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4Q24 Investment Update



Bob is a financial services industry veteran with over 40 years of experience managing large cap equity strategies as well as long and long-short equity strategies. His weekly, quarterly, and annual investment commentaries focus on key themes and risks driving equity markets, monetary policy, and the global economy. Bob is a regular guest and contributor to multiple media outlets such as CNBC, Bloomberg TV, Moneywise, and Fox Business News.

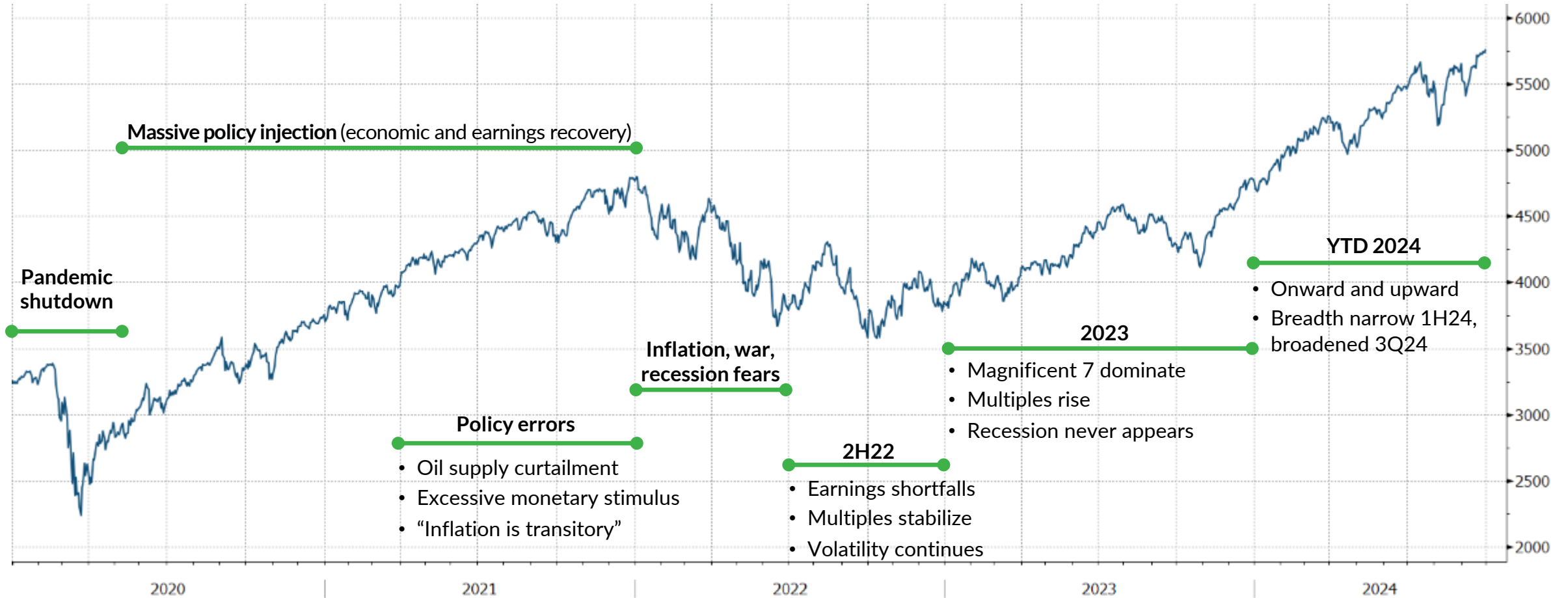
Recent returns



Index	1H24 (%)	3Q24 (%)	9 MOS. YTD 2024 (%)
90-Day Treasury Bills (Bloomberg U.S. Treasury Bill 1-3 Month TR)	2.7	1.4	4.1
10-Year U.S. Treasury (Bloomberg U.S. Treasury 10+ Yr TR)	-2.0	5.7	3.6
U.S. Bonds (Bloomberg U.S. Agg Bond TR)	-0.7	5.2	4.4
High-Yield Corporate Bonds (Bloomberg U.S. Corp High Yield TR)	2.6	5.3	8.0
S&P 500 TR Index	15.3	5.9	22.1
S&P 500 Equally Weighted	5.1	9.6	15.2
MSCI World Ex. U.S. (MSCI World Ex USA NR)	5.0	7.8	13.1
MSCI Emerging Markets (MSCI EM NR)	7.5	8.7	16.9
Commodities (DJ Commodity TR)	5.1	0.7	5.9

Source: Bloomberg as of Sept. 30, 2024

S&P 500 4-¾ year history



Source: Bloomberg as of Sept. 30, 2024

Introduction and summary



- We are in a high-risk, momentum-driven bull market.
- Predicting the end of a momentum run is a fool's game.
- Focus on earning predictability, earnings persistence, and good cash flow generation in equity selection.

Intractable imbalances/problems

- There are consequences to the Fed raising rates from 0% to 5.25% in 18 months.
- 10+ years of quantitative easing (essentially zero interest rates) will go in history books as a major policy error.
- The U.S. is running a high federal budget deficit at essentially full employment.

Recent government economic statistics revisions were massive



- More income than previously reported.
- Better employment than previously reported.
- More corporate revenue than previously reported.

Conclusion: Economy is stronger than previously reported.

Note: Normally, economic revisions don't matter much as they are usually minor, and of course, are about the past.

Current conditions



1. Fed 50 bp cut has modestly increased odds of a soft landing.
2. Labor market conditions continue to weaken.
3. Credit balances are up; credit growth weak.
4. Fed shifting from fighting inflation to supporting employment raises chances of return of inflation.
5. China policymakers have reduced the downside, but maybe not increased upside potential.

Key swing factors heading into year-end



1. **Inflation:** Potential upside surprises.
2. **Employment:** The Fed's main focus.
3. **Election:** Within a margin of error.
4. **Manufacturing:** On the verge of turning up?
5. **AI:** Keeping the dream alive.
6. **Consumer:** Will high-end spending stay strong?
7. **Housing activity:** Many crosscurrents.
8. **China:** Sugar high or something more sustainable?
9. **Oil prices:** Volatile into geopolitical risks.

Bulls vs. bears



Bull case

Fed cutting rates

Disinflation continues

Stable labor market

Reasonably healthy consumer spending

AI growth theme continues

Bear case

Valuations very high

Fed can't fight inflation as labor market weakens

Earnings estimates at risk

Consumer confidence declining

Technology (including AI) fading

Probabilities



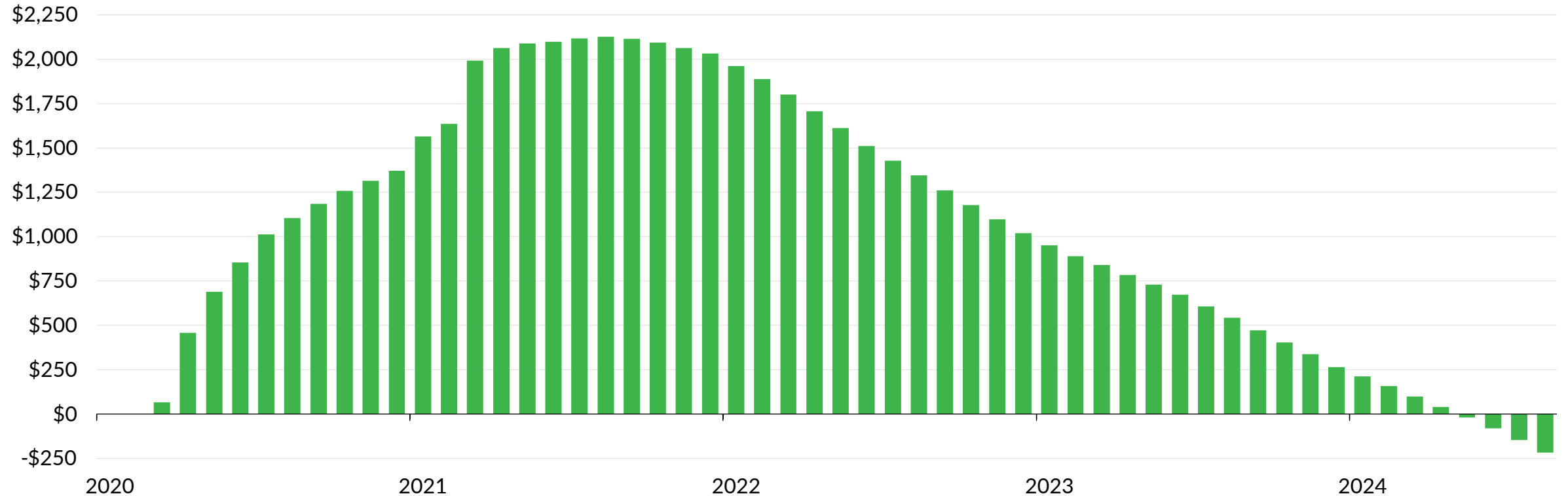
Bumpy landing	40%
Hard landing	30%
Soft landing	20%
No landing	10%

Prediction 1



The U.S. economy experiences a mild recession as the unemployment rate rises above 4.5%

Cumulative excess savings held by U.S. households (\$B)



Source: Federal Reserve Bank of San Francisco (through August 2024)

The economy is slowing



- Long and variable lags of Fed policy are beginning to kick in.
- Ex Mag 7, revenue growth is slowing:
 - Comp costs are two-thirds of compensation
 - Therefore, layoffs are beginning
 - Unemployment 3.4% → 4.1% (likely to go to at least 4.5%)
- Workweek ↓, Temporary Employment ↓, Inventories ↑
- Real incomes are beginning to deteriorate:
 - Real retail sales flat YTD
 - Auto sales flat for 12 months
 - Delinquency rates rising
- Weakness in demand is causing pricing weakness (which is why inflation is slowing).

Likely consequences

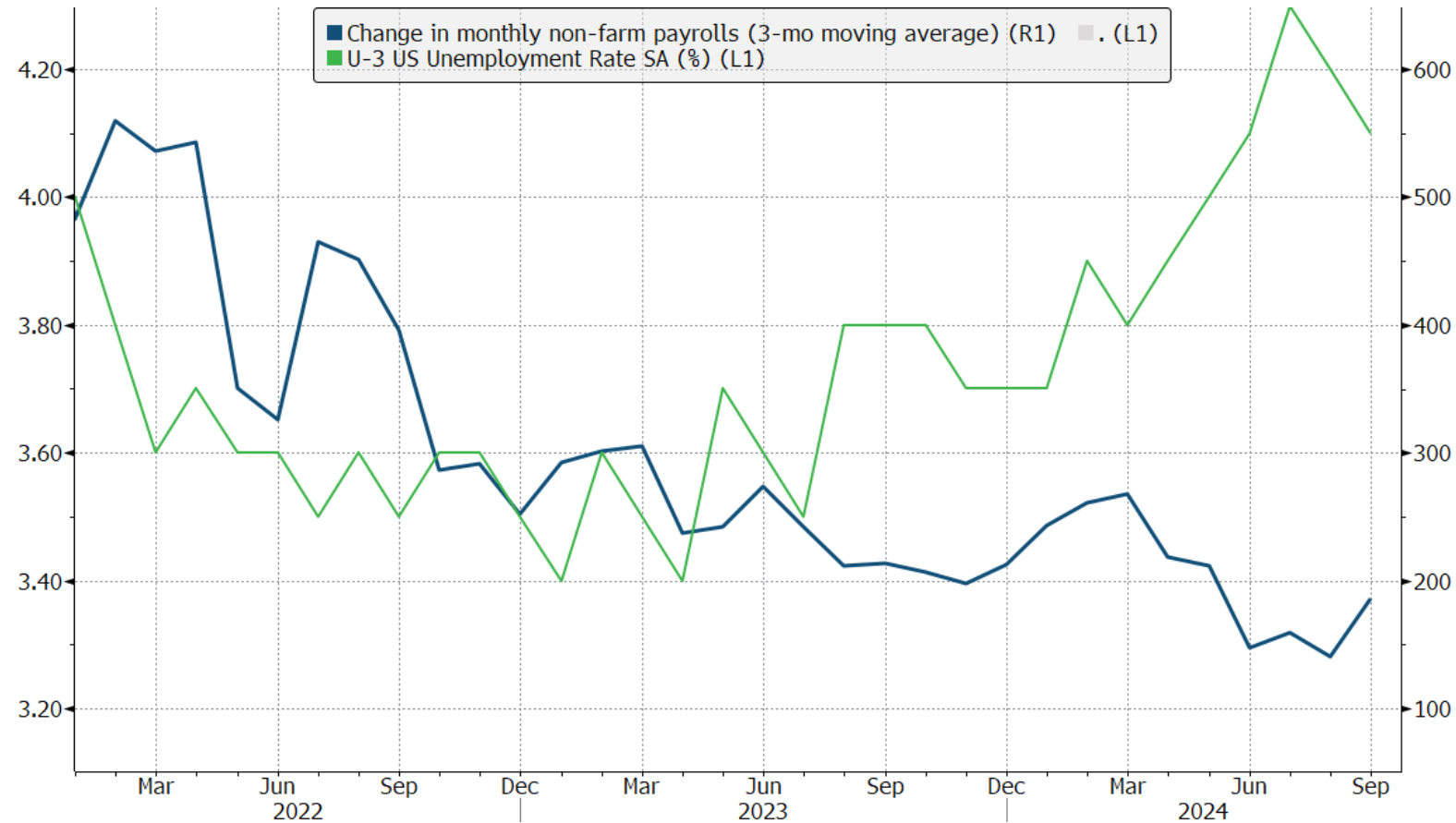
- Bumpy landing into 2025
- Fed focus shifts from cooling inflation to fighting economic weakness
- Likely two more 25 bp cuts before year-end

The economy is slowing

The unemployment rate is rising and payroll growth is slowing



U.S. unemployment rate vs. change in NFP (3-month moving average)

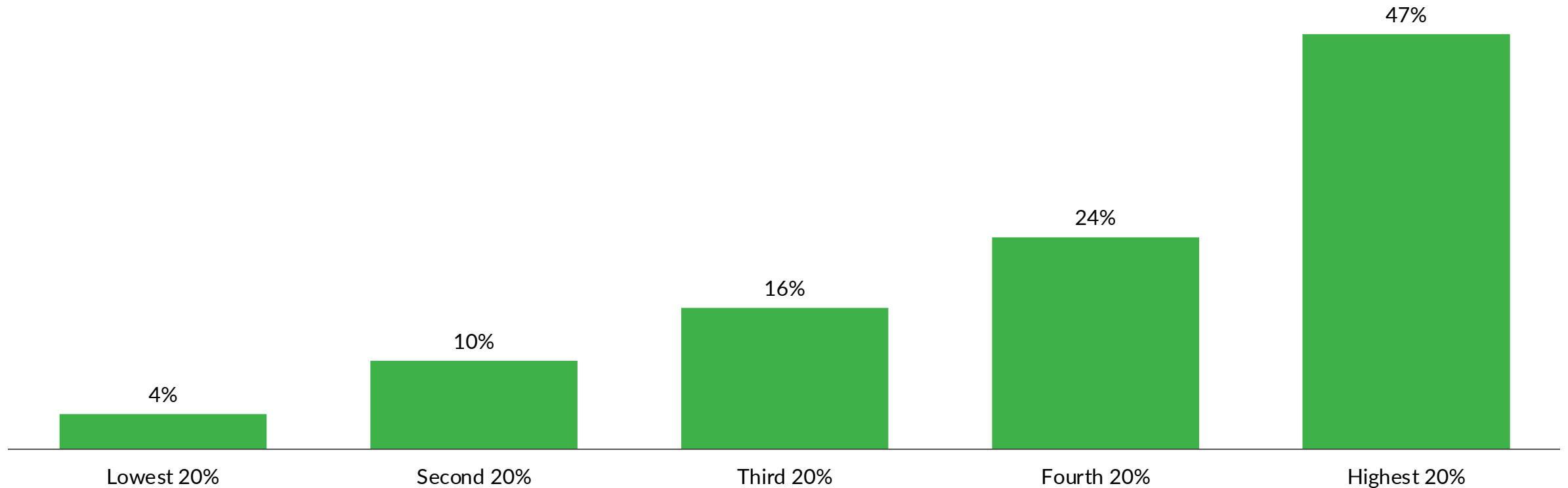


Source: Bloomberg

Consumer: Will high end spending stay strong?



Share of aggregate expenditures by quintile pre-tax income 2021



Sources: Wolfe Research Portfolio Strategy, BLS, Federal Reserve, and Bloomberg as of Oct. 8, 2024

Prediction 1

The U.S. economy experiences a mild recession as the unemployment rate rises above 4.5%



We're just entering the timeframe when tightening triggers a downturn

Fed funds initial hike	First quarter of recession	Quarters from liftoff
3Q 1958	3Q 1960	8
4Q 1967	1Q 1970	9
2Q 1972	1Q 1974	7
2Q 1977	2Q 1980	12
4Q 1980	4Q 1981	4
4Q 1986	4Q 1990	16
2Q 2019	2Q 2021	8
3Q 2004	1Q 2008	14
Average	—	10
1Q 2022	?	13

Source: Piper Sandler

Prediction 1



The U.S. economy experiences a mild recession as the unemployment rate rises above 4.5%

U.S. unemployment rate total in labor force (seasonally adjusted)



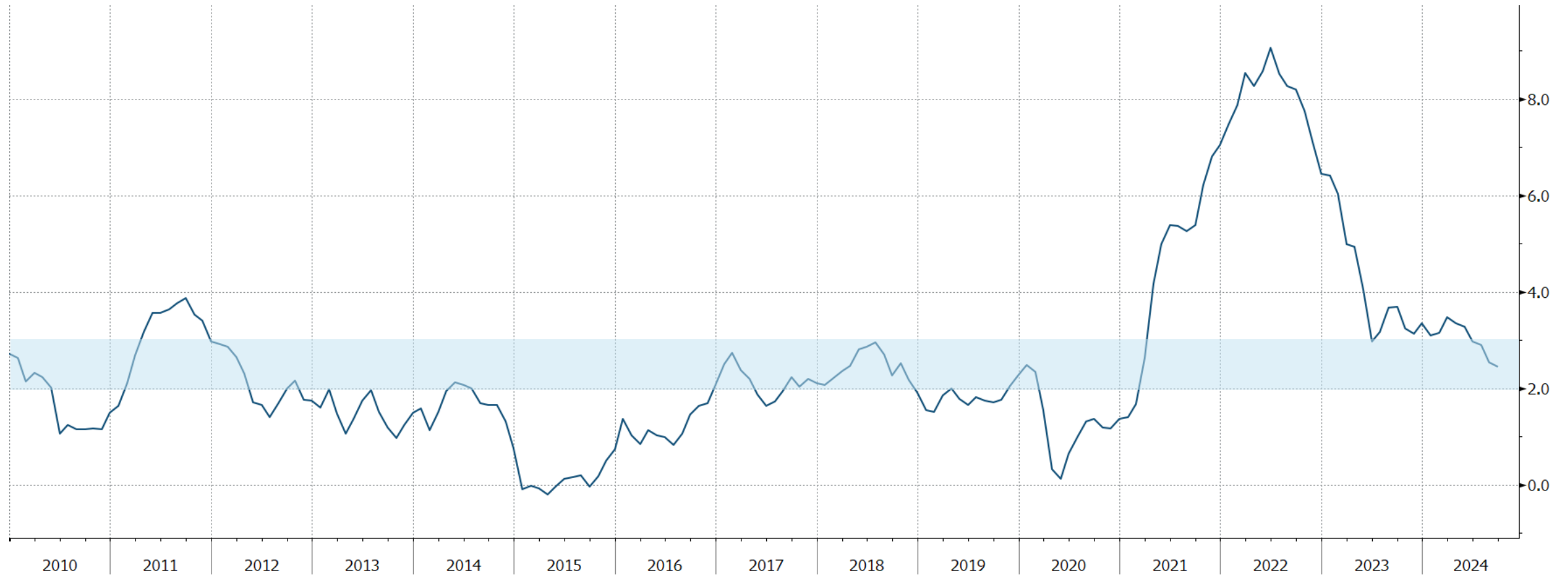
Source: Bloomberg as of Sept. 30, 2024

Prediction 2

The 2-3% inflation ceiling of the 2010s becomes the 2-3% inflation floor of the 2020s



U.S. CPI inflation year over year (%)



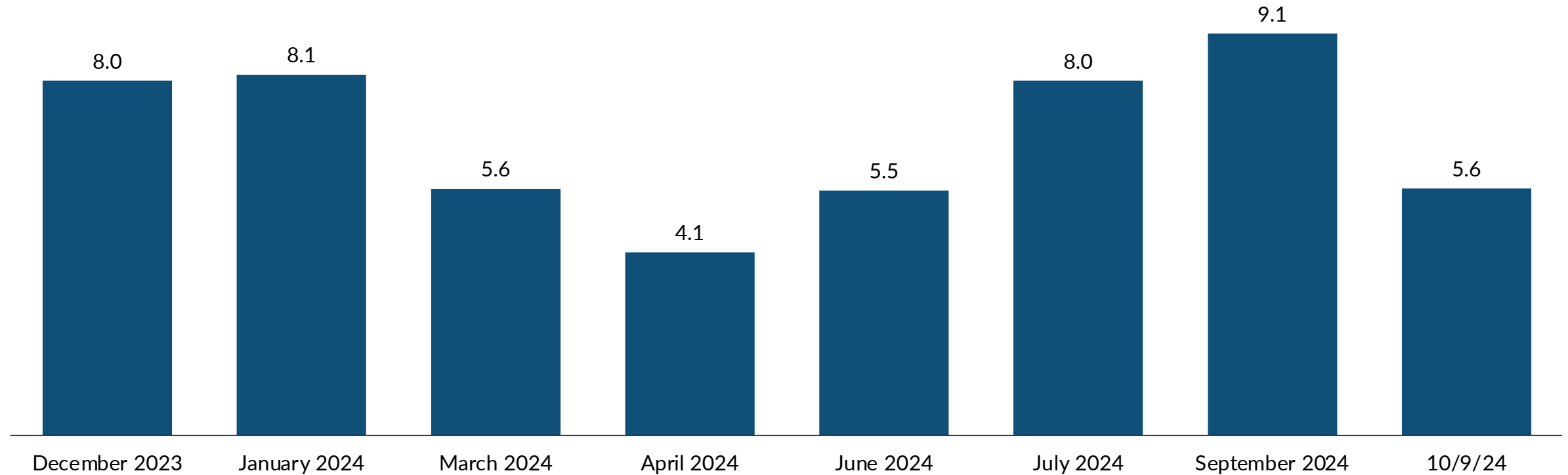
Source: Bloomberg as of Sept. 30, 2024

Prediction 3



of 25 bp cuts by YE25 implied by Fed fund futures 1 day AFTER recent Fed meetings

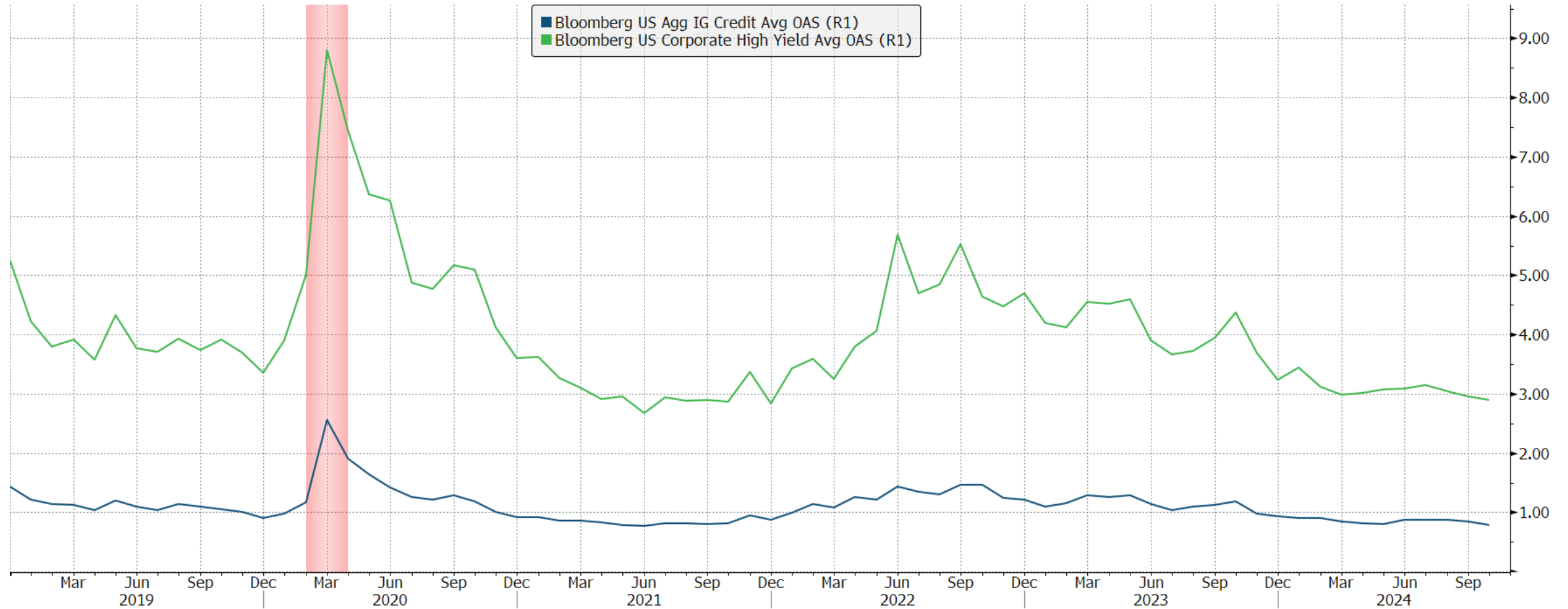
Implied cuts by year-end 2025



Source: Bloomberg as of Sept. 30, 2024

Prediction 4

Credit spreads widen as interest rates decline



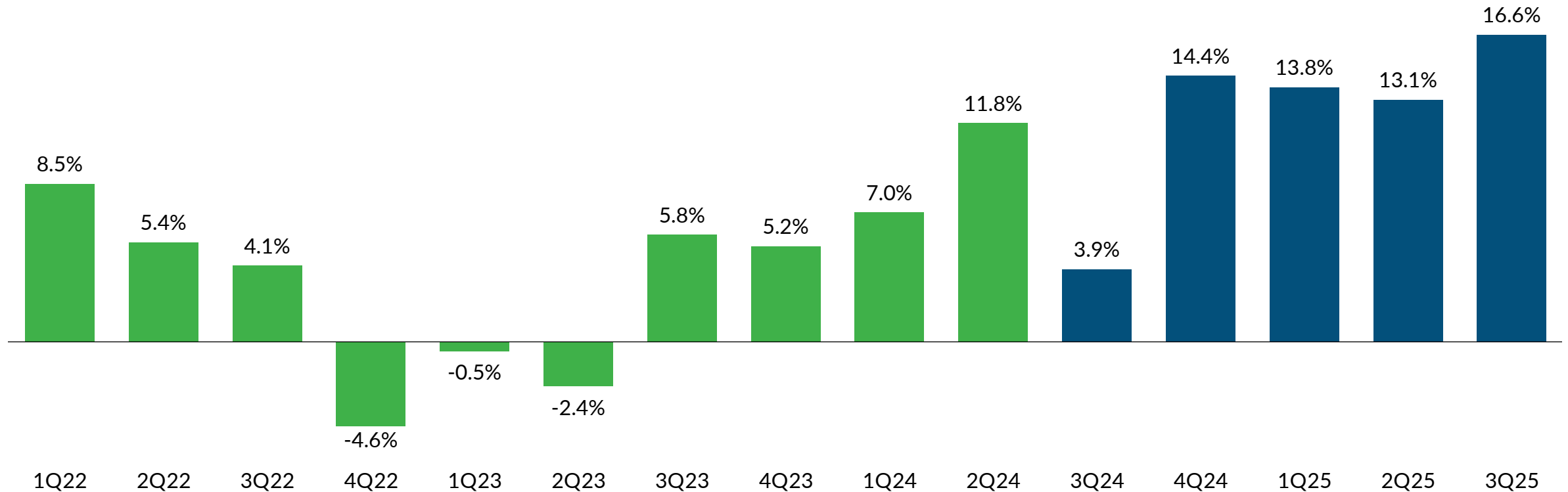
Source: Bloomberg as of Sept. 30, 2024

Prediction 5



Earnings growth falls short of the double-digit percentage consensus expectation

Consensus: The earnings recession is likely over



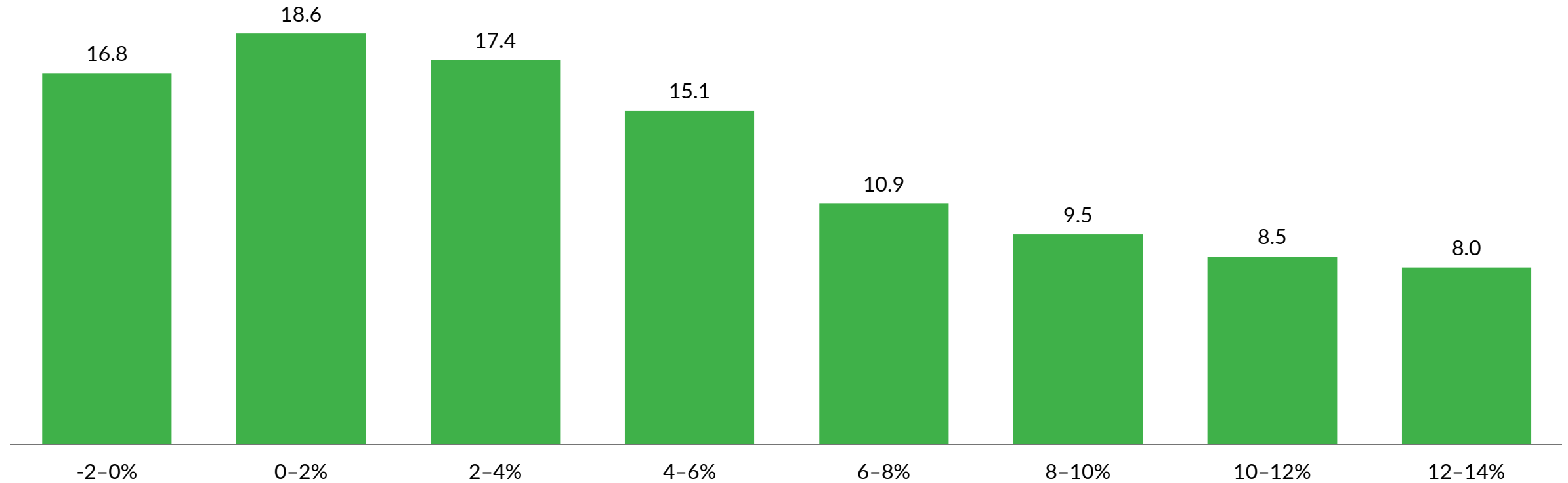
Source: FactSet as of Sept. 30, 2024

Prediction 6



Stocks record a new all-time high early in the year, but then experience a fade

S&P 500 P/E vs. Inflation: Average S&P 500 TTM P/E by CPI Y/Y Tranche (1950–Current)



Source: Strategas

Prediction 6

Stocks record a new all-time high early in the year, but then experience a fade



Valuation metric	S&P 500	
	Current	Historical percentile
Forward 12M P/E	21.8x	91
EV / T12M EBITDA	16.5x	97
EV / T12M Sales	3.3x	98
Free cash flow (T12M) yield	3.0%	81
Price/book	5.1x	99
U.S. market cap/GDP	206%	96

Prediction 6

Stocks record a new all-time high early in the year, but then experience a fade



Starting P/E	S&P 500 average forward returns (%)			
	1-year	3-year	5-year	10-year
<10x	13.4	11.2	12.3	11.5
10-12	14.9	13.0	10.4	10.5
12-14	10.5	9.1	8.5	9.6
14-16	12.4	10.9	9.8	9.3
16-18	6.4	6.3	5.3	5.2
18-20	7.4	6.0	5.5	4.4
>20	3.9	4.4	5.5	3.0

Prediction 6

Stocks record a new all-time high early in the year, but then experience a fade



Sources: Professor Robert Shiller, Yale School of Management, Strategas

'Mag 7' stocks account for 44% of S&P 500 return YTD



Total returns of "Mag 7" stocks through YTD 2024 (%)

Ticker	Company	1H24	3Q24	YTD 2024
NVDA	NVIDIA Corp.	+150	-2	+145
META	Meta Platforms Inc.	+43	+14	+62
AMZN	Amazon.com, Inc.	+27	-4	+23
AAPL	Apple Inc.	+10	+11	+21
GOOG/GOOGL	Alphabet Inc.	+30	-9	+19
MSFT	Microsoft Corp.	+19	-4	+15
TSLA	Tesla Inc.	-20	+32	+5
"Magnificent 7"		+37	+5	+44
S&P 500		+15	+6	+22

Source: FactSet as of Sept. 30, 2024

Prediction 7

Energy, financials, and consumer staples outperform utilities, healthcare, and real estate



Overweights	YTD 2024 return ¹ (%)	Underweights	YTD 2024 return ¹ (%)
Energy <ul style="list-style-type: none"> • Cheap; strong earnings generation • Strong and growing cash flow • Global energy security concerns Risk: World peace	+5.7	Utilities <ul style="list-style-type: none"> • Dividend yield less attractive • Payouts high • Not cheap vs. bonds Risk: Late cycle outperformance track record	+27.5
Financials <ul style="list-style-type: none"> • High quality/low leverage vs. history • Historically inexpensive • Eventually positive yield curve Risk: Regulatory risk; commercial real estate	+20.4	Healthcare <ul style="list-style-type: none"> • Typical election year underperformance • Poor drug pipeline • Not particularly cheap Risk: Good defensive characteristics	+12.9
Consumer staples <ul style="list-style-type: none"> • Defensive characteristics if recession • Weakening dollar beneficiary • Valuations have de-rated Risk: Will lag in economy and market recovery	+16.5	Real estate <ul style="list-style-type: none"> • Commercial/office space risk • Tough to secure investment capital • Patience required given headwinds Risk: Dividends strong	+11.5

¹ Source: Bloomberg as of Sept. 30, 2024

Prediction 7

Energy, financials, and consumer staples outperform utilities, healthcare, and real estate

Preferred characteristics

- High quality.
- High earnings predictability.
- High earnings persistence.
- Good cash flow generators.
- Selected quality cyclicals.

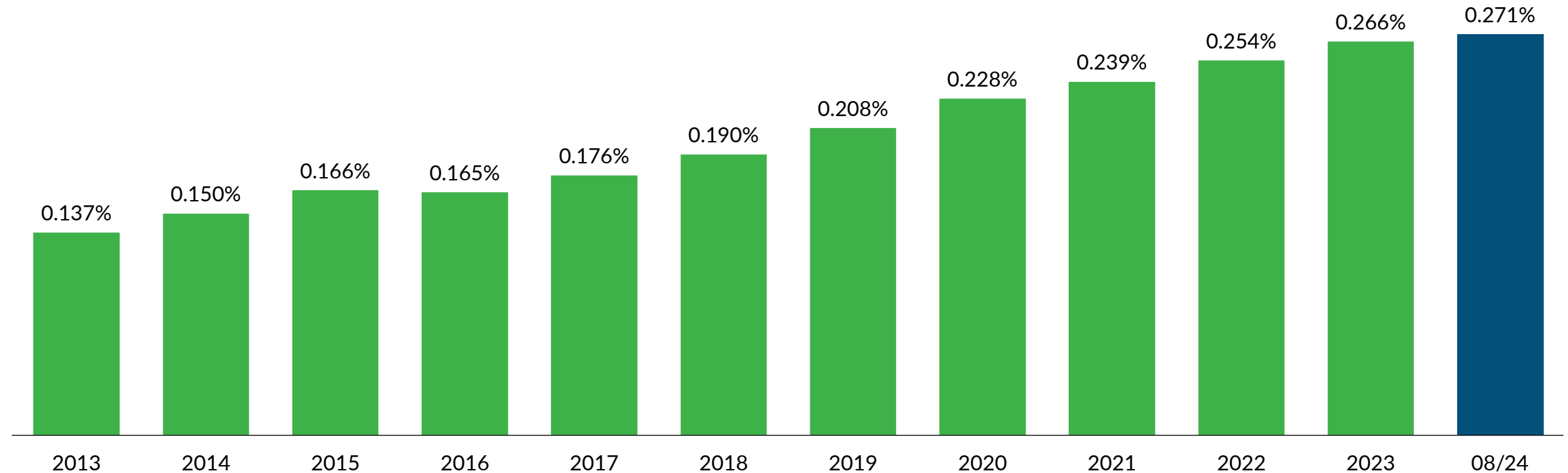
Small caps cheap but tend not to do well in economic deceleration.



Faith-based share of industry AUM rises for eighth year in a row



Faith-based market share (percentage of total industry AUM)



Sources: Morningstar and Crossmark as of Aug. 31, 2024

Prediction 9

Geopolitical crosscurrents multiply but have little impact on markets



Geopolitical issues

1. Extreme polarization within U.S. (on lots of issues, especially wars)
2. Two highly unpopular leaders running for president
3. Ukraine-Russia war
4. Middle East war
5. Iran nuclear threat
6. China cold war
7. Global political uncertainty: 40% of countries, 41% of population, nearly 60% of global GDP and nearly 80% of stock market capitalization experiencing national elections in 2024

Prediction 10

The White House, Senate, and House all switch parties in November



Key issues

1. Tax policy (extension of Trump tax cuts)
2. Massive fiscal deficits/increased interest expense/entitlements
3. Relationship with China (trade, technology, Taiwan)
4. NATO commitment/Ukraine funding
5. Middle East war funding/Middle East relationship
6. Possible tariffs (more nationalism)
7. Southern border/drug traffic/cities and crime

Will the Supreme Court play a significant role in the election?

Election observations: Wild election cycle

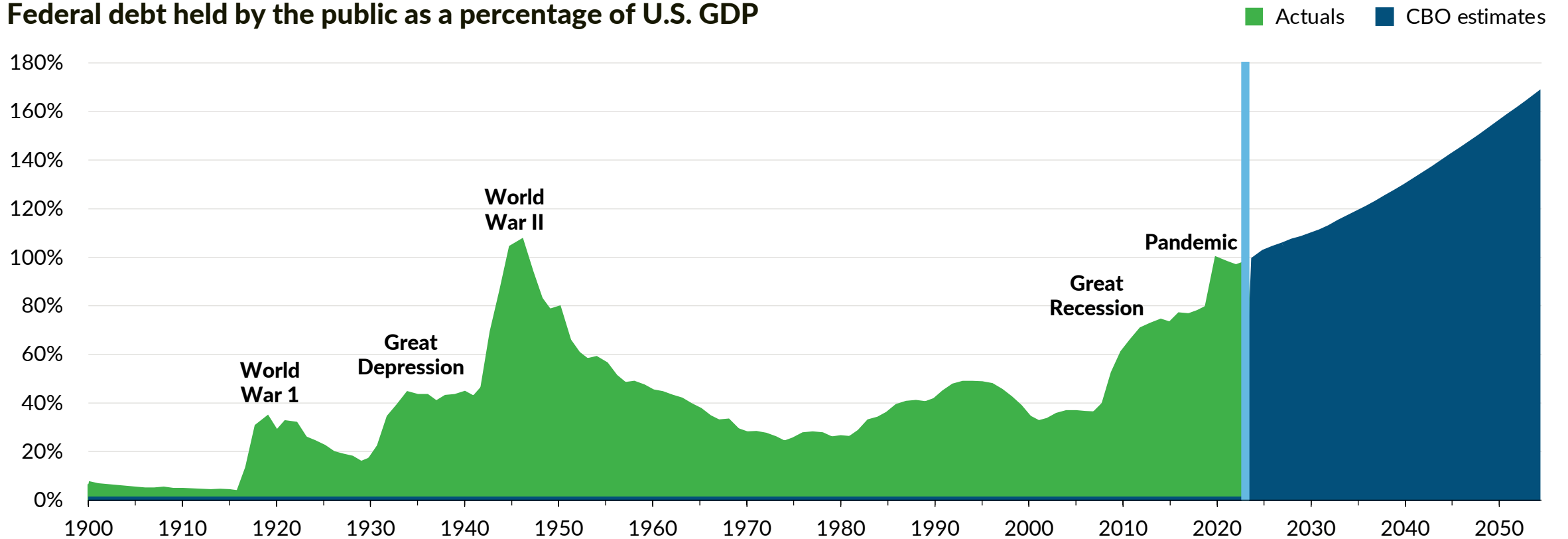


1. Presidential race fluid and unpredictable.
2. Democratic enthusiasm jumped significantly (20% → 80%).
3. Economic predictors (stock market performance, VIX, Misery Index) favor Harris.
4. Republicans likely to recapture Senate.
5. Unified government would likely cause sell-off; markets can cope with divided government.
6. Deficit will increase significantly under either candidate.
7. Country will remain bitterly divided.

The big long-term risk



Federal debt held by the public as a percentage of U.S. GDP



Source: Congressional Budget Office (CBO)

Summary assessment



The wall of worry

1. Labor market deterioration.
2. Falling consumer confidence.
3. Falling consumer savings/rising consumer debt.
4. Yield curve normalizing after long inversion (often the sign of a recession).
5. Too high earnings growth expectations (+10% in 2024; +15% in 2025; +12% in 2026).
6. High valuation levels.
7. Massive and rising federal debt/interest expense levels.
8. Very close election.
9. Rising geopolitical tensions.
10. Threat of trade wars.

The offsetting positives

1. Decline in inflation.
2. Central banks lowering rates.
3. Still good economic growth.
4. Strong earnings growth expectations.
5. AI/productivity.

What to do?



- 1 Expect choppy markets (buy dips/trim rallies).
- 2 Focus on earnings growth and free cash flow (not P/E expansion).
- 3 Own some quality fixed income.
- 4 Diversify across asset classes and geographies (more non-U.S.).
- 5 Own high-quality value and less expensive growth.
- 6 Consider an absolute return strategy to complement market exposures.
- 7 Be prepared to step up if significant weakness.

Equity investors



Receive:

≈ 8% annual return

Tolerate:

3 corrections of 5% per year

1 correction of 10% per year

1 correction of > 15% once every 3 years

1 correction of > 20% once every 6 years

S&P 500 “batting average” (i.e., % of positive calendar years) since 1926: 75%

What to expect over the next 10 years



- 1 More modest investment market returns

- 2 Another recession

- 3 Population: older, with more grandparents than grandchildren
 - World population growth nearly 100% in 65 and older citizens
 - Obese children now outnumber underweight children for the first time ever

- 4 Technological innovation: information, healthcare, energy, and manufacturing

- 5 Robots and automation threaten jobs

- 6 Smart phone turns into smart everything

- 7 Space tourism

- 8 Globalization replaced by more isolationism/protectionism/populism

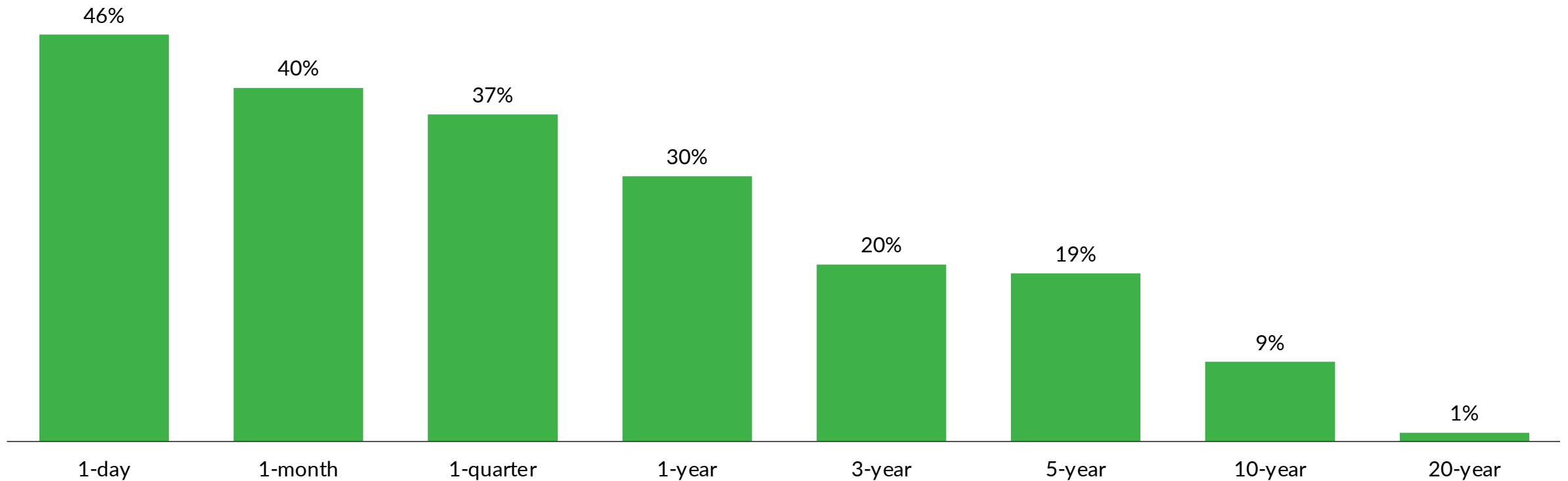
- 9 U.S./China cold war

- 10 Cyber warfare, possible biological warfare

Time is on your side as an equity investor



S&P 500 Index probability of negative returns (1930–2021)



Sources: Bloomberg and Crossmark as of Dec. 28, 2021

Important information



Crossmark Global Investments Inc. (Crossmark) is an investment adviser registered with the Securities and Exchange Commission that provides discretionary investment management services to mutual funds, institutions, and individual clients. Investment advice can be provided only after the delivery of Crossmark's firm Brochure and Brochure Supplement Form ADV (Parts 2A and 2B) and Form CRS, and once a properly executed investment advisory agreement has been entered into by the client.

All investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results.

An investment cannot be made in an index.

Equity investments generally involve two principal risks—market risk and selection risk. The value of equity securities will rise and fall in response to general market and/ or economic conditions (equity market risk). The value of any individual equity security will rise and fall in response to the market's perception of the issuer's revenues, earnings, balance sheet, credit worthiness, business plan, and overall perception of the viability of the issuer's business (selection risk).

Fixed income investments generally involve three principal risks—interest rate risk, credit risk, and liquidity risk. Prices of fixed-income securities rise and fall in response to interest rate changes (interest rate risk). Generally, when interest rates rise, prices of fixed-income securities fall. The longer the duration of the security, the more sensitive the security is to this risk. There is also a risk that the issuer of a note or bond will be unable to pay agreed interest payments and may be unable to repay the principal upon maturity (credit risk). Lower-rated bonds, and bonds with longer final maturities, generally have higher credit risks. As interest rates rise and/or the credit risk associated with a particular issuer changes, bonds held within a portfolio may become difficult to liquidate without realizing a loss (liquidity risk).

Investments in securities of issuers in foreign countries involves additional risks not associated with domestic investments. These risks include, but are not limited to: (1) political and financial instability; (2) currency exchange rate fluctuations; (3) greater price volatility and less liquidity in particular securities and in certain foreign markets; (4) lack of uniform accounting, auditing, and financial reporting standards; (5) less government regulation and supervision of some foreign stock exchanges, brokers and listed companies; (6) delays in transaction settlement in certain foreign markets; (7) less availability of information; and (8) imposition of foreign withholding or other taxes.

Investments that use values-based screening policies exclude certain securities from the universe of otherwise available investments. As a result, funds/strategies that use values-based screening policies may not achieve the same performance they otherwise may have in the absence of the screening process. If the funds/strategies have invested in a company that is later discovered to be in violation of one or more screening criteria and liquidation of an investment in that company is required, selling the securities at issue could result in a loss for the funds/strategies. Further, the funds/strategies' values-based screening policies may prevent the funds/strategies from participating in an otherwise suitable investment opportunity.

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Index definitions



TR (Total Return) indexes include the effect of daily reinvestment of dividends.

The **S&P 500 Index** is an unmanaged, market-cap-weighted index considered representative of the U.S. stock market. It reflects the price changes (not the effect of dividends) of the 500 largest publicly traded U.S. companies.

The **S&P 500 TR Index** is an unmanaged, market-cap-weighted index considered representative of the U.S. stock market.

The **S&P 500 Equal Weight Index** is an unmanaged index that measures the performance of the S&P 500, but each of the 500 companies in the index is equally weighted.

The **Bloomberg U.S. Treasury Bill 1-3 Month TR Index** is an unmanaged index considered representative of short-term U.S. government debt instruments.

The **Bloomberg U.S. Treasury 10-Year TR Index** is a benchmark considered representative of U.S. Treasury bonds with maturities of approximately 10 years.

The **Bloomberg U.S. Agg Bond TR Index** is an unmanaged index considered representative of the U.S. investment-grade, fixed-rate bond market.

The **Bloomberg U.S. Corp. High Yield TR Index** is an unmanaged index considered representative of fixed-rate, noninvestment-grade debt.

The **MSCI World Ex USA NR Index** is an unmanaged index considered representative of the performance of large and mid-cap companies from developed markets excluding the U.S. NR stands for "Net Return," i.e., the index accounts for the reinvestment of dividends after taxes applicable to nonresident investors are deducted.

The **MSCI EM NR Index** is an unmanaged index considered representative of the performance of large and mid-cap companies from emerging markets around the world. See above for the explanation of NR.

The **Dow Jones Commodity Total Return (TR) Index** is a benchmark that tracks the performance of a broad group of commodity futures.



Q&A



Thank you!



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