



February 28, 2025

REVIEW OF 2024 & PREVIEW OF 2025

The S&P 500 gained an astounding +25% in 2024 and spent the entirety of last year in positive territory with only one or two monthly hiccups along the way. Returns can be summarized as follows: There was the MAG7 and then there was everything else. On average, the MAG7 stocks ripped +60.5% last year compared to a measly +13.0% and +11.5% for the S&P 500 Equal Weight Index and Russell 2000, respectively. Statistically, the Russell 2000 had its worst year relative to the S&P 500 since 1998.

Concentration within the U.S. stock market continued to climb throughout the year as MAG7 trounced the rest of the market. The top ten stocks in the S&P 500 combine for a record-setting ~37% of total market capitalization (and the top five combine for ~27%). By comparison, the top ten percentage exceeds the Dot-Com bubble by ~14%. Cheap stocks stayed cheap or got cheaper while expensive stocks got progressively more expensive.

For example, Costco (COST) and Walmart (WMT) started last year at ~41x and ~22x NTM EPS. Currently these stocks trade at ~56x and ~37x NTM EPS. We can appreciate both are great businesses but, on a long enough time horizon, valuations eventually matter. Apple (APPL), the largest weight in the S&P 500, hasn't grown inflation adjusted revenues or meaningfully increased operating margins since 2022. And, despite that, the stock was +31% last year and trades for ~32x NTM EPS. We suspect this price action is driven by structural, not fundamental, forces.

Euphoric equity sentiment goes well beyond the greatest businesses trading at lofty valuations. We have seen a broad resurgence in animal spirits across many types of risk assets, especially since the election, and wonder when we might reach peak fear-of-missing-out. Less proven businesses are trading at multiples which seem impossible to grow into. Totally unproven artificial intelligence and/or quantum computing companies have gone parabolic. Cryptocurrencies are enjoying their own speculative frenzy. The list goes on.

We would be remiss if we didn't mention Fartcoin, an obviously worthless digital "asset" created as a joke, which was worth \$2.42 billion at its peak. While the market capitalization has since dropped to ~\$291 million, the average daily volume still exceeds \$73 million. This was not a one-off either. Numerous internet celebrities are pumping and dumping their own branded versions of these worthless "meme coins" and cashing in when the price surges 100,000%+ after posting about it on social media.

Risk appetite across the board is simply skyrocketing. We haven't even discussed the exploding ODTE options contracts volume or the fact betting websites like Polymarket allow people to gamble on anything and everything. For instance, users can place bets on how many tweets Elon Musk will send next week, whether Andrew Tate will leave Romania before April, or how many Federal employees will accept the government's buyout offer. Based solely on market conditions and participant behaviour, you would think we were about to embark on an aggressive rate hiking cycle to reign in this speculative mania, but the opposite is true.

As we enter 2025, the S&P 500 is statistically expensive on almost every quantifiable metric, both in absolute and relative terms. Negative equity risk premiums, stretched valuation multiples, and optimistic growth expectations may weigh on index returns. What worked last year almost never works again the following year. That observation, combined with the unsustainably high market concentration discussed below, suggests to us that the SPW will outperform the SPX. We are also inclined to believe individual stock dispersion will be a key theme in 2025.

Market Concentration

It feels like we are constantly writing the same thing over and over again about market concentration. Large cap stocks have had strong performance over the past decade which left the market top-heavy entering last year. Dominance from the MAG7 companies over the past twelve months leaves the market more concentrated than ever before. The closest parallels to this level of lopsidedness (in terms of top ten stock performance differential and market concentration) were the periods prior to the Dot-Com bubble in 2000 and the Great Depression in 1929.

We are beginning to read more about an emerging MAG7 bubble. The combination of factors such as unsustainable market concentration, stretched valuations, aggressive earnings growth expectations, and passive market-cap weighted fund inflows have created a seemingly unstoppable juggernaut destined to end badly. Our view is less cogent. We think the heavy concentration will ultimately unwind one way or another. And, while the MAG7 are far from cigar butts, there are so many garbage non-MAG7 stocks out there trading at obscene valuations. Worth noting, many of these stocks have been taken behind the woodshed on earnings misses so far this year.

In our view, the greater risk to the market is structural, not fundamental. Passive investors have enjoyed the tailwinds from market-cap weighted fund inflows over the years. Any negative development could reverse the self-reinforcing process and turn an up-to-the-right staircase into a down-and-to-the-right elevator as price insensitive sellers all rush for the same limited exits at the same time. We will discuss this in more detail below.

Interest Rate Cuts, Higher Yields and Persistent Inflation

The long-anticipated “Fed Pivot” finally began in September when the FOMC lowered interest rates by 50 basis points followed by an additional two 25 basis point cuts in November and December. Generally, the long end of the yield curve decreases when the Fed begins an interest rate cutting cycle at the short end. However, the opposite happened this time. While the Fed decreased interest rates by 100 basis points, the 10-Year yield actually increased by 100 basis points (Appendix A). Interestingly enough, the rise in yields from 3.6% to 4.5% did not occur gradually. It happened immediately following the Fed Pivot. This has significant implications for corporate debt and mortgage rates and, by extension, the rest of the economy (not to mention the effect on annual budget deficits).

Inflation peaked more than two years ago but has failed to return to the elusive 2% target stipulated by central bankers and Keynesian economists. Disinflation momentum appears to be stalling out at around 3%, suggesting the last one percent remains the most challenging. Cumulative inflation since the pandemic still wreaks havoc on the median consumer who pinches pennies and believes eggs should now be considered a luxury good. There is a real risk inflation reaccelerates from here. As such, we believe future interest rate cuts will be reactive rather than proactive in nature.

WINNERS WIN; LOSERS LOSE

Describing the performance of individual stocks last year can be overgeneralized in one sentence: Winners kept winning and losers kept losing. Stocks that had gone up lately would continue to march higher, and stocks that languished couldn’t get themselves off the mat. Business momentum was the strongest factor that determined which bucket any given stock would fall into. Rising expectations, positive earnings revisions, and improving rates of change fostered incremental buying irrespective of valuation and vice versa.

In our view, this winners-win-and-losers-lose dynamic is partly due to an intentional decision by valuation agnostic active managers utilizing quantitative and algorithmic trend following strategies. Quality stocks, as a group, are bid up to extreme valuations reminiscent of the Nifty Fifty era so long as incremental news remains positive. But when the business momentum rate of change turns negative or results fall short of expectations, look out below.

However, we suspect an even larger driving force is the continued shift towards passive investing. Passive investing broadly inflates valuations, distorts the relationship between price and intrinsic value, exacerbates momentum effects, and thus systematically disadvantages value-oriented active managers. According to Bank of America, passive investing is currently 54% of the market (Appendix B). Of that, 68% are cap-weighted passive vehicles so incremental fund flows further exacerbate the historic degree of market concentration discussed earlier.

Market concentration and stretched valuations are known knowns. Investors have largely accepted the artificial intelligence has limitless potential, so no price is too high narrative as a sufficient justification for both. We believe, while there is an underlying element of truth to the untapped potential aspect to the thesis, the passive fueled structural nature of this dynamic is profoundly underappreciated by investors. If we are correct, this will ultimately pose a significant risk during the next bust cycle as the process works in reverse, whenever that may occur.

Losers Lose – Value Stocks in Q4 2024

Speaking of losers, there was no bigger loser than value stocks in the 4th quarter of last year. The S&P 500 Value Stock Index (IVE) was flat heading into the election, ripped +5% higher over the next three weeks post-election, and then proceeded to relentlessly decline by almost -8.5% over the following fourteen consecutive trading days (previous losing streak record was nine days).

The return disparity for the month of December was enormous. The S&P 500 was -2.4% but most sectors experienced absolute carnage (Appendix C). The S&P 500 Equal Weight Index (SPW) finished -6.3% on the month and its underperformance since the election was drastic (Appendix D). Technology carried index returns with the Nasdaq-100 and S&P 500 Growth Index (SGX) gaining +0.5% and +0.9%, respectively. Meanwhile, the S&P 500 Value Index (SVX) and Russell 2000 (RTY) finished the month -6.8% and -8.3%, respectively (Appendix E). Statistically, this was the worst monthly performance for the Russell 2000 relative to the Nasdaq since the Dot-Com bubble.

Highly speculative assets performed extraordinarily well despite the Russell 2000 being flat. Bitcoin (BTC) was up +47.2% during the quarter, for example, and plenty of other questionable companies trading at nosebleed valuations experienced substantial multiple expansion. The broad rotation toward asset classes furthest out on the risk curve was surprising given the 10-Year yields were spiking simultaneously. While frothiness is undeniable in certain pockets of the market, we believe there are attractive opportunities in other parts.

WHERE WE SEE OPPORTUNITY

Truth be told, our view is the S&P 500 is fairly-to-fully valued especially given the heightened degree of political and economic uncertainty we anticipate over the next few years. We remain cautiously optimistic on underlying business fundamentals but recognize multiples are at the high end of historic ranges and sentiment is stretched. Investor behaviour is bordering on reckless, and the Levkovich Index is in euphoric territory (Appendix F).

That said, value stocks are at their cheapest relative to growth stocks since the bursting of the Dot-Com bubble (Appendix G). The return for the S&P 500 Growth Index (SGX) trounced the S&P 500 Value Index (SVX) by a whopping ~24% last year (36% vs. 12%). The aftermath of this massive discrepancy was productive hunting grounds for value-conscious bottom-up stock pickers throughout the early 2000s. We wonder if the next few years will provide a similar opportunity set.

While year-to-date performance appears pedestrian on the surface, plenty of individual stocks are experiencing heavy drawdowns and things are getting ugly for certain areas of the market. As we peruse our extensive watch list, one thing is clear. When upward momentum breaks there is usually a substantial air pocket underneath. Earnings season has been unforgiving for companies that miss expectations or provide lacklustre guidance and, as a result, many stocks are down 25-30%+ from recent highs.

The reward for surpassing expectations is often short-lived. Numerous stocks we track pop higher on earnings beats only to fade those gains, and then some, over the following days or weeks. Upward momentum seems tougher to sustain, anecdotally speaking. Owning stocks into results seems asymmetric when misses are punished, and beats are not commensurately rewarded. However, this set-up can give long-term investors an opportunity to increase the size of their position when strong results further support their thesis. Accumulating shares with new information and higher conviction for the same price can be profitable but requires patience.

We continue to see opportunity in SMID-caps. Specifically, higher quality companies that can comfortably withstand elevated interest rates for the foreseeable future. We believe neglected stocks that don't fit neatly into style boxes and have not benefitted from passive fund flows could be significantly underpriced but will require patience. Mega-cap stock performance over the past decade, and especially the past few years, has made investors believe diversification is unnecessary. The result is a vast graveyard of abandoned stocks that few care about. We recognize most of these businesses deserve to be left behind but there are undoubtedly diamonds in the rough.

As discussed in earlier letters, we continue to remain skeptical of the winner-take-all mentality with respect to artificial intelligence. We highlighted our reasons as political activism undermines trust in the end product, large bureaucratic incumbents have always been disrupted by small nimble new entrants during times of profound technological change, and barriers to entry will vanish as innovation and efficiency gains drive down the entry cost.

These realities hit the stock market like a freight train in one weekend. DeepSeek challenged the notion that a handful of the largest technology companies on earth had been anointed with an impenetrable moat. On January 27th NVIDIA closed down -17%, erasing \$590 billion of market capitalization, in a single day. This was the biggest 1-day loss for any individual stock in recorded history and it's not even close. Investors are beginning to question whether the dominance of current AI leaders is etched in stone, or their stranglehold today is merely a transitory first mover advantage doomed to fade with time.

Highly concentrated markets generally tend to experience greater single-stock volatility (and lower prospective returns). Combined with the fickle nature of rapidly changing technological evolution and you have the ingredients for seismic selloffs in the event of negative developments. This emphasizes the importance of risk management. Outsized moves can be sources of great opportunities if you're positioned to take advantage of them.

Another interesting subset of stocks worth considering are potential M&A targets. In our view, the agenda of the last FTC regime was borderline radical. Former Chair, Lina Khan, had a clear mandate for the agency which aggressively challenged and sued to block numerous proposed mergers and acquisitions for any reason imaginable. The incoming administration should be more friendly from an M&A standpoint and there could be years of pent-up activity in the pipeline. While it's possible to identify strategic targets for potential buyers, it's difficult to initiate a long position based solely on favourable takeover prospects. Instead, we view this as upside optionality and a welcomed tailwind for SMID-cap performance going forward.

Our view is that, while the easy gains have already been made, we continue to see opportunities in the market. We anticipate a bumpier road this year compared to last and would not be surprised to see prolonged pullbacks. We believe the theme this year will be patience. At times we may initiate a position too early and take losses. At other times, we may miss gains waiting for our thesis to be confirmed before sizing up. Our intention is to remain nimble and patient, rather than recklessly chase potential opportunities. This approach will hopefully allow us to use heightened volatility to our advantage.

LOOKING BEYOND 2025


Every prevailing paradigm eventually comes to an end. Incremental passive fund flow dollars have disproportionately found their way into the largest handful of companies, creating a self-fulfilling prophecy in the process. What we are left with now is extreme market concentration and stretched valuations. These conditions, when met with downside risk, lay the foundation for lost decades such as the Nifty Fifty and Dot-Com bubbles.

Given these starting conditions, combined with a relatively unpredictable political backdrop, rising inflation uncertainty, and worsening fiscal situation, we find ourselves wondering if maybe the market is on the cusp of a leadership regime change that unfolds over the next decade. Fundamentally, today's behemoths appear to have impenetrable moats, and the consensus opinion is that investors should own these stocks irrespective of valuation. We appreciate tremendous business quality, but we also recognize how quickly sentiment shifts in tumultuous times.

What has worked over the past ten years is unlikely to work over the next ten. The era of MAG7, meme coins, growth-at-any-price, disruptors-regardless-of-cash-burn, etc. may give way to a decade of outperformance from owning profitable, fairly-priced companies with outstanding returns on capital. We are cautiously optimistic individual stock dispersion would increase under such a scenario which bodes well for active managers. The relentless underlying passive bid buoying asset prices could suddenly dry up should optimism evaporate.

Alternatively, passive investing could easily continue to take over the world. Maintaining the current trajectory of this trend obviously has profound implications for price discovery which is widely discussed. However, we believe the impact on corporate governance is rarely talked about and will increasingly come to the forefront over the next several years. Inside ownership and shareholder base quality will come into focus for long-term investors who will prioritize an alignment of interest in the pursuit of maximizing shareholder value.

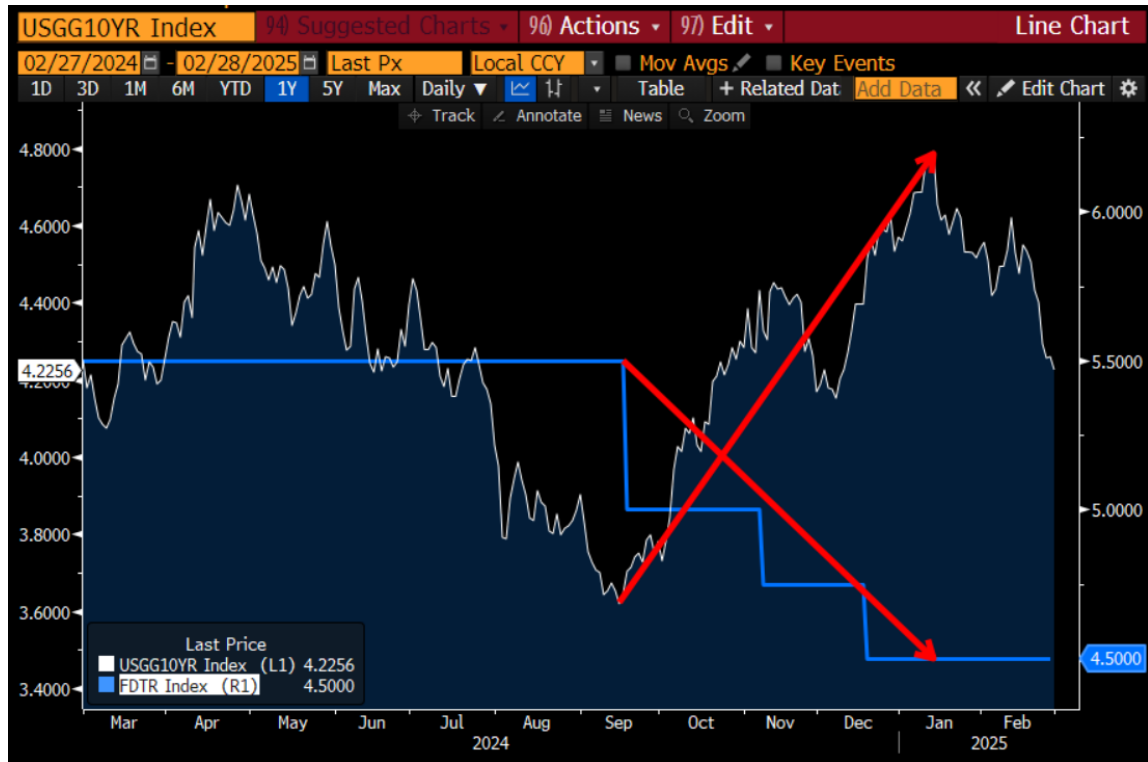
Sincerely,

A handwritten signature in black ink that reads "A. Agostino". The script is fluid and cursive, with the first letter of the last name being a large, stylized capital 'A'.

Alexander Agostino

APPENDIX

Appendix A:

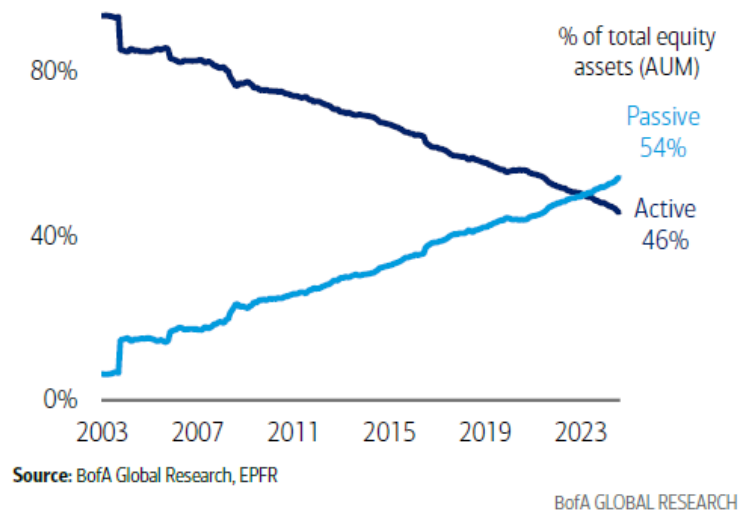


Source: Bloomberg

Appendix B:

Exhibit 8: Passive now > active in equity funds

Passive and active share of total equity fund AUM since 1996

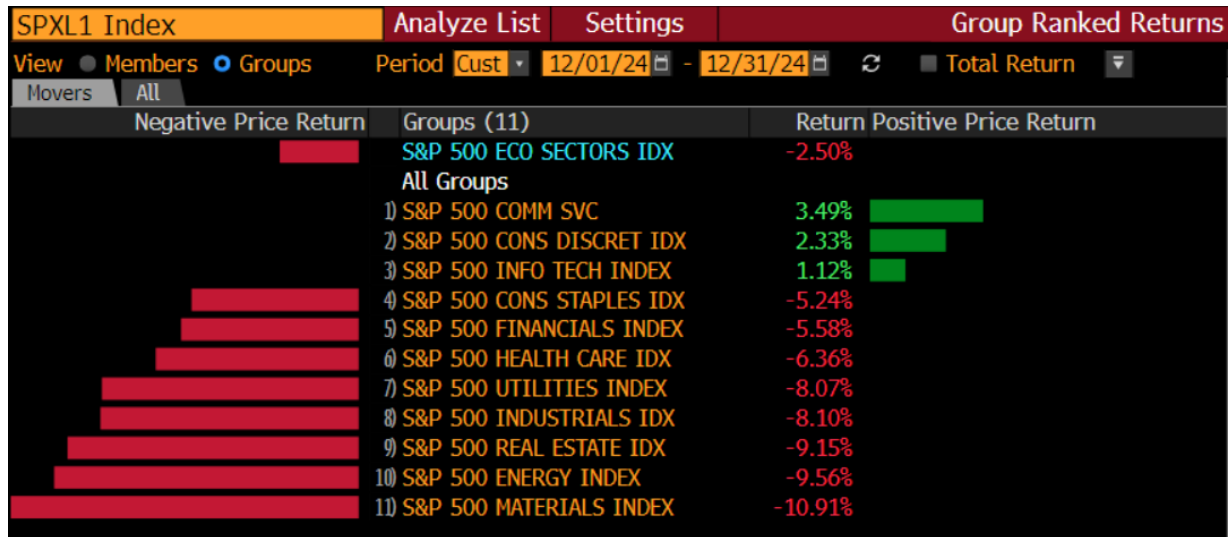


Source: BofA Global Research, EPFR

BofA GLOBAL RESEARCH

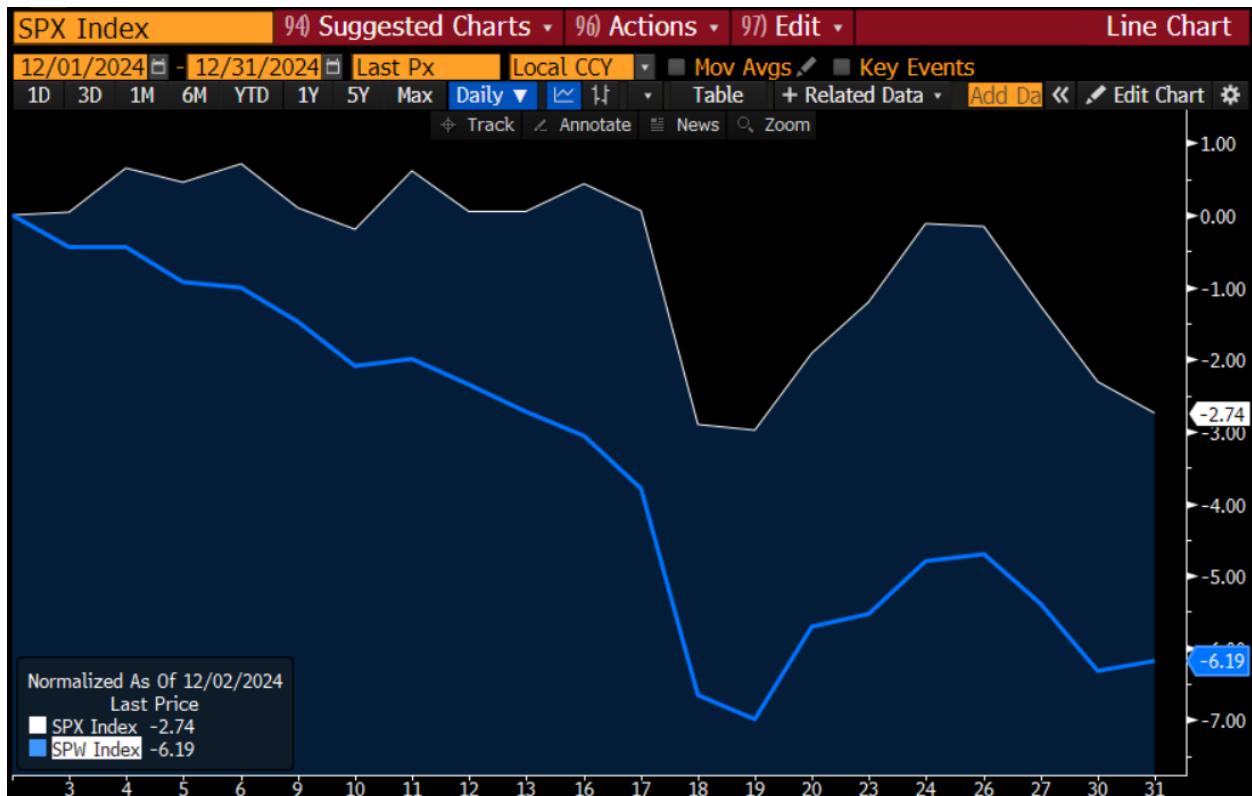
Source: Bank of America – Note Title – Date Needed

Appendix C:



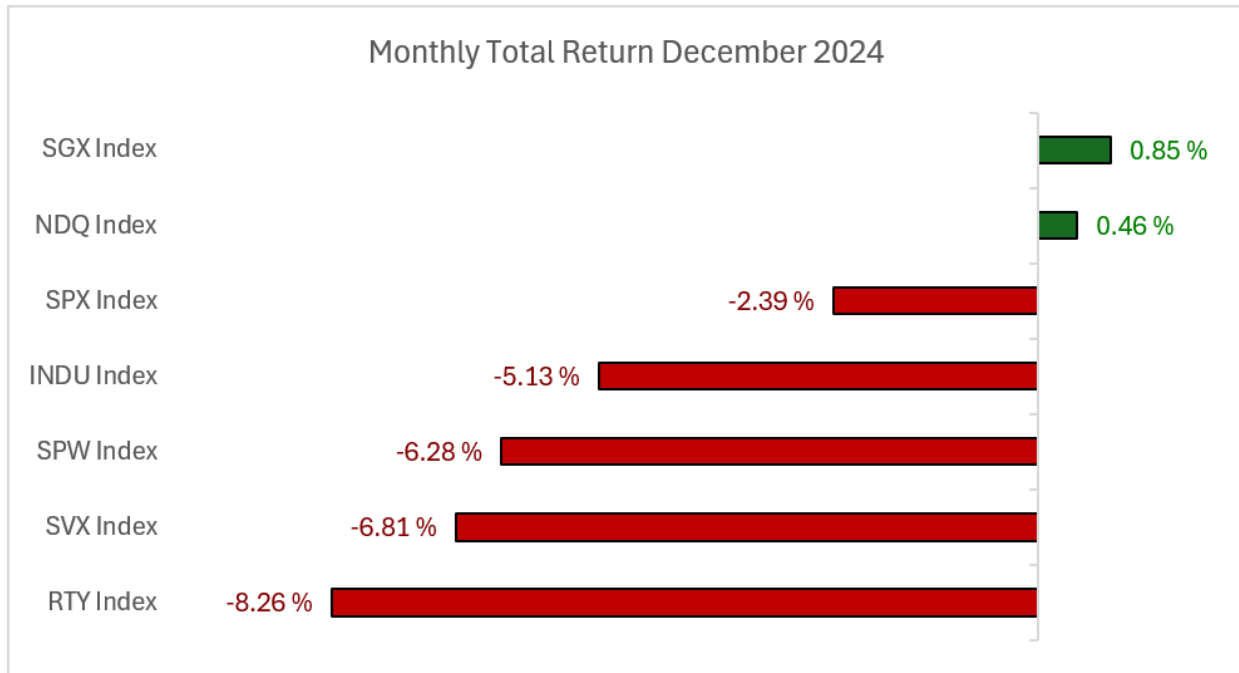
Source: Bloomberg

Appendix D:



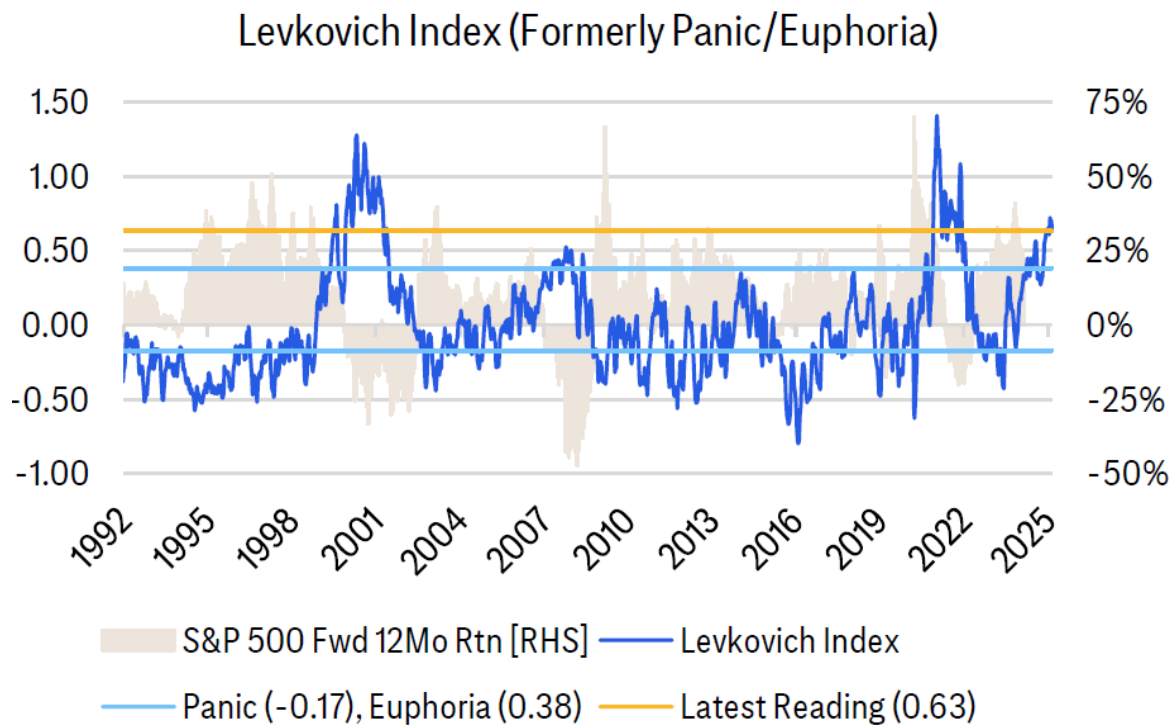
Source: Bloomberg

Appendix E:



Source: Kinsman Oak Capital Partners

Appendix F:



Source: Citi Research – The PULSE Monitor – February 21, 2025

Appendix G:



Source: Bloomberg

LEGAL INFORMATION AND DISCLOSURES

This commentary is intended for informational purposes only and should not be construed as a solicitation for investment in the Kinsman Oak Equity Fund. The Fund may only be purchased by accredited investors with a high risk tolerance seeking long-term capital gains. Read the Offering Memorandum in full before making any investment decisions. Prospective investors should inform themselves as to the legal requirements for the purchase of shares.

The views expressed are those of the author as of the date indicated. Such views are subject to change without notice. The information in this document may become outdated. The author has no duty or obligation to update the information contained herein. Forward-looking statements, including but not limited to, forecasts, expectations, or projections cannot be guaranteed and should not be relied upon in any way. Actual results or events may differ materially from any forward-looking statements contained herein. The author has no obligation to update or revise any forward-looking statements at any time for any reason. Do not place undue reliance on forward-looking statements.

This document is being made available for educational and informational purposes only. The information or opinions contained herein do not constitute and should not be construed as investment advice under any circumstance. Investing involves risk including the complete and total loss of principal.

In preparing this document, the author has relied upon information obtained from independent third-party sources. The author believes that these sources are reliable and the information obtained is both accurate and complete. However, the author cannot guarantee the accuracy or completeness of such information and has not independently verified the accuracy or completeness of such information.

The author may from time to time have positions in the securities, commodities, currencies or assets mentioned herein. References to specific securities, commodities, currencies or assets should not be construed as recommendations to buy or sell a security, commodity, currency or asset. Furthermore, references to specific securities, commodities, currencies or assets should not be construed as an indication of any past, current, or prospective long or short positions held by the author.

This document may not be copied, reproduced, republished, posted, or referred to in whole or in part, in any form without the prior written consent of the author.