LEUTHOLD FUNDS

January 31, 2025

4Q24 Market Commentary

Overall, despite historically high stock-market valuations and continuing red flags about the health of the economy, our quantitative work has yet to turn negative toward stocks.

Doug Ramsey
Chief Investment Officer

With the decades of experience and quantitative testing that feeds into our asset allocation strategy, our stance over the last year might be summarized very simply: We are not as cautious on the stock market as we might be otherwise, because it is *going up*.

In the Technical category of our weekly market assessment—the Major Trend Index, or "MTI"—our work captures many dynamics underlying stock market activity, such as momentum, breadth, and leadership characteristics. Some analysts like to compare the message of the "technicals" to that of the "fundamentals," such as stock market valuations, earnings trends, and monetary policy. However, technical market action, itself, could be considered an important fundamental variable—and one that's probably more important now than ever before.

The stock market has a solid record of anticipating turning points in the U.S. economy, with a typical lead time of about three to six months. Yet, there's a subtle reason for the market's forecasting prowess, which is almost never mentioned: It plays a starring role in economic outcomes. And, as the stock market grows in size relative to the economy, we believe the effect has been amplified. Today, the total market capitalization[1] of U.S. equities is about $60 trillion, or a little over twice the size of the country's Gross Domestic Product[2] (GDP). That's *more than double* its historical average relationship to GDP.

We suggested throughout 2024 that, while the Index of Leading Economic Indicators[3] (LEI) pointed to an elevated risk of recession, the massive wealth effect as a result of rising stock prices could postpone the day of economic reckoning. That's still our view in early 2025. Remember, though, while stock prices are a better predictor than any human economist, they are also *myopic*—with visual acuity extending out to six months, at most. Based on other measures with longer-term forecasting horizons, we believe there is a high probability that an economic downturn will materialize in the second half of this year.

While real GDP growth of 2.8% in 2024 exceeded most projections, the economy entered the new year on less sustainable footing than one year ago. In 2024, real personal disposable income grew at 2.4%, one-half the rate of the previous year. This falloff has triggered a spike in mortgage- and auto-loan delinquencies, along with a sharp drawdown in the personal savings rate—which was 3.8% in December compared to 5.5% at the business-cycle peak.

Such signs of distress wouldn't be so troublesome if job growth was either stable or accelerating. Yet, the annual growth rate in non-farm payroll employment, both in November and December, was less than 1.4%. In all but one instance measured back to 1950, readings below that threshold were soon followed by an economic downturn. Furthermore, despite a stable U.S. unemployment rate of 4.1%–4.2% since mid-2024, the number of unemployed workers who are still part of the labor force is up by more than 10% from a year ago—a level that has invariably been associated with recessions. To date,

[1] The total market value of all public companies in the U.S. that are listed on the Nasdaq Stock Market, New York Stock Exchange, or OTCQX U.S. Market.

[2] GDP is a key indicator of a country's economic health; it measures of the total value of goods and services produced within a country or region over a specific period of time. A stock market index tracking performance of 500 of the largest U.S. companies.

[3] LEI s a composite index that predicts economic turning points by analyzing trends in a variety of economic indicators.

4Q24 Market Commentary (continued)

we think the wealth effect from rising stock prices has partially offset the slowdown in job growth and income. However, while the wealth effect is large in magnitude (an $11 trillion gain in U.S. stock market value over the last twelve months), its benefits are highly concentrated: 10% of U.S. households now own a record 93% of U.S. stocks, equity mutual funds, and equity ETFs.

Overall, despite historically high stock-market valuations and continuing red flags about the health of the economy, our quantitative work has yet to turn negative toward stocks. Our tactical asset allocation portfolios, including the Leuthold Core Fund, Core ETF, Core private accounts, and the Leuthold Global Fund, are positioned with net equity exposure of 58%.

In 2024, our equity portfolios did not keep up with the S&P 500[1], as the rise in the index proved historically narrow. In each of the last two years, the average S&P 500 stock trailed the index by more than 12%, the worst two-year performance in history. The Russell 2000[1] lagged the S&P 500 for the seventh time in eight years, while the S&P 400 MidCap[1] index underperformed the S&P 500 by the largest margin in its 34-year history (11.1%).

As for fixed income, the valuation profile of the bond market has improved sharply since last September, with yields on the 10-year U.S. Treasury up about 100 basis points[2] (bps) to 4.60%. That's still well below our "fair value" estimate of 5.70%, which is based on long-term inflation expectations. Our bond holdings' average duration is 5.6 years, a bit shorter than the benchmark's 6.0 years. Our portfolios' fixed-income allocation remains relatively minimal at 15%, far below the customary base level of 30%.

As noted above, the broader equity market has struggled to compete with the likes of the Magnificent Seven[3] and their cohorts, which are dominating the performance of the headline stock indexes. That has pressured many active equity managers to chase those mega-cap growth stocks responsible for this state of affairs. On the other hand, we think the absurd valuation gap between the wider universe of U.S. equities and the "top-heavy" S&P 500 is increasingly unsustainable. Better times are almost certainly in store for active equity managers.

Sincerely,

Doug Ramsey, CFA, CMT
Chief Investment Officer

[1] The S&P 500 is a stock market index tracking performance of 500 of the largest U.S. companies; The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell Index; The S&P 400 MidCap Index is a value-weighted index that provides investors with a benchmark for mid-sized companies from all major industries.

[2] 100 basis points are equivalent to 1%.

[3] Refers to seven dominant tech companies that have played a crucial role in driving market growth: Apple, Microsoft, Alphabet, Amazon.com, Nvidia, Meta Platforms, and Tesla. Due to their outsized market capitalizations, Magnificent Seven stocks hold a disproportionate influence on the market-cap-weighted S&P 500 index.

Other Market Notes

VALUATIONS: RELATIVE VS. ABSOLUTE

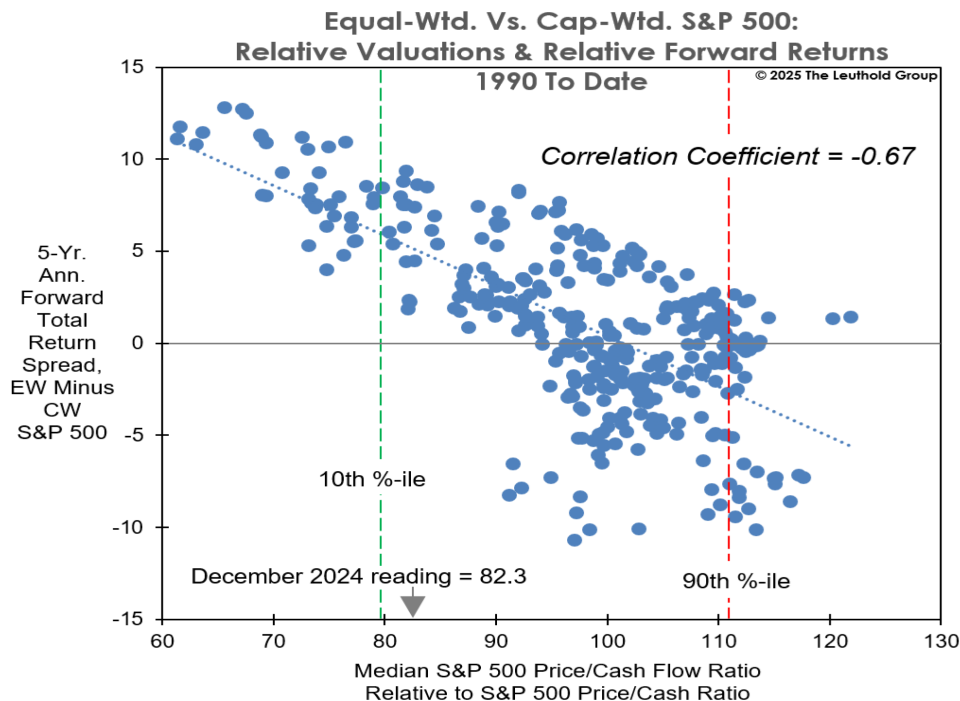
December was the worst month for the Equal Weighted[1] (EW) S&P 500 in 35 years—it lagged the conventional cap-weighted[1] S&P 500 by 3.9%. This performance drove the valuation for the index's median stock down to near the undervalued zone (the bottom decile).

The *relative* Price/Cash-Flow[2] ratio, our preferred valuation metric, is low enough to suggest that the EW version of the S&P 500 (representing the median stock) should significantly outperform the S&P 500 index over the next several years.

In fact, in every case when this ratio closed a month below 90% (horizontal axis on the chart), the EW S&P 500 outdid the traditional index over the next 60 months.

The drawback of relative valuation is that it tells us nothing about the appeal of either asset on a standalone basis (*absolute* valuation). Today, the median stock looks cheap versus the S&P 500, but compared to its own history, the median stock trades in the top decile based on four of the five metrics shown in the accompanying table.

Consequently, although we anticipate the median stock is poised to "outperform" the S&P 500, it won't necessarily "go up a lot."



S&P 500 Median Stock Valuations

© 2025 The Leuthold Group	Trailing P/E	Normalized P/E	Price/ Cash Flow	Price/ Sales	Price-to-Book	Average
December 31, 2024	25.1 x	28.1 x	16.1 x	3.06 x	3.56 x	
1990-To-Date Percentile	93	89	94	96	94	93

[1] The equal-weighted S&P 500 assigns equal weights across the index's 500 stocks, providing a more neutral performance assessment of the component equities. The mainstream S&P 500 index is capitalization weighted, which results in the largest companies having a greater influence on performance.

[2] Trailing P/E Ratio = current stock price divided by earnings per share (EPS) over the previous 12 months; Normalized P/E Ratio = five-year arithmetically-averaged annual earnings (six-months ahead and 54-months back); Price/Cash Flow = a company's market cap divided by the most recent fiscal year's operating cash flow; Price/Sales = a company's market capitalization divided by the most recent year's revenue; Price/Book = a company's current stock price per share divided by book value per share.

Other Market Notes

FROTHY SENTIMENT

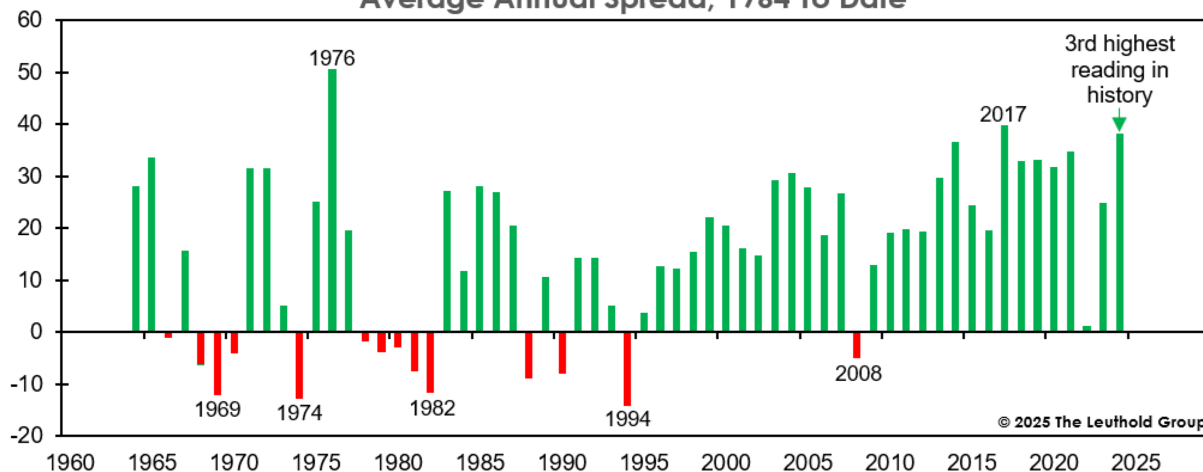
Entering 2025, key measures of S&P 500 valuation are at levels last seen only in the final gasps of the Y2K Tech Bubble and the 2021 post-COVID mania. Many investors would say, however, that today's speculative psychology is not at the same heights as in those two prior market extremes. Based on at least one sentiment measure, they're correct: It's higher!

Investors Intelligence[1] has tracked the opinions of market-newsletter writers since 1964, recording the gap between bullish and bearish views each week. The average reading for the variance during 2024 was 38.2%—the third highest in history! It's worth noting that the two years with even more inflated bullish sentiment were not bubble eras (1976 and 2017).

While most think of sentiment readings as a short-term timing tool, Investors Intelligence has a decent forecasting record on a one-year horizon.

- Following the nine prior years with the highest average bull-bear spread, the S&P 500 posted an annual gain of just 0.4%.
- The more favorable environment is when the bull-bear spread is *depressed*. In the years following the ten lowest annual sentiment readings, the S&P 500 gained an average of 18.9%. (The only year of the current century that was among the ten with the most deflated sentiment was 2008.)

[1] An independent research boutique.



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Past performance does not guarantee future results. Investing involves risk, principal loss is possible. Index performance does not reflect fund performance and it is not possible to invest directly in an index.

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