



2Q24 Market Commentary

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Doug Ramsey
Chief Investment Officer

The U.S. bull market in stocks remains intact through the middle of the summer, and the winning themes year-to-date are the same ones we've written about for the majority of the last dozen years: large-cap stocks over small caps and growth over value. Based on the valuation gap between the leaders and laggards, investors appear to be betting on an indefinite extension of the status quo.

The S&P 500¹ has gained about 55% since bottoming in October 2022, on par with the average return of a bull market nearing its second birthday. While the 2022 bear-market low is officially in the record books, it was unusual in a couple of ways, and therefore, worth revisiting.

First, the October-2022 bottom occurred with the unemployment rate (3.5%) at a lower level than seen at the start of any other major market upswing. Such a muted unemployment rate is usually associated with "late-cycle" ills, including a squeeze on corporate profit margins, higher than average inflation, and tight monetary policy. We've observed all of those maladies in the last year-and-a-half, yet the stock market has persistently shrugged them off.

Second, based on our most reliable valuation measures, this bull market commenced with the S&P 500's valuation² 25-30% above the levels observed at any prior bear market low. Thanks to this dubious head-start, valuations are now at heights attained in only two previous market cycles: the last phase of the Technology Bubble (1999-2000) and the post-COVID market mania of

2021. As of late July, the S&P 500 P/E ratio traded near 21.0x twelve-month-forward earnings estimates³, and 31.0x our five-year normalized EPS⁴ estimate. The market's current price/cash flow ratio⁵ of 19.0x is also at a threshold that's never been breached outside of those same two aforementioned bubble episodes.

Still, we would stop short of calling today's stock market a "bubble." Rather, it is only *priced* like one. While an excessive price is necessary to meet the definition of a bubble, it is not a sufficient condition for that label. The missing piece is irrationally giddy investor psychology that accompanies a genuine asset mania. While most surveys of investor sentiment appear overheated, our subjective opinion is that the fervor doesn't yet match the extremes of either Y2K or 2021. However, if one is inclined to wager that it *will eventually* reach those excesses, we think that is a tremendously bad bet from a risk/reward perspective. Nonetheless, that's precisely what many asset allocators are implicitly positioned for.

The irony is that today's pricey valuations have been partly enabled by the ongoing slowdown in the U.S. economy. The deceleration has spawned hopes for an initial interest-rate cut in September, reversing the Federal Reserve's⁶ lengthy tightening⁷ campaign. However, investors should be careful what they wish for. Back in January 2001 and September 2007, the Fed's initial rate cuts forewarned that a recession was imminent.

There's a growing list of economic measures that look pre-recessionary.

¹ A stock market index tracking performance of 500 of the largest U.S. companies.

² S&P 500 valuation based on the price-to-earnings (P/E) ratio measures a company's current share price relative to its per-share earnings.

³ The 12-month-forward P/E ratio uses forecasted earnings.

⁴ Five-year arithmetically-averaged annual earnings-per-share (EPS), looking six months ahead and 54-months back.

⁵ The share price divided by cash flow per share.

⁶ The central banking system of the United States.

⁷ Tightening occurs when central banks raise the federal funds rate (the interest rate that banks charge other institutions for lending excess cash on an overnight basis).

2Q24 Market Commentary (continued)

Prices for industrial commodities, which provide a real-time barometer of manufacturing activity, have wiped out most of their year-to-date gains in just the last month. July's weekly run-rate for initial unemployment claims was up about 15% from its first-quarter lows, while applications for unemployment insurance hit a new high for the post-COVID expansion¹. Both of those series showed very similar spikes in the months leading up to previous economic downturns.

Meanwhile, the number of full-time U.S. jobs has, in fact, shrunk by 1.2% in the last twelve months, which is usually only characteristic of a recession that is well underway. In turn, that contributed to a June drop in the annual growth rate of real personal-disposable income² to just 1.0%, down from a solid 4.0% at the end of 2023. If it sinks further, it's apt to unleash the vicious cycle that defines a recession: shrinking demand, job cuts, and an outright contraction in real incomes.

The economy and stock market have performed better during the last several months than our monetary and liquidity gauges would have suggested. In fact, the *stock market, itself*, is probably among the reasons the economy has so far been able to defy two years of tight monetary policy. Over the last nine months, the S&P 500 has gained about 35%. While that's a big move in a short period, it's hardly unprecedented.

Nevertheless, thanks to its already-high

Sincerely,



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valuation, the surge in U.S. stock market capitalization³ has amounted to \$14 trillion—roughly 50% of U.S. GDP!⁴ For perspective, such an increase is larger than that generated by the historic bull market of 1982-1990. The resulting wealth effect helps to offset the recent slowdown in real incomes, but we think it has also been a factor in the stickiness of various measures of consumer price inflation.

On the whole, the monetary and economic backdrop reflects above-average risk, while equity valuations provide little margin for error. However, our technical market disciplines have refused to break down and are the pillars of support behind our neutral (rather than negative) stance toward equities. Following a modest reduction in mid-July, net equity exposure across our tactical allocation portfolios stands at 55%.

In sum, several of our valuation metrics have escalated to levels previously only achieved during the market manias of 1999-2000 and 2021. At the same time, economic risks are now very concerning. With technical market action being the lone bullish prop keeping our stock market assessment afloat in the neutral zone, we wonder if the sudden broadening of strength across equity styles is a final “hook” to lure aboard the remaining skeptics. Only time will tell!

Thank you for your support—please let us know if you have any questions!

¹ An increase in economic activity, production, and employment, which leads to more goods and services, higher incomes, and a boost in household and business spending.

² After-tax income available to U.S. households adjusted for inflation.

³ The total dollar value of a company's outstanding shares, calculated by multiplying the current market price of one share by the total number of shares.

⁴ The value of the final goods and services produced in the United States.

Other Market Notes

STEVE LEUTHOLD'S "TEN LESSONS I HAVE LEARNED" PART 2

One year ago in March, we lost our friend and the founder of this firm, Steve Leuthold. We deeply miss his counsel, candor, creativity, and cantankerous nature.

Around Y2K, Steve compiled his "Ten Lessons I Have Learned" as part of an essay, which was later published in 2002, "The Global-Investor Book of Investing Rules: Invaluable Advice from 150 Master Investors."

Last quarter, we published the first half of Steve's "Investment Ten Commandments." As promised, here we present the final five of what Steve also referred to as his prudent investment dogma: The lessons he believed to be most important when managing one's serious money. (True to his nature, Steve learned most of these lessons only after first violating nearly every one!)

VI. Bonds Can Be Best

If the 20-year bond yield fell from 7% to 6% over a year's time, it would gain 20% total return. That is twice the historical annual return achieved by the stock market. What of the risk? If yields rise to 8% rather than fall to 6%, the loss would be less than 2%. Considering the minimal downside versus the incredible potential upside, this is a very attractive risk/reward scenario.

VII. "New Valuation Eras" In The Stock Market Have Always Been Temporary

When stocks run-up big (like 1998-early 2000), and Wall Street uses the term "new era," saying "It's really different this time," well, that's the signal to consider asset-class alternatives—like cash and bonds. While market bubbles can inflate beyond expectations, in the end they always burst.

Conversely, in the latter innings of a big *bear* market, many on Wall Street ultimately surrender and concede that it must be a "new era" with a depressed economy, depressed earnings, and depressed equity valuations as far as the eye can see. Again, the refrain is "It's really different this time." Those bearish "new eras" have also always proved

to be temporary and are the prime times to build equity holdings.

Case in point: In late 2002, while we constantly heard from "new-era" bears, our own indicators turned positive toward stocks, directing us to increase equity exposure in tactical portfolios to the maximum guideline level (70%). In retrospect, it was the perfect time to buy—while the majority of investors were running for the exits!

VIII. Short-Term Trading Is A Loser's Game

It took me 20 years to learn this. It's true there are some full-time, professional short-term traders who have consistently won, but eventually, they either burn out or go down in flames due to one or two huge losses. About 95% of non-professional short-term traders end up losers if they stay in the game.

Even those with winning trades two-thirds of the time can end up has-beens, because losses on bad trades are usually at least twice that of the average gain from the good trades. Even if successful, the ultimate price can be high; the few who do prosper are disposed to end up failures in life, married to their trading machines, losing their families and other personal connections.

IX. History Is Experience... Learn From It

Financial history is not a Xerox machine and does not repeat itself exactly. Yet, simply put, history is mankind's best experience. And, it is said that experience is the finest teacher.

It's much less painful to learn the hard lessons from others' experience. That's why financial history is a vast early warning system, and why I hope you'll learn from, and pay attention to these ten investment lessons derived from my past mistakes.

Why does seemingly "ancient" history offer so many guideposts in today's world of advanced technology? Well, human nature has never changed. Investor psychology in the horse-and-buggy days was no different than now. Society has evolved, but fear and greed continue to be the dominant market forces... just like in 1905 and 1805.

Other Market Notes

"TEN LESSONS I HAVE LEARNED" PART 2 (continued)

X. Not Even Microsoft Is Forever

How about forgetting lessons 1-9. Instead, why not just buy a portfolio of America's outstanding companies and let them ride? That would seem a simple and prudent way to invest your mother lode.

Alas, it's a mistake to assume that today's celebrated firms will continue to be the dominant companies of tomorrow. History shows that shifts in the relative fortunes of America's leading corporations have taken place in a far more dramatic manner than most of us might perceive.

In 1970, these were among America's Top-50 firms based on market capitalization: Eastman Kodak (#5), Polaroid (#33), Xerox (#9), S.S. Kresge (#44), Avon (#15), and Burroughs (#45). So where are they now?

74% of 1945's richest companies (ranked by assets) were no longer among the Top 100 as of 2005, and

37% of 1995's 100 richest companies were not in the Top 100 in 2001—just six years later.

Less than 10% of the companies included in the S&P 500 in 1957 were still in the index in 2005, and estimates by McKinsey & Company advised that S&P 500 firms would be index members for just ten years or less, on average.

Accordingly, not only does history demonstrate that no company's earnings growth is permanent—but the rise and fall of corporate fortunes seems to have shifted into high gear as creative destruction accelerates.

And so it goes... even Microsoft may not be forever!

LEUTHOLD DOMESTIC EQUITY PORTFOLIO TOP TEN STOCK HOLDINGS (06.30.24)

Microsoft Corp.	4.9%	Applied Materials Inc.	2.7%
Meta Platforms Inc. Class A	3.5%	PulteGroup Inc.	2.0%
Apple Inc.	3.3%	Netflix Inc.	1.9%
Lam Research Corp.	3.2%	Oracle Corp.	1.8%
Alphabet Inc. Cl A.	2.9%	KLA Corporation	1.8%



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