BCWM
PROVIDING PEACE OF MIND

Prepare for Landing

What a difference a month can make. The day after we published our last Commentary, Donald Trump and Joe Biden were about to square off in the first presidential debate, and we wrote:

"If Trump appears to have gained the upper hand in the debate, look for the Democratic Party to quickly find another presidential candidate. The Democratic National Convention is not until August 19th. Plenty of time to change horses."

Well, that was pretty prescient.

But *very few* could have predicted what would happen next: the monumental lapse by the Secret Service that allowed a suspicious-looking, rifle-carrying 20-year-old to set up a ladder to a roof barely a football field away from former President Trump. The gunman then climbing that ladder, spending minutes setting up, and firing off eight shots at the former president before snipers took him out. One of those eight shots taking a chunk out of the former president's ear, missing killing him by less than an inch thanks to a turn of the head at the exact, fortuitous moment. And, lastly, the former president defying his security detail to stand triumphantly — bloodied, pumping his fist to the crowd, and yelling "Fight! Fight! Fight!" — while the American flag billowed above him, providing the world one of the most iconic American photos of all time.

The image of President Trump was altered that day for many Americans (much to these comedians' dismay). He looked less like an old man and more like a young soldier from Iwo Jima. He then went on to pick J.D. Vance as his running mate, a man half his age.

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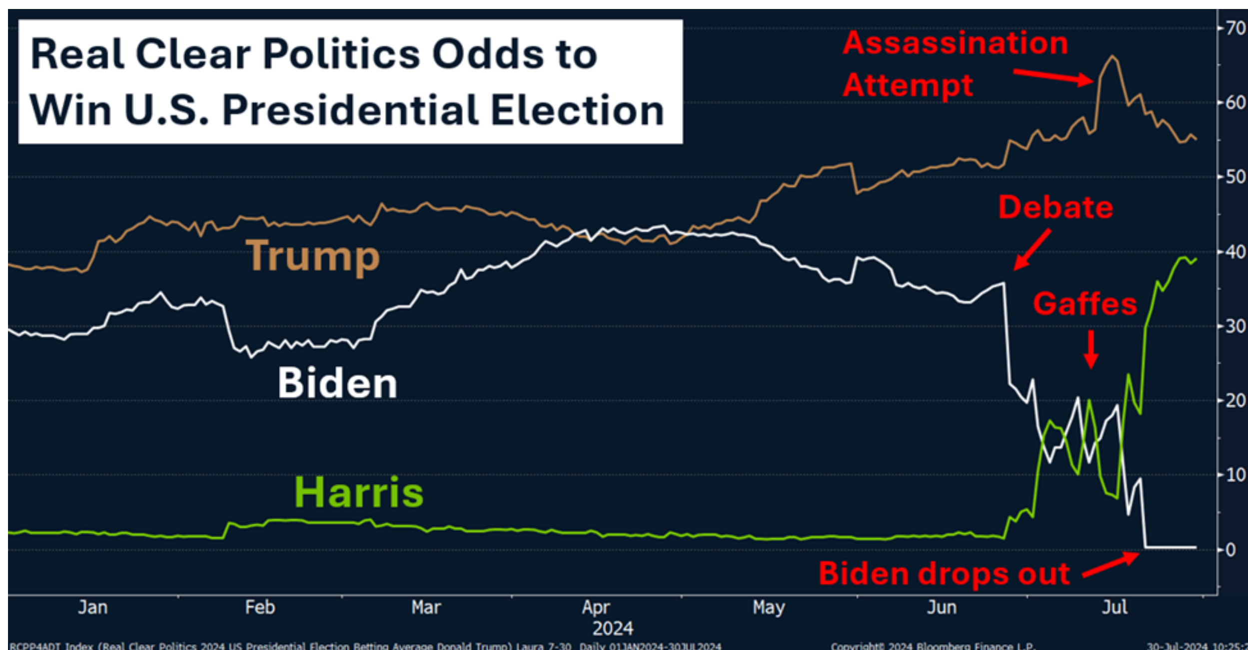
Meanwhile, Biden tried to save his campaign but continued making gaffes, calling his vice president “Trump” and Ukrainian President Zelensky “Putin,” giving his opponents additional fodder.

With his chances of winning the election slipping, and Democratic support drying up, Biden had no choice but to drop out. And with Biden “dropping out,” Kamala Harris decided to “drop in,” and (as of today) she is the leading candidate for the Democratic presidential nomination.



Although the Democratic National Convention is a few weeks out, Harris is the presumptive nominee and is already beginning to make some noise. According to political news website Real Clear Politics, Harris’s chances of winning the presidency started rising after the last debate.

Now, with just over three months until what will arguably be one of the most chaotic, divisive, and predictably unpredictable presidential elections ever, we feel it is important to remind you that major investment decisions should not be made based on the outcome of the election.

In other words, “*Sell everything because my guy didn’t win*” is not necessarily a good investment strategy.

For example, from the day Trump was elected in 2016 until the day Biden was elected in 2020, the average stock of the S&P 500 Index increased about 12% per year. Not bad. It would have been a shame to miss out on that because you were convinced Trump was going to destroy democracy.

Coincidentally, since Biden was elected in 2020, the average stock of the S&P 500 Index has likewise increased about 12% per year. Not bad. It would have been a shame to miss out on that because you were convinced Biden was senile.

This is the part where we remind you, again, that the president of the United States gets way too much credit when things are good . . . and way too much blame when things are bad. There are so many events over which the president has no influence or control. It is not wise to mix politics with investing.

And be skeptical of knee-jerk reactions.

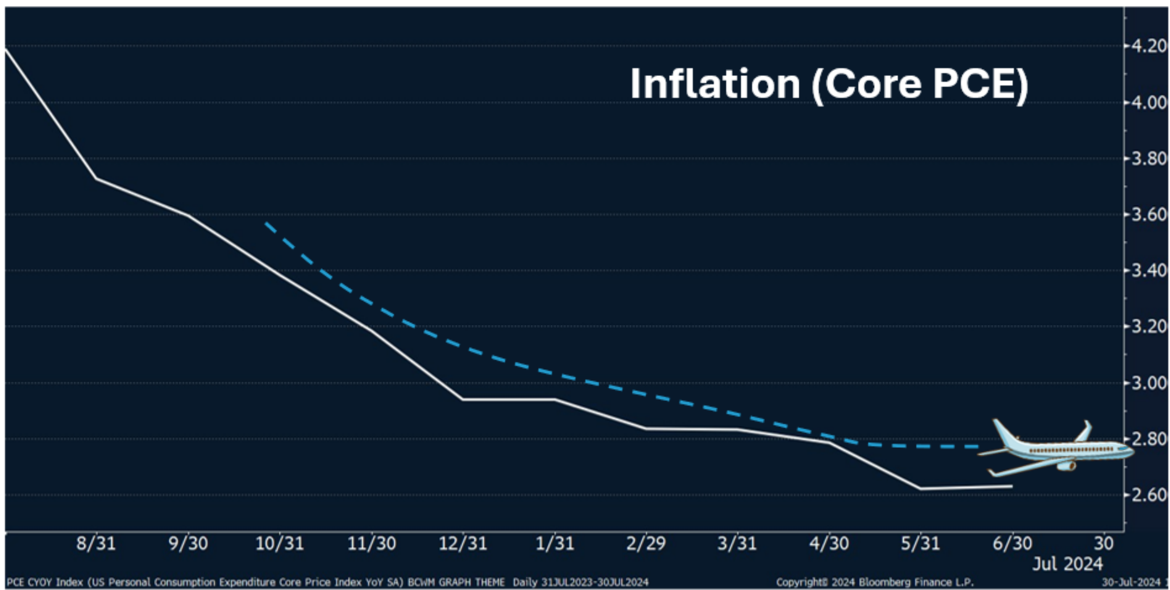
Case in point: When investors discovered that Hillary Clinton had LOST the election in 2016, the stock market dropped about 5% over night because emotional investors who hated Trump rushed for the exits. But by the time the market closed the next day, it finished UP 1%. Investment sanity was restored in less than a day, but those who sold were left to lick their wounds.

Something similar seemed to happen in the bond market last month. In the two days after Biden's terrible showing at the debate, the 10-year U.S. Treasury Rate shot up 0.20% (a significant move in the bond world) and then retreated back to where it started over the next several days. No other meaningful news had come out to justify the move. We surmised that skittish bond investors, worried about Trump policies stoking inflation (and higher interest rates), sold their bonds, thus pushing prices down and rates up . . . temporarily.

So, while we're keeping an eye on the presidential race, we're not letting it distract or direct our investing decisions.

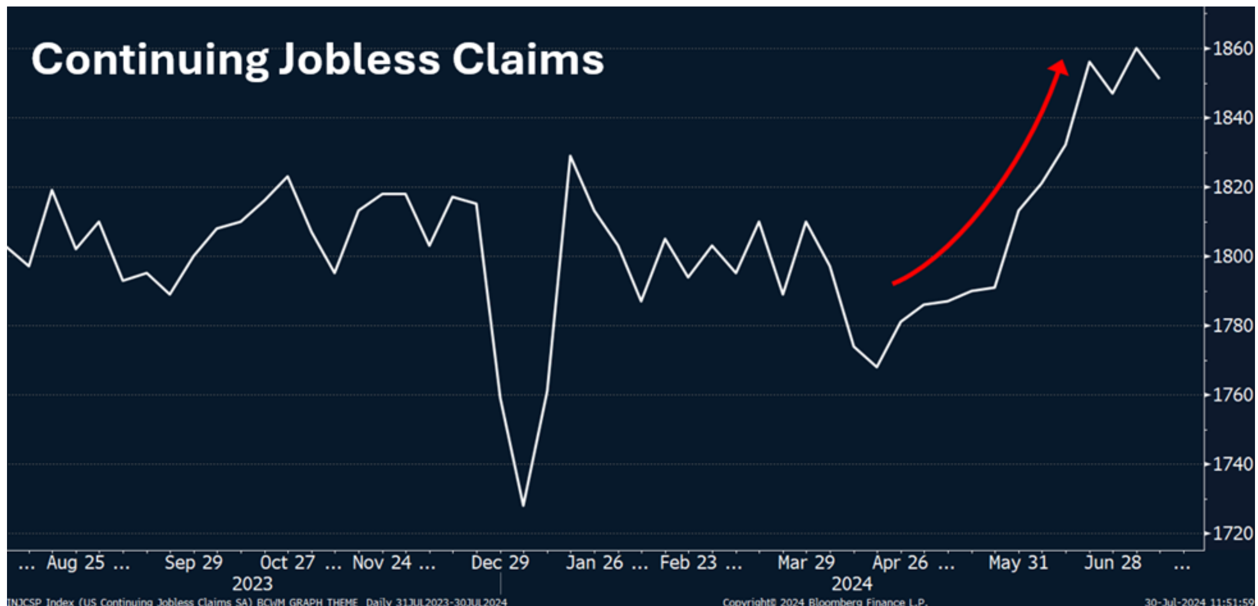
What we are most interested in right now is whether the Federal Reserve can deliver the elusive "soft landing" following its sharp increase of short-term interest rates to fight inflation. In other words, can it avoid a recession?

On the inflation front . . . things are going well. "Headline" inflation was 3% over the last year, down from 9.1% in June 2022. And there has actually been DE-flation (lower prices) over the last couple of months. More importantly, the trajectory of the Fed's preferred inflation measure, "core PCE," kind of resembles a soft runway landing.



Inflation is clearly headed in the right direction, but we are not out of the woods yet. What typically follows a slowdown in inflation is a slowdown in the economy. And some important economic data is starting to catch our attention.

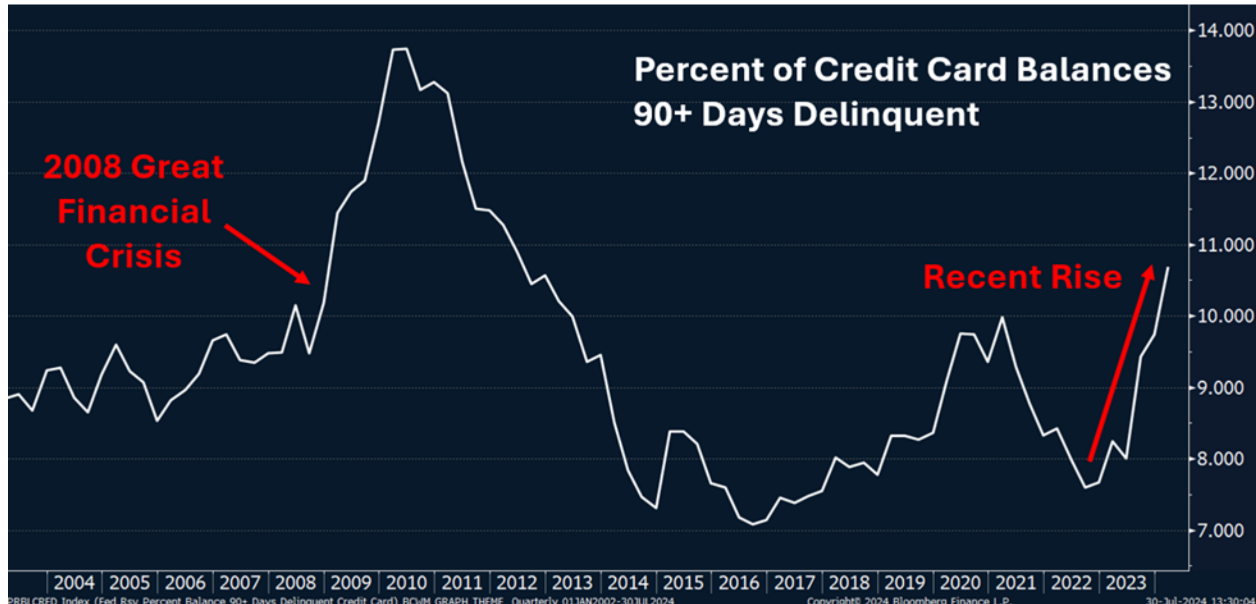
Although the unemployment rate is still low, it is persistently creeping up. After bottoming out at 3.4% in January 2023, it has since risen to 4.1% as of June. Continuing Jobless Claims (a.k.a. the number of people claiming unemployment) more or less measures the same thing, albeit with greater frequency, and this metric has ramped up in the last couple of months.



At the same time, retail sales have been decelerating. Nothing extreme, but enough to illicit an eyebrow raise.

Consumer spending drives an economy. And when increased spending results in higher credit-card balances (because you have a job, you can pay your bills, so splurging with your credit card becomes more frequent), that's a good sign. However, a bad sign is when those credit-card payments start becoming delinquent (you had fun splurging but, oops!, you just lost your job).

The overall credit card delinquency rate is rising, but it is still rather low and not all that concerning. However, people who are behind on payments are getting really far behind, to a level not seen since the 2008 Great Financial Crisis. The percentage of credit-card balances that are 90 days or more delinquent is rising rapidly.

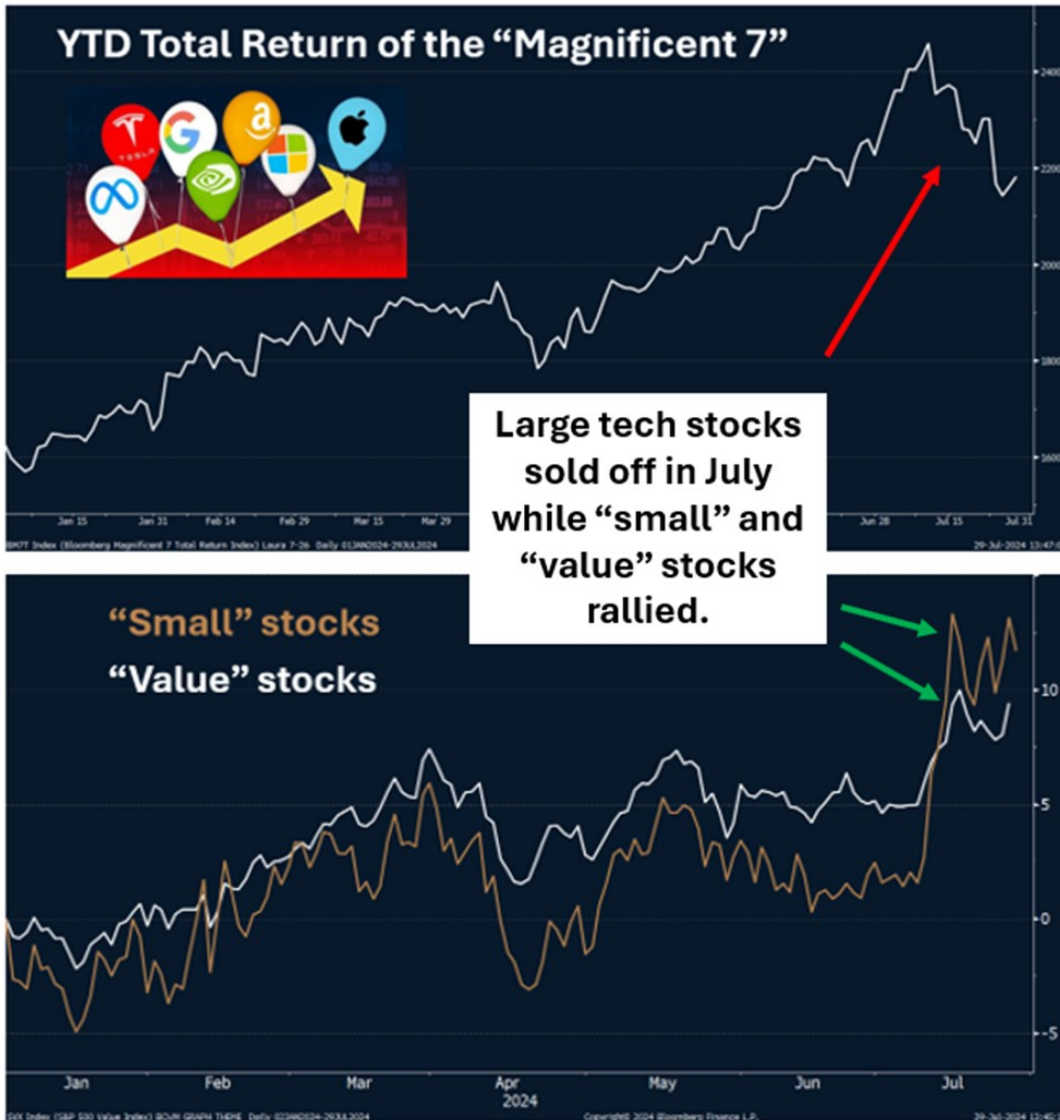


These are some worrisome indicators; but the economy *has been* growing. In fact, it was just announced that it grew much faster than expected in the last quarter.

So, it's not that all signs point to a crash, it's just that we are unconvinced the Fed can thread the needle and deliver the soft-landing. We expect that it will finally begin reducing interest rates in September — and again before year-end. If the economic data continues to show a deceleration, whoever enters the Oval Office in 2025 could soon face an economic slump . . . a slump for which he/she will get blamed but didn't cause.

As we've explained before, returns of the S&P 500 have been distorted by the largest companies in the index. These companies — Microsoft, Apple, Nvidia, Amazon, Meta (Facebook), Alphabet (Google), and Tesla — are known as the "Magnificent Seven" . . . although, after Tesla's dismal performance this year, the group should really be re-named the "Magnificent Six." These companies are so large that they make up about a third of the S&P 500. When they do well, so does the index — and vice versa.

These stocks have done so well for so long that they have become rather expensive. This month, investors finally decided to take some profits off the table. Expectations for lower interest rates led to a rotation of money out of those high-flying stocks and into companies that have been ignored for the last several years. The Magnificent Seven together are down about 10% since the group peaked on July 10th, and money has been pouring into "small" and "value" stocks, up about 10% and 5% this month, respectively.



Smaller companies typically have higher debt-loads. They do better when borrowing costs fall. Value stocks typically pay out high dividends, which become much more attractive when interest rates are lower.

If the Fed is able to "land the plane" without a bump, expect the stock market to continue to do well. But if bags start falling from overhead compartments, the "value" segment of the market is where you want to be. BCWM portfolios are well positioned for such a bumpy landing.

Next month we are excited to host a private webinar for BCWM clients featuring Michael Townsend, Schwab's Washington-based political analyst. Please plan to join us August 22nd to learn more about the current political landscape.

In the meantime, let's all take a break from politics and cheer on our Olympians in Paris — a team for whom we can all root.

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