FORTITUDE CAPITAL MANAGEMENT

Independence · Integrity · Insight

800 Roosevelt Road
Bldg. B, Suite 413
Glen Ellyn, IL 60137
630.545.2800
fortitudecapitalmgmt.com

October 11, 2024

"We know they are lying, they know they are lying, they know we know they are lying, we know they know we know they are lying, but they are still lying." – Aleksandr Solzhenitsyn

"One idiot is one idiot. Two idiots are two idiots. Ten thousand idiots are a political party" – Franz Kafka

Fellow Investors:

There is an old adage cited for the equity markets that the market "climbs a wall of worry". And it seems like there is a lot to be concerned about of late. Besides our approaching election here in the US, there are two wars raging that threaten to expand, assassination attempts on a presidential candidate, economy disrupting strikes, devasting storms and an exploding national debt. Yet, the market advances.

The S&P 500 provided a total return of 22.1% through the end of the third quarter, although still dominated by a handful of companies. Small caps returned 11.2% as measured by the Russell 2000 and international developed markets gained 13.5% as measured by the MSCI EAFE. We are still experiencing a high level of concentration in the S&P 500 with the top seven companies by market capitalization ending the quarter accounting for 30% of the index and the top ten companies by market capitalization accounting for 36% of the index. Without the "Magnificent Seven" companies, the return of the remainder of the S&P 500 components was 11% through the end of the third quarter. The Mag 7 returned 35%.

Stock prices are driven by expected future returns to shareholders discounted back to the present by prevailing interest rates. One standard measure for this is the price to earnings ratio or P/E ratio. The P/E ratio is often used to measure how "expensive" a stock may be relative to its current or expected earnings. Currently P/E ratios are high by historical averages, again driven by large tech companies. The top ten companies in the S&P 500 have a current P/E ratio of 30.5 times, well in excess of their 30-year average of 20.5x. However, even the remainder of the index sports a P/E of 18.4x, above its 30-year average of 15.7x. Does this indicate that the US equity market is overvalued? Only time will tell. A higher than average P/E is not necessarily a negative indicator as it may reflect a valid view of future performance. In 2024 there was solid earnings growth, exceeding the average for this century and forecasts are for continued earnings growth. That and the expectations for lower interest rates take a little off the argument for overvaluation.

Things are looking more likely that the Fed may achieve its hoped for "soft landing". Real economic growth is centering on 3% and employment numbers have kept the unemployment rate well below the 50-year average. The Fed made a surprise 0.50% cut in its target Federal Funds rate, the surprise being the size of the cut not the timing. The Fed also made statements indicating that we can expect another 0.50% in cuts for the remainder of the year and perhaps a full 1.0% over the course of 2025. The ten-year treasury rate started the third quarter at 4.48% and declined to 3.81% by quarter end, however recent geo-political events have pushed rates back above 4.0%. The two-year treasury rate began the third quarter at 4.77% and finished September at 3.66%. Like the ten-year, the two-year has ticked up since the end of the third quarter. Short term rates remain very high as the three-month treasury rate is in the 4.7% range. All this leaves us with a positive yield curve (barely) from two years out, but very short-term rates reflect continued near term

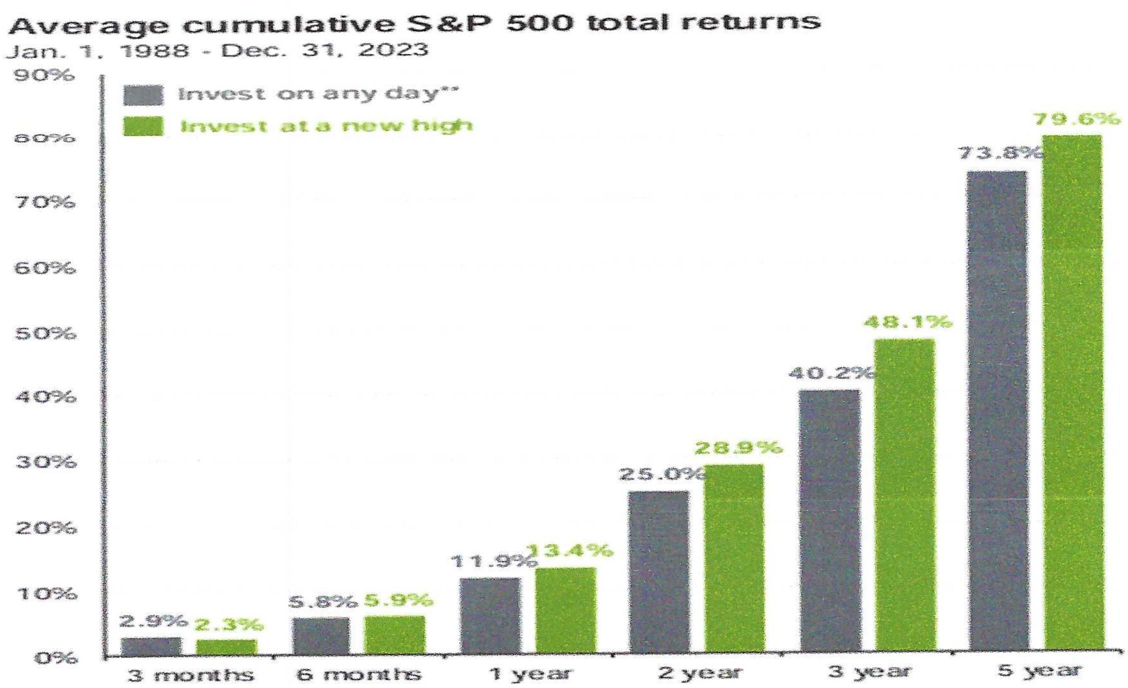
800 Roosevelt Road
Bldg. B, Suite 413
Glen Ellyn, IL 60137
630.545.2800
fortitudecapitalmgmt.com

uncertainty. It is hoped that lower rates will loosen up the housing market as mortgage rates have come down to the low to mid 6% area.

The consumer drives 70% of US GDP. The open question is if the US consumer may become tapped out as a result of the impact of past inflation on everyday expenses and dwindling savings. The University of Michigan Consumer Sentiment Index is up from its low in June 2022, but still well below the average for the last 50 plus years. The personal savings rate remains well below the historic rate and recent levels of auto and credit card delinquencies are increasing from the low reached thanks to the Covid stimulus program. Rising equity values counters this by creating a wealth effect to the consumer conscious and thus spending, but a sharp selloff in equity markets could quickly turn this around.

Besides the near-term risks listed in the first paragraph, the long-term risk for our economy is the national debt and its rate of growth. With a projected annual deficit of $2 trillion adding on to a $35 trillion national debt load, the situation is truly becoming an existential threat. The ability to address the needs of society may become very limited under the weight of this growing debt service and we have already felt the pain of inflation caused by excessive government deficit spending funded by creating money. It has been a topic for 50 years, but we believe the breaking point may be closer than many want to admit. Neither political party appears to have a clear plan to address this looming problem.

There is indeed a lot of risks for investors to navigate. A peaking equity market in turbulent times is unsettling. However, we do warn against market timing. The chart below from JP Morgan Asset Management makes a valuable and interesting point.



FORTITUDE CAPITAL MANAGEMENT
Independence · Integrity · Insight

800 Roosevelt Road
Bldg. B, Suite 413
Glen Ellyn, IL 60137
630.545.2800
fortitudecapitalmgmt.com

What this chart shows is that except in the very near term (three to six months), investing at a new high in the market has historically outperformed investing on any day. Despite our fears it is always sound to remember that "it is time in the market and not timing the market" which leads to long-term success. The long-term performance of the equity markets speaks for itself, but riding out the occasional storms requires fortitude and perspective. We encourage our clients to keep their focus on the horizon and not the distractions in the near future. Historically, elections make little difference regardless of the result, although they may be entertaining.

Sincerely,

Erik Ford

Jason Marrs

[1]The price-to-earnings (P/E) ratio measures a company's share price relative to its earnings per share (EPS). Often called the price or earnings multiple, the P/E ratio helps assess the relative value of a company's stock. It's handy for comparing a company's valuation against its historical performance, against other firms within its industry, or the overall market. P/E can be estimated on a trailing (backward-looking) or forward (projected) basis. The figures cited above are forward-looking.

The S&P 500 Index, or the Standard & Poor's 500 Index, is a market-capitalization-weighted index of the 500 largest publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market capitalization because there are other criteria to be included in the index.

The term Russell 2000 Index refers to a stock market index that measures the performance of the 2,000 smaller companies included in the Russell 3000 Index. The Russell 3000 is a capitalization weighted index representing approximately 96% of the investable U.S. equity market.

The MSCI EAFE Index serves as a performance benchmark for the major international equity markets and includes companies in 21 countries in Europe, Australasia, and the Far East (East Asia).

The Michigan Consumer Sentiment Index (MCSI) is a monthly survey of consumer confidence levels in the United States conducted by the University of Michigan. The survey is based on telephone interviews that gather information on consumer expectations for the economy.

The "Magnificent Seven" include AAPL, AMZN, GOOG and GOOGL, META, MSFT, NVDA and TSLA.

** Invest on any day represents the average of forward returns for the entire period.