Resources (EOG)**, which also boast lucrative variable dividend payouts.

We have also recently added **Chevron (CVX)** as a new recommendation for the meaningful improvement to its leverage profile, action on the M&A front, progress toward decarbonization and willingness to spend billions on new technologies. Shares trade at a steep discount and sport a healthy yield. We also tout **Devon Energy (DVN)**, a Texas-based oil & gas exploration & production company with exposure in the Permian Basin. Shares have been beaten down and the valuation is inexpensive, while management has actively repurchased stock and yield is healthy.

INTELLIGENT WAYS TO PLAY A.I.

Artificial Intelligence (A.I.) has been all the rage. And it was wild, in our estimation, to watch share prices rapidly rise and fall based on the latest management commentary related to budding A.I. technology. The more the technology was hyped up on calls, the higher prices rose. If A.I. wasn't mentioned, a plunge often followed. Thankfully, the price action has moderated and companies are being evaluated (once again) on their monetizable plans to employ A.I. in their operations.

In many ways, we've found ourselves at the right place at the right time with some A.I. picks, thanks in large part to another theme for the last decade or so, cloud computing. We have long liked companies like **Microsoft (MSFT)**, **Apple (AAPL)**, **Alphabet (GOOG)** and **Meta Platforms (META)**, who are scaling up their A.I. offerings with plans to generate additional revenue. We believe smaller-company names like power management concern **Eaton (ETN)** and data center REIT **Digital Realty (DLR)** also stand to benefit from widespread A.I. adoption.

Chipmaking giant **Intel (INTC)** has been somewhat left behind in the A.I. discussion, but we think CEO Pat Gelsinger & Co. are on the right long-term track to finally reverse fortunes for the former market leader. Happily, Intel's road map includes new chips specifically designed for A.I. and Nvidia has publicly stated that Intel is in the running to produce future generations of Nvidia graphics chips (GPU), which would diversify the company's manufacturing exposure and improve GPU supplies. And speaking of manufacturing, we also like semiconductor capital equipment makers **Lam Research (LRCX)** and **Kulicke & Soffa (KLIC)**.

With Artificial Intelligence technology still in its infancy, we think investors should continue to pay attention to valuations as we have been able to take advantage of some of the euphoria by cashing in some of our winnings on chipmakers like **Broadcom (AVGO)** and **Qualcomm (QCOM)**, even as we are comfortable holding the balance of our stakes given still-reasonable valuation metrics. We believe long-term-oriented investors should review Tech

company opportunities carefully for inclusion in their broadly diversified portfolios. There are deals to be had, even as monetization of the technology with consistency will come further down the road and there are likely to be bumps along the way, resulting in a strong preference to spread the exposure over several stocks, rather than larger stakes in one or two.

SMALL COMPANY, BIG POTENTIAL

Small capitalization stocks (defined by Russell/FTSE as the smallest 2,000 companies in the broad-market Russell 3000 index) of the Value variety outpaced their Growth counterparts by 12 percentage points in 2022, though the latter has won the performance derby over the last year and a half by a similar score. Though small-cap Value stocks got whacked particularly hard in the Bear Market that occurred at the beginning of the pandemic, they have outpaced Growth stocks by a wide margin (more than 35 percentage points from the low point on March 23, 2020. While some of the valuation disparity has gone away thanks to strong Value stock returns, we think significant appreciation potential still exists in this corner of the stock market.

Our all-cap Value flagship strategies include small and mid-cap names, but we also offer our asset management and wealth management clients a managed account strategy that specifically caters to Small-and-Mid-Cap Dividend (SMiD) stocks. The forward P/E ratio on the SMiD portfolio is near 11, compared with 23 for the Russell 1000 index and 17 for the reasonably priced Russell 1000 Value index.

Considering our SMiD strategy, several names we highlight for the next three-to-five years are oil field services concern **RPC Inc. (RES)**, food producer **Fresh Del Monte (FDP)**, semiconductor capital equipment manufacturer **MKS Instruments (MKSI)**, regional bank **Western Alliance (WAL)**, orthopedic products maker **CONMED Corp (CNMD)** and furniture maker **Ethan Allen (ETD)**.

ENHANCING EXPOSURE BY LEVERAGING THE POWER OF THE WORLD

Although our portfolios are exclusively constructed of equities traded on U.S. exchanges, exposures outside the U.S. are sought after in our efforts to diversify. After all, as a percentage of 2023 revenue, 34.7% of aggregate revenue for the Russell 3000 index comes from outside North America, while the figure is 36.1% for the large-cap Russell 1000 index and 23.6% for the small-cap Russell 2000 index.

A strong U.S. dollar has been cutting into revenue and profitability figures for larger U.S.-based companies as the value of sales and earnings made in euros, pounds and other currencies are not worth as much after translations back into greenbacks. With persistent inflation also a headwind in many global markets and corporate profit margins for many multinational companies under pressure, many stocks are trading at discounted levels, presenting opportunity to add international exposure at inexpensive prices.

That in mind, we enhance our portfolios with ownership in a variety of foreign companies, from German parcel carrier **DHL Group (DHLGY)**, which derives 75% of revenue outside the Americas, to French drugmaker **Sanofi (SNY)**, which earns 60% of its revenue abroad, has a robust therapeutics pipeline and sports reasonable valuation metrics, to Canadian crop input and service provider **Nutrien (NTR)**, which is impacted by developments in the global commodities markets.

The operations of **ManpowerGroup (MAN)** are based in the U.S., while 64% of revenue is derived from Europe. The staffing services provider has deftly navigated previous expansions and contractions across the Continent, rewarding shareholders with sizable profits and generous dividends through thick and thin. A swap we made in 2018 for the ailing General Electric, **Siemens AG (SIEGY)** earns just 24% of its revenue in North America. The industrial conglomerate stands to benefit from a global rotation to cleaner technologies, leading to healthy earnings growth and supporting a solid annual dividend.

CLOSING

Those that have been reading these periodic Outlooks should not be surprised to see that our themes are little changed. After all, we are buying our undervalued stocks for their three-to-five-year or longer potential, with the intention of holding them through a business cycle or two. We think the market is offering those with long-term time horizons substantial opportunity as evidenced by the litany of names mentioned above, while most offer generous dividend payments, with that income helping investors better navigate the inevitable volatility of the share prices.

Of course, one must still construct a diversified portfolio of these stocks, so we offer the reminder that we have wealth and asset management services available. After all, we feel inclined to reiterate that the secret to success in investing is not simply to select good stocks, but to not get scared out of them. Indeed, we have made money over the years from our stock holding as well as our stock picking!

PARTNER WITH US

For more than 47 years, we have collaborated with our clients in their investment decision making process as they pursue their long-term financial goals. We are committed to keeping your goals, concerns and attitude about investing at the heart of your plan. If you're ready to experience our personalized investment approach and exceptional client service, contact Jason R. Clark, CFA at 949.424.1013 or jclark@kovitz.com.

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The description of products, services, and performance results contained herein is not an offering or a solicitation of any kind. Past performance is not an indication of future results. Securities investments are subject to risk and may lose value.

All returns are geometric average unless otherwise stated. The geometric average is calculated using the mean of a set of products that takes into account the effects of compounding.

The federal funds rate is the rate banks charge on loans to each other.

The factor-based (book value-to-price) portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into four groups: large value, large growth, small value and small growth. The aggregate Value and Growth portfolios are monthly averages of the two returns.

The Standard & Poors 500 index (S&P 500) is a broad stock market index based on the market capitalizations of the largest 500 companies listed in the U.S. Small company stocks, via Ibbotson Associates, are the bottom twenty percent of the New York Stock Exchange. Large company stocks, via Ibbotson Associates, are represented by the S&P 500 index. The S&P 500 Growth Index is a market capitalization weighted index. All the stocks in the underlying parent index are allocated into value or growth. Stocks that do not have pure value or pure growth characteristics have their market caps distributed between the value & growth indices. Prior to 12/19/2005 this index represented the S&P 500/Barra Growth Index. The S&P 500 Value Index is a market capitalization weighted index. All the stocks in the underlying parent index are allocated into value or growth. Stocks that do not have pure value or pure growth characteristics have their market caps distributed between the value & growth indices. Prior to 12/19/2005 this index represented the S&P 500/Barra Value Index.

Growth stocks = 50% Fama-French small growth and 50% Fama-French large growth returns rebalanced monthly. Value stocks = 50% Fama-French small value and 50% Fama-French large value returns rebalanced monthly. The portfolios are formed on Book Equity/Market Equity at the end of each June using NYSE breakpoints via Eugene F. Fama and Kenneth R. French. Dividend payers = 30% top of Fama-French dividend payers, 40% of middle Fama-French dividend payers, and 30% bottom of Fama-French dividend payers rebalanced monthly. Non-dividend payers = Fama-French stocks that do not pay a dividend. Long term corporate bonds represented by the Ibbotson Associates SBBI US LT Corp Total Return index. Long term government bonds represented by the Ibbotson Associates SBBI US LT Govt Total Return index. Intermediate term government bonds represented by the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills represented by the Ibbotson Associates SBBI US 30 Day TBill Total Return index. Inflation represented by the Ibbotson Associates SBBI US Inflation index.

The Russell 3000 Index is composed of 3000 large U.S. companies, as determined by market capitalization. This portfolio of Securities represents approximately 98% of the investable U.S. equity market. The Russell 3000 Index is comprised of stocks within the Russell 1000 and the Russell 2000 Indices. Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The MSCI ACWI Index is a free-float weighted equity index. It was developed with a base value of 100 as of December 31 1987. It includes both emerging and developed world markets. The Bloomberg Barclays Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. The DJ US Real Estate Index represents REITs & other companies that invest directly or indirectly in real estate through development, management or ownership, including property agencies. The index is a subset of the Dow Jones U.S. Index, which covers 95% of U.S. securities based on float-adjusted market capitalization. The S&P GSCI Total Return Index in USD is widely recognized as the leading measure of general commodity price movements and inflation in the world economy. Index is calculated primarily on a world production weighted basis, comprised of the principal physical commodities futures contracts.

From 1927 to present, we utilized the dividend-weighted portfolio data from Eugene F. Fama and Kenneth R. French. The dataset is broken into five groups: non-dividend paying, top 30% of dividend payers, middle 40% of dividend payers, bottom 30% of dividend payers and all dividend payers (weighted 30% of top dividend payers, 40% of middle dividend payers and 30% of low dividend payers).

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