Executive Summary

Performance in the 3rd quarter was behind the OE's benchmark and ahead of the S&P 500. Small caps and international stocks outperformed the S&P 500 this quarter, which was a welcome reversal. The prospects of Fed interest rate cuts but no recession led to investor enthusiasm for a broader set of stocks than the technology heavy S&P 500 in 3Q. Stock prices continue to grow at a faster rate than earnings growth so earnings will need to grow significantly in 2025 and 2026 to sustain the strong performance of the stock market. That might be difficult to achieve if the US economy slows down. The election should help bring some clarity to future economic policies but also might usher in an era of modest fiscal restraint that would not be a welcome near-term development for the economy.

The Opportunistic Equity Strategy returned 9.2% in the third quarter of 2024, behind its benchmark and ahead of the S&P 500. Stock selection has been weaker than usual in 2024. There is a heavy allocation to companies with margin improvement plans that are set to be reflected in 2025 results and beyond. Many investors are skeptical these companies are anything more than a value trap. I am of the opinion a modest level of patience will be rewarded in 2025.

What matters most for the stock market is earnings growth. 2025 and 2026 earnings growth have a high degree of uncertainty at this point. Will we have a split government that leads to some fiscal restraint or not? Fiscal restraint, if that is to occur, will impact earnings growth. Will AI tools broaden out to justify the elusive ROI that is present with so many AI investments today? We have recently seen weakness in some tech leaders while Nvidia continues to climb as investors are becoming more and more skeptical the massive investments being made are going to be profitable. S&P 500 earnings growth is projected to be double digits in 2025 and 2026. And yet that hasn't occurred in the past couple years so what exactly is going to create an acceleration? Even if the economy does not slip into a recession, growth looks to be cooling. The P/E ratio has risen to a level where generating significant earnings growth from share buybacks will be difficult. So that means company earnings need to grow faster than economies, a trend that might be difficult to continue. Profits are already historically high compared to GDP. How will geopolitics unfold under a new US administration and how will that impact earnings growth for companies?

As of 9/30/2024	QTD	YTD	1 year	3 year	5 year	Since Inception
OE	9.2%	9.4%	20.1%	7.8%	N/A	17.1%
Benchmark	9.7%	10.9%	26.0%	4.2%	N/A	7.7%
SPX	5.9%	22.1%	36.3%	11.9%	N/A	14.8%

Inception: 1/1/2020

Despite general cautiousness about stock price valuations, if many of the OE companies can execute on self-help margin improvement plans, earnings growth will be strong. Below are a few of the stocks that have struggled in 2024 but through self-help can provide solid earnings growth in 2025.

Societe Generale has struggled to reach a 9 to 10% ROE level that peers are at or have surpassed. There have been execution issues but also French banks have not benefitted from rising interest rates like other European banks have due to some particulars in that economy. Lower interest rates are a good thing for French banks.

Macy's has talked about 2025 as the year it can resume modest revenue growth with mid-single digits earnings growth. This is supposed to come about from a number of self-help business decisions. Macy's only trades at a 6x 2024 earnings forecast with a valuable real estate backstop. A return to growth would be a shock that would send the stock up perhaps by quite a bit.

Investors don't seem to think ThyssenKrupp can untangle itself from funding money losing Steel Europe but the company is diligently working to address Steel Europe and in 2025 the picture will become a lot clearer. With the strength of its balance sheet, a positive development with Steel Europe would be a shock that would send the stock price higher.

Xperi, Inc. has put out some revenue and margin targets for 2025 that are not believed by investors. While I am a little skeptical as well, there is a very solid risk vs reward with this stock. It has multiple product pathways that can help reestablish revenue growth.

Linamar manufactures equipment for autos, agricultural and construction. All those markets are weakening but if Linamar can reestablish its previous auto margins, a near-term goal, it will experience earnings growth despite market slowdowns.

Canadian Solar is dealing with an unprecedented wave of capacity hitting the upstream solar markets. That is impacting profitability but Canadian Solar has done a nice job diversifying its business. Recurrent, its downstream developer, has a nice backlog to execute on that will slowly improve margins in that division. Canadian Solar was also an early mover in establishing battery storage capacity. That pipeline of business at solid margins can help Canadian Solar weather the downturn in 2024 and then accelerate margins in 2025.

Baidu Inc. is maintaining solid profitability while investing heavily in AI initiatives. If some of those initiatives scale well, they will turn from money losers to at least breakeven and that will accelerate Baidu earnings growth.

General Motors will face lower profitability in its core ICE auto business in 2025 because the market is getting more competitive. However, losses in the EV portfolio should narrow meaningfully allowing GM to maintain operating earnings. Maintaining operating earnings is all GM needs to do since it can buy back more than 10% of its share count each year by doing so.

Nokia is another holding with margin improvement potential in 2025. It is lowering its cost base to deal with the slowing baseband market and to improve its margin profile in other divisions as well. Nokia is a company that should have a higher margin profile than it does and these are welcome developments. Lowering the cost base should be able to lead to earnings growth without harming the business.

Suzano is dealing with lower pulp pricing for the later part of 2024 but is also ramping what should be its lowest cost pulp mill. Once Cerrado is fully ramped in 2025, Suzano will get a margin bump.

PagSeguro Digital is sacrificing margin for revenue growth in its core payments space. Payments margins were bound to fall anyway so this appears to be a solid anticipatory move yet investors don't like it. Expanding its customer base can lead to modest payments growth despite a lower take rate but also allows for ancillary services to be provided. Those ancillary services can provide good operating leverage over time. PagSeguro has established themselves as a leading digital bank in Brazil but makes little money off of that business at this point. There is upside potential and management thinks so too with its recent share repurchase authorization.

The list of securities goes on. Those are just some of the many examples of stocks in the OE that should have earnings growth in 2025 despite economic conditions. A common theme among that list of stocks I just put forth some notes on is they all trade around 10x earnings or less with the exception of Canadian Solar and ThyssenKrupp. Canadian Solar probably has as much operative leverage as any and ThyssenKrupp trades at much less than its cash value so some unique circumstances with those two. Companies that trade at a significant discount to the stock market multiple can provide meaningful upward stock moves if they are able to prove they do have a stable business that is able to grow with defensible margins. That would be a shock to pessimistic investors and those types of positive shocks are one of the things the OE looks for.

The OE had several holdings experience very strong stock performance in the 3rd quarter. Hanesbrands, Inc was recently trimmed after it rallied in 3Q. Hanesbrands was originally bought thinking the innerwear business was a strong solid earning business and Champion could be turned around to become a major brand that could compete with some of the biggest athletic apparel brands. Unfortunately, Champion has struggled and Hanesbrands entered into an agreement to sell the Champion business. The proceeds have allowed Hanesbrands to lower its net debt level but the proceeds were below what one optimistic on the Champion brand would have liked to see. There isn't as much operating leverage to improving conditions now with Champion gone so the upward momentum likely will stall. Hanesbrands still has a very strong innerwear business capable of generating solid earnings so a reasonably good story is still intact.

Advancers/Decliners	2024 3Q Return
Hanesbrands, Inc.	48.9%
Alibaba Group Holding	47.4%
Daqo New Energy Co	39.6%
Impinj, Inc.	38.1%
Embraer SA	37.0%
Fresh Del Monte Produce Inc.	36.3%
Intel Corp.	<23.4%>
Macy's, Inc.	<17.3%>
ThyssenKrupp AG	<10.3%>

Alibaba rallied on improving sentiment towards Chinese stocks. Monetary and fiscal stimulus are supposed to be put in place to address economic conditions in China.

Daqo, similar to Alibaba has been pulled higher by improving sentiment towards Chinese stocks with monetary and fiscal stimulus on the horizon. Daqo was recently trimmed but continues to trade an extremely depressed level, lower than its cash value.

Impinj was also trimmed recently. Impinj has a great secular growth story but upon being added to a mid-cap index, it rose 13% just in anticipation of being added. The stock moves on inclusions and exclusions to indices seem to keep getting more pronounced. I decided to sell half the position on the index inclusion rally. It has since moved considerably higher.

Embraer is one of the largest holdings in the portfolio. Embraer's stock has had a nice run but if it continues to execute in all 3 of its main divisions, it will push higher. Embraer has good catalysts across all 3 divisions which have the potential to lead to meaningful growth.

Fresh Del Monte has the potential to benefit from a movement toward fresh cut fruit and vegetables in diets. It has some valuable land and has a particularly strong position in pineapples. They have been introducing new pineapples that will help with growth. Global conditions are challenging for bananas right now but at the same time, Fresh Del Monte is executing on some margin improvement plans across all divisions that have the potential to increase earnings power.

There were not as many poor performers this quarter but Intel was still in the mix. The Intel 2Q earnings report was really disappointing. While many investors were looking past 2024, Intel essentially said investors need to look past much of 2025 as well since gross margin improvement won't meaningfully pick up until Intel is able to use its own 18A wafers for products. There is a credibility issue that has developed and now Intel must execute on 18A or its business will really be ready for a breakup. Gaudi 3 was never supposed to be a huge money maker but even still, it seems modest expectations are being scaled back. There is no imminent jump in AI revenue. On the bright side, the new Xeon data center chips are strong and should lead to an upgrade cycle. 18A appears to be making progress while competitors like Samsung are really struggling. It won't be healthy for the semiconductor markets if TSM is the only advanced foundry around. Lunar Lake is a very strong product, albeit at lower margins. Intel needs to show steady progress the next couple quarters. It is a stock the OS is holding but not adding to or selling.

Macy's needs to prove it can return to modest growth in 2025. Investor pessimism over the future of department stores is very high. Macy's stock price has also now lost any premium it maintained due to a potential buyout.

ThyssenKrupp is in the midst of a battle with its Steel Europe subsidiary about funding. ThyssenKrupp is looking for some structural changes to keep funding Steel Europe. Industrial conditions are currently very poor in Europe, particularly Germany, and ThyssenKrupp has too high of a cost base to operate effectively when economic conditions weaken. The high cost base has hurt earnings this year. The market continues to have no confidence management will be able to win some concessions from labor boards and investors believe ThyssenKrupp will continue to be stuck in a high cost position for a long time. Perhaps naive, but I think ThyssenKrupp's new CEO is determined enough to successfully execute cost restructuring for ThyssenKrupp. It just requires a little bit of patience holding the stock.

While the election and ensuing economic policies could create some market angst, I am optimistic that in 2025 some of the OE stocks will be able to prove they do in fact have a solid business that warrants a higher earnings multiple.

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