Spring always offers opportunities for renewal and rebirth, and in many ways, the portfolio has seen a resurgence after a challenging two years. The strong start to the year has given new life to portfolio balances, and it is safe to say that it is a welcome sight for all! In this update, I'll go over where we've been and where I think we'll be going for the remainder of 2024 and into next year. There is much to be hopeful for in the future regarding the financial markets, but there are also issues we need to be aware of as we move forward. As always, if you want a quick synopsis, all you need to do is read the Executive Summary, and if you want to get deep in the weeds with me, then this entire email is for you!

Executive Summary:

- No portfolio changes have occurred since the January rebalance, and all portfolios are fully invested in the markets with cash balances at a minimum of approximately 5% weighting.
- The technology sector continues to lead the equity markets, and we are also seeing strength in the industrial, financial, and consumer discretionary sectors.[1]
- The technical data suggests that domestic and international equities are the best areas to concentrate the portfolio's weightings, and commodities are also starting to show signs of strength.[2]
- Gold and Bitcoin have reached new highs recently,[3] and my impression is that money flows are going into those two asset classes in response to the unrelenting increase in our national debt levels.[4]
- Corporate earnings are expected to rise year over year,[5] and the Federal Reserve has been consistent with its narrative about lowering short-term rates this year.[6] If both those items come to fruition, their directional trajectory should be conducive to further gains in the financial markets.[7]

I stated in my last email that the path of least resistance looked to be to the upside, and that certainly has been the case for the first quarter of 2024.[8] The stock market has continued with its upward ascent, which started last November and continues to this day.[9] As I write this on March 23, the technical data looks very strong, and both the S&P 500 and NASDAQ appear to have further room to move up,[10] which may seem surprising to hear! Without getting into too much detail, when looking at the chart of the S&P 500 in different scale increments (25-point, 30-point, 35-point, 50-point), price objectives can be calculated based on the chart pattern. Relying upon price objectives shouldn't be taken as gospel, but looking at the different price objectives, I see anywhere from 6,080 upwards to 7,500 for targets on the S&P 500.[11] For the NASDAQ, those price objectives range from 18,000 to 24,200.[12] A couple of caveats here. One, there is no time component to these charts, so I have no idea how long it would take for those targets to be reached, whether they would take a month, a year, or something longer. Two, think of these price objectives as more suggestions than something written in stone—these price objectives gauge which direction the market is trending and the possible magnitude of the move. Third, don't expect a straight shot at those price objectives should they come to fruition!

Yes, it has been a great start to the year,[13] but you should be fully expect to see a correction of anywhere from 5%-10% in the market at some point this year.[14] That should not be a cause for alarm. I consider that healthy for the equity markets where participants can book profits and the markets can consolidate prior gains, creating the condition for further advancement. While I enjoy seeing account balances go up as much as anyone, I also realize we need to be pragmatic about what we should expect to see going forward. That said, I am very optimistic about the equity markets this year and for the foreseeable future, and here's why.[15]

When I look at the technical data, the short, intermediate, and long-term data looks very strong, and surprisingly not too overbought.[15] The data is fluid and can change at any time, but where we stand today, things look good. So why is that? My first thought is that earnings have been relatively good and are expected to improve as the year progresses.[16] As I have mentioned numerous times, earnings are the mother's milk of the stock market,[17] and when earnings are good and increasing, that provides a solid tailwind to the stock markets.[18] Second, the Federal Reserve has been very consistent for the past nine months, stating that they believe the economy is getting to the point where interest rates have peaked, and they will be able to cut short-term rates later this year.[19] It was initially thought late last year that the Fed might cut rates six or seven times in 2024, which was farfetched to me.[20]

Now, the anticipation is for three rate cuts.[21] There are a few things I want to mention on rate cuts. Number one is that any rate cuts for 2023 are most likely already accounted for in the financial markets since the cuts have been so well telegraphed.[22] Number two is that the Fed only controls short-term rates, also known as the Fed Funds rate.[23] They do not control the long end of the yield curve, i.e., 10, 20, or 30-year rates.[24] The financial markets control those rates,[25] and to me, it looks like long-term rates want to rise, which is precisely what we have seen so far this year.[26] In January, I reduced the interest rate risk to the fixed income portion of the portfolio by reducing the portfolio's duration (a measurement of interest rate risk), which appears to be the correct posture to date. The third point I want to make is if the Fed starts to cut short-term rates while simultaneously long-term rates move up that will create a normal-looking yield curve, something we haven't seen for a long time.[27] That is a very healthy occurrence because it directly affects the health and financial strength of the banking system by creating a more positive net interest margin environment for banks.[28] One of the primary ways banks make money is by borrowing money on the short end through customer deposits (low rates) and lending out on the long end (higher rates), with the difference between the two the profitability (net interest margin) of the bank.[29] Therefore, the higher the net interest margin, the more profitable the banks will be, and a healthy banking system typically bodes well for the economy.[30] This return to a normal-looking yield curve is partly why I think the financial sector is doing so well this year.[31] There is one more point about the Federal Reserve that I would like to make.

In my last email, I touched upon the overnight repo markets and how the liquidity was draining from the financial system, which could cause the Fed to revert to QE later this year.[32] Well, during Fed Chairman Powell's press briefing this past week, he touched upon this topic. He mentioned that the Fed was getting very close to the point where they would start to slow down the reduction of their balance sheet, i.e., QT (Quantitative Tightening).[33] It seems apparent to me that the Fed is aware of the danger of reducing the financial system's liquidity too far, and they will take steps to ensure that doesn't happen.[34] This reduction in QT is a de facto implementation of an easing in financial conditions[35], which the financial markets should warmly greet. I think this is why we saw such a positive reaction in the markets to the Fed's announcement and Powell's press briefing.

Another reason for my optimism for this year is that it is an election year. Just like any other administration in power, the Biden administration will try its best to ensure the economy and the stock market are doing as well as possible because people vote with their pocketbooks, as the old saying goes.[36] Remember James Carville's "It's the economy, stupid!"?[37] We are already seeing the Biden administration curry favor with voters by the recent loan forgiveness announcement.[38] Additionally, to keep the economy humming along, the current rate of spending by the federal government is approximately $1 Trillion dollars in new debt every three months.[39] While posting good economic numbers is essential, much comes from deficit spending, and I will touch upon this later. Nonetheless,

the intended outcome of that deficit spending produces favorable results for the economy and the stock market.

Beyond this year, I am also getting more optimistic about the economy and the stock market for two reasons. The first is the implementation of AI within corporations.[40] I recently read an article highlighting how different companies from disparate industries used AI in the here and now.[41] The commonalities among those companies were the following: they all use AI to increase productivity by doing things faster and more efficiently while increasing revenues by doing things "smarter." Hence, those companies are increasing revenues and decreasing costs, which makes them more profitable, and they are doing this now, not five years into the future. This trend in the use of AI is only going to rise in the year's ahead and it isn't going to stop.[42] Large numbers of publicly held companies are moving in the same direction.[42] I see what companies say in their press releases and earnings conference calls, and most companies are all saying the same thing as those companies in the article. In my estimation, AI will be a game changer for more companies' profitability.[43] As I mentioned earlier, earnings are the mother's milk of the stock market. Hence, as time rolls along, I expect to see better earnings from corporate America as AI gets further entrenched in businesses.[43]

My second reason for being optimistic about the future is the economic war we are currently in with China.[44] Please make no mistake about it: we are in an economic war that began with the Trump administration back in 2018.[45] The Biden administration has continued with the Trump administration's policies towards China and added to that.[46] This war is especially pronounced in the semiconductor sector, where China has seen more and more restrictions placed on the purchases of AI semiconductor chips.[47] As this bifurcation between the two superpowers continues, we are seeing the global economic landscape morphing into two distinct camps: those aligned with the U.S. and those countries aligned with China.[48] As a result of this split, the opportunity and incentive for U.S. businesses should grow as far as repatriating manufacturing facilities back to the U.S.[49] The COVID pandemic illustrated how beholden the U.S. is to China as it pertains to supply chains, especially in critical industries like pharmaceuticals, semiconductors, and rare earth metals used in high-tech electronics, from cell phones to missile guidance systems.[50] Through the intelligent use of tax incentives, bringing back manufacturing jobs with good-paying jobs is not a far-fetched idea, and I think we stand an excellent chance of seeing this happen within the next ten years.[64]

These are the reasons I think the worst is behind us since much of the challenging environment over the last two years directly resulted from the rapid rise in interest rates.[51] However, there is still another concern that is lingering in the not-too-distant future, and that is the level of our national debt.

If there is one thing that keeps me up at night, it is the nearly $35,000,000,000,000 and growing national debt.[52] The interest on our national debt will soon overtake spending on national defense and will be fourth in line only behind Social Security, health care and Medicare.[53] As I mentioned earlier, our debt is growing by approximately $35,000,000,000 **per day,[54]** which equates to nearly $1,000,000,000,000 every three months.[55] There seems to be no end in sight, given the recent agreement in Congress on funding the government,[56] and the recent new highs in the gold and Bitcoin (digital gold) markets are due in part to the debasement of the U.S. dollar.[57] While currencies are always relative in nature,[58] if the current trajectory of spending isn't curtailed, history has not been kind to those governments with such profligate spending, i.e., the Roman Empire, the French government in the late 1700s or the Weimar Republic in the early 20th century.[59] To me, this is the most significant future threat to the financial markets because it could directly affect the bond markets with a big spike upwards in interest rates as a result of the debt.[60] As we all saw in 2022 and part of 2023, financial markets do not respond positively

to significant spikes in interest rates.[61] The other aspect of such large deficits could manifest higher income tax rates with whomever assumes the next executive branch of government after the elections this fall.[62] For this reason, we emphasize maxing out Roth IRAs whenever possible. Let's hope our elected representatives become better stewards of the nation's finances. We don't want to see interest on the national debt surpass Social Security and Medicare as the number one expense for the federal government, which it is slated to due by the end of 2024.[63]

To wrap this up, the outlook for 2024 looks very promising, and I think, at this point, so does 2025. Currently, the portfolio's asset allocation is focused on the strength in the financial markets, which has played a large part in the portfolio's success so far this year. However, don't be surprised to see a decent market pullback at some point this year. It is not a cause for alarm and could be very healthy for the markets. I don't foresee reducing the equity exposure in the portfolio any time soon. Therefore, the next time I anticipate adjusting the portfolio will likely be during the early summer semi-annual rebalance. Until then, I hope you found this email insightful and valuable, and I look forward to catching up with you soon!

Best Regards,

Jim

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