FALL 2024 | VOL. 32 | NO. 4
Quarterly Perspective

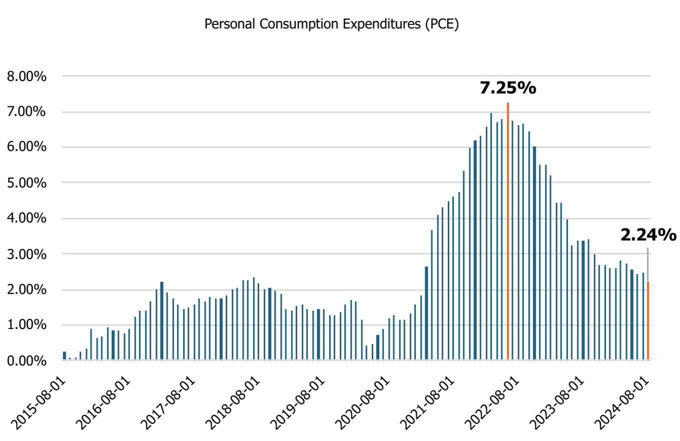
Non-Transitory?

by Will Williams
Chairman, President & CEO

On September 18, the Federal Reserve lowered its short-term interest rate target from 5.50–5.25%, the highest target rate since 2001, to 5.00–4.75%. It was widely anticipated that the Fed would lower rates at their September FOMC meeting, but the consensus was for a cut of .25 of 1%, not a full 50 basis point reduction. The Fed's more dramatic move led some economists to conclude that Chair Jerome Powell and the Board of Governors had identified widespread economic weakness in the recent data, warranting a more dramatic monetary response.

I would argue that the August 30 release of the Fed's go-to inflation indicator, the Personal Consumption Expenditures (PCE) data, gave them enough confidence that inflation was well under control and still trending toward their long-term target of 2%. The release of August's PCE data on September 27 showed a 2.24% increase, further reinforcing that perspective. (Note that the PCE inflation rate peaked at 7.25% in June 2022, following the post-COVID surge. See Chart 1 for reference.)

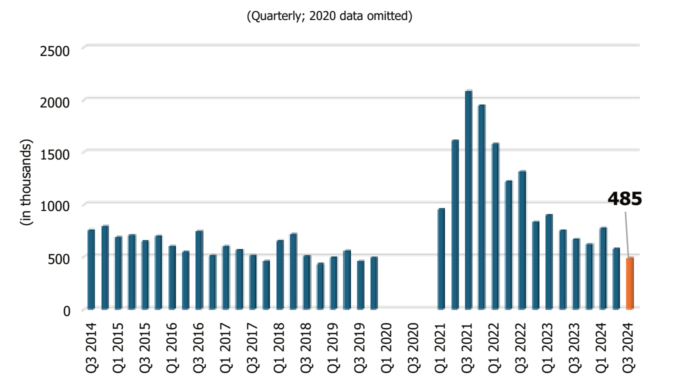
Chart 1: U.S. Inflation Data (Annual % Change)



Source: U.S. Bureau of Economic Analysis

In addition to managing inflation, the Federal Reserve's second mandate is to support full employment. Although the quarterly growth of non-farm payrolls has been declining, the nearly 500,000 increase in non-farm payrolls achieved in the third quarter of 2024 (Chart 2) is by no means, from a historical perspective, a leading indicator of a recession. At the end of September, nearly 162 million people were employed in the U.S., and we stood at a 4.1% unemployment rate. To me, this further validates the fact that the recent inflation trend was far more influential in the Fed's recent decision-making than any perceived economic warning signs.

Chart 2: U.S. Non-Farm Payrolls



Source: Federal Reserve Bank of St. Louis

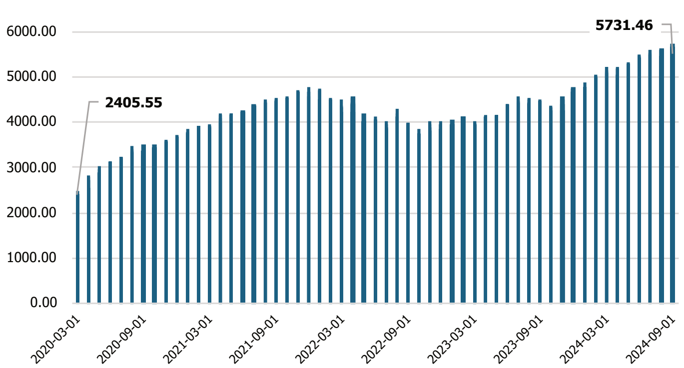
The Wealth Effect

It is hard for me to get my head around the case for a dramatically weakening U.S. economy. Yes, the unemployment rate is up from its recent low of 3.7%, but it remains materially lower than the nearly 80-year average of 5.7%. Additionally, wage growth over the past year has been strong, coming in at an annual rate of 4%.

Regarding overall consumer confidence, despite what I will describe as anxiety surrounding the current political environment, it is hard to argue that the significant increase in household net worth does not bode well for the domestic economy. Recent statistics from the Federal Reserve indicate that aggregate household net worth surged to nearly $164 trillion by the end of the second quarter, representing an almost 40% increase since the post-pandemic peak in 2019. Three primary factors drove this increase:

(1) ongoing strength in the common stock market (see Chart 3);
(2) record-high home prices (see Chart 4 on page 4);
(3) a reduction in household debt as a percentage of U.S. GDP to its lowest level in 23 years.

Chart 3: S&P 500 Index



Source: Federal Reserve Bank of St. Louis

continued on page 4

Half-Full, Not Half-Empty

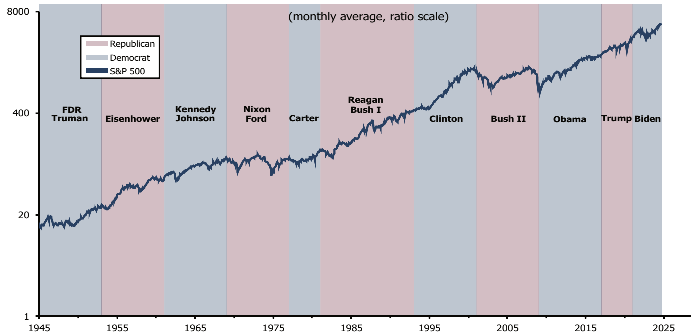
by Brian Christensen, CFA®
Senior Vice President & CIO

The daily news headlines paint a bleak picture—perhaps the most doom and gloom I've seen in my career. Maybe it's because I strayed from my usual routine of reviewing financial news, market data, and sports updates, only to get sucked into the dark hole of negativity in the social media abyss. The polarization across the U.S. as we head into a presidential election, war in Eastern Europe and the Middle East, and devastating natural disasters are difficult to stomach. At times, it's been difficult to embrace Big David's words: "If you're going to invest in stocks, you always have to view the glass as half-full." With that in mind, it is time to refill the glass!

As we approach the final days before the 2024 election, it's worth remembering that presidential administrations have limited control over market performance. The stock market tends to rise regardless of who is in the White House (see Chart 1)—a point I highlighted in last quarter's newsletter—which is why investors should avoid letting personal political views influence their investment decisions.

Though unpredictable and complex, geopolitical crises have historically presented buying opportunities. A study by the Carson Group[1] analyzed market impact from forty geopolitical events going back to 1940. The S&P 500 Index showed average gains of 0.1% after 3 months, 2.0% after 6 months, and 2.1% after 12 months following the event; median gains were 2.5%, 4.0%, and 7.4%, respectively. Further, the index was higher 64% of the time at the 3-month mark post-event. Time and again, many stocks did just fine, and the economy was strong enough to withstand the disruption (See Chart 2).

Chart 1: S&P 500 Index & Presidents' Party



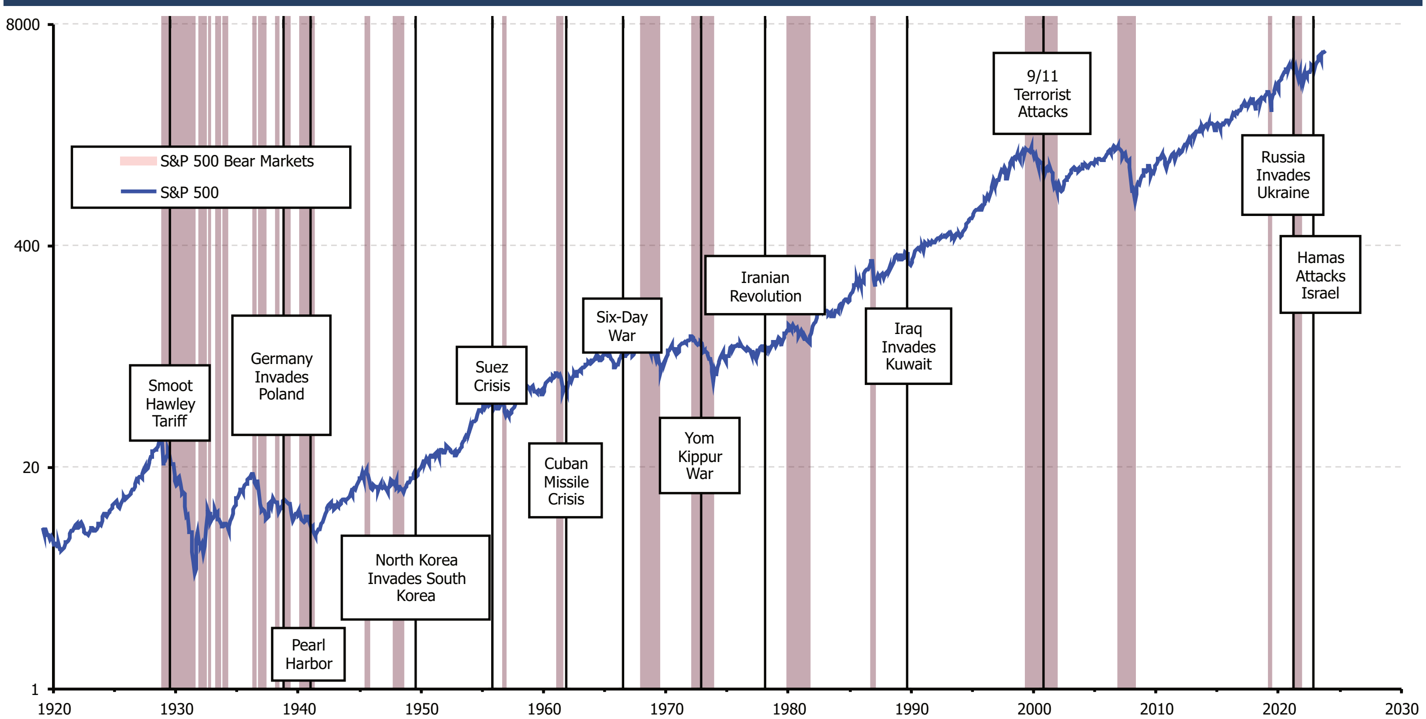
Source: LSEG Datastream and Yardeni Research.

Finally, we've shared before that consumer spending accounts for about two-thirds of U.S. economic expansion, measured by the Gross Domestic Product (GDP). As of June 30, consumption made up 67.8% of Real (inflation-adjusted) GDP. To put things in perspective: at the start of the 2001 recession, Real GDP was $14.2 trillion. By the end of the 2008-09 financial crisis, it had grown to $16.5 trillion. Most recently, as of June 30, Real GDP stands at $23.2 trillion, with real consumption per household at record highs. Clearly, when Americans are depressed, they go shopping. When they spend, the economy expands. And economic expansion is a major driver of corporate earnings, which, in turn, heavily influences stock prices.

Simply put, the trend in corporate earnings plays a crucial role in determining market direction. The macroeconomics firm MacroMicro indicates the correlation between corporate profits and the S&P 500 Index is greater than 80%. Visually,

[1] Ryan Detrick, "Let's Talk about Geopolitical Events," Carson Group, 2024 April 23, https://www.carsongroup.com/insights/blog/lets-talk-about-geopolitical-events/.

Chart 2: S&P 500 Stock Price Index & Geopolitical Crises (ratio scale)



Source: LSEG Datastream, Yardeni Research

continued on page 3

continued from page 2

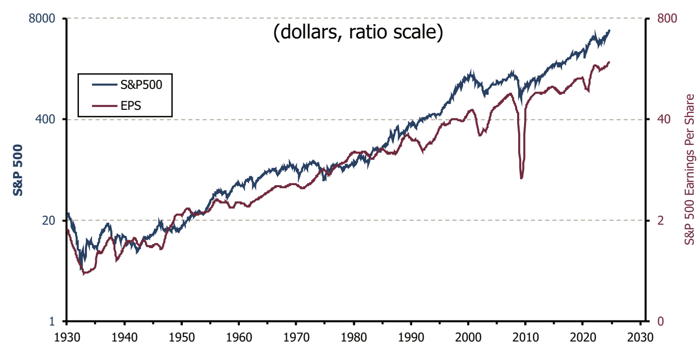
the correlation speaks for itself in Chart 3, which shows reported earnings per share (EPS) for S&P 500 companies alongside the S&P 500 Index (excluding dividends) since 1930. If past is prologue, the stock market's direction should follow earnings growth. In fact, Wall Street analysts project S&P 500 growth of 14.8% in 2025 and 12.4% in 2026.

Additionally, since 1928, the stock market has delivered positive returns in nine out of twelve months on average. The exceptions—February, May, and September—have historically been the losing months, with average declines of -0.09%, - 0.06%, and -1.17% respectively. Over this period, stocks have risen 75% of the time.

As investors, our biggest challenge might be tuning out the daily noise from wherever it may come. History has shown that patience and discipline, a hallmark of the DVI investment philosophy, is the antidote to the fog of uncertainty.

Chart 3:

S&P 500 Stock Price Index vs. Reported Earnings Per Share (EPS)



Source: LSEG Datastream, Yardeni Research, and Standard & Poor's.

The Changing Landscape for Money Market Funds

by Steve Hinrichs, CFA®
Vice President of Investment Research

While investors tend to focus on the stock and bond markets, one of the most significant shifts over the years is how idle cash in brokerage accounts is managed. For many years, unused cash was automatically swept into high-yielding money market funds, offering a rate of return that satisfied investors.

This dynamic began to change when brokerage firms slashed commission rates for stock trades about a decade ago. When they eliminated trading commissions to attract more customers, brokerage firms significantly reduced a key revenue source. To compensate, many turned to cash sweep programs as an alternative source of income. Instead of automatically sweeping idle cash into high-yielding money market funds, firms began sweeping it into very low-yielding bank deposits. This change enabled brokerage firms to generate substantial profits by investing or loaning that cash at higher interest rates.

To better serve our valued clients, DVI developed a strategy to counter the low interest rates on idle cash in managed accounts by utilizing Purchased Money Market Funds, which pay a significantly higher interest rate than the brokerage-preferred sweep options. As the name implies, these funds are a non-sweep option for cash, meaning they require active buying and selling through trades. While Purchased Money Market Funds provide notable benefits, they also come with certain drawbacks:

Benefits:

- ○ The biggest benefit of these funds is the higher rate of interest.
  - For example, Purchased Money Market Funds from Charles Schwab have been yielding around 5.0% for most of 2024, while cash swept into the Charles Schwab bank deposit has only been earning around 0.5%.
- ○ Some Money Market Funds primarily invest in U.S. government obligations, making most of the interest earned exempt from state income taxes—especially beneficial for our clients in Illinois!
  - For instance, in 2023, 99.6% of the interest earned from the Schwab U.S. Treasury Money Fund came from U.S. government obligations, thus not taxable for Illinois state income tax purposes.

Drawbacks:

- ○ Investors do not have immediate liquidity when their cash is invested in a Purchased Money Market Fund. If an investor needs cash for a withdrawal, the fund must be sold, and the cash will not be available until the next business day after the trade settles.
- ○ Every time a Money Market Fund is bought or sold, the investor receives a trade confirmation from the broker. *Every. Time.*

At DVI, we often hear from clients about the multiple trade confirmations related to these funds. While we understand that the extra confirmations can be bothersome, we typically find that once we highlight the additional interest earned, clients agree that the extra income makes the inconvenience worthwhile!

continued on page 4

Key Terms

CD: Certificate of Deposit; a time deposit offered by banks that provides fixed interest rates for a specified term on the condition that the money deposited cannot be withdrawn during that term.

Liquidity: The ease of converting assets to cash quickly.

Purchased Money Market Fund: A mutual fund purchased to hold excess cash reserves; the fund invests in short-term, low-risk debt securities; considered a cash equivalent.

Rate of Return: The gain or loss of an investment compared to the initial cost over a specified period; expressed as a percentage.

T-Bill: A Treasury bill, a short-term debt obligation backed by the US Department of the Treasury with a one-year maturity or less.

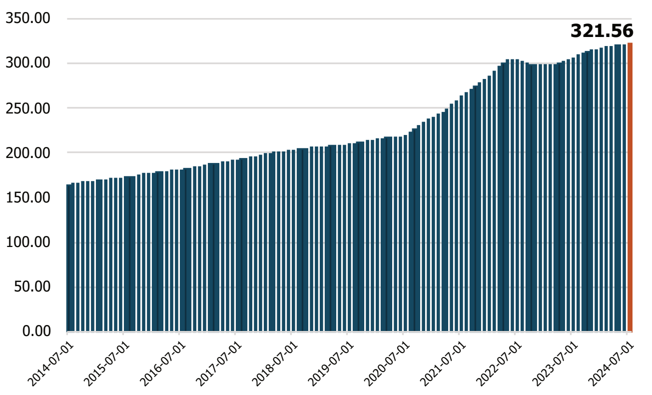
Trade Confirmation: A document required by regulatory authorities to ensure transparency and protect investors; a record of the transaction to help verify its accuracy.

Trailing 12-Month (TTM): A financial metric that describes the past 12 consecutive months of performance data; reflects past performance rather than predicting future outcomes.

Non-Transitory? ...continued from page 1

Economists may debate the extent of the influence and significance that this surge in wealth will have on personal consumption behavior and U.S. GDP, but no economist would argue that the impact of this household balance sheet strength is not both meaningful and positive. As we have often noted in the past, nearly 68% of all economic growth is tied to consumption. Therefore, barring any material exogenous shock to the economy, the health of U.S. household balance sheets should serve as a stabilizing force for both the U.S. economy and corporate earnings.

Chart 4: Case-Shiller National Home Price Index



Source: S&P Dow Jones Indices LLC

For the sixth year in a row, DVI has earned a spot on CNBC's Financial Advisor 100, ranking as the top firm headquartered in Illinois. The CNBC FA 100 recognizes firms that offer more than just portfolio management, highlighting those that assist clients with all aspects of their financial well-being. This honor emphasizes the value of trust in the advisor-client relationship.

Only 2% of the 40,896 Registered Investment Advisory (RIA) firms in the SEC database met CNBC's initial ranking criteria. The ranking process narrowed that list to the top 100 by evaluating various criteria including years in business, the number of Certified Financial Planners (CFP®) on staff, services offered, and the percentage of discretionary assets managed.

"While we are always grateful to be recognized by CNBC, we understand the competitive nature of the RIA industry demands our continued focus; we simply cannot rest on our laurels," said DVI President & CEO Will Williams. "Our clients rely on us for their financial peace of mind, and we must not lose sight of DVI's responsibility to deliver that outcome day-in and day-out."

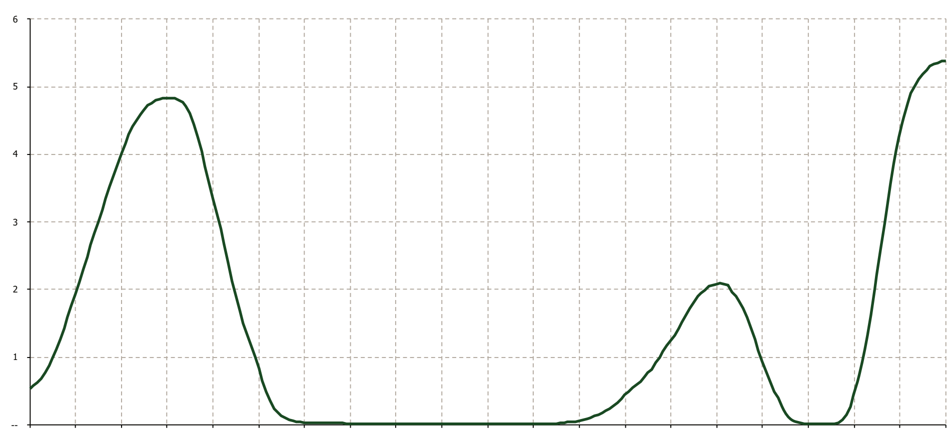
This rating is not indicative of DVI's future performance. The analysis for the CNBC FA 100 rating was conducted by CNBC with the assistance of AccuPoint Solutions, and neither the participating firms nor their employees pay a fee in exchange for inclusion in it. For more information regarding the CNBC FA 100, including the methodology and how the firms were selected, visit https://www.cnbc.com/2024/10/02/cnbc-fa-100-ranking-methodology.html.

Financial Advisor 100

CNBC
2024

The Changing Landscape for Money Market Funds ... from page 3

Chart 1: TTM* Performance of Lipper Money Market Fund Index (2004-2024)



*Trailing Twelve-Month
Source: Lipper, a Refinitive company, data as of 08/31/2024

Another key factor that changes over time with Money Market Funds is the interest rate. Unlike CDs or T-Bills, which lock in a fixed interest rate for a set time period, the interest rate on Money Market Funds fluctuates based on the Federal Funds rate. As illustrated in Chart 1, interest rates for Money Market Funds have varied significantly over the last twenty years. While investors have recently enjoyed rates around 5%, these rates are expected to decline as we head into 2025, following the Federal Reserve's decision to begin lowering the Federal Funds rate in September.

However, even with this decline, money market rates are likely to remain much higher than the historically low levels seen from 2010 to 2016 after the financial crisis, and again in 2021 during the COVID-19 pandemic. Given this backdrop, DVI will continue to utilize Purchased Money Market Funds whenever possible to help our clients earn additional interest income on the idle cash in their accounts.

DVI
David Vaughan Investments

Peoria, Illinois | Winter Park, Florida | www.dviinc.com