MORSE ASSET MANAGEMENT, INC.
23 Old Kings Highway South, Suite 200, Darien, CT 06820

October 21, 2024

2024 Q3 Investment Commentary

In the third quarter the US markets continued to climb a wall of worry, grinding through two corrections and pushing to new highs. Mixed data points around inflation, employment, industry and the consumer caused markets to whipsaw as expectations for the Federal Reserve cutting rates fell into question. The resulting volatility was compounded by US election politics and geopolitical events. Thankfully, the Federal Reserve began easing in September and economic data continued to improve, surprising to the upside. As a result, US markets rose steadily for the last six weeks achieving multiple new highs. Sentiment and valuations are again extended, therefore a digestion of recent gains is needed to keep exuberance in check and the trend healthy. The bull market is intact, but continuation will need to wait until after the election.

Much like Q2, the past few months were a story of choppy data driving volatility, but ultimately the market rose in anticipation of the Fed cutting rates and the economy remaining stable. One major difference was a string of significant exogenous events. On July 13th, the first assassination attempt was made on former President Trump. A little over a week later, President Biden withdrew from the presidential race and named Vice President Harris the nominee. Then, in August, the Japanese Central Bank surprised by raising rates, triggering an unwind of leveraged carry trades that rippled across markets and caused the CBOE Volatility Index to spike to the highest level since March of 2020. Consequentially, the S&P 500 fell six percent over three days. In a sign of strength, the markets shook off these events quickly and recovered.

Inflation data has continued to trend lower. The annual rate has fallen for the sixth straight month to 2.4% (Chart 1). The labor market and consumers continue to be resilient, improving from summer weakness. The unemployment rate in the United States is 4.1%, down from July highs (Chart 2). Retail sales improved during the quarter and continued to beat expectations (Chart 3). The Atlanta Fed's GDPNow model estimate for real GDP growth is now +3.4%, up from a low of 2% in August (Chart 4). The US economy is strong and growing above trend.

As expected, the Federal Reserve began lowering rates on September 19th, ending the two and a half year tightening regime, and surprised markets with a 50-bps cut in rates. Powell justified the "recalibration" in response to a shift in the balance of risks away from inflation to unemployment. He added that the larger cut was not in response to a deteriorating economy but a commitment to not being behind on their employment mandate. The market responded strongly to what was viewed as the Fed confirming no recession.

For Q3 2024, according to FactSet's October 18th *Earnings Insight*, the estimated year-over-year earnings growth rate for the S&P 500 is +3.4%. If reported, this would mark the fifth straight quarter of growth. Earnings have and will continue to be led by the Magnificent 7, which are expected to report year-over-year earnings growth of +18.1% for the third quarter vs +0.1% for the remining 493. This spread is expected to narrow significantly as breadth continues to improve (Chart 5). Analysts expect earnings to accelerate to +14.0% in Q4 and remain strong next year, projecting +15.1% earnings growth for 2025 (Chart 6).

Valuations continue to be stretched as price outpaced modest third quarter earnings growth and cautious revisions. The current forward 12-month P/E ratio for the S&P 500 is 21.9, above the 5-year average of

19.5. However, we are entering a period of accelerating earnings and Fed easing cycle which can keep valuations in check (Chart 6). The 12-month bottom-up target for the S&P 500 is now 6377, up from 6062 in July, and 9.2% above Friday's closing level of 5841.

Despite strong US index performance, multiple rotations have occurred and reversed within them as uncertainty has reigned. Swings have occurred between Growth and Value, Cyclical and Defensive, Large and Small Cap strategies. In addition, swings in equities perceived as Trump and Harris policy beneficiaries, or Fed cutting late versus the Fed cut too soon, have given us pause. We continue to look for new leadership and adjust accordingly but look for confirmation following the election before overcommitting portfolios.

We remain in a secular bull market, supported by the weight of evidence. Moderate economic growth, strong balance sheets, an earnings tailwind, coupled with a normalized rate environment and conclusion of the US election should support a continued broadening of equity market returns and positive performance. We favor high-quality growth at reasonable prices and businesses with stable free cash flow and healthy balance sheets. We will continue to balance growth and value and are prepared to shift defensively if necessary.

Our playbook continues to focus on significant secular, cyclical, and structural trends. A few important themes we are following are the reshoring of industry and reconfiguration of supply chains, datacenter and AI infrastructure, semiconductor cycles, underinvestment in energy and materials, beneficiaries of normalizing interest rates and the shifting Presidential election dynamics.

Election years bring positive change (Chart 7). Falling interest rates will be an added tailwind for markets. We are bullish but remain cautious in the near term as the market digests recent events.

Robert B. Morse

Chief Investment Officer

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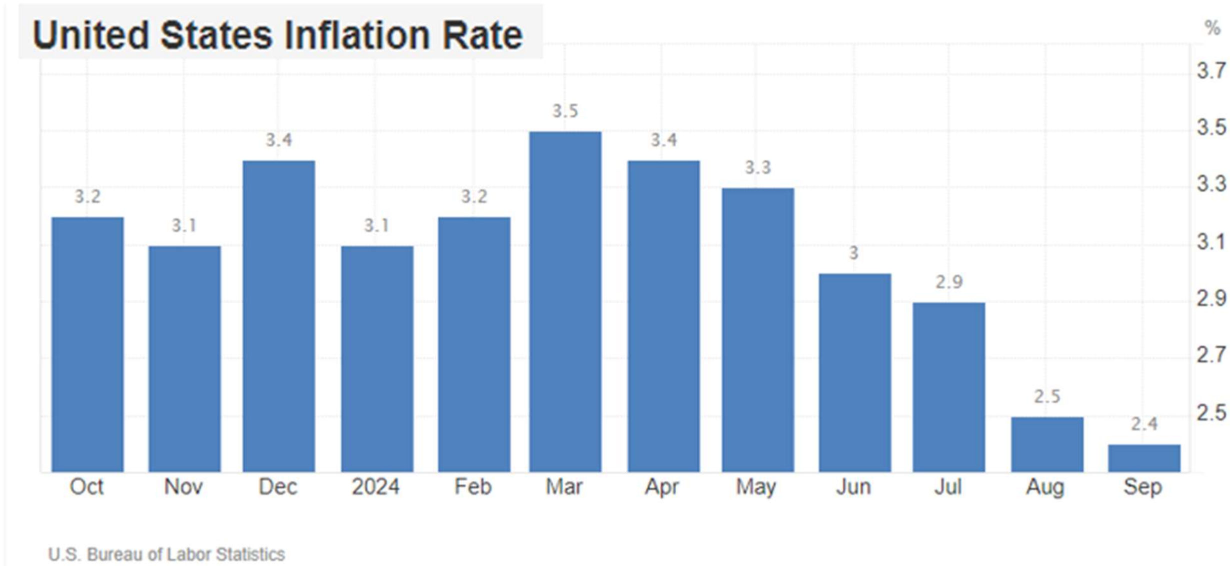

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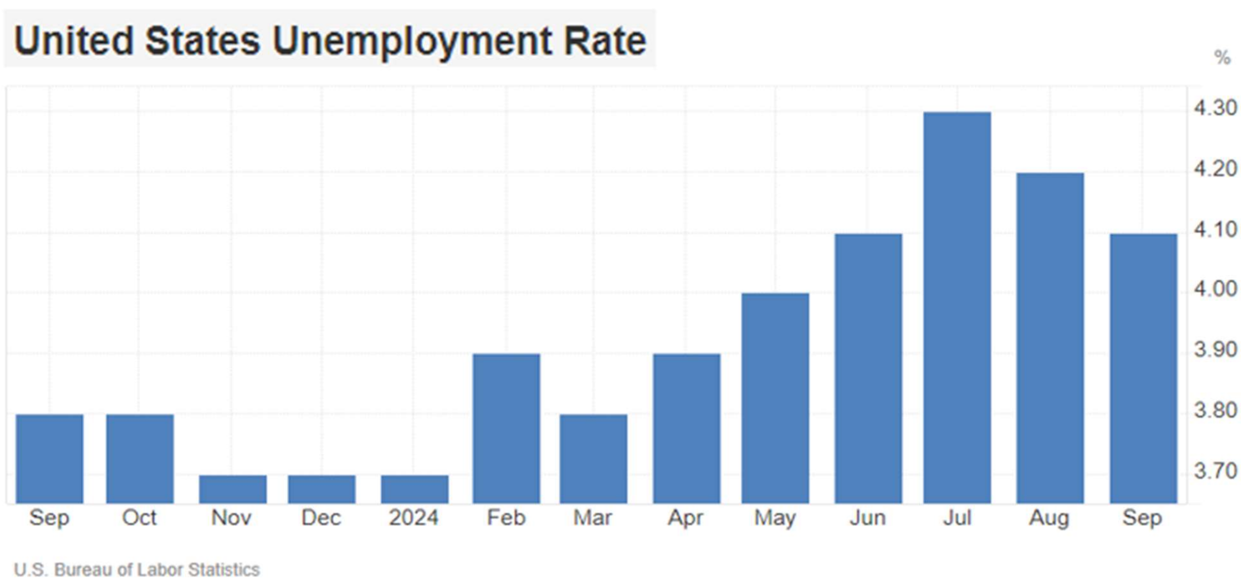

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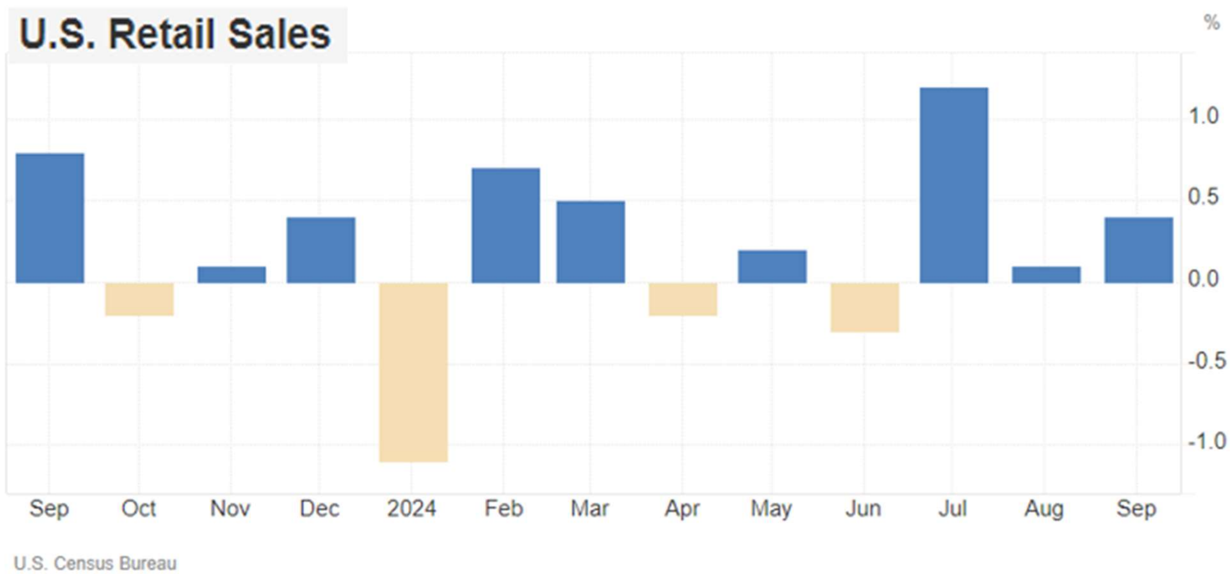
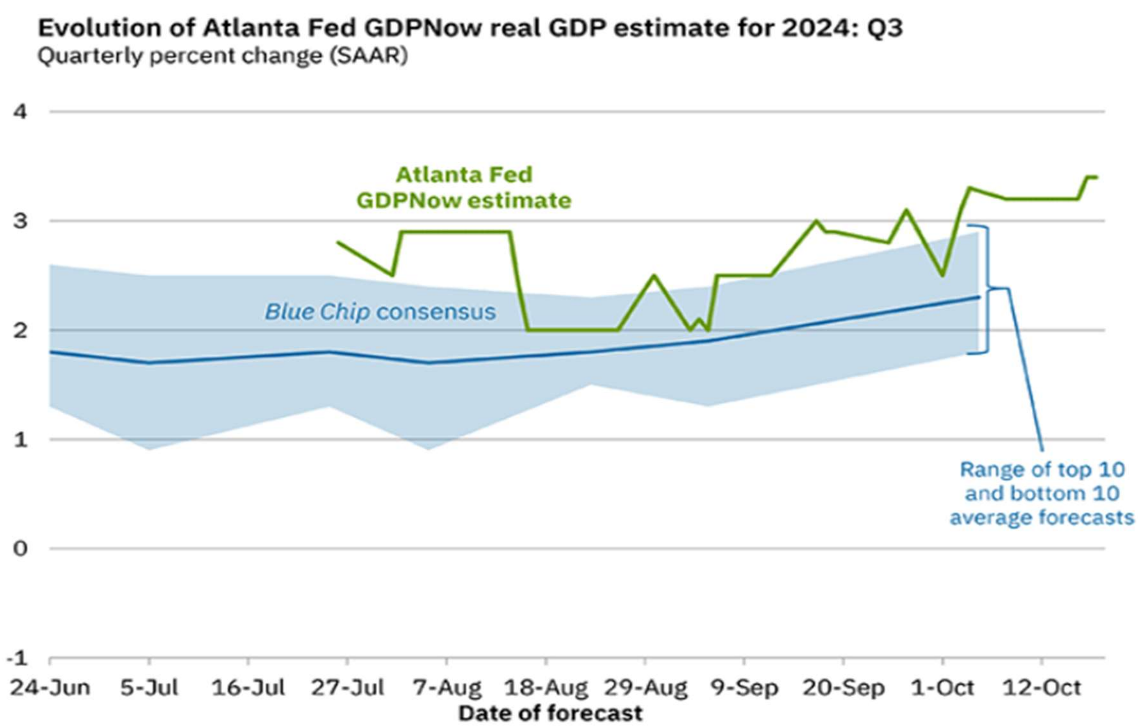
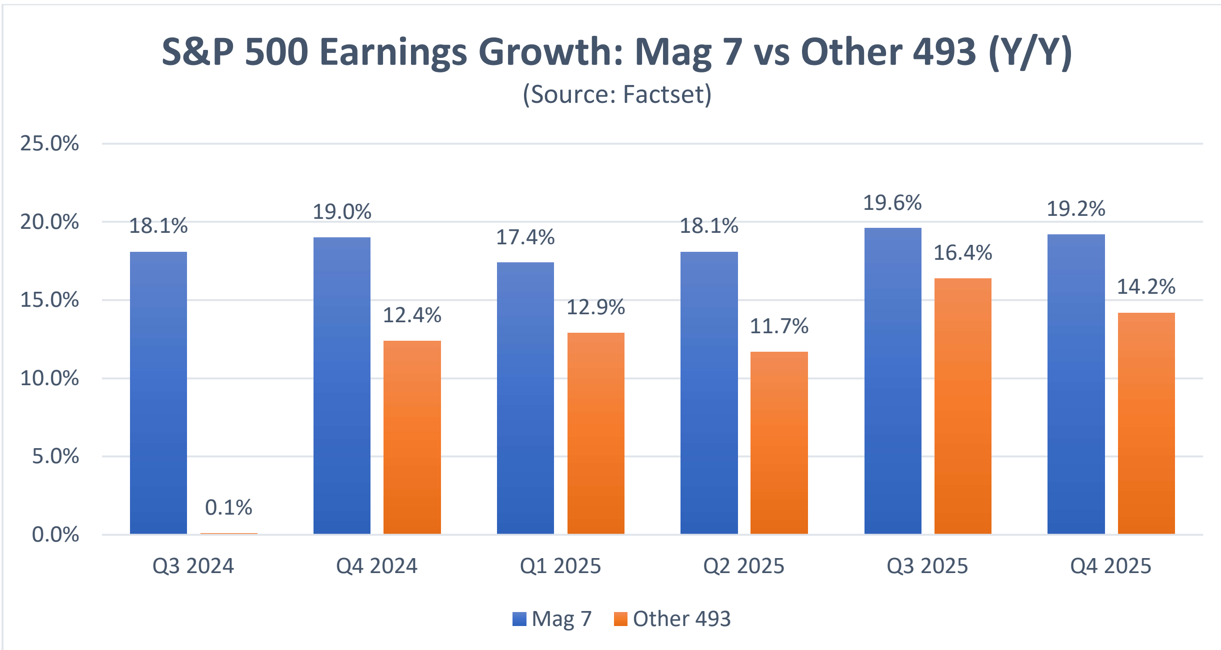

U.S. Retail Sales
%
1.0
0.5
0.0
-0.5
-1.0
Sep
Oct
Nov
Dec
2024
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
U.S. Census Bureau

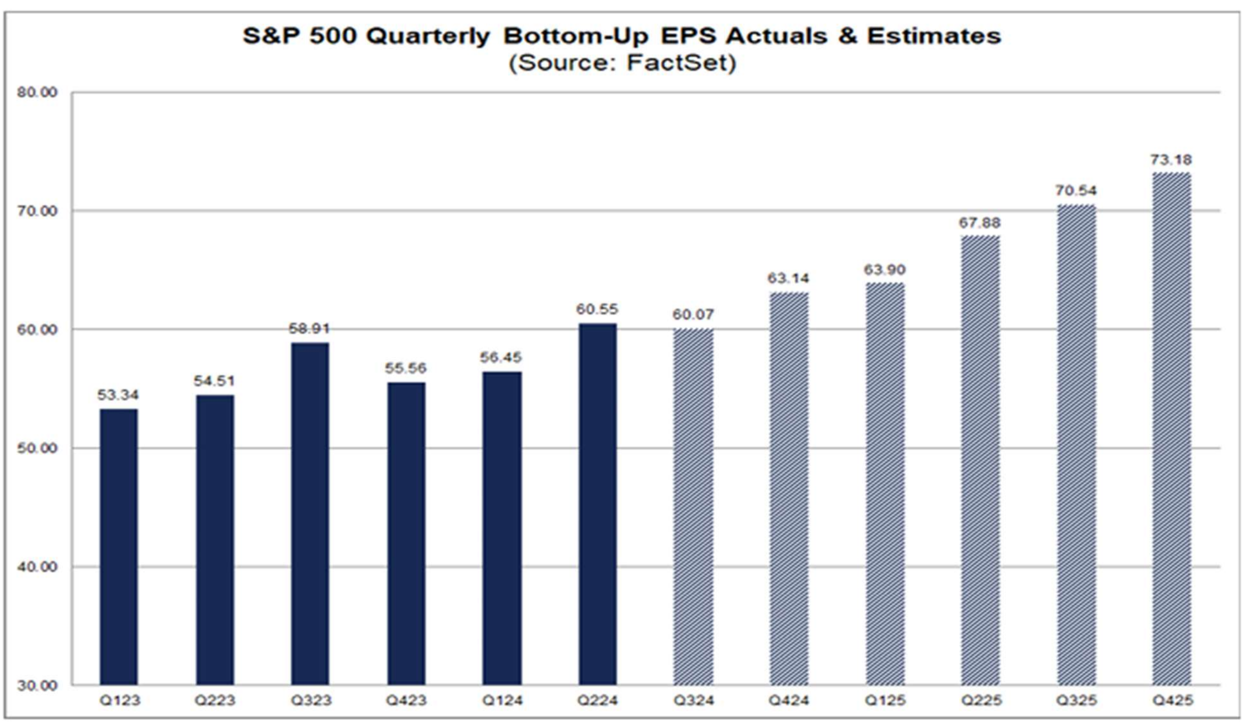
4.


Evolution of Atlanta Fed GDPNow real GDP estimate for 2024: Q3
Quarterly percent change (SAAR)
4
3
2
1
0
-1
Atlanta Fed
GDPNow estimate
Blue Chip consensus
Range of top 10
and bottom 10
average forecasts
24-Jun
5-Jul
16-Jul
27-Jul
7-Aug
18-Aug
29-Aug
9-Sep
20-Sep
1-Oct
12-Oct
Date of forecast

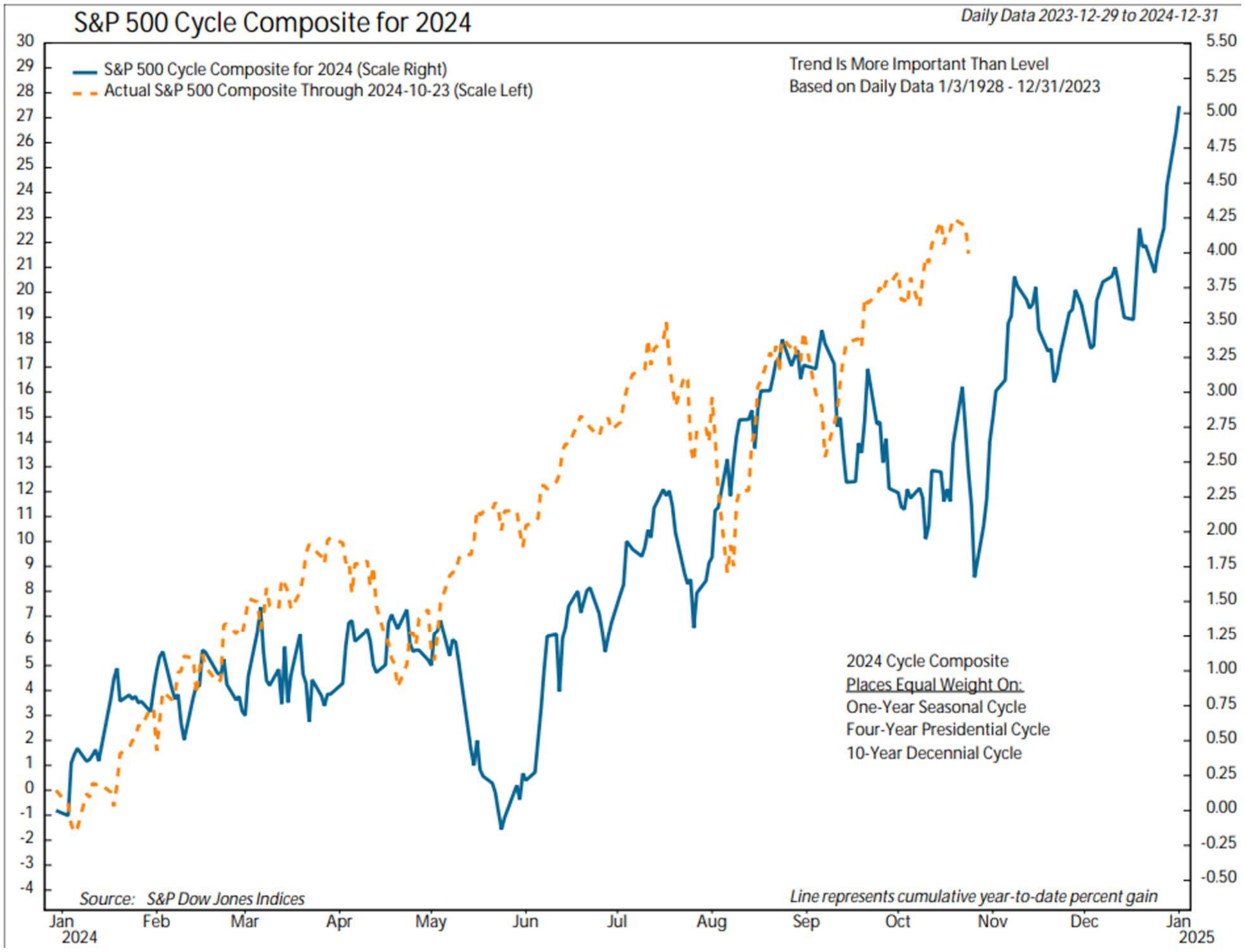
5.


S&P 500 Earnings Growth: Mag 7 vs Other 493 (Y/Y)
(Source: Factset)
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
18.1%
0.1%
19.0%
12.4%
17.4%
12.9%
18.1%
11.7%
19.6%
16.4%
19.2%
14.2%
Q3 2024
Q4 2024
Q1 2025
Q2 2025
Q3 2025
Q4 2025
Mag 7
Other 493

6.


S&P 500 Quarterly Bottom-Up EPS Actuals & Estimates
(Source: FactSet)
80.00
70.00
60.00
50.00
40.00
30.00
53.34
54.51
58.91
55.56
56.45
60.55
60.07
63.14
63.90
67.88
70.54
73.18
Q123
Q223
Q323
Q423
Q124
Q224
Q324
Q424
Q125
Q225
Q325
Q425

7.



Note: Aligning with historical cycle trends provides context, not a prediction.