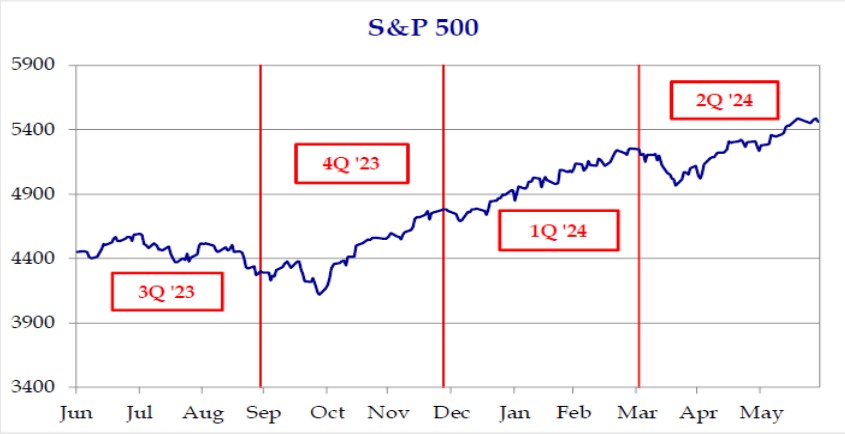
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Wealth Enhancement Group®
KINGS POINT TEAM

MID-YEAR OUTLOOK – RECESSION AVOIDED AS INNOVATION DRIVES GROWTH

Chart I



Source: Strategas Securities, LLC as of 6/30/2024

"It's tough to make predictions, especially about the future" is a famous quote from Yogi Berra. We began the year with many predicting a recession of varying degrees, followed by a Federal Reserve rate-cutting cycle that would be welcomed by financial markets. We got neither. What we did get is a continued path of innovation spurred by capital flowing into innovative business ideas like Generative AI and GLP-1 drugs. The former has garnered more attention and investment dollars. Currently, we are halfway through an election year, with the Federal Reserve inching closer to the start of a rate-cutting cycle, an economy that is slowing, and an improving inflation backdrop. Market breadth, or participation by a broader group of stocks in the market advance, is also improving, albeit slowly. This is a very encouraging sign and likely signals that we are still in the early to middle innings of a bull market that began in October 2022.

The most positive factor affecting markets right now is the cash positioning by investors and corporations. Stocks go up when you have more buyers than sellers, and buyers need cash to make purchases. Large amounts of cash are sitting in money markets, bank CDs, T-bills, and on corporate balance sheets. If the Federal Reserve initiates a rate-cutting cycle, even if prompted by a weakening consumer or labor market, we will likely see more cash move into risk assets such as stocks and bonds, providing further buying power to propel us forward.

However, the list of concerns remains long and growing. The election cycle is certainly anxiety-ridden, and it brings us closer to the expiration of key income and estate tax policies at the end of 2025. Next year will also usher in a period of high government debt maturities that will need to be paid off by issuing more government debt at prevailing market interest rates. With rates so much higher now than when these bonds were issued, the level of debt service costs the government will incur by refinancing maturing debt will push the Federal deficit to unprecedented levels. Where does this take us for the balance of the year? We believe the market has made impressive gains that need to be consolidated. Valuations in many parts of the market are still attractive and can expand. Therefore, we believe it is plausible that the market will show modest gains for the remainder of the year. It will not surprise us if we see market volatility in the seasonal period heading into the final stages of the election cycle. We plan to use this period to carefully improve the investment portfolios we manage, while keeping a vigilant watch on the growing list of concerns that could cause a directional change in this positive investment cycle.

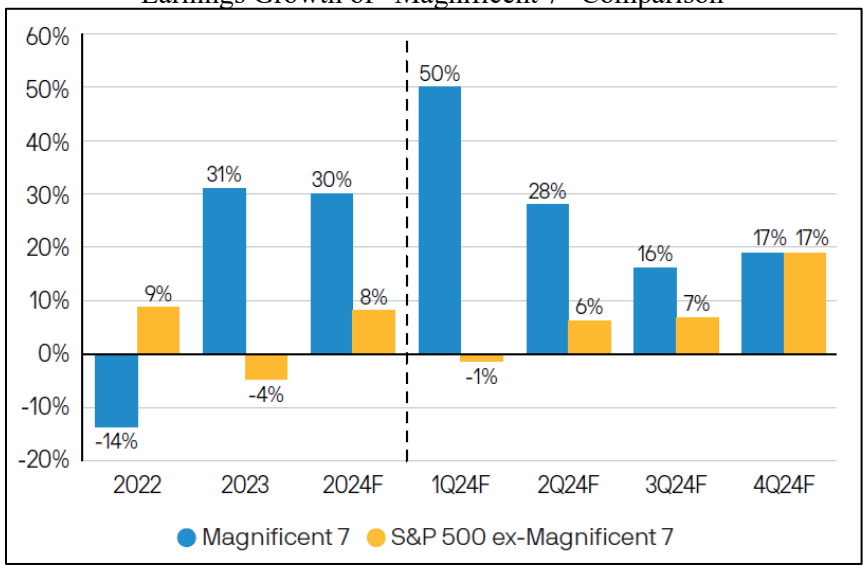
Advisory services offered through Wealth Enhancement Advisory Services, LLC, a registered investment advisor and affiliate of Wealth Enhancement Group®.

Magnificent 7: Looking Back and Looking Forward

Much has been written about the "Magnificent 7" which is a name given to a group of stocks in the S&P 500 that have had an outsized impact on market returns. These seven stocks (MSFT, AAPL, AMZN, NVDA, TSLA, GOOGL, META) have truly been magnificent if you look at the earnings growth they have delivered recently. In the first quarter of 2024, the 'Magnificent 7' were estimated to deliver 50% earnings growth year-over-year as depicted in Chart II below. Markets care more about the future than the past so the question to ask is, "Where are analysts expecting future earnings growth to come from?" If you look at the orange bars in Chart II below, you will see the other 493 companies in the S&P 500 are estimated to deliver the same earnings growth in the fourth quarter of this year. This suggests a shift in investor focus is coming, and portfolios will be rewarded by focusing on companies outside of the Magnificent 7 for the balance of this year. This is also supported by our analysis of Market Breadth, where we have seen sectors outside of Technology begin to play catch-up recently.

Chart II

Earnings Growth of "Magnificent 7" Comparison



Source: JPMorgan Market Insights: 2024 Mid-Year Investment Outlook

Valuation Disparity: Largest Stocks Versus Rest of Market

As demonstrated above, the larger stocks in the market have contributed much more to earnings growth than smaller stocks over the last 12-18 months. This is largely due to the innovative trends in mega-cap tech stocks, particularly those focused on Generative AI. While we believe in the technology and see productivity benefits coming, we also believe expectations have run ahead of reality.

Recent bearish articles on AI suggest the payback for capital invested into AI has been scarce or slow to appear. Could the fever pitch in AI be creating a mini AI bubble? Looking forward, compare the valuations of the largest companies to the rest of the market. Chart III shows the last 60 years of valuations of the Top 10 stocks in the S&P 500 compared to the other 490 stocks. The green line shows the forward price-to-earnings (P/E) ratio of the larger stocks, while the dark line shows the same for the smaller stocks. You can see the larger stocks are trading at 48% above their historical average, while the smaller stocks are only 12% above. For many years in the last decade, the 490 stocks traded at valuations ABOVE those of the 10 largest stocks. We see opportunity in this chart and believe these lines can converge at some point.

Chart III

Valuation Disparity Between 10 Largest Stocks and Rest of Market



Source: JPMorgan Guide to the Markets as of 6/30/2024.

Portfolio Highlights

Our investment committee meets weekly (with daily re-assessments) to discuss macro trends, existing portfolio holdings, and new positions we are considering. As we pass the two-year mark since the merger with Wealth Enhancement, we can confidently say our research process has never been on stronger footing. This is confirmed by analyzing the portfolio moves the investment committee has made since it was reconstituted almost a year ago. Importantly, Wealth Enhancement's Fundamental Research Group (FRG) now represents an extension of our research capabilities and provides valuable research insights that we did not have before.

Looking at some of our recently portfolio moves, our decision to exit our position in Ulta Beauty (ULTA) was driven partly by our risk management approach to preserving gains and partly by our analysis that Ulta was facing increasing competitive threats and business weakness. This decision proved beneficial as the stock declined further after our exit. The same could be said for our sale of Comcast (CMCSA). In both cases, we viewed these stocks as less attractive than other companies that appeared on our radar. During the quarter we made additional purchases in Starbucks (SBUX), O'Reilly Auto Parts (ORLY), Nvidia (NVDA), and Salesforce (CRM). A further explanation of some of these portfolio moves is below:

New Additions

Salesforce is a $250+ billion market cap customer relationship management "CRM" platform. Their cloud-based software is used by over 150,000 companies (ours included) to help manage client relationships and run business software. Salesforce was a pioneer of the software as a service (SaaS) business model. This subscription-based model produces highly predictable, recurring revenues at high margins. Salesforce's asset-light business does not require spending on factories or inventory to grow. This translates to high free cash flow generation ($11B over the last twelve months) and minimal capital expenditure. The company has over $4 billion in net cash on its balance sheet and has recently begun buying back significant amount of shares. Last quarter they instituted a $1.60 annualized dividend (0.6% yield).

We bought Salesforce on a 20%+ pullback after a disappointing quarter raised fears of slowing growth. We thought this sell-off was overdone given 1) Salesforce's sticky, high quality business model and 2) the company is still growing quickly. Consensus expects Salesforce to grow revenue by 9% annually for the next 2 years. We were happy to buy a best-in-class software leader at a ~5% free cash flow yield.

O'Reilly Automotive is a $60 billion market cap auto part supplier. They are the largest U.S. supplier of auto products and have over 6,300 locations in 43 states. We like ORLY's recession-resistant, highly profitable business model and exceptional management team. We view ORLY's business model as more stable and less cyclical than the broader consumer discretionary space. Cars will always break down. This helps explain why ORLY achieved positive same-store sales growth in 2008 and 2009 despite a major recession. ORLY augments this growth by opening about ~200 net new stores every year (see chart below). ORLY generated 4%+ revenue growth and 7%+ EPS growth for each of the last 15 years. Despite years of expansion, the company still only has ~10% market share in the U.S. ORLY recently expanded into Canada and Mexico which should offer additional growth opportunities.

O'Reilly's biggest competitive advantage is scale. Being the largest in the space gives ORLY the capital, technology, and footprint to keep their shelves better stocked with inventory. Having the right part available at the right time is critical for ORLY's customers—time is money for mechanics. As one auto repair shop owner put it, "we don't shop price, we shop availability". ORLY should also benefit from the increased proliferation of hybrid cars given that their higher average price and high-tech parts leads to higher repair costs. Financially, ORLY generates 40% returns on every dollar they invest—one of the highest rates in the S&P 500. The company is a "share cannibal" having bought back >40% of its shares in the last 10 years. For shareholders this means that your stake in ORLY would've grown by over 40% without doing anything.

NVIDIA is the clear worldwide leader in designing advanced semiconductors. Semiconductors are the building blocks for technological innovation and NVDA is at the vanguard of that trend. The company is expected to generate over $60 billion in free cash flow this year driven by demand for their AI chips. NVDA is highly profitable generating ~50% net profit margins and 70%+ ROIC (return on invested capital) on minimal capex (~$1B/year). They have $20 billion in net cash on the balance sheet. The management team is widely considered to be visionary in this industry. We took advantage of a ~20% pullback in April to add a best-in-class name in a growing industry. We are constantly looking to improve the quality of our portfolio. As part of this process, in June we took advantage of a 10%+ correction in NVDA to add to our position by exiting our position in CDW Corporation. While CDW is a fine business, we believe NVDA is a higher quality company with better long-term growth prospects (see comparison below).

	CDW	NVIDIA
Revenue Growth Next 2 Years	**2-4%**	**30%+**
EBITDA Margin	**10%**	**60%+**
Net Debt / EBITDA	**2.5x**	**$20B in net cash**
ROIC	**16%**	**70%+**

Source: Bloomberg data as of 6/25/2024.

We recognize concerns over AI hype, but NVDA's valuation is nowhere near the levels of the 2000 tech bubble. NVDA trades at 35x next year's earnings compared to the >100x P/E's of many large tech companies in 2000. We see 35x P/E as attractive for the leading semiconductor company with 30%+ projected revenue growth, 60%+ EBITDA margins, and $60B+ in annual free cash flow generation.