Hutchinson Financial Advisors, Inc.
5243 Hickory Park Drive, Suite C
Glen Allen, VA 23059

Main: 804.729.6420
Fax: 804.729.6425

HutchinsonAdvisors.com

4th Quarter Market and Economic Update

January 2, 2024

"The big money is not in the buying and the selling, but in the waiting." -Charlie Munger

"Spend each day trying to be a little wiser than you were when you woke up. Those who keep learning keep rising." -Charlie Munger

"He who lives by the crystal ball will eat shattered glass." -Ray Dalio

Happy New Year! Well, 2023 certainly turned out differently than many "experts" predicted at this time last year. Coming off of one of the worst years in history for both equities and fixed income, the mood at the end of 2022 was dour. The vast majority of predictions by those the financial press loves to trot out on TV was that 2023 would be more of the same: stocks and bonds to post negative returns. As you may recall, I was more sanguine than those predicting doom. With the usual caveat that my crystal ball is cracked and broken, in my 2022 year-end letter, I wrote the following: "*While we can't know for certain until this time next year, I believe that 2023 will prove to be a better year for financial markets than many are predicting*." What we saw were gains for every major asset class. Broadly speaking, equities and fixed income rallied smartly in 2023, but to be fair, there were wide variances within each asset class. For example, at the end of October, the average stock was actually lower, as was the equal-weighted S&P 500, while the cap-weighted S&P 500 was higher. That major divergence closed some as a healthier and more broad-based rally ensued over the final two months of the year. In the end, 2023 proved to be a profitable year for investors.

Even though I always include the caveat about my crystal ball, I am often asked by clients, friends, and acquaintances what I think the markets will do in the upcoming year. While I have some fun with predictions, and always have a base case for what I think may happen, I'm going to touch on that later in this letter. Instead, I'm going in a different direction than normal with this piece.

The world at large, and the investment world in particular, lost a giant of a man just after Thanksgiving. Charlie Munger, the vice-chairman of Berkshire Hathaway, and Warren Buffett's right-hand man and close friend for over 60 years died on November 28, at the age of 99; he would have turned 100 on January 1. Mr. Munger was known for many things: his willingness to be second fiddle to Buffett, his philanthropy, his intelligence, and maybe mostly for his quick and acerbic wit. At Berkshire Hathaway annual meetings, held the first Saturday of each May in Omaha, shareholders would ask questions. Buffett would answer first and spend anywhere from five-to-ten minutes answering before asking Charlie for his thoughts. Munger's reply typically lasted about 30 seconds or less and often brought roars of laughter from the thousands in attendance.

While this letter will be neither a tribute nor a biography of Mr. Munger (there are plenty of those on the internet already), it is his wisdom, along with several others, that has shaped my philosophy on investing. As I've said often over the years, Wall Street is not really about investing. Wall Street is about the short-term, facilitating the trade. (CNBC and much of the financial media is as well.) True investors think more about the long-term. That's what equity investing is: buying businesses for the long-term to meet certain goals for a portfolio. In other words, the big money isn't made in the trading, but in the relatively boring part of sitting and waiting. That doesn't mean one should never make a trade, but rather that doing nothing is also a viable strategy more often than not. Frankly, most people I encounter tend to over-trade.

As most of you know, we have three investment programs here at HFA. Simply put, the three are growth, balanced, and conservative income. When we trade, the idea is to meet at least one of the following objectives: 1) Increase the portfolio's quality; 2) Increase the portfolio's potential resiliency; 3) Increase the portfolio's expected potential returns; and 4) To provide a durable and growing stream of income for those who need it. We are always looking for a "margin of safety" when we purchase any asset for your portfolio, which essentially means that we are trying to buy something for less than we think it's worth in the future. That's the foundation on which Mr. Buffett and Mr. Munger built Berkshire Hathaway. In equities, we are looking for long-term compounders and/or special situations during a certain part of the business cycle. In fixed-income, we want to make certain that our more conservative clients are being appropriately compensated for the risk being taken, while hopefully providing a steady and growing stream of income, as mentioned above.

Another Munger quote I've used before at the top of my updates is this: "*Investing is simple, but it isn't easy*." He's absolutely right. Investing is simple. It is neither rocket science nor brain surgery. However, it is incredibly hard because humans are emotional beings and emotion often clouds judgement and reason. It's one reason I spend as much time reading as I do. Anyone who's ever been into my office knows I have a stack or two of reading material on my desk, much to the chagrin of my staff. It is that reading and also constantly going over any mistakes I've made that hopefully helps me end every day a bit wiser than when I woke up. That's the goal anyway, but I have a feeling my wife, Kathy, might beg to differ on some days. 😊

Sadly, Charlie Munger wasn't the only investing legend we lost in 2023. Byron Wien was a legend on Wall Street. He passed away just before Halloween at the age of 90. He is most famous among investors and Wall Street professionals for his annual list of possible surprises that may occur in the upcoming year. He published that list for decades, and it was always a good read. However, more interesting to me was the list of '20 Life Lessons' he published some years ago. Among this fantastic list were things like "read all the time to gain wisdom and understanding" and "evolve as a person to avoid burn-out". However, I think my favorite "life lesson" from Mr. Wien was the following: "At the beginning of every year, think of ways you can do your job better than you have ever done it before." That's the reason I always look back at the mistakes I've made individually and at the mistakes we've made as a company. It's not always a pleasant exercise for me, but it is absolutely worthwhile. While we always strive for perfection, it is unattainable; well, for me it is unattainable.

That leads me to the folly of forecasting that happens every December and early January, and not just in the investing world. In this morning's Richmond Times-Dispatch, I saw an article with 12 sports predictions for 2024. (One was about VCU basketball, so I hope that one comes true.) Making predictions and forecasts is fun and mostly harmless unless one acts solely on those predictions. One reason forecasting is so hard and why we shouldn't invest solely based on forecasts is that we've been in one of the most unique economic cycles in history. From shuttering the economy at the outset of Covid to unprecedented fiscal and monetary support from the federal government and the Federal Reserve, respectively, we've seen rapid changes in the economic outlook. I think Joe Kalish of Ned Davis Research put it best when he said, "*This unusual set of events has created some oddities among several economic indicators*. *Whether it is inflation, higher interest rates, deficits, domestic politics, or geopolitics, there is a sense of dread about the broader economic outlook. Yet when people are asked about current conditions, they generally remain upbeat*." I see and hear this type of thing almost every day in my interactions with people. There is a sense of dread about the future of the country, but when asked about their own circumstances and their personal future, they are usually upbeat. At this time last year, everyone was certain we'd be in a recession at some point in 2023. Instead, economic growth was solid. I'm reminded of this observation by noted astrophysicist and writer, Neil deGrasse Tyson, who said, "*The universe is under no obligation to make sense to you.*" It occurs to me that statement would apply to the economy and financial markets, too.

So, what is my prediction for financial markets and the economy for 2024? My best GUESS is that the economy will slow but avoid recession. I would think equity markets would be a bit more volatile, and yet end the year modestly higher. In 13 of the previous 16 election years, the equity market finished higher, so I'll stick with that history. Interest rates (bonds) will depend on the Fed and inflation. However, with rates higher than they've been in almost 15 years, it is possible to get solid returns from fixed income. One often overlooked benefit of what the Fed rate hikes have done is brought some normalcy back to financial markets. Zero-percent interest rates are not normal; they are extraordinary. Simply put, higher interest rates (normal interest rates) bring common sense to financial markets. I like common sense, so I welcome this change.

Housekeeping notes: 1) HFA has had lots of people asking us to help them manage their workplace retirement plan. We've already launched a fully compliant partnership with Pontera to allow us to do this very thing. A number of clients have already signed up, and things have gone rather seamlessly. 2) Salary deferral limits for 401k/403b/457 plans have increased for 2024, as have IRA and Roth IRA contribution limits. 3) Given the ever-increasing compliance requirements as it relates to communication with clients, for any work-related discussions, we ask that you contact us via phone or email. If you must text me for any reason, then please use the following compliant phone number to reach me: **804-395-7056**. Please contact us with any questions as it relates to any of these items.

I hope you and yours are healthy and enjoying a wonderful start to the new year. Please let us know if there is anything we can do for you. We're always here to help. From all of us at HFA, thank you for your trust, confidence, and loyalty. It is a joy and a privilege to work with you and your family.

Best wishes,

Harvey E. Hutchinson IV

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President

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