NBW CAPITAL LLC

INVESTMENT REVIEW AND OUTLOOK

September 30, 2024

Market Summary

Equity markets continued their strong march upwards with the S&P 500 reaching record levels by the end of the month. The 22.08% return for the S&P 500 marks the strongest nine month start to a year since 1997. An important characteristic about the third quarter's performance was that market breadth broadened out. We have previously talked about the narrowness of the market and performance being driven by the Magnificent 7. However, the third quarter saw small and mid-cap stocks outperform, with all groups posting strong results.

Index Total Returns

Source: NBW Capital

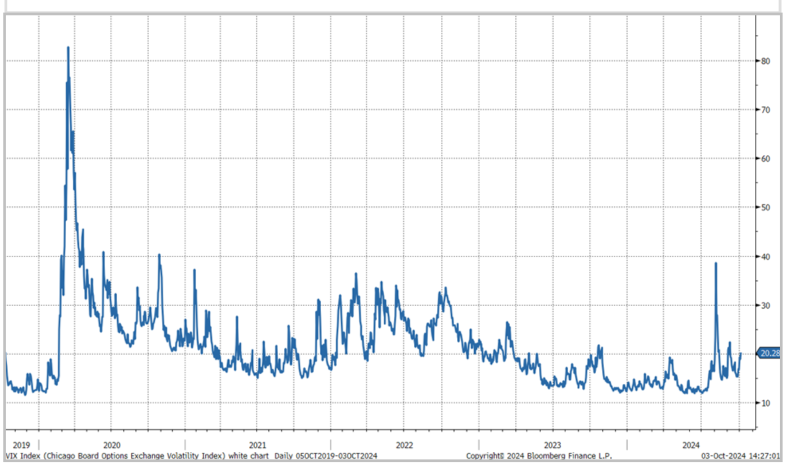
	Three Months Ended 9/30/2024	Nine Months Ended 9/30/2024
S&P 500 (Equities)	5.89%	22.08%
Bloomberg U.S. Aggregate Bond Index (Bonds)	5.20%	4.45%
Alerian Total Return Index (MLPs)	0.72%	18.56%
Russell 2000 Index (Small-Cap Stocks)	9.27%	11.17%
MSCI EAFE (Foreign Stocks)	7.33%	13.50%

*September 30, 2024 quarter end point in time data. The above returns are industry index benchmark returns, your actual portfolio return can be located on the "Performance Overview" page of your reporting package.

While these were strong, the quarter was not without volatility. Early August saw a significant pullback due to a combination of weak economic data and missed earnings from bellwether companies, such as Cisco and Intel. These weak earnings propelled the technology heavy Nasdaq-100 into correction territory of down more than 10%. The CBOE Volatility Index experienced a spike not seen since the early days of COVID-19. Additionally, the weak economic data sent bond yields down across the yield curve as fears of a hard landing entered the market. Bond traders quickly priced in a more aggressive federal reserve easing cycle, which came to fruition with a 50 basis point initial cut to the fed funds rate. By the end of the quarter, some better economic data not only brought back the base case of a soft landing, but also clear signs of a global interest rate easing cycle.

CBOE Index

Source: Bloomberg



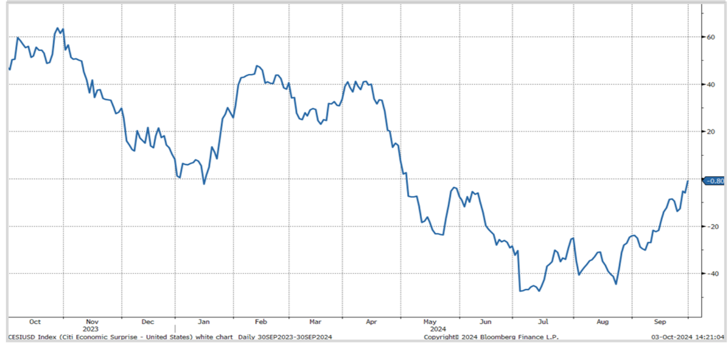
Outlook

Key on investors mind has been the path of the economy and the debate between a hard or soft landing. Our commentary last quarter that the fed seems to have engineered the soft landing came into doubt with a weak jobs report on August 2, 2024. Anecdotal evidence was also abundant in company commentary during the second quarter earnings calls, in particular, growing signs of weakness in consumer trends. To pick on one segment of the market, companies like Marriott International and airlines highlighting weakening trends suggesting the post-COVID-19 travel boom is waning.

However, by quarter's end. other consumer-oriented companies were highlighting positive trends, reinforcing that U.S. consumer spending is not falling off a cliff. The University of Michigan consumer sentiment surveys all showed improving trends. On the macroeconomic front, the Citi Economic Surprise index, which measures positive versus negative economic announcements, clearly moved to an uptrend as seen in the chart on the right. The volatility and surprises in both economic data and company announcements strongly suggests this is not a time to be overreactive to a single or even a few data points in the economy and markets.

Citi Economic Surprise Index

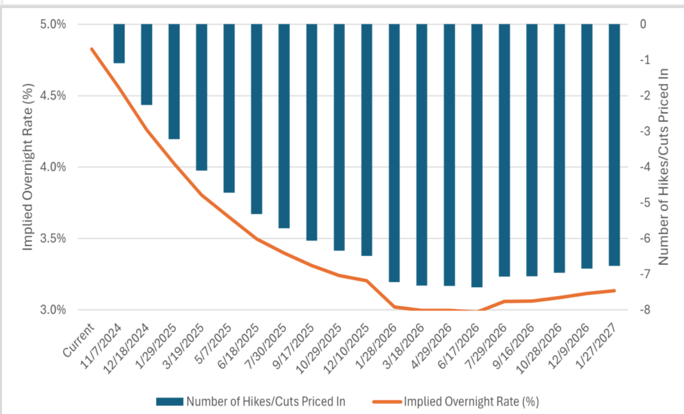
Source: Bloomberg



Additionally, inflation remains under control in the U.S. and globally. In the U.S., labor markets remain healthy but not stretched with wage inflation running just under 4%. Freight rates, which applies to nearly all goods continues to fall rapidly and with gas prices trending down could see more easing. Within the CPI, we continue to believe rent is overstated at 5.2% and the downward trend in this large component of CPI will continue. Bond traders seem to agree and are now pricing in seven rate cuts as the Federal Funds rate moves towards 3% by the middle of next year.

Fed Funds Expectations

Source: Bloomberg



Globally, the cooling inflation trend is being seen in most countries, with major economies experiencing inflation around 2%. The cooling inflation has led to a global easing cycle, as countries around the world are now cutting rates. China, dealing with a very weak economy, surprised the market late in September and brought out a bazooka of policy actions to stimulate their economy. All of this portends to an improving global economy with inflation remaining under control.

Geopolitical landscape

Unfortunately, the global geopolitical landscape remains tenuous. The war in the Middle East continues to escalate and a resolution to the Ukraine situation seems elusive. Both these situations remain unpredictable but are not yet having a significant impact on the global economy. The U.S./China relations are strained and seem likely to get worse before better. Again, a situation that is difficult to predict. Our analysis focuses mainly on the potential for tariffs and the impact it could have on the companies we own.

Domestically, as November approaches, we move closer to a tense presidential election. Hopefully, by our next writing, we will know the President for the next administration with less drama than what played out in the last election. As we wrote in the past, positioning a portfolio based on an expected election outcome is risky and often doesn't generate the expected outcome. As such, we prefer to focus on managing risk in this environment.

Oil prices coming down

Oil prices have been trending down over the past year. A vague announcement that Saudi Arabia is going to shift their focus to market share as opposed to supporting the price of oil sent prices tumbling in September. However, prices stabilized around the $70 level by the end of the month. We would argue that there is very little risk premium in the price of oil associated with the turmoil in the Middle East. Additionally, an improving global economy, in particular the China stimulus, may create added demand for oil. As such, we see more risk to the upside in the price of oil. While we are overweight the energy sector, our focus has been on U.S. midstream companies where

Oil Price (WTI)

Source: Bloomberg

they are paid mainly to move oil and gas. These companies benefit from record domestic production of hydrocarbons and their cash flows are not significantly impacted by changes in the commodity price.

Earnings and valuations

Second quarter earnings delivered a much more mixed message from companies than previous quarters. As mentioned earlier, notable misses from companies in the technology and consumer discretionary sector highlighted weakness in certain pockets of the economy, but a cautionary message was felt in most sectors. Despite the mixed commentary on the quarterly calls though, the overall earnings trend for the S&P 500 remains strong. Consensus estimates for the S&P 500 are for 13.5% growth in 2025 and estimates are holding reasonably steady. The economic environment of a global easing cycle coupled with modest inflation has us believing these estimates are achievable.

We often view company commentary as a forward looking indicator as to what may eventually appear in economic data releases. Perhaps the Federal Reserve has the same view, leading to their more aggressive first cut. With the S&P 500 trading at 21x earnings, it will be important for the overall market to deliver on earnings expectations. But importantly, as mentioned in the past, the average stock as measured by the S&P 500 Equal Weight Index is trading at a more modest 17x earnings leaving room for upside.

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