Portfolio Management, LLC

Building Wealth Wisely

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~~Greed~~ Growth is Good

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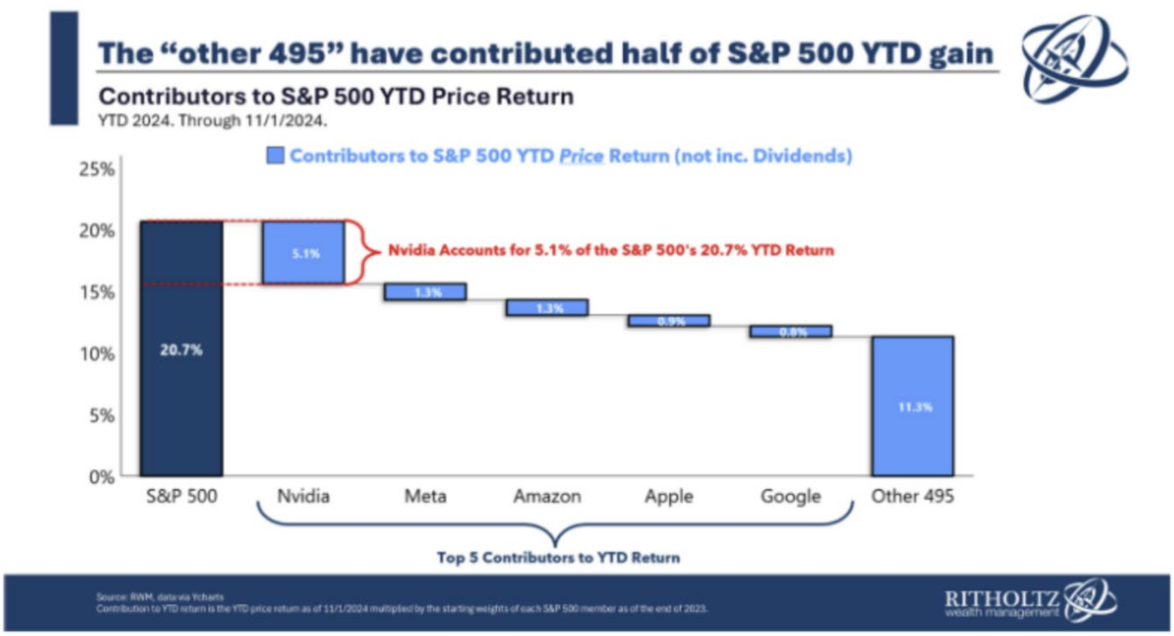
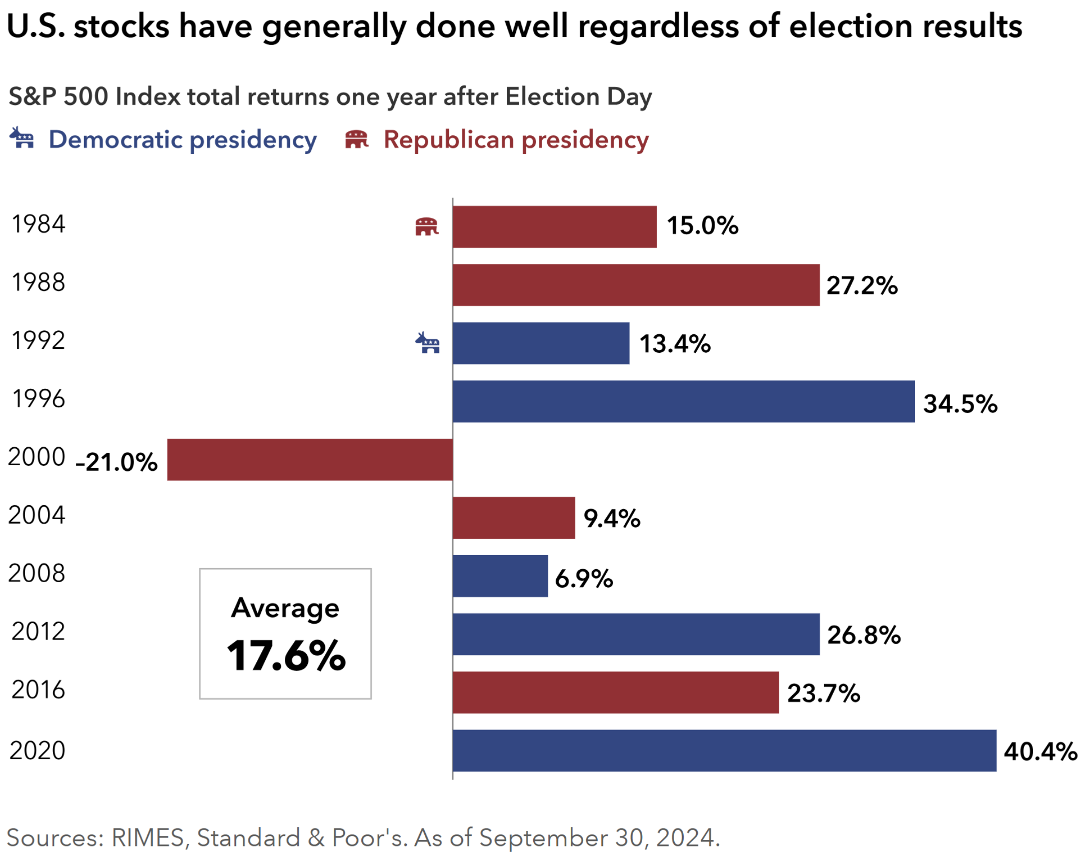
In response to signs that the economy might be slowing, the Federal Reserve started reducing interest rates in September. Despite concerns about weak domestic manufacturing and obstacles to global trade, it looks like the U.S. economy is still on track for positive results in the coming year. The job market appears relatively healthy, and inflation seems to be under control for now.

Financial markets have trended in a positive direction for most of this year, but the results are still somewhat lopsided as the prospects for Artificial Intelligence continue to propel large cap growth stocks to new highs. Nearly half of this year's gain in the S&P 500 Index has come from just five stocks.



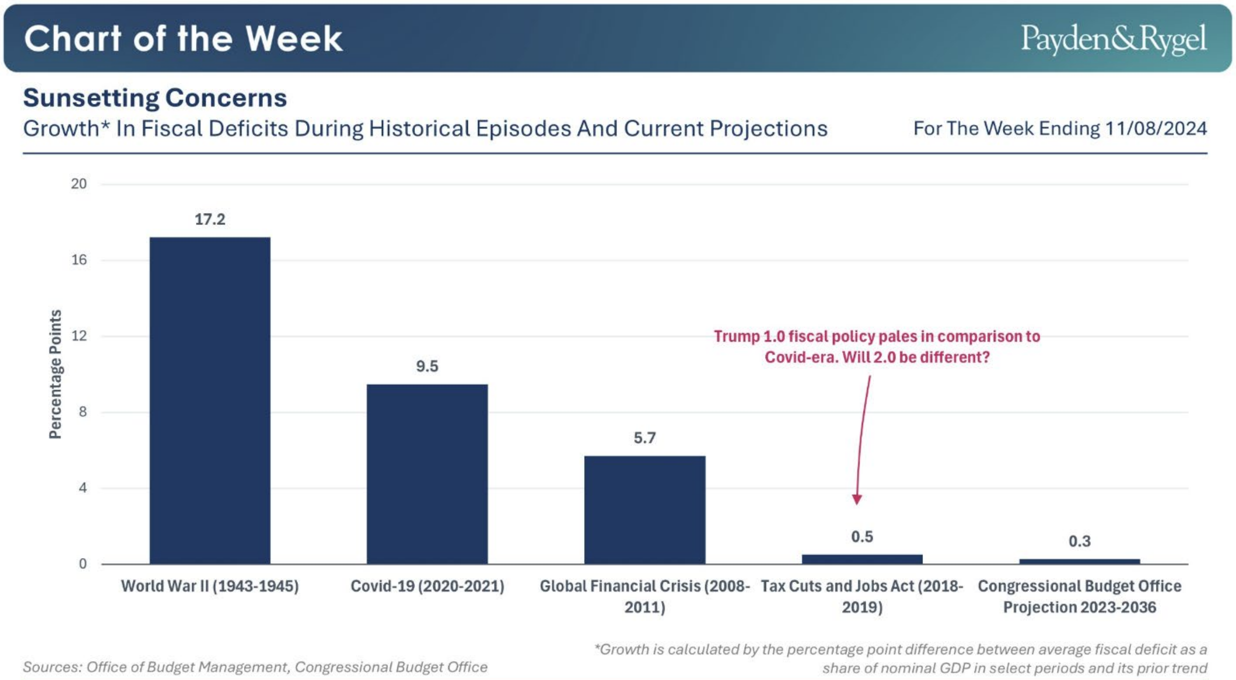
The recent election of Mr. Trump to a second term as President does not substantially change our long-term investment views. While elections are certainly consequential, their impact on long-term investment results has generally been overstated. Historically, investment markets have trended to the positive regardless of politics.



President-elect Trump’s proposed policies, if enacted, should be favorable for economic growth. Consumers will likely benefit from lower taxes and a healthy job market. Lower corporate taxes and less regulation are expected to generate greater business profits, which should translate into healthy U.S. stock returns. In the days following the election, the S&P 500 Index hit 6,000 for the first time in history.

On the other hand, Trump's plan to increase tariffs has the potential to trigger higher inflation and increased federal deficits. In response, the bond market has wavered. Our firm’s emphasis on individual and target-date bonds should help to mitigate the effects of volatility in the bond market since we expect to hold these bonds for clients to maturity and receive par value.

Although many have expressed concern over the prospects for a meaningful acceleration in government debt under a second Trump term, a review of Trump’s first term in office doesn’t support this fear. The following chart shows there was far larger growth in the deficit during the past two Democratic presidencies, as well as during World War II, than during the pre-Covid period of President Trump’s previous term.



Furthermore, if President Trump's pro-growth policies are anywhere near as effective as the similar supply-side policies of President Reagan after the Carter era, the national debt could shrink in size relative to a growing GDP.

It is hard to determine how many of Trump's campaign promises will actually come to fruition. For example, the last time Trump was elected, he mainly used the threat of higher tariffs as a negotiating tactic. Additionally, to enact many of his plans, Trump will need to deal with Congress, where the filibuster is still in place in the Senate and the House is still nearly evenly divided.

Looking at current circumstances from a longer-term perspective, there is a good chance some degree of power in Congress will swing back in the other direction at mid-term elections in two years, and then Trump would become more of a lame duck President for the remainder of his term.

It is interesting to note that when President Biden was inaugurated, many experts recommended selling traditional energy stocks associated with fossil fuels and buying clean energy stocks like solar power. But, to the surprise of many, solar energy stocks have declined over 50% over the past three years while the oil & gas sector is up over 50% over that same time period.

In anticipation of continued economic growth, the stock market has started to broaden more in recent months, which is beneficial to diversified investment strategies like ours. The following graph shows how well the broader stock market performed after previous periods when a narrow group of stocks dominated returns.

1972-1973 Nifty Fifty

Year	S&P 500 performance (%)	Equal-weighted S&P 500 performance (%)
1972	19	9.8
1973	-14.7	-21.5
1974	-26.5	-22.9
1975	37.2	54.4
1976	23.9	35.7
1977	-7.2	-2.0
1978	6.6	8.2
1979	18.6	28.7

1998-1999 Dot-com bubble

Year	S&P 500 performance (%)	Equal-weighted S&P 500 performance (%)
1998	28.6	12.2
1999	21.0	12.0
2000	-9.1	9.6
2001	-11.9	-0.4
2002	-22.7	-18.2
2003	28.7	41.0
2004	10.9	17.0
2005	4.9	8.1

2023-2024 Magnificent Seven

Year	S&P 500 performance (%)	Equal-weighted S&P 500 performance (%)
2023	26.3	11.8
First six months of 2024	24.6	13.9

The above numbers bode well for diversified portfolios over the long term, but investing is not without risk. It is normal for equity markets to experience corrections periodically. Historically, the S&P 500 index has experienced a 10% dip about once a year on average and a 15% drop around every two years. A decline of either magnitude within the next year would not come as a surprise; we haven't had a meaningful correction since the current bull market began over two years ago.

Fortunately, the stock market has always recovered from previous declines and eventually gone on to reach new highs. Moreover, while equities have struggled at times this year, bonds have appreciated in price as yields have come down over the past 12 months. Fixed income continues to look its most attractive in many years.

Perhaps the most concerning aspect of the election results is the potential impact on international stocks. Higher tariffs will likely cause headwinds for international equities. Fortunately, we have already modestly reduced our allocation to international equities in recent years. In the long term, we think the prospects for international equities to perform well remain good given their relatively attractive valuations. As a comparison, U.S. stocks are trading at 21 times future earnings right now versus only 13 times anticipated earnings for international stocks. Historically, stocks tend to trade at around 15 times potential earnings.

Elections have consequences – and this election is most likely positive overall for the economy and investing – but most successful investment strategies are based on other more significant long-term factors. Interest rates, productivity, and corporate profits tend to drive market returns over time. Economic growth is paramount to investment success.

Going forward, the prospects for growth seem to be favorable. While our firm is not a proponent of “greed is good” as famously espoused by Michael Douglas’s character in the movie “Wall Street,” we do believe growth is good.