PETERSON FINANCIAL SERVICES

Limited Liability Company ◆ Registered Investment Advisory Firm

FINANCIAL FOCUS

First Quarter 2024

April 1, 2024 – No foolin'

AT THE CURRENT MOMENT, OUR ECONOMIC CONDITIONS ARE DOING FINE. BUT GROWING GEOPOLITICAL RISKS ARE OF CONCERN.

QUARTERLY MARKET RECAP

Gains from the strong final quarter of 2023 continued into this year. As is usually the case, certain asset classes did far better than others, but with the exception of fixed income, all the equity markets did well. The end to the Federal Reserve's tightening cycle led to speculation surrounding the start of the upcoming loosening cycle. Inflation figures hover below 3%, so they aren't quite to the target of 2%, but the risks of a recession in the absence of lowering rates is the new driver.

Last quarter the DJIA picked up 5.62% and along with other indexes, hit a new all-time high during the quarter. The S&P 500 added the most at 10.16%, and the NASDAQ gained 9.11%. The small-cap Russell 2000 is pulling up the rear, but it also added 4.81%. Global equities earned 8.44% as well. For over a year, inflation has been steadily declining but in recent months, that has leveled off. It has not gone back up, so interest rates have fluctuated as the bond market tries to figure out upcoming Fed moves. As a result, the Barclay's Aggregate Bond Index reversed it's positive 2023 gains, and declined 0.81% last quarter. We expect this to reverse again to the upside toward the end of the current quarter. Strong labor markets and positive economic growth should persist through this year, but in 2026 the lower current income tax rates are scheduled to revert to pre-2017 levels.

THE WORLD'S DICTATORS ARE CLOSELY WATCHING OUR ACTIONS AND POLICIES, AND ARE CALCULATING

While our politicians seem more interested in forcing us to buy cars we don't want, and ignore our annual $1.4 trillion deficits and insane $34 trillion debt, the world is boiling over on several fronts. We tend to pay close attention to strictly economic data when assessing our investment direction, but history reveals that the impact of deadly and costly wars on the economy and markets is substantial. Until recent decades, we were economically decoupled from our global adversaries and computer technology was not the factor it is today. Everything that enables our daily lives and our national defense will cease to function properly without semiconductors, the internet, and other technologies, including AI. As a result, the disruption of these will be catastrophic.

Totalitarian dictators are gaining strength around the world, and possess technology that rivals ours. They respond to carrots and sticks, and watch our every move for signs of weakness, which would invite them to boldly move against us and our allies.

Our abrupt, chaotic, and unnecessary pullout from Afghanistan was not lost on Vladimir Putin. It signaled we didn't have the stomach to support an ally for the long haul. It is inconceivable that this didn't enter into his calculation to invade Ukraine. Foolishly stating that a "minor incursion" across the border would be permissible, meant the green light was given. Showing early support was all good, but not providing the means to win the war rather than just not lose it, sent yet another message and is costing innocent lives. And we're still sending it by not working out a meaningful aid package. Notwithstanding the moral equation but only applying a concern for the economics of it, if we think a few hundred billion dollars is a waste of precious resources now, wait until we are forced to commit our American military to a fighting war defending NATO allies, costing trillions of dollars.

Add to that our feckless support for Israel's right to defend itself against a terrorist group that denies its right to exist. It didn't take but a few months before our "support for whatever it takes for as long as necessary" turned into calls for surrender via cease fire. Houthi terrorists hold the Red Sea shipping lanes hostage to missile attacks and while we have the capacity to take them out, we lack the will to do so.

And then there's China's Xi. Already pushing the limits in the South China Sea against neighboring sovereign nations' territories and shipping, threats against Tiawan are growing daily. Lest we think this is all just foreign policy and politics that don't affect our global economy and world financial markets, we need to be mindful of the extreme integration of global technological and other supply chains, trade, and our reliance on them.

A war over Tiawan would be far more devastating to the world economy than anything going on in the Middle East or Europe. The vast majority of semiconductors manufactured worldwide runs through Tiawan at some stage of production. If China, sensing the moment is ripe, pursues the forcible "re-unification" it desires with Tiawan, their control of that supply would cripple every aspect of life for virtually every inhabitant of Earth. This is not hyperbole – it is fact.

The global shock to the closing off of the South China Sea and the waters around Tiawan in a blockade of international trade would be more disruptive than anything that's happened economically since WWII. Other allies, like Japan and South Korea are more heavily dependent on imported fuel and food than most, and their contribution to the world economy is substantial. Both of those economies provide a huge portion of global manufactured goods and they import most of their raw materials to produce them.

And don't dismiss the possibility that North Korea would smell blood in the water and take the opportunity to attack while American forces are stretched thin in potentially three theaters: Europe, the Middle East, and the Pacific Rim. Our enemies will coordinate. The products and components we use that are produced in these areas would vanish from American and European store shelves. And we do not have the manufacturing capacity to infill those losses. Supply shortages experienced during the pandemic would seem cute. Stocks would crash.

Our dependence on the internet, satellites, power grids, computer hardware and software, and countless other things that didn't even exist a few decades ago is absolute and the loss of them would be crippling. China has aggressively advanced their capabilities in AI, hypersonic missiles, hard Blue Ocean assets, cybertheft and hacking, space weaponry, essential rare-earth minerals, and countless other areas. And they are not the only ones. We are not keeping up.

Over the last few decades, our Navy's fleet has been more than halved. We have not maintained our technological edge in weapons systems. Our Air Force and Army are underfunded and under-supplied. Munitions are low. The just-passed $1.2 trillion spending bill has a pathetic 1% increase in defense spending. With inflation running at almost 3%, this is a real cut of 2%. China's current defense budget increased 7.2%.

One of the greatest strengths America has had in the post-WWII era is its deterrence, fueled by both our enemies' and friends' understanding of our resolve to do what was necessary to defend our interests. That is in question now, and will lead to serious problems for us if not reversed.

"The tree of liberty must be refreshed from time to time with the blood of patriots and tyrants."

- President Thomas Jefferson

ABOUT PETERSON FINANCIAL SERVICES, LLC

As an aside, we wish to remind our clients of our various services. While we specialize in portfolio management, we continue to provide financial planning and insurance services. Longtime clients may have forgotten this, and newer clients may not be aware of this. Additionally, we build our business through referrals, and much appreciate them. Please keep us in mind as you come across friends, family and colleagues who might benefit from our financial services. We appreciate your business.

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