Executive Summary

Performance in the 3rd quarter was behind the OS's benchmark and ahead of the S&P 500. The market had a modest reversal in the 3rd quarter whereas small cap stocks outperformed the technology heavy S&P 500. International stocks also outperformed the S&P 500. Investors were enthusiastic about the prospects of Fed interest rate cuts which are viewed as a positive development for many economically sensitive sectors. Inflation has been cooling and the jobs market weakening, but the jobs market has been resilient enough to create an expectation of no recession on the horizon. The stock market has continued to rise more than earnings growth this year. Earnings growth will need to accelerate to sustain the strong stock market performance. That might be difficult to achieve if the US economy slows down. Even if companies believe internally they have a good earnings growth story to tell for 2025, investors won't get an indication of such soon, especially with the election approaching and uncertain domestic economic policies ahead.

The Opportunistic Strategy returned 8.2% in the third quarter of 2024, behind its benchmark but ahead of the S&P 500. A higher than usual bond allocation and a higher than usual cash allocation has modestly limited returns in 2024 but the biggest factor leading to underperformance has been stock selection. Some of the underperforming stocks are supposed to meaningfully improve earnings performance in 2025. If they do, the stocks should rally but if not, the value trap moniker that is attached to many of them will persist.

The United States economy has been resilient in the face of 500bps of interest rate increases. Many recession indicators with close to a 100% success rate have been flashing red for a while but there has been no recession. Some of those indicators have a manufacturing bias and are not dynamic enough to account for the post-covid economy we are in, one that has had strong services and government spending. Still, there are no shortage of recession indicators that have so far proven inaccurate.

Inflation is on a downward trend and while jobs growth has slowed, the jobs market is still in okay shape. Productivity has been strong this year. At this point, many investors are eyeing Fed interest rate cuts but no recession, a sort of goldilocks scenario. While many positive economic dynamics have developed, we are likely heading for another year where the deficit grows by more dollars than nominal GDP does.

Since the end of 2019, the treasury total public debt outstanding has risen from around 23 trillion to around 35 trillion. Meanwhile, US Nominal GDP has grown from around 22 trillion to around 29 trillion. The trend of growing debt at a faster pace than economic growth is unsustainable and the quality of our economic growth over the past few years has been weak, despite an uptick in productivity. Debt-financed growth is not the preferred means to generate economic growth. The post World War 2 boom in economic growth was opposite to today. A large national debt to GDP shrunk to a low level from the late 1940's to early 1970's. That was because the strong economic growth created budget surpluses over that time frame.

Increasing labor force productivity is a welcome development and raises the quality of economic growth. Productivity can bounce around though, and it is not yet clear US labor force productivity is set to remain or even grow from its current solid level. Many investors believe AI is the necessary tool to keep productivity strong. However, its usefulness needs to dramatically broaden out. Not a very high percentage of jobs can benefit meaningfully from AI at this point. I would argue the wealth gap that continues to widen in our country will be an obstacle to productivity going forward. The ability for business owners to disproportionately benefit from economic growth has its limits. If workers are productive, they absolutely should receive pay increases above inflation but it is still better for economic growth if workers perform more work at lower pay. A final obstacle to persistent above trend productivity growth is the government. It does not appear the government in its current fiscal condition is going to be in a position to make significant investments to support productivity. High national debt levels can hurt productivity. There are some risks to the current narrative that US growth is going to stay strong because of productivity. The OS is investing with the belief a US recession is still on the horizon and this one is going to start with the government being forced into modest fiscal restraint.

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?

While all investing environments have a degree of uncertainty looking forward, it does seem things are particularly cloudy at this point and a modest degree of conservatism, which the OS has implemented through all of 2024 is the right go forward judgment.

Despite general caution about stock price valuations, there is quite a bit to look forward to with the OS portfolio in 2025. A good percentage of the portfolio is in stocks that are turnaround companies. These are companies that through self-help measures can improve earnings performance. Investors are skeptical these companies can hit their goals and so if they are able to, that is the type of shock than can lead to a sharp upward move in stock prices.

For instance, 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. If Societe Generale can improve performance to reach a 10% ROE, its stock price should move much higher. 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 its money losing Steel Europe division 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. 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. There are many other examples of stocks in the portfolio that just need to show earnings are going to be stable in 2025 and that is likely all that will be needed for a rally.

As of 9/30/2024	QTD	YTD	1 year	3 year	5 year	Since Inception
OS	8.2%	10.7%	21.2%	6.5%	15.2%	15.3%
Benchmark	9.2%	15.7%	27.0%	7.4%	9.9%	9.3%
SPX	5.9%	22.1%	36.3%	11.9%	15.9%	14.8%

Inception: 9/1/2016

The OS 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%>
Chord Energy Corp.	<21.0%>
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 Taiwan Semi 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.

Chord Energy is a stock held that came about from holding Whiting Petroleum bonds through bankruptcy. The stock has had a nice return, one of the few situations where holding unsecured bonds through bankruptcy was the right decision. It has become a shareholder friendly oil and gas company. Chord had a poor quarter because oil had a poor quarter. Concerns about China's economy and some potential supply increases have lowered oil prices.

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.

The bond allocation continues to be a higher than historical weighting. Credit quality is also higher than it has been historically. There are several different paths our country could be put on depending on the election. While clarity after the election may lead to a small cap rally despite who wins, on the flip side, any meaningful fiscal restraint would disproportionately impact small caps. The OS will continue to allocate to companies that are able to reestablish earnings power regardless of the direction of the economy. I am optimistic some beaten down stocks will be able to reverse course in 2025, perhaps even this quarter.

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