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# 2nd Quarter Market and Economic Update

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*"We should not, like sheep, follow the herd of creatures in front of us, making our way where others go, not where we ought to go." – Seneca*

*"Everything we hear is an opinion, not a fact. Everything we see is a perspective, not the truth." -Marcus Aurelius*

*"The biggest risk of all is not taking one." -Mellody Hobson*

Happy early summer to everyone. I trust this letter finds you and yours doing well and looking forward to the Independence Day holiday. It's hard to believe the year is already half over. Time seems to fly by faster every year.

As the year began, the general consensus among market observers and the Federal Reserve ("Fed") was that the Fed would cut short-term interest rates 6-7 times in 2024. The Fed told us as much at the end of 2023. Through the first six months of the year, the Fed has not made a single rate cut. The Fed's own forecast of rates is one reason I am hesitant to invest based on anyone's predictions, including my own. If the people who control short-term interest rates (the Fed) can't predict accurately with any consistency, then why invest based on any predictions and forecasts, particularly those made for political reasons. Predictions are fun to make, but that's as far as it goes.

Most of you know that I have been in the camp that the economic world changed after Covid. This new era we find ourselves in may be characterized by higher inflation than we've become accustomed to in the last 14 years, the reconfiguration of global supply chains, more money spent on defense, and higher prices for many commodities. All of these things lead to higher interest rates than those the world experienced from 2008-2022. As I have mentioned a few times over the last couple of years, interest rates are now back to "normal". The rates we experienced for the last 14 years or so were not normal; they were extraordinary. To be clear, that doesn't mean the Fed won't cut rates this year or in the future. They certainly will at some point, but as long as the economy is growing and the unemployment rate remains low, then the Fed will be in no hurry to cut interest rates.

Recently, I was asked "*is now a good time to invest*?". My reply to the person asking was, "*Well, that depends on what the investment is, what the price is relative to the underlying intrinsic value, whether you are being compensated for the risk you are taking, and what the rest of your financial life looks like*." I'm reminded of a story I read about people who have kept almost everything they have in bank accounts, earning almost nothing since Covid first hit. Apparently, they listened to "experts" who said the U.S. economy was going to collapse because of Covid. Then they listened to others in their circle who said the economy and stock markets would crash if the 2020 election went a certain way. Throughout the last four years, they listened to doomsayers and became paralyzed with fear, keeping virtually all of their financial assets in bank savings and money market funds inside their company 401k plan, earning about 1%. It saddened me to read this, but it provided the inspiration behind this quarterly letter.

Financial markets and the economy have continued to confuse many experts who called for a bear market and an economic recession in 2023 and again in 2024. Neither materialized in 2023 and through half of 2024, neither appears on the horizon. Listening to experts in the media is fine, but it should not be the basis of an investment plan. It's usually one person's opinion at a moment in time. Arguably the greatest trader in history is Stanley Druckenmiller. He is interviewed on TV a few times a year (it's a must watch for me), where he is inevitably asked about what securities he owns and what he may be buying or selling. At some point in his answer, Mr. Druckenmiller makes certain to let the viewing audience know that they shouldn't do what he's doing because he could change his mind tomorrow and be in completely different investments a week later. The point is that we shouldn't just blindly follow an expert on TV, or the herd, when deciding where to invest our hard-earned money. Often times the best thing we can do is to venture away from the herd when making an investment. How much better would those people have been had they invested just half of their money into equities instead of keeping it all in the bank for the last four years? As I've mentioned for the last two years, one can now get some attractive returns in fixed income (bonds) for the first time in fifteen years. With rates now more normal than they've been, the opportunity set has grown for investors, and that's a good thing. The worst thing one could have done was to sit in cash earning 1% or less, but fear often makes people act in a manner that isn't best for them. As Mellody Hobson suggests in the quote on page one, avoiding all risk is sometimes the biggest risk a person can take. One of my favorites, Howard Marks, put it like this in a recent memo, "*You shouldn't expect to make money without bearing risk, but you shouldn't expect to make money just for taking risk. You have to sacrifice certainty, but it has to be done skillfully and intelligently, and with emotion under control*." That can be hard to do, because as humans we are naturally emotional beings, which is wonderful. However, emotion can cloud one's judgement, so it's important to not let things like fear and greed get in the way of our investment plan. Unfortunately, much of what passes for news today, even financial news, is nothing more than narratives being pushed to play on people's most basic emotions.

As you may recall in my 1st quarter letter of April 2nd, I suggested a correction could happen at some point in the 2nd quarter because equity markets were very overbought, and complacency seemed to be setting in for investors and traders. As if on cue, major equity indexes entered into a very brief and shallow correction, if you want to call it that, falling roughly 5% in April. By the end of May, the S&P 500 and Nasdaq had both made up their respective correction declines. Notice that I didn't say either the Dow Industrials or the Russell 2000 have made up their correction declines. Both of those indices remain below their March highs. This is what we call a negative divergence. Ideally, we want to see solid breadth, meaning the majority of equities are moving higher together. We have not really seen that since the end of April, as the rally off of the correction low has been more narrow than broad. This is certainly something to which we need to pay attention as we move through the summer. It leads me to conclude that we could be in for some rougher waters in the 3rd quarter, which is not unusual in most years, but particularly presidential election years. We typically see some choppiness in the lead up to a presidential election. I suspect this is due to the uncertainty that may come with the candidate challenging the incumbent, or the incumbent's party. On the other hand, both the challenger and the incumbent are well-known at this point, so perhaps that may alter the typical election year cycle a bit. Recently, I had a very long-time client tell me that he couldn't tell which way I leaned politically. That's partly by design, as I learned long ago not to let politics cloud my judgement when investing. However, I will say this: after watching the debate on June 27th, I don't know whether to laugh or to cry. I never thought I'd see two presidential candidates debating about whose golf game is better.

No matter what you may hear between now and election day, the U.S. economy remains resilient, growing with the risk of recession low at this time, but it is showing signs of slowing a bit. The global economy also shows signs of growth, and we are starting to see other central banks begin to cut rates, while the Fed remains on hold. It's fascinating to see the disconnect between the economic data and the consumer surveys done each month here in the U.S. I suspect that the consumers are reacting to the very real toll that inflation has taken on our wallets, as the cost of everyday items we need to live remain high. Inflation has certainly come down a lot since June of 2022, when the CPI was 9.1%. However, I must remind everyone that the lower inflation we have now, with the CPI at 3.3%, doesn't mean prices have fallen. Rather, lower inflation means that prices aren't going up as fast. So, yes inflation is much lower now than two years ago, but prices are still rising.

Without an imminent recession on the horizon, equity markets remain in a cyclical bull market, which started in late 2022, within a secular bull market that started in March 2009. If the soft economic landing signs persist, and the Fed cuts rates at any point this year, then it is likely that any correction between now and election day may be viewed as a healthy development within an ongoing uptrend. For any correction may relieve some excessive optimism and set the stage for a resumption of the bull market later in the year. A broadening of any rallies would also be supportive of the cyclical bull market. We'll watch that closely.

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) I wanted to remind everyone of the importance of an annual review. Not only is it a compliance requirement for me, but it is also just a good thing to do, like an annual check-up with your doctor. It helps us to identify areas that may need modifying in your financial life and to keep you on track to reach your family's goals. 3) While a more formal 'Save the Date' notice will be going out soon, please make a note that we will hold our Client Appreciation Event on Monday, September 30th.

I hope you and yours are healthy and enjoying the summer. 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 continued 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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