

## QUARTERLY RECAP

**While markets, employment, consumer spending, and earnings have remained impressively resilient considering the cumulative impact of higher inflation and interest rates, we have begun to see some fractures.**

Stocks gains have been concentrated in a handful of high momentum, expensive valuation AI (Artificial Intelligence) focused companies.

With everything happening in the country and the world, the lack of market volatility has been remarkable as we haven't experienced a 2% single day benchmark S&P 500 decline in over a year vs. the historical average of such a dip every 34 trading days or less than 2 calendar months. 5% pullbacks from the most recent high, average 4.5 times per year since 1980. Historically and statistically speaking, we are long overdue for more volatility and a 5-15% market decline which will likely precede further gains and new highs. With active portfolio management, we are well positioned to take advantage of stock, bond, and real estate volatility to increase growth and income while focusing on risk reduction and tax efficiency.

## GLASS ½ FULL

- Though inflation is not all the way down to the Federal Reserve's 2% target, it seems to be holding in the much improved 3% range.
- Interest rates certainly seemed to have peaked and 1 or 2 quarter point decreases are possible later this year and could continue into 2025.
- Some areas of inflation are slowing considerably, and we're starting to see some price wars in more competitive industries where supply issues have improved such as fast-food value meals, insurance prices, cars, and travel to name a few.
- While unemployment has ticked up to 4% from a 50-year low of 3.4% a year ago, this would still be considered in the range of "full employment" and more people working means more spending ability.
- With the cumulative effects of much higher interest rates and that rising unemployment, it's historically remarkable that we avoided a recession in 2023 and through the first half of 2024 and at this point it is unlikely that anything other than a relatively mild, short-lived recession is likely in the near-term.
- Game changing AI (Artificial Intelligence) will lead to both more investment and productivity gains for years to come.
- While some product, travel, and dining is starting to slow, the demand for post-pandemic social and experiential activities remains fairly strong.
- Affluent Americans continue to spend, even with much higher prices as high stock and real estate valuations fuel their confidence.
- While parts of the market are expensive, lower interest rates will make that less of an issue, and much of the non-momentum areas of the domestic market as well as international markets that are ahead of us in lowering interest rates are very reasonably priced and could perform well as the market advances spread out beyond mega-cap, AI – tech stocks.
- Lower interest rates will have a positive impact on consumer and business expenses and spending, as well as improve the outlook for interest rate sensitive investments such as technology, utilities, real estate, small cap, and emerging market stocks.

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## GLASS ½ EMPTY

- Even though most people that want jobs have them and even minimum wage and service/blue collar jobs are paying fairly well, for the estimated 60% of Americans living paycheck-to-paycheck are finding it tough to cover the essentials and high credit card, mortgage, and auto loan interest are beginning to hamper discretionary spending.
- We are starting to see more credit card and auto loan past due payments and defaults for consumers as well as the same issue for some office buildings in the commercial real estate space. With the lack of supply in residential real estate, that is not an issue, since any homeowners that get too squeezed have plenty of buyers ready to swoop in and buy them out at generously high prices.
- As housing, transportation, food, energy, insurance costs, and loan interest has climbed, other spending will be contained.
- Corporate earnings are starting to show declines in some industries and on a company-by-company basis there are now high-profile losers to balance out the successful companies.
- There is a high level of domestic political dissatisfaction as polls show that 25% of voters (pre-debate poll) are displeased with both presidential candidates, and with the divisiveness that exists, there will be a high level of American frustration regardless of who's elected.
- Geopolitical risks are high with continuing wars in the Mid-East and Eastern Europe, the potential for China to attempt a takeover of Taiwan and flex their political and financial muscle, and in addition to the aggressive behavior of Iran and several communist countries the concern over the growing communication and cooperation between Russia, China, and N. Korea is especially concerning as is the threat of domestic or international terrorism.
- With a lack of residential housing inventory that never caught up to the growing post 2008 Recession real estate crash needs, and owners of dramatically lower interest mortgages hesitant to sell their homes, one of the greatest drivers of consumer spending – the multiplier effect (remodeling, appliances, furniture, electronics, landscaping, maintenance) from home purchases has been reduced.
- The demand for offices remains the weakest part of commercial real estate as the pandemic work from home or work from anywhere phenomenon continues. Less people going to an office as regularly also limits that economic multiplier effect (office apparel sales, transportation spending, restaurant sales, and office overhead).
- The concentrated successes in the market may have or be near the peak prices and valuations that investors are willing to pay, and may need to take a breather before continuing their upward climb.
- If important non or less discretionary areas of spending - housing, transportation, food, and energy remain too expensive, high for longer interest rates could slow down the spending and corporate earnings needed to see continued stock market growth.
- Even though the Federal Reserve is unlikely to raise short-term rates, the longer benchmark 10-year as well as the 30 -year bonds could be forced to pay higher interest rates if the demand does not meet the high supply of Treasury bond issuance needed to cover the very high and growing \$35 trillion national debt that we are passing on to future generations.

## WHERE DO WE GO FROM HERE?

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- Markets are still richly valued, though it is now not as concerning as it was since the risk of a recession, higher interest rates, and growing inflation rates are now much lower than in 2022/2023.
- With the worst of inflation and high interest rates likely behind us, we still have the potential for markets to decline based on a delayed start and potentially fewer quarter point interest rate reductions than were previously priced in.
- With stocks technically over-bought and having gone an unusually long period without a 5% pullback for the benchmark S&P 500 since October 2023, we may be due for a “breather” before stocks will go considerably higher.
- We have had impressively low unemployment and good GDP growth considering the historically large interest rate increases that fought inflation effectively without major negative day-to-day consequences so far.
- There have been some cracks in terms of some Americans not being able to stay up with high prices exhibited by paying their debts late, increasing their high interest credit card balances to over \$1 trillion nationally, or outright defaulting on auto or other loans.
- With the politicalization of so many current issues, and polarized viewpoints, we are likely to see more divisiveness as we approach the 2024 elections.
- Geopolitical issues and continued military conflicts will continue to have both a social and economic impact.
- Some of the inflation variables like supply chain breakdowns were transitory, while other factors such as pay levels, food, transportation, and housing costs may continue to rise or stay elevated, limiting discretionary spending.
- Our staggering \$35 trillion national debt may have more noticeable effects moving forward including higher long-term Treasury interest rates as the Federal Reserve progresses to lowering short-term interest rates they directly control.



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## CURRENT STRATEGY

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- We will continue to increase our investments in high dividend and covered-call stock investments. Many of these investments have 6-12% distribution yields and should allow us to achieve our goal of 6% average equity income yields plus long-term appreciation for a targeted 8-12% total average annual growth from the stock portion of our portfolios in most years.
- As previously discussed, with prices still elevated for many growth stocks, owning covered call ETF and Closed-end fund strategies allows us to participate in some but not all of the gains, while avoiding some of the price decline risk and earning WELL above bond interest rate yields (at a lower tax-rate).
- This defensive – “get paid while we wait” approach allows high income yield while stock price volatility likely increases.
- During market pullbacks we will increase our holdings in both value and GARP (Growth at a Reasonable Price) investments through individual stocks, ETFs (Exchange Traded Funds) and Closed-end funds that can trade at substantial discounts to NAV and have those high 6-12% yields through defensive, covered call option premiums.
- We will add interest rate sensitive investments such as technology, housing real estate, small-cap, emerging market, and dividend stocks that will benefit from future lower interest rates.
- We will also take advantage of relatively under-valued stocks other than U.S. large cap growth stocks such as small/mid cap stocks, international equities, and emerging markets that often out-perform after an environment like that we have just gone through.
- To lower risk and improve long-term income yields and appreciation, we typically make relatively small initial buys, so we can buy more on price dips. Typically, when we do this, we continue to hold the lowest price, highest yielding lots and may sell-off higher lots at or above break-even and redistribute those funds to better prospective investments as they become available.
- Whether growth or value stocks, we consider the fundamentals of P/E and PEG ratios (P/E divided by earnings growth rate), cash flow, sales, historic price patterns, forecasted changes, influential trends, and competitive companies when choosing investments.
- We take advantage of using our retirement and non-retirement accounts to maximize tax efficiency by putting investments in the account that will create the best after-tax growth and income yield whenever possible.
- In this volatile environment actively managing our investments by taking advantage of price swings and using fundamental analysis can limit the risk of just following the market momentum and this includes using fundamental quality factors in choosing the passive index portions of our portfolios.
- We will continue to invest in “risk-free” short-term fixed-income vehicles that earn 5%+ rather than leave funds as cash.
- We will add some medium to longer-term bond investments either individually or through discounted closed-end funds which should increase in value as interest rates eventually decline.

## YOUR SITUATION

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As we enter the third and fourth quarter of the year, please let me know if you have any updates to your personal investment goals:

- **Tax loss or gain needs**
- **Retirement plan goals with tax-deductible or tax-free Roth plans**
- **Growth, income, and risk reduction goals**

Please do not hesitate to reach out to me if you would like to review your accounts or if you have questions or life changes that will impact your financial goals.



Have a fantastic Fourth of July -  
**Thank you,**  
John