MEDALLION WEALTH MANAGEMENT

## *May 2024 Market Commentary*

***Entertain Us***

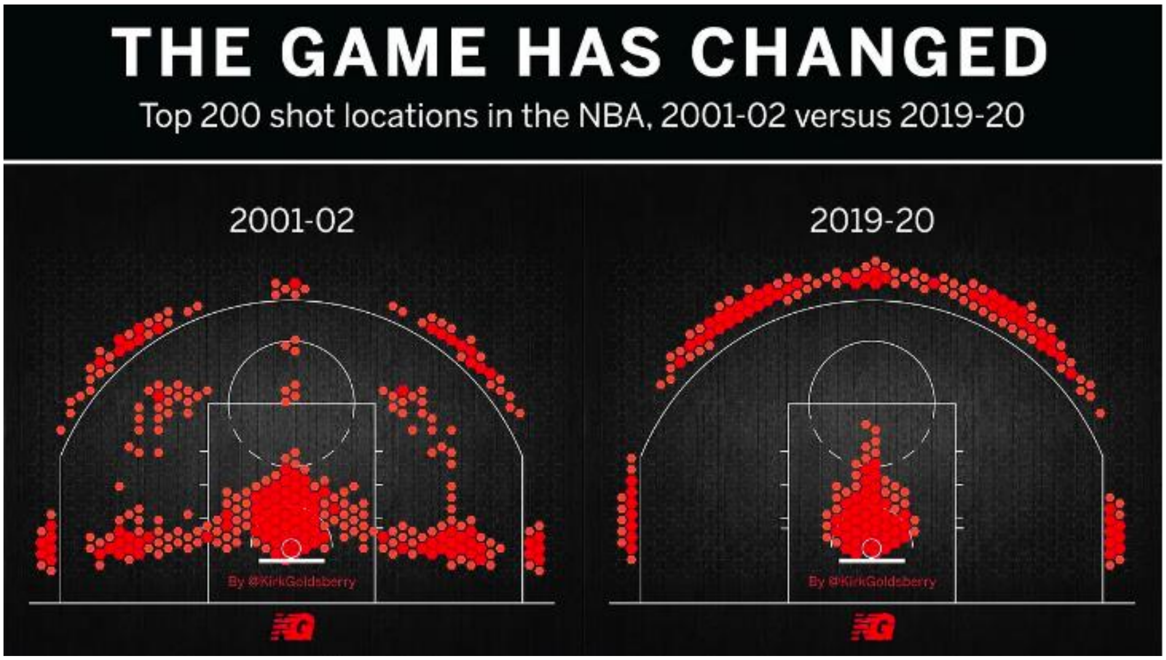
***Hello, hello, hello, how low***
***Here we are now, entertain us***
***I feel stupid and contagious***
***Here we are now, entertain us***
***https://www.youtube.com/watch?v=hTWKbfoikeg***
***Nirvana – Smells Like Teen Spirit***

One of the traits of many great artists is that they are ahead of their times, in the moment their work may be puzzling, but given some time it becomes prescient. Thirty-three years ago (can't believe it's been that long), when Kurt Cobain wrote "Smells Like Teen Spirit", Nirvana touched on the ever increasing boredom we face and the need to be entertained. Today that boredom seems omnipresent.

Over the decades, our world has grown increasingly more boring. In 2022, the 10 most popular films in the world included eight franchise sequels (Top Gun, Jurassic Park, Avatar, Minions, Shrek, Batman, and three Marvels). In 2023 we had two more Marvels, and rehashes of Fast and Furious, Mission Impossible, Barbie, Super Mario, Little Mermaid, and Willy Wonka.

We get content that is formulaic, comfortably familiar and boring. The music industry has also become more data driven. Studies have shown that not only are songs in particular genres becoming more similar, but the genres themselves are getting more and more alike. Country, Rock, Pop, and Rap are crossing over so often that they sound alike. Entertain us!

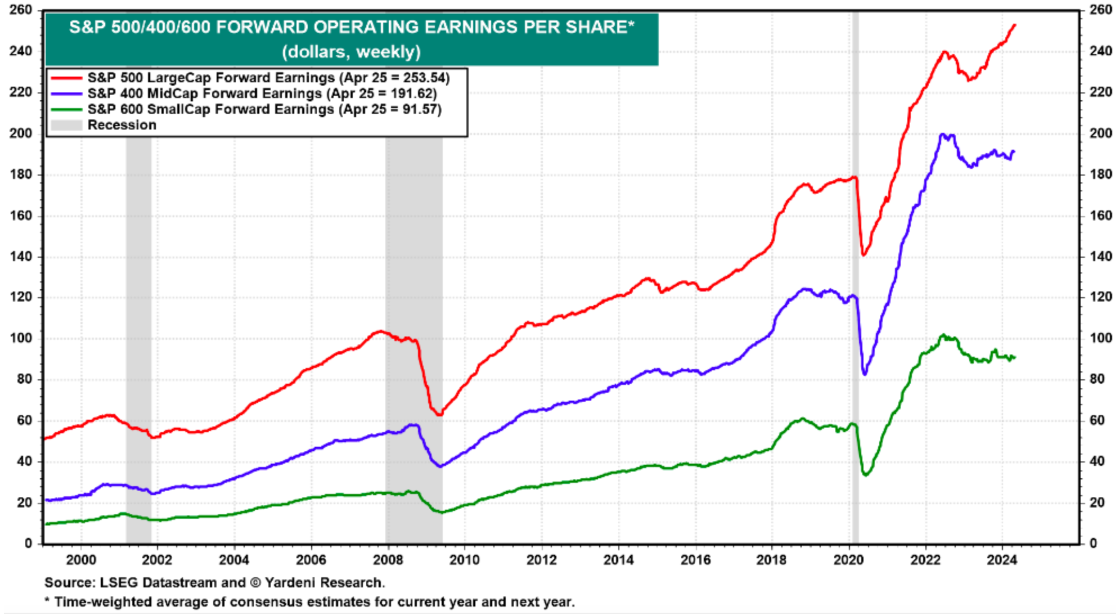
Sports too have become more boring. Maybe you've seen this graphic making the rounds. It shows, very clearly, how the data driven quantitative revolution has affected basketball. When you run the numbers, mathematically the only places it makes sense to take a shot is from 3-point land or right under the basket. As a result, this is how basketball is now played. And it's not just basketball, all sports are becoming more and more analytical, predictable, and boring.



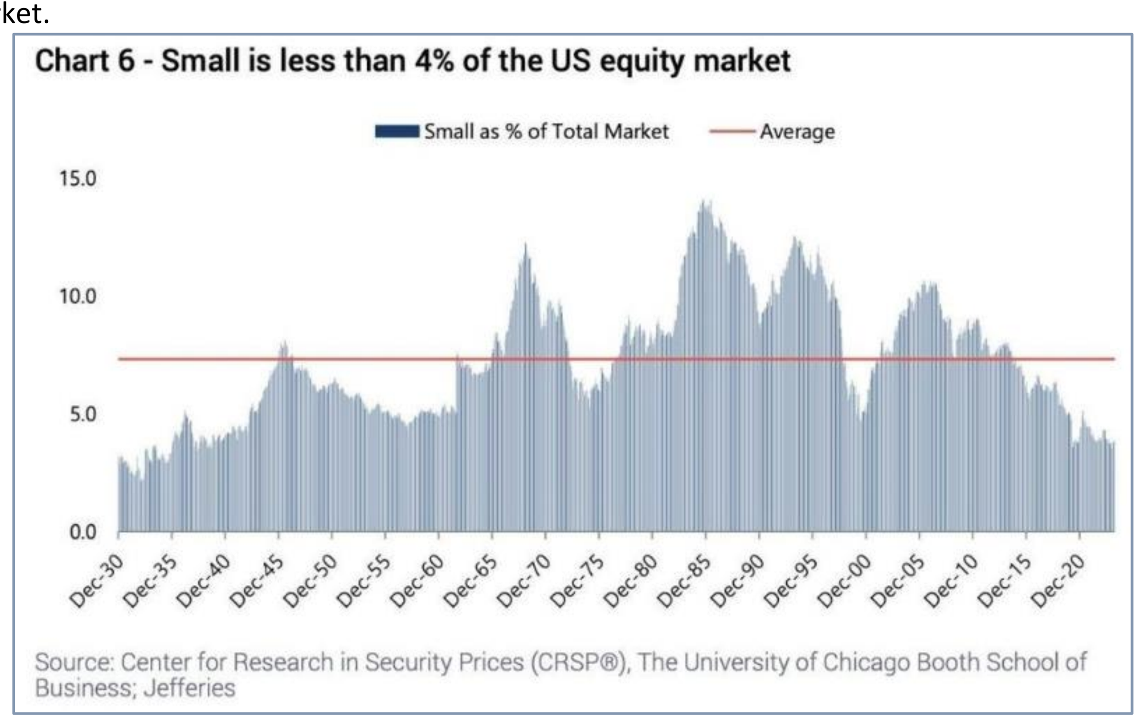

Mathematics (big data computing) is making our lives more efficient, more optimized, more boring. Social media is built on the backs of big data. TikTok, Facebook (Meta), YouTube, Twitter (X) and Instagram feed us a constant stream of frustratingly addictive content. In a battle to monopolize our time and sell more advertising, algorithms calculate what we are most interested in and continuously feed us the same thing over and over again.

Unfortunately, as AI (Artificial Intelligence) takes over it will get even worse. Everything that has ever been written, every image, every recipe will be instantly scrutinized and incorporated into your feed. Creativity passes from the human to the computer, where it is homogenized and optimized to maximize corporate profits. Everything you see, taste, feel, think will be algorithmically predicted. Boring!

This isn't just happening in our entertainment venues; it is also happening in our work environment. Corporations use data analysis and AI to determine best work practices and to enhance efficiencies. There are so many productivity enhancement tools available that even small companies need a Chief Information Officer (CIO) to sort it all out. Maximizing profitability is always the goal and that has been the result over the last decade. We have seen a steady creep higher in profit margins throughout corporate America, but this creep higher has not been even. The graphic below shows earnings for the larger S&P 500 stocks surging higher, while those of the Mid and Small-Cap stocks stagnates (this is even more dramatic if we were to break out the Mega-Cap stocks). Currently, all of this new AI is extremely expensive and is therefore being implemented by the largest, healthiest companies in the marketplace. It's an arms race and the smaller companies have no arms.




Mr. Market has noticed this growing gap in competitiveness between the largest and smallest companies, and we've seen a steady decline in the relevance of Small-Cap stocks in the overall market.



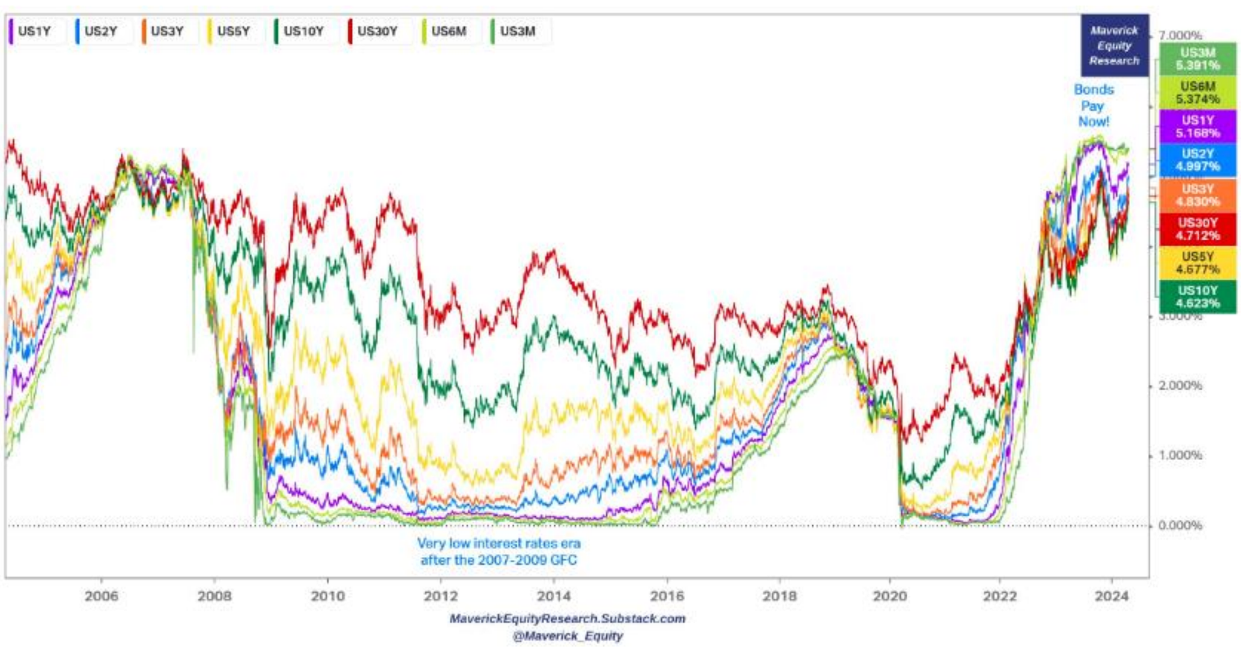

So, boring, AI generated, algorithmic big-data has taken over corporate America and the stock market too. I'm not sure if this is a good or bad thing. As investors pile into index funds, and the computers that run those funds continue to overweight the winners, the winners keep winning. I've always believed that the best investors are in harmony with the market, going with the flow, and for now that flow is certainly favoring large over small, and mega-large over everything else. The excitement will come when something causes this trend to break, unfortunately there is no way to know what or when that will happen.

From a humanity perspective though, we need to fight this sameness, we need to think, and create in a different, unpredictable way. We need to unplug more often and expose ourselves to the unpredictability of nature. That's what makes the world interesting, and even entertaining.

***<u>Market Commentary:</u>***

So far this year the S&P 500 is up nearly 6%, even after a 4% decline in the month of April. Generally, 6% in four months is pretty nice, but we're spoiled since we were up 10% at the end of the first quarter.

The abrupt sell-off in April can be blamed on a jump upward in inflation and a corresponding move higher in interest rates. As the chart below shows, you can get nearly 5% on any maturity of Treasury debt.

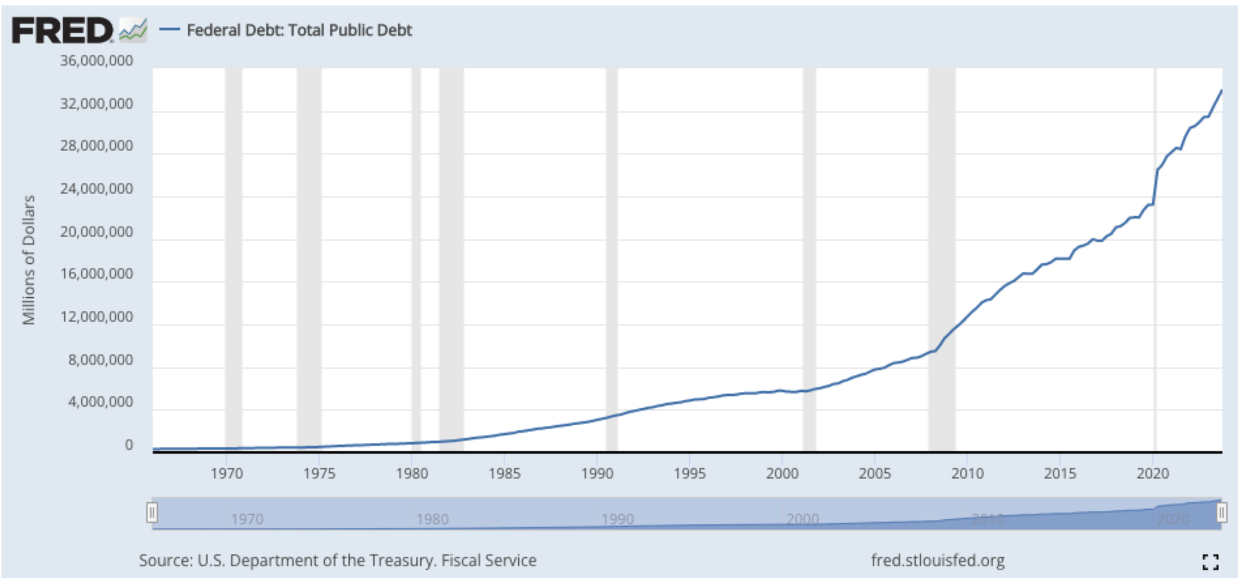



The Fed's stated goal is to devalue the dollar by 2% annually (2% inflation target), but unfortunately inflation has been running a little hotter than that. **Here's the average annual inflation over the last 1-10 years:**

- 1 Year: 3.2%
- 2 Years: 4.6%
- 3 Years: 5.7%
- 5 Years: 4.2%
- 7 Years: 3.5%
- 10 Years: 2.8%

Nowhere to be found: 2% inflation.

The Fed's main problem with trying to get inflation under control is the fact that there are very few people in Washington who know how to say no. Saying that they are spending like drunken sailors assumes that drunken sailors have unlimited spending accounts, and that they are that irresponsible.

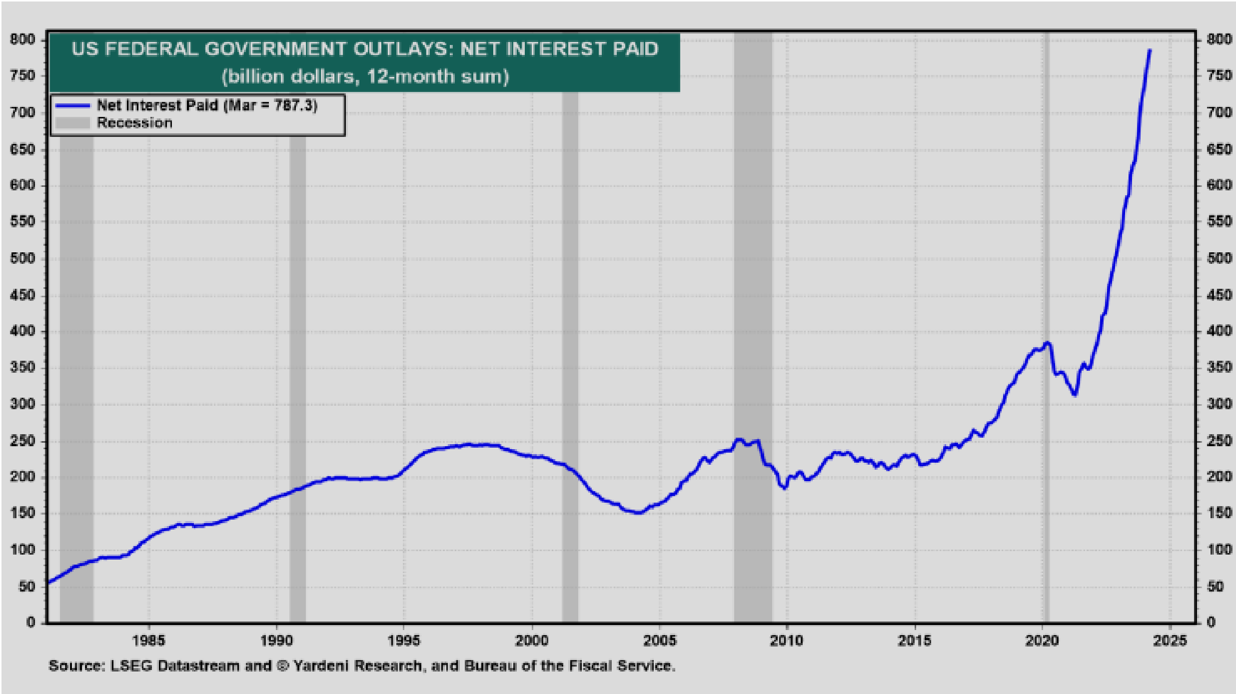



The Federal government doesn't pay off this debt, they simply roll it over and refinance it. This ballooning level of debt is now being financed at higher interest rates, causing the interest on the debt to explode. The interest on our debt has now passed Defense Spending as the third largest government outlay, only Social Security and Medicare are larger. And because those bonds maturing today are being refinanced at much higher rates, the interest on our debt will soon pass one trillion dollars.

How big is a trillion? There are 86,400 seconds in a day, and there are one trillion seconds in 31,546 years! That takes us back to the Ice Age when humans were just learning to communicate. **Look how far we've come, now we spend a trillion dollars just on interest!**

One of the biggest problems with this debt is our elected officials (both parties) willingness to ignore it. Their willingness to ignore debt sets an example for the rest of us, debt doesn't matter, paying back debt doesn't matter, we're entitled to whatever our politicians say we can have.

My question to those politicians: If debt doesn't matter, then why do you even bother collecting taxes?

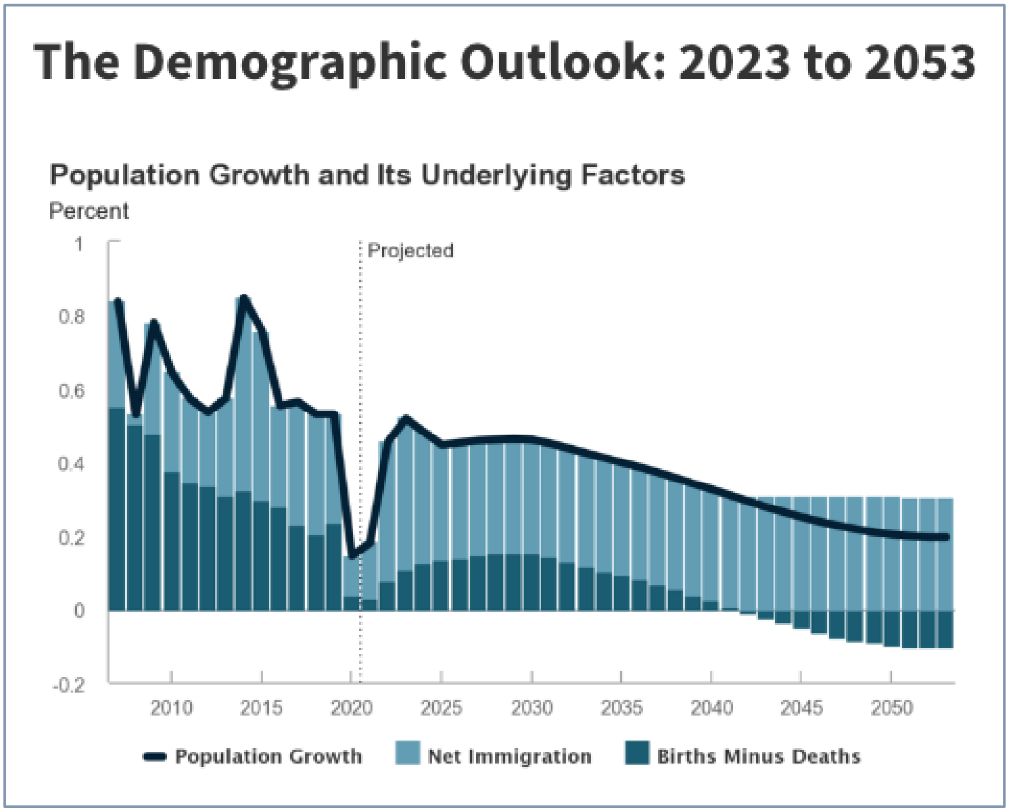



When will debt, and soaring interest payments matter? When the bond market says they do. There will probably be a day when the Treasury goes to auction off their bonds and the buyers don't show up. Only the power of the bond market can reign in our spendthrift politicians.

This debt, and the resulting threat of higher for longer inflation and interest rates is the main reason we continue to keep our fixed income portfolios on the relatively short side of the yield curve, with a duration around 3 years.

Finally, in homage to the baby swimming after the sinking dollar on Nirvana's classic album cover, let's spend a minute looking at one of the main engines of economic growth, babies. Economies can grow in two ways; by boosting labor or by increasing productivity. Generally, it is easier for a country to grow if they have population growth, or at least population stability. Those countries with declining populations tend to struggle with economic growth.

Demographics, namely a countries birth/death ratio play an integral part in determining long-term growth, and our numbers here in the United States don't look too good. Our population grows when births outnumber deaths, and through immigration. Right now our country is seeing population growth almost entirely through immigration. Births barely outnumber deaths, and will most likely turn negative in the next few years. In the U.S. we would need an average of 2.1 births per woman to have population equilibrium (excluding immigration), we currently have a new low birth rate of 1.6 births per woman. Please do your part and procreate.




I like to think of myself as a pragmatic optimist. Mankind has been around for a bit over a trillion seconds and we have proven to be very resilient. From an investors perspective (my day job) I still believe that making money and protecting assets are jobs one and one A. Being aware of the environment we currently find ourselves in and trying to navigate it is how I entertain myself. There are a lot of things going on in this country that I might not agree with, but the fact of the matter is that Mr. Market doesn't care. Our job continues to be to identify those areas of the market where we can participate in growth…entertain us.

As always, be careful out there.

Chris Wiles, CFA

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