

Best Day

Weekender

June 15, 2024

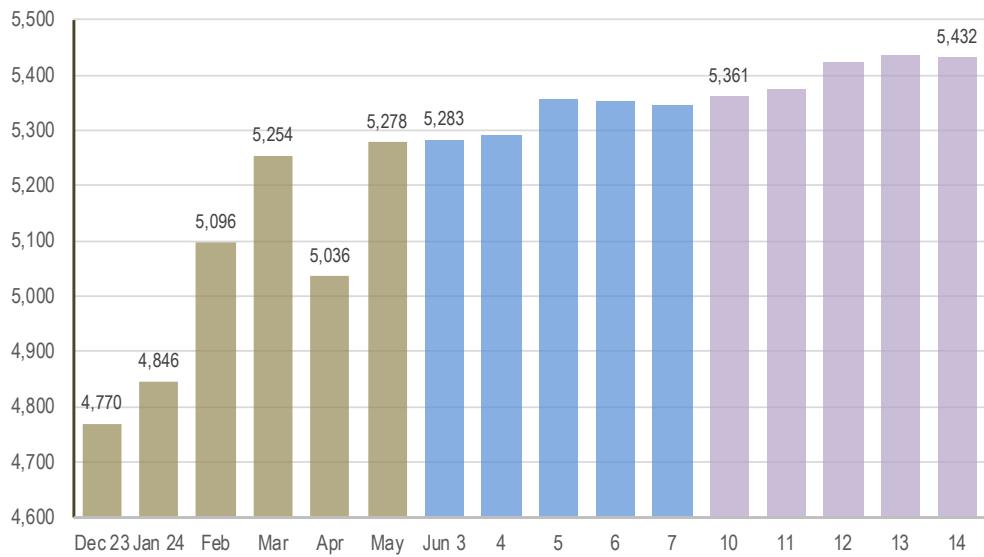
The call of fatherhood is in fact a call of sacrifice, not in some heroic sense where a father is lifted high on some glowing pedestal with all of his sacrifices held up to the awe of those around him. Rather, it is a call that will cost him all that he has, that will be absent of accolades, where rewards will be sparse, and where he will someday find himself having spent all, but in the spending have gained everything. And this is the glory of fatherhood.

Craig D. Lounsbrough

Good morning and welcome to the *Weekender* for Saturday, June 15, 2024. Equity markets rested the week at another record close. Year-to-date, the S&P 500 is higher by 13.9%, while the tech-heavy Nasdaq index is higher by 17.8%. One company, Nvidia, accounts for approximately 35.2% of the total gain in the S&P 500. Finding non-Fed-related equity drivers is hard. Most important economic data has already been posted, and earnings for the second quarter are still a month away. We are entering the summer data doldrums.

S&P 500 Index Levels

(Source: Bloomberg)



It was another excellent week among many. As measured by the S&P 500, US equities were higher by 1.6% for the week.

Financial markets are still focusing on the Federal Reserve, which announced on Wednesday that it would keep interest rates steady and was unlikely to pursue an aggressive lowering path anytime this year. In his prepared remarks, Fed Chair Jerome Powell mollified market participants by suggesting only one minor downward rate adjustment was likely this year and only if the data supported it.

This week, a quartet of inflation measures for May were released. They all told a similar story: Consumer and producer prices continually declined, homing in on the Federal Reserve's arbitrary target of 2.0%. Import and export prices confirmed the trend. The point. For data wonks and economic soothsayers, inflation is coming down. However, prices are still well beyond where they were before the pandemic for the person on the street. They are never going back. Our price perceptions are primarily anchored before a big move, and the perception, despite a fall in the rate of price increases, is that the absolute price level remains well above its pre-pandemic levels.

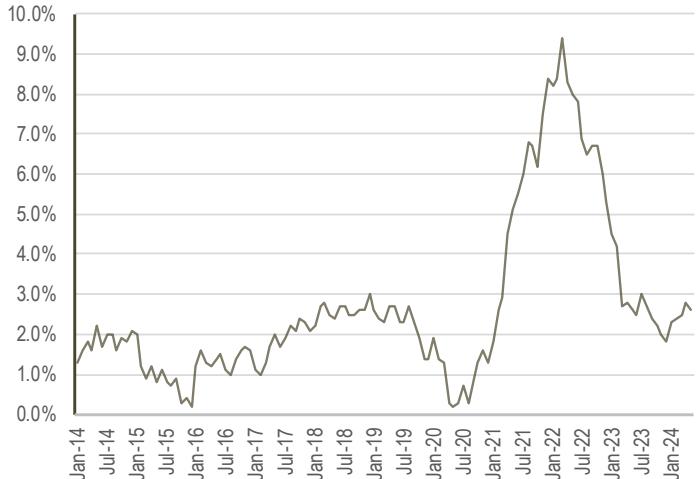
Looking forward, some price pressures are beginning to rebuild. Shelter prices provide a ballast to inflation due to the tight housing supply. As interest rates start falling, demand for homes will increase, and prices will lift further. In the automobile sector, although inventory is building and purchase incentives are beginning to be familiar again, prices are still well above their pre-pandemic levels. Similarly, as interest rates fall, vehicle demand will keep prices firm. Services inflation has largely disappeared. While this is good inflation news, the other side of the same coin suggests softer demand for services is the culprit, which is troubling.

With most of the revenge travel and spending behind us, services, which account for approximately 2/3 of US economic output, are trying to find their new normal. Price inflation for both services and shelter has remained stubborn. Service inflation just blinked in May. A decline in consumer demand for services is the most likely cause. If this lasts through the summer, which is usually a hot time for services, we expect a softer second half of the year.

US Services Inflation

January 2014 - May 2024

(Source: Bloomberg)



In early April, members of the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) began a correction that, at the time, seemed deserved and earned. To many, the highflyers were a bit over their skis. But after a brief correction, they are off to the races again.

Mag 7 (Brown) and S&P 500 without the Mag 7 (Green)

January 2 - June 14, 2024, Cumulative Return

(Source: Bloomberg)



Many investors have expressed concern with the dramatic moves of the Mag 7 and have suggested that a bubble may be forming. There are remarkable similarities between where we are today and the early days of the internet bubble in the late 1990s. But the differences are worth focusing on. All members of Magnificent 7 are both profitable and leaders in their respective market segments. Their valuations are based upon

actual earnings and free cash flow; their earnings and cash flow growth are 3-5x that of the broader equity market.

Earnings Growth

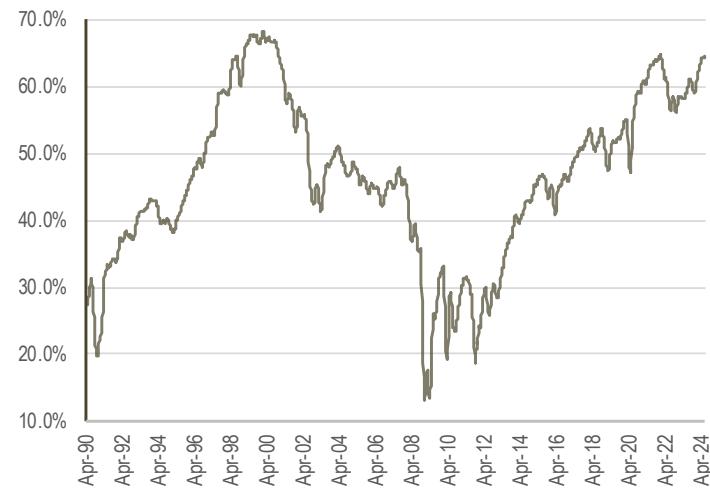
Company	EPS 2024	EPS 2025	Earnings Growth
Alphabet	7.66	8.72	13.8%
Amazon	5.29	6.42	21.4%
Apple	6.59	7.24	9.8%
Meta	20.87	23.91	14.6%
Microsoft	11.80	13.31	12.8%
Nvidia	2.70	3.58	32.5%
Tesla	2.46	3.29	33.8%
S&P 500	277.19	302.16	9.0%

When or if equity prices become disconnected from each company's earnings, bubbles are created, and bubbles always pop. The following graph plots the percentage of the S&P 500's cumulative value that cannot be explained by the present value of earnings over the next three years. This metric is approaching internet bubble levels.

Percent of S&P 500 Value without Earnings Support

April 2, 1990 - June 6, 2024

(Source: Bloomberg)



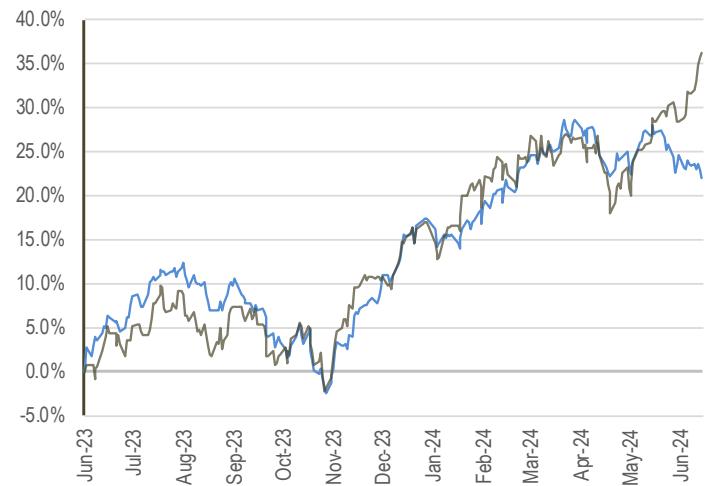
We remain compelled that six of the Magnificent Seven are names worth holding. Tesla is the exception. Our concern is not the Magnificent Seven but the rest of the equity market. Something interesting is beginning to manifest in equities. Over the past year, cumulative returns for the Russell 1000 US Industrial Index have closely tracked the largest non-financial technology companies within the Nasdaq 100. But a month ago, their returns began to diverge. This bifurcation

portends trouble ahead for those who believe equity markets are omniscient.

Nasdaq 100 (Brown) Russell 1000 Industrials (Blue)

April 1, 2023 - June 14, 2024, Cumulative Return

(Source: Bloomberg)

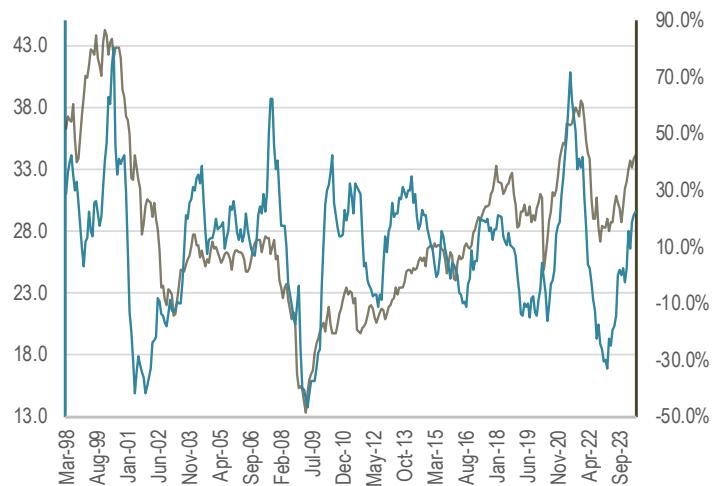


Individual investors begin feeling the animal spirits as equity markets continue to rise. FINRA data suggests that individual investors are increasingly purchasing equity shares on margin. Increased debt-fueled demand is pushing up valuations. We believe margin balances are still within a normal healthy range and do not pose a particular problem. However, what goes up also goes down. Any meaningful market reversal will result in margin calls and forced selling.

Margin Balance Growth (Brown) Nasdaq PE Ratio (Blue)

March 1998 - June 2024

(Source: Bloomberg)



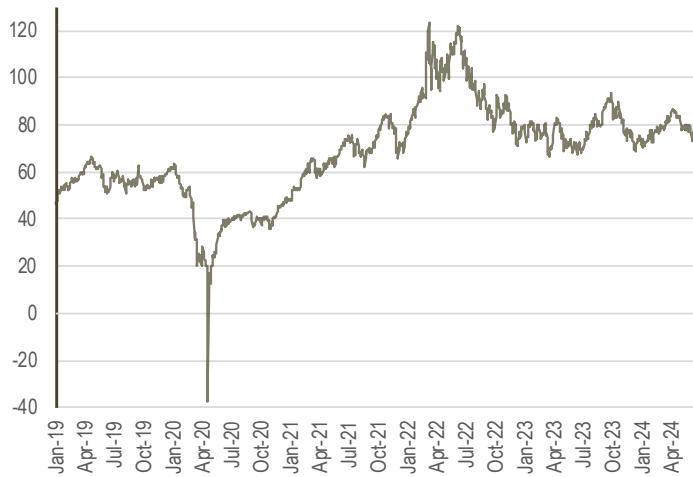
One key factor in moderating inflation was energy prices, which fell by -3.7% last month at the consumer level. During May, West Texas Intermediate crude

prices fell -6.0 %. Crude's retreat came under the assumption that domestic demand may soften in a weakening US economic environment. Recent data suggest the economy remains relatively robust now. Over the last month, more global crude supplies have pushed prices lower while crude stockpiles swell. Meanwhile, OPEC+ is desperate to increase production.

West Texas Intermediate (WTI) Price per Barrel

January 2, 2019 - June 14, 2024

(Source: Bloomberg)

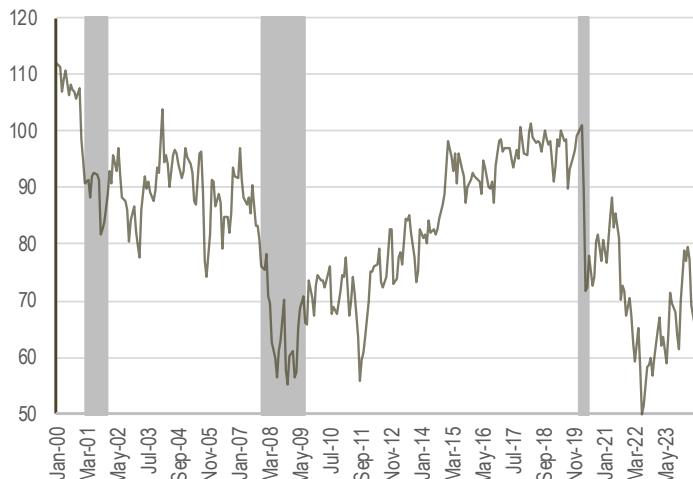


Consumer sentiment unexpectedly fell to a seven-month low as the specter of high prices compared to the pre-pandemic era combined with deteriorating consumer financial conditions. Consumers' assessment of their personal finances fell to the lowest level since last October. While lower-income families have experienced significant wage gains in the face of inflation, persistently higher prices continue to dim their view

Consumer Sentiment Index

January 2000 - June 2024

(Source: Bloomberg)



Weekender

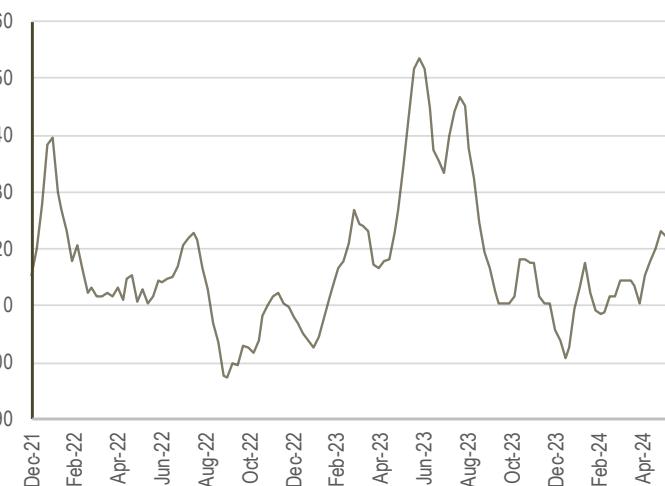
of the future. Consumers are pushing back on higher prices, which we believe will put a crimp in revenues and earnings for consumer-elastic companies.

The post-pandemic economy and stock market owe their existence to a remarkably robust and resilient labor market. But cracks are beginning to form. Job openings, although still historically high, are starting to fall. Workers are increasingly less likely to quit their jobs. Most notably, initial unemployment claims are rising.

New Unemployment Claims

December 2021 - June 2024

(Source: Bloomberg)



For a long time, we have been discussing what we believe will be a slowing of the US economy. Such a slowdown has been happening, and we expect the slowdown rate to quicken in the coming months.

California

My home state of California continues to earn the epitaph of a "basket case." Governor Newsom's new \$20 per hour minimum wage targeting the fast-food sector, unless you have a bakery included, which saves his friend who owns Panera Bread, continues to send shock waves through the state after being in force for only two and a half months. Rubio's, a restaurant chain from Carlsbad, is closing forty-eight of its 134 locations due to the "cost of doing business." In-N-Out, one of the country's most consistently successful fast-food chains, recently closed a location in Oakland, California, for the first time in the company's history. Pizza Hut is firing its entire California delivery

service, and Burger King has rapid plans to replace cashiers with automated order systems. Unemployment in California is now up to 5.3 percent, significantly above the national rate of 4.0%. As Forrest Gump reminds us, “Stupid is as stupid does.”

To cover their higher personnel costs, Starbucks, McDonald’s, and *dozens* of popular fast-food restaurants have raised prices to unprecedented levels, leaving California consumers in an uproar and investors wondering what the long-term trajectory of less profitable food business may be. Additional legislative proposals relating to expanded healthcare coverage and additional wage measures in other sectors are in the hopper—meanwhile, those who can are voting with their feet.

East vs West

The St. Petersburg International Economic Forum (SPIEF) was held last week. Chief among the conference’s themes was the discussion of what a multipolar model of the world economy would look like and how to transition to it. As expected, the conference’s primary attendees were BRICS nations (Brazil, Russia, India, and China). In addition, 139 additional countries were represented at the meeting, and almost \$72 billion in contracts and agreements were executed.

Developing countries like Zimbabwe, whose leaders attended the Russian conference, are making statements about the Western world’s “regrettable and unacceptable pursuit of hegemony” and declaring Russia their most “consistent global ally.”

But it’s not just the banana republics causing all the mayhem. Countries around the world seem to be stepping back from the “New World Order” promised as the Berlin Wall fell in 1989 in favor of a warmed-up dish of nationalism. Governments throughout Europe are pushing farther to the conservative right in ideology. Unchecked refugee immigration is a cudgel being used to support the move.

We believe it is the first public step by Eastern powers to move focus away from trade relationships with the United States. While behind the scenes, China has been moving away from dependence on the West for years, recent tariff threats from the Biden administration, the situation in Taiwan, and extensive involve-

ment at SPIEF suggest China is aligning with Russia much faster than most imagined. While hesitant to get back in bed with Russia, minor Eastern powers increasingly see a multipolar world with the US, Europe, China, and Russia all exerting influence and providing options as positive for their future.

One More Thing

At the beginning of 1999, we moved from London, England, to Seattle, Washington. Two parents, three boys, and two girls. A change in employment necessitated the circumnavigating move. We were leaving the world of high finance to start an energy-based investment firm. As with most start-ups, the hours were grueling, as was the stress. On a particular weekend, I promised the boys that we would spend a night camping at the top of Snoqualmie Pass. It was going to be a perfect weekend. As soon as I got home in the early afternoon on Friday, we would load the truck, make the short one-hour drive up the Snoqualmie Pass to the campground, set up the tents, cots, sleeping bags, and chairs, start a roaring fire, roast hot dogs and smores, tell scary stories, for which I possess a fondness and vast library, and have a great time together.

I love being a dad.

As a form of confession or at least explanation, I spend most of my life in that busy and dangerous intersection of procrastination and taking on more than I should. In typical fashion, I let my Friday get away from me. As is typical in our home, Jeanne did all the hard work. She had the kids ready, the camping gear loaded in the truck, and the pre-cooked food prepared. I arrived from work late, barked a few orders about how we were running late, put the boys in the truck, and drove off.

When we arrived at the campground, it was dark. Our reserved spot was taken, so we found another and hoped the rightful owner would never show up. They didn’t. Recent rainstorms made it impossible to light a fire, and unfamiliarity with the camp in the darkness made finding a spot to pitch a tent nothing but a fool’s errand. Disappointed with our situation, I asked the boys, Thomas (7), Ben (5), and little Henry (2) if we should pack it in and just go home. The disappointment shone on their faces in the darkness. They were heartbroken.

As a last-ditch effort to make something out of disaster, we threw the sleeping bags in the back of the truck and tried to find a comfortable horizontal position. As we all lay there in high-mountain darkness, we looked at the stars, told silly stories, talked more about farts than I ever thought possible. It was a night of silliness and nonsense.

Finally the conversation gave way to exhaustion as we lay quiet, just waiting for sleep to overtake us. Thomas, the oldest, looked me square in the face, and softly broke the stillness and said, "This is the best day of my life."

It was mine as well, and it has been many times over again, as I recall it.

I love being a dad.

Happy Father's Day.

Conclusion

That's it for this *Weekender*. Have a wonderful week.

Disclosure Statement

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