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Some of the optimism that drove the stock market rally in the first half turned out to be misplaced, particularly expectations that the Federal Reserve would soon pivot to lowering rates. It now appears rates will stay higher for longer than originally thought. Fixed income markets are offering the highest rates in 15 years as the bond market is flirting with its third consecutive down year. At the same time, the "Magnificent 7" ran out of steam. Investors went into the third quarter confident that a recession this year was unlikely thanks to a continued healthy job market and robust consumer spending. Consequently, rate cuts expected in 2024 are now looking unlikely, even though signs point to inflation pressures easing.

Our Kirwan Capital Strategy portfolios lost 4.18% for the quarter**, versus the market as measured by the S&P 500 ETF*, which finished with a loss of 3.22%. The quarter's result leaves our average compound annual return after fees since Jan 1, 2013 at 11.66%, which would have turned a $10,000 investment into $32,720 in 10 3/4 years. Among our holdings, Activision Blizzard, Casey's, and Alphabet were our biggest winners, while our worst performers were Hanesbrands, Apple, and Equifax. Our usual aversion to activity continued, but we did purchase some shares of Kraft Heinz and Kellogg late in the quarter, as Kellogg was set to split its growing packaged snacks business from the legacy cereal business, and after food stocks had universally drifted lower for much of the period.

The current prevailing higher interest rates have made assets appear more expensive based on time value of money calculations, and sharply more expensive if borrowed funds are being used to fund a purchase. While this has curtailed home buying and capital expenditures, the current interest rate environment has not been a negative for everyone. It has been an unexpected boon for a few companies like Microsoft, which has more cash and short-term assets on its balance sheet than current borrowings. Due to its stellar financials, Microsoft was able to secure extremely low rates on very long-term bond issuances during the pandemic, when many countries were struggling with negative real interest rates. The result of this dynamic is that the company is now earning a higher yield on its cash assets than it is paying on its debt. Though Microsoft may be the most obvious example, there are several large, well-heeled companies that are seeing tailwinds from this situation. While the negative consequences of higher interest rates are surely greater than the positive across the economy, this is just one example of the many economic crosscurrents caused by higher inflation and the resulting higher interest rates.

Sincerely,

Patrick J. Kirwan
President and Portfolio Manager
Kirwan Capital LLC

* The benchmark I use against which to gauge our performance is the SPDR S&P 500 ETF (ticker symbol SPY). It's purpose is to closely track the stocks in the S&P 500 Index. Often cited as a proxy for the U.S. equity market, it is the most heavily traded security in the world. It can thus easily be purchased by any investor, as opposed to the oft quoted S&P 500 Index, which is simply a calculation, and does not include costs of ownership.
** Kirwan Capital Strategy quoted returns are calculated using the quarterly composite average of all accounts using the strategy in aggregate. Due to the individually managed nature of our accounts, not all accounts have similar performance. Factors such as available cash, tax considerations, and timing of previous purchases or sales can effect returns. Transactions noted may or may not have been made for all accounts. Past performance is not indicative of future results and investing entails a degree of risk and potential loss of principal. The Kirwan Capital Strategy uses fundamental analysis in an attempt to measure the intrinsic value of securities with the objective of buying undervalued securities and realizing dividends and capital gains over a long-term (at least one year) holding period.