Q3 2024 Investment Update

Current Observations

Let's start with **ECONOMIC CONDITIONS**. The economy continues to surprise the doomsayers who've been forecasting recession since the Federal Reserve started raising interest rates 2 ½ years ago. Despite higher rates the economy continues to grow, although at a modest rate. Of course, there is still the possibility of an economic downturn at any time. Also called a recession. We preach—a little excessively to be sure—that predicting the economy is a fool's game. And there are already enough fools in this game, so we'll steer clear.

Next up is **INFLATION**. It's certainly been one of the main points of discussion in the upcoming elections. Consumers have been hit with higher prices for gasoline, food, rent, mortgage payments, home and auto insurance, and just about everything else. The good news is inflation has receded significantly from a high of 9% to the current 2.5% level. This significant inflation reduction has allowed the Fed to start cutting rates which should help overall economic conditions.

INTEREST RATES are the magic elixir that can help propel spending and investment or reduce economic growth, depending on whether rates are going up or coming back down. We're now at the point where short-term rates could decline from over 5% recently to 3% or so over the next couple of years. This isn't our forecast since we don't make forecasts…but represents a consensus among economists. Lower rates should stimulate spending on big ticket items such as homes, cars, business equipment and factories along with general consumer spending.

Overall, our best guess is that the economy will continue to grow slowly with declining interest rates providing some support and inflation continuing to be moderate.

Now on to **FINANCIAL MARKET CONDITIONS**.

Despite the dire warnings of numerous market pundits., The **STOCK MARKET** continues to progress upward. Those market timers who thought they were smart enough to exit the market given all the challenging news on inflation, interest rates and geopolitical turmoil are likely kicking themselves if they are still sitting on the sidelines. As some undoubtedly are. Money market funds are sitting on $6 trillion of cash. In technical terms that's what's known as a mountain of cash. Some of that cash will find its way into the stock market. Eventually. After the market climbs some more, no doubt. Remember, ya gotta be in it to win it.

It's such an easy thing to talk about…yet difficult for so many investors to practice. We're talking about:

- Creating an investment plan based on your personal goals
- Selecting an appropriate asset allocation to meet those goals
- (Most importantly) sticking with the plan through the ups and downs that inevitably—always—occur over many years.

What about **FIXED INCOME**? For those clients with fixed income allocations the conditions today are better since interest rates are higher than they have been in many years. It's much easier to find relatively attractive fixed income investments. Since fixed income generally fluctuates less than the stock market this provides a buffer during particularly volatile economic and financial market conditions.

Even **CASH** holdings are relatively more attractive today since money market yields are close to 5% today compared to near 0% just a couple years ago. In this environment we don't mind having a little extra cash on hand as it's generating a decent yield while we wait for attractive investment opportunities. As short-term interest rates decline in line with Fed policy, we'd expect money market rates to decline, so keeping large amounts in cash isn't a suitable long-term investment option.

OTHER CURRENT TOPICS:

The most important long-term trend that we're watching today is what's going on outside of our borders. Specifically, **GEOPOLITICS**. While it might seem unimportant as these events don't impact the U.S. directly—at least yet—we still live in a very connected world. What happens in the Middle East, or Europe, or Asia, has multiple direct and indirect impacts on our economy and living standards. We don't see that lessening any time soon. Today's world is the most complicated and perhaps dangerous since World War II.

The most recent hotspot is the Middle East. The Iranian regime is fomenting trouble for Israel via its proxies in Gaza, Lebanon, Iraq, Syria and Yemen. Russia is covertly helping Iran and China is quietly rooting for the U.S. to get bogged down in another conflict.

Moving over to Europe we have the ongoing war between Russia and Ukraine. The Russian invasion has evolved into a grinding war of attrition, now 2 ½ years old. Here again we can't predict an eventual outcome as it appears that Ukraine does not have enough firepower to push the Russians out of Ukrainian territory. Europe has dragged its feet on assisting Ukraine, despite Russia being in its backyard. Russia assumes that the West (yes, mostly the U.S. so far) will eventually tire of supporting Ukraine with financial and military assistance. Our opinion is the world allows Vladimir Putin free reign at its peril. While Ukraine gets little help from the West, China and North Korea are both providing support to Russia. Dictators stick together while the West twiddles its thumbs.

European governments haven't done nearly as much as they should. Why? In our opinion, Europe has lulled itself into strategic complacency thanks to the American defense umbrella. In addition, Europe has long preferred social spending to defense spending. Well, guess what? A new era is upon us, and Europe will be forced to boost its defense spending for years. Thank you, Vladimir Putin. Meanwhile, Putin's delusional ambitions continue to cost Russia. It reminds us of a family that burns its furniture to keep warm. The long-term losers are the Russian people. Let's all hope for a leadership change.

Lastly in the geopolitical realm, we have the Chinese dictatorship to consider. The Chinese economy has been a mess for the past several years. In our opinion this is what happens when you have an enormous economy comprised of 1.4 billion people—4 times the size of the U.S. population—with central control in the hands of roughly 100 major Communist Party leaders. Actually, it's even more concentrated than that as 24 Politburo members control nearly everything.

Eventually reality catches up as it's impossible for a small group of people to effectively manage the economic activities of hundreds of millions of people. The leaders love to invest in "stuff." In the past real estate got their love, which created an enormous real estate bubble. Of course, that led to a crash around 2021, and the government is still trying to mop up the mess. Let's just say it hasn't been easy.

Now China is focusing its efforts on exporting their "stuff"—including cars, electronics, steel etc.—to the rest of the world. The global reaction? Huge increases in tariffs by Europe and the U.S. on electric vehicles, steel and other Chinese exports. China doesn't play by the same rules as other countries, given its government meddling in the economy and massive business subsidies. This situation is likely to be with us as long as Communist dictators control the country. Which is to say for the foreseeable future.

China has been encouraged by its trading partners to promote more domestic consumption to rebalance its export-driven and lately ailing economy. Leadership (Xi Jinping) has refused, believing that domestic consumption is wasteful. Combine this bias against consumption with China's major trading partners refusing to accept cheap subsidized exports and you have a potential long-term impediment to Chinese economic growth. Add the reality that China has a demographic problem as it will lose roughly 40-50% of its population over the next 75 years. That's not a typo, their one child policy for 40 years from 1980 to 2020 meant not many youngsters. Result? Now China has plenty of oldsters. The young folks today don't want kids. China potentially will get old before it gets rich.

And let's not forget that China still has its eyes on Taiwan. Xi Jinping the Chinese Dictator wants China to be ready to invade Taiwan by 2027.

We can't predict the potential outcomes of these various conflicts but hope that there isn't further escalation into a full-blown war. Impacts to our economy could include recession, higher oil prices, higher defense spending, nuclear weapon use, and reputational damage to the United States.

Why all the focus on international conditions? Free trade has been a major source of global growth over the past 20 years. Given the current emphasis on domestic priorities such as securing borders, onshoring of production for trade and national defense, free trade will likely have less impact on future growth for U.S. companies. The global economy will need to adjust through either slower growth or finding new sources of growth. Other parts of Asia, Africa and South America could benefit. We'll be watching.

The U.S. election is less than one month away. It's entirely unclear at this point who the likely winner will be. The typical view is that a Harris win would mean higher taxes, higher government spending and more regulation. A Trump win is thought to lead to lower taxes, reduced government spending and less regulation.

Well, here's a recent headline from The Wall Street Journal:

Trump's Plan Boosts Budget Deficits by $7.5 Trillion

The former president's tax and spending ideas add up to more red ink than those of the vice president, according to a new analysis.

Remember, this headline is from The Wall Street Journal, not exactly a radical left-wing publication! Regardless of the election outcome, the reality is that the economy and the stock market will adjust to the new regime. Interest rates matter more: the stock market has risen in 12 of the past 14 declining rate environments, with a median one-year return of around 14% or so. As to whether Democrats or Republicans are better for investors, here's the scorecard. We'd say it doesn't matter:

President	Return
Carter	12.0%
Reagan	15.1%
Bush 1	14.6%
Clinton	17.5%
Bush 2	-4.5%
Obama	16.3%
Trump	16.3%
Biden	12.7%

Source: Richard Bernstein Advisors LLC, Bloomberg Finance L.P.
*Presidential Term measured by Inauguration dates.

U.S. EXCEPTIONALISM:

We'll close this section with a short discussion of one of our favorite topics. Why the United States continues to outperform so many other countries in economic terms.

We all know about the problems facing the United States. Let's reel off a few: political polarization, class division, urban/rural divisions, drug epidemics, massive national debt, declining life expectancy. It's enough to make a person despair for "the good ol' days."

Yeah well, the good ol' days actually weren't that good. Just think of all the advancements in technology, medicine and creature comforts that most Americans would complain about if they were taken away.

The U.S. has some incredible advantages. Let's list a few, although this isn't an exhaustive list, and you might include some others:

Our educational system is world class, particularly in higher education. Yes, we need to improve our grade schools and high schools, but the U.S. continues to be an education magnet globally, feeding our innovative technology industries, entrepreneurial culture, robust venture capital and business formation.

We've discussed China's declining population, and Russia is shrinking also. The U.S. continues to grow its population, and whether we agree or not, a growing population means a growing economy. A prosperous economy provides the economic resources to enable defense spending to protect our way of life and defend against foreign threats. The U.S. median age is around 39; China is older with a median age of 40 and rising, while its population is destined to shrink dramatically over the rest of this century. It's hard to be a global power when your population drops by 40 or 50% over decades.

The U.S. is a country of laws, as the Constitution and 200+ years of legal system development has created a relatively predictable environment where citizens can expect certain legal protections, and businesses can enter into contracts with the expectation that agreements will be honored or litigated. Imagine trying to agree with someone based on a handshake. That may have worked years ago, but not today. Our economy thrives partly based on our Constitutional protections and our legal system.

The U.S. also benefits from our geographic position. We have oceans on both sides, protecting us from would-be aggressors. We have two friendly nations to our south and north. Yes, Mexico could be doing more to secure the border and stop the drug flow into the U.S. Regardless, it beats having China or Russia on our doorstep.

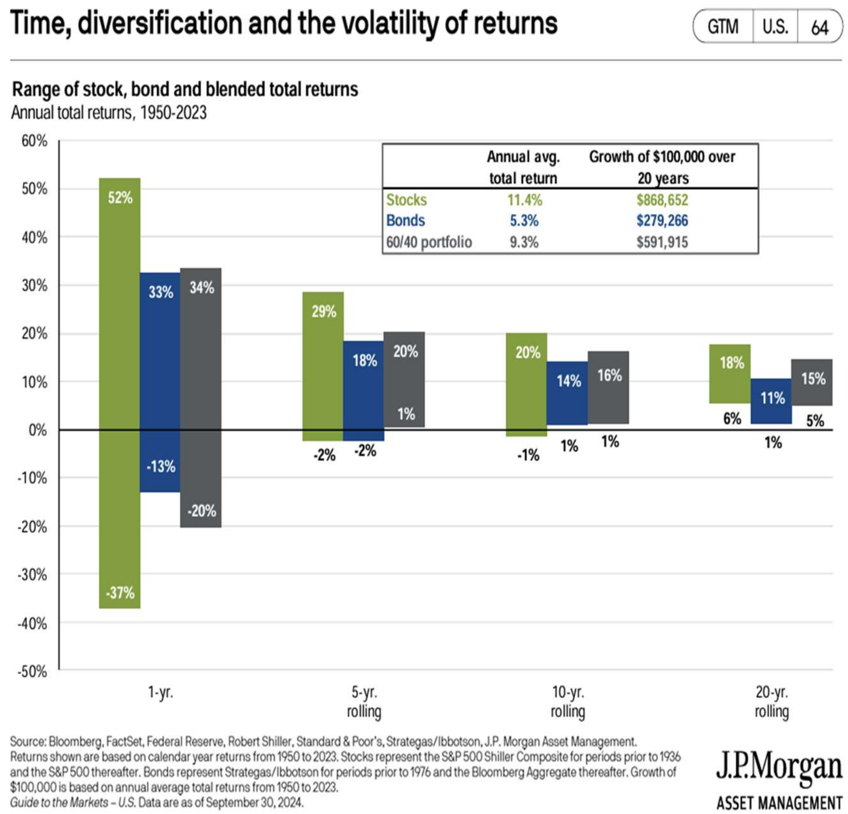
We also have some of the most fertile farmland in the world. Not only are we self-sufficient in food, but we are also largely energy independent today given our large oil and natural gas resources and production.

We could list more favorable U.S. attributes, but you get the idea. We take for granted the natural and man-made benefits of our society and its institutions. We often ask ourselves, "***where else in the world would we want to live***?" The answer is always not very many other places.

As long as the U.S. remains a relatively attractive destination, we'll continue to attract people seeking freedom and opportunity. Yes, we must do a better job of immigration, but America has attained its global preeminence due to decades of immigration. Smart immigration is a source of U.S. long-term economic strength.

Climbing down from our soapbox, let's end our discussion with some important long-term investment ideas.

We think it's helpful to periodically remind ourselves of history. Investment progress comes ONLY over long periods, as the short-term ups and downs of the economy and markets tend to be smoothed over time. This chart on the next page shows that as you extend your investment time horizon, the probability of earning a positive return increases. In simple terms, anything can happen over one year, whether it's big gains or big declines. As you extend out to 5-, 10- and 20-year rolling periods, we've seen positive results in just about every period under consideration since 1950. Something to remind yourself the next time the financial media talking head screams at you to dump your investments. That is a recipe for financial disaster, in our opinion.



And finally, this chart reminds us that investors have been rewarded over time despite enduring numerous crises, pandemics, natural disasters, recessions, political upheaval, rising interest rates, wars, terrorism, market declines, inflation, deflation, etc. The stock market has historically provided above-inflation returns to those who remain patient, accept periodic volatility as a normal market function, and stay focused on their long-term goals.

Important Beliefs

- Whether it's retirement funding, income replacement, travel, charitable contributions, college costs, or financial assistance to children or grandchildren; our job is to help you determine your future needs and chart a course to help get you there. To accomplish these long-term objectives, ***you need a long-term plan***.

- Regarding your investment policy, nothing has changed, because nothing ever changes. That is: ***we are long-term, goal-focused, plan-driven equity investors***. We own diversified portfolios of quality companies; these companies have demonstrated the ability to increase earnings (and in many cases dividends) over time, thus supporting increases in their value.

- This graphic provides a good visual of how to think about financial matters and your emotional well-being. Focus on those things within your control and try to avoid the all-too-human tendency to dwell excessively on those things well beyond your control. Yes, it's easy to say, and more difficult to do. We acknowledge that. We're ALL subject to these occasional feelings. ***Recognizing these feelings but not acting upon them is a critical part of long-term success.***

General Principles

Together, we are **long-term, goal-focused, planning-driven investors**. We've found in our experience that the best course for you is to formulate a financial plan—and to build portfolios to serve the plan—based **not** on a short-term view of the economy or the markets, but on **your most important lifetime financial goals**.

- Since 1960, the S&P 500 Index has appreciated approximately **76 times**; the cash dividend of the Index has gone up about **33 times**. Over the same period, the Consumer Price Index has increased **10 times**. So historically, equities have functioned as an extremely efficient hedge against long-term inflation and a **generator of real wealth** over time. We believe this is likely to continue in the long run, hence our investment policy of primarily owning successful companies rather than lending to them.

- We believe that **acting continuously on a rational plan**—as distinctly opposed to reacting to current events—offers the best chance for your long-term investment success. The best recent example of sticking to the plan was seeing the market's reaction to COVID. Simply stated: **unless our goals change, there is little reason to alter your financial plan**. And if our portfolio is well-suited to that plan, we don't often make significant changes to that, either.

- **We do not believe the economy can be consistently forecast, nor the markets consistently timed**. We're therefore convinced that the most reliable way to capture the long-term return of equities is to ride out their frequent but ultimately temporary declines. In practice, this means being mentally prepared to handle roughly 15% short-term declines annually, and roughly 33% declines every 5 years or so.

- **Avoiding costly changes in reaction to short-term volatility provides you the potential to earn higher long-term returns.**

- The performance of your portfolios relative to their benchmark(s) is irrelevant to your investment success as we define it. **The benchmark we care about is the one that indicates whether you are on track to achieve your financial goals**. One of the biggest goals is making sure you don't run out of money during your lifetime.

- Our investment philosophy is to invest in businesses with a history of providing essential products and services. We prefer significant management ownership to create an alignment of interests with us. We seek to invest at reasonable prices and hold these exceptional businesses for many years. Assuming no nuclear annihilation or World War III…we expect this approach will do well over long periods.

As always…please keep us updated with any changes to your financial situation that might suggest altering your asset allocation and investment portfolio and let us know if you'd like a current copy of our Form ADV Part 2.

Your LOYALTY and PATIENCE remain our secret weapons. We value our relationship with you and appreciate the opportunity to continue to serve you and your family.

Thank you for being our client. It is our privilege to serve you.

Sincerely,

John Heldman, CFA   Dave Hutchison, CFA

October 7, 2024

"The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go. In the end, what matters isn't crossing the finish line before anybody else but just making sure that you do cross it."

-Benjamin Graham, <u>The Intelligent Investor</u> (and Warren Buffett's mentor)

"Forecasts are highly uncertain. Forecasting is very difficult. Forecasters are a humble lot with much to be humble about."

-Jerome Powell, Federal Reserve Board Chairman

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