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Dear Clients of MacDougall Financial, July 14, 2024

DEMENTIA VS. DEMENTED

These words come from the European press coverage before the Presidential debate and it is almost as good as the post-debate summary of "2 bald men fighting over a comb". However, we try to steer clear of politics in our business, so instead, I am using this quote to describe our current economic situation. In this 'rendering', we the voters are the ones with Dementia for we are forgetting that debts need to be repaid. We vote for anyone who increases our subsidies and abhor anyone who expects us to pay for it. It is a variation on the familiar economic conundrum called the "Tragedy of the Commons" whereby the voters (aka the entire body politic) have no interest in reducing our profligacy. Meanwhile, over on the Demented side, are both political parties whose solutions are either more taxes (Dems) or lower taxes (Repubs). Neither party has a plan to reduce spending, to lower deductions, or to balance the budget in a meaningful way. Since 2000, our debt has risen 8-fold ($4trn to $32trn approx.) for the borrower's appetite is insatiable and the lenders are all too happy to take on more short term government debt. The guards have joined the inmates to run the asylum! My personal belief is that this 'party' will go on for a while, as there are no impending signs of global financial discipline.

On the broader economic front, the data varies from benign to positive. Inflation is declining, private wages have risen 21% since the start of the pandemic, and housing prices are stable to up sizably despite the record high mortgage rates. Consumer spending is the backbone of our economy and to date shows only small signs of deterioration. This is not to imply that there is no bad news for the increases in interest rates, insurance costs, taxes, and home values warrant caution. That said, in the year to date, we have recorded over 30 new market highs for the S&P 500 index led by the Magnificent 7. The concentration of both absolute and relative returns in the Mag 7 is well documented and is supported by the following 'tailwinds': 1) Since the late 1990's, US publicly traded companies have declined from 8,000 to around 4,600 today. 2) A sharp decline in new listings or IPO's due to the regulatory burdens of being public and the attractiveness of private capital financing. These 2 factors, coupled with share buybacks and strong foreign demand for US equities, have combined to place us near the top in global stock and bond market performances. This will probably change, for remember that in the classic movie the Magnificent 7, four of the seven heroes die.

A dash of humility is always wise when dealing with predictions for at the start of 2023, all economic forecasts were sure of a recession either late '23 or certainly in '24. High rates, coupled with high inflation, and massive indebtedness were precursors to financial Armageddon. What transpired over the past 18 months is that only one of the 11 S&P sectors declined (Utilities, down 4%) and the other 10 sectors recorded positive returns varying from +1% to +46%. A majority of sectors witnessed double digit increases! In sum, our economic performance, bond yields, currency appreciation, fiscal metrics, unemployment, and even inflation numbers are the envy of the world.

Moving on to your portfolios, the ½ year returns are nearly all positive and exceeding expectations. Of the 11 S&P sectors, only one has declined in 2024 – real estate, down 1.9%. Our recommendations accompanying your financial reports are generally about reducing our growth asset allocations and adding to value, small caps and bonds. The stock market has continued to rally into July and appears to be broadening the base, but valuations, especially growth, are undoubtedly stretched. Taxable bond funds are finally paying nominal yields of 4-7.5%, depending on quality, and real yields have rarely been higher. After a long slog through the land of zero interest rates, bonds are again a viable investment category providing both income and safety. The government's financing needs are voracious, 'crowding out' others, and there is alarm at the rise in public borrowing costs. However, neither political party want to tell the public that we are funding long term commitments with short term money for this mismatch was what brought down Silicon Valley Bank and others.

No analysis of the first half is complete without a comment on the burgeoning field of artificial intelligence (AI). Nvidia has the lead supplying north of 80% of the businesses in the gaming and AI markets with its multi-core "accelerators" which use parallel processing to run millions of calculations per second. Their technical lead is enhanced by a superior networking technology allowing them to connect the thousands of chips necessary for the Large Language Models (LLM). They also have the best software suite used to fine tune the processors to the application (CUDA). This triumvirate of services is unmatched in the industry, but note that AMD and Intel are closing in on the hardware side. The ubiquity and applications for AI will take years to develop and some 'downsizing' of expectations is inevitable. Remember that the time and electricity required for a ChatGPT search is estimated at 10X a regular search so sector profitability could be years away. The top tier of companies sport vertiginous valuations so we are looking at the second tier of companies that either use or benefit from AI to improve their day to day operations. This field is new, undoubtedly growing, but it is wise to recall that "the past is no guide for the future" especially for high growth, high multiple companies. In this vein, Goldman Sachs just released a 31 page report "Gen AI: Too Much Spend, Too Little Benefit" which is damning, documents the unprofitability and limitations, and forecasts waning investor enthusiasm. Made for trading not investing!

We expect the second half of 2024 to be flat to up mainly because our politicians are united in their desire to spend money. No one will 'rain on their parade' for they borrow with the full faith and credit of Uncle Sam. It is a year of worldwide elections and thus volatility should be expected due to the unpredictable results like Iran, France and upcoming, the USA. But we have difficultly seeing the drivers for a broad market decline over the near term. We are not discounting the chances of unforeseen exogenous events, but we cannot build portfolios around supposition. A cause for concern is that the forces of isolationism, protectionism, and nativism are rising as are the sheer number of global conflicts. Challenging times might propel us to take dramatic actions when, in fact, the statistically correct choice is thoughtful inaction. We are parsing the entrails of the markets, looking for signs of economic deterioration or constrictive monetary or fiscal policies, but so far see nothing that raises alarms. Our counsel is to enjoy the summer months, go for long walks, hug someone every day, and please do contact us about our recommendations or any questions.

Best, Lanny, Teri, Kurt and Liz