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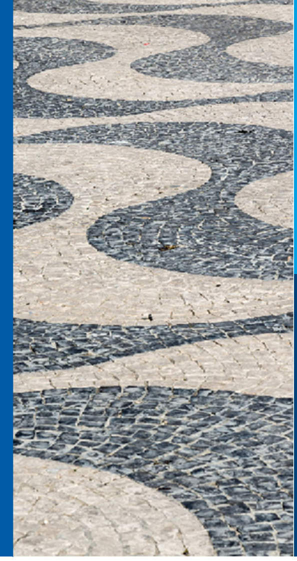

Equity Market Commentary

SLIMMON'S TAKE | APPLIED EQUITY ADVISORS TEAM | March 2025

The following views and perspectives are formed by the work of the Applied Equity Advisors team in managing assets for investors.

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One of the hallmarks of the "*optimism phase*" of a bull market is an increase in the level of *retail and CTA*[1] *speculative trading*.

A certain group of stocks captures the zeitgeist of renewed enthusiasm for equities. It is not the companies' fundamentals that attract the buying, it's their quick price levitations.

Palantir, Cloudflare, Roblox, Microstrategy…I could go on. All are very popular trading stocks, and all are selling for valuations well above 100x P/E.[2]

Yet the perceived danger of outrageous valuations is not important; stock price movement is.

2

These traders, having only recently resumed activity in this optimism phase, are largely "*weak holders*" of stocks.

They lack the conviction of the "*strong holders*" who stuck with equities through the 2023 "pessimistic" and 2024 "skepticism" phases.

The "weak holders" are *quicker to sell at the first sign of bad news*. That means speculative stocks can get hit very hard given these "weak holders" have crowded into them.

We have experienced this over the last couple of weeks. A dramatic unwind in more speculative names.

This weighs on the overall market.

3

That's why the volatility in the stock market increases in the "optimism phase." *More "weak holders" have now reentered the stock market.*

Expect larger swings in returns in 2025 than what we experienced in 2023 and 2024.

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[1] A commodity trading advisor (CTA) is US financial regulatory term for an individual or organization who is retained by a fund or individual client to provide advice and services related to trading in futures contracts, commodity options and/or swaps.
[2] Bloomberg.

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

4 *Following "optimism," the inevitable next phase of an equity bull market cycle, "euphoria," worries me far more than the pickup in volatility.*

In the euphoria stage, the weak holders view most every pullback as an opportunity to add to positions.

Their confidence is overflowing. Bad news no longer shakes them. They buy *even more* of these speculative stocks on the slightest pullbacks.

5 The last two euphoric years, in my opinion, were 1999 and 2021. Both of which led to bear markets.

I do not think we are nearing this phase…yet.

6 There are many ways to measure "optimism versus euphoria."

Here are two:

A. At the 2000 and 2022 frenzied peaks, a substantially higher percentage of overall stocks traded at dizzying valuations than today.[3]

B. Charles Schwab has a Stock Trading Activity Index (STAX) which monitors retail trading activity on their brokerage platform. While retail trading has increased over the last two years, it's still 34% below the 2021 peak.[4]

7 The recent panic we've seen in these frothy stocks is a very healthy sign.

Consider:

A. We have a modestly less dovish Fed.

B. We now have a tariff czar as the US President.

C. Deep government cuts could slow the economy.

All of these could negatively impact the economy, and the market has therefore recently repriced lower due to these increased risks.

When the negatives stop impacting the market, that's a danger sign in the later phases.

8 As discussed in our January 2025 outlook webcast, the Applied Equity Advisors' *base case* is a positive, single digit return for the S&P 500 overall. (Although as detailed in the most recent January Slimmon's Take, the broader rollout of artificial intelligence could at some point drive a productivity enhancing bull market to bigger returns.)

A pause year is normal for the third year of a bull market.

I thought this quote from Piper Sandler Portfolio Strategy well defined what could be ahead:

> *Imagine all the gyration, volatility and doubt that exists over 251 trading days in the years when the market only posts single digit returns.*[5]

9 As I've said, I could see a scenario where S&P 500 earnings growth exceeds its price return, thereby pulling its seemingly lofty P/E lower.

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[3] In the year 2000, 15% of the Russell 3000 traded at over 10x price to sales. In 2021, 19%. Today that is only 9%. Strategas. February 25th.

[4] Bespoke. February 23rd.

[5] Piper Sandler. February 24th.

What worries me about the valuation is not that “22x is too high.”

The investing cemetery is full of strategists/fund managers who thought they could determine when the overall market was worth buying or selling purely based on valuation.

However, now that the top-down strategists’ earnings estimates have finally been brought up in-line with the bottom-up numbers, this suggests to me that currently *everyone’s expectations are high*.

Therefore, there is less room for error when companies report results.[6]

This could put a cap on further P/E expansion.

10 To be clear, however, there are many great companies trading at substantial valuation discounts.

Here is one example:

Should JP Morgan, *the premier bank in the world*, trade at a 36% discount to the S&P 500 index?[7]

11 The US increased resistance to any technology transfer into **China** *is good for Chinese equities*.

In my opinion, this was the impetus behind Chairman Xi’s reembrace of the Chinese private sector on February 17th, *a pivotal moment*.

To me, a friendlier CCP government, improving corporate fundamentals, depressed expectations (relative to the U.S.), and far cheaper valuations augur for Chinese equities.

However, President Trump’s headlines will not abate. While we can increase our China exposure, we are very mindful that there is *high headline risk here.*

12 One final point:

We believe short-term volatility is to Applied Equity’s advantage. We embrace it.

Macro-driven selloffs pull many stocks down, regardless of fundamentals. This creates more disequilibrium.

In turn, that allows us to reduce our lower conviction calls and increase the names we believe in more highly.

That makes me very excited for what’s to come in 2025, even if there are more “gut check” moments than in the past couple of years.

Andrew

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[6] In 2023 and 2024, the consensus top-down strategists estimates were far lower than the bottom-up and hence were raised during those years.

[7] JP Morgan is held in all AEA active strategies. This is shown for illustrative purposes only.

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