SAPPHIRE
FIDUCIARY ADVISORS

April 8, 2024

Dear clients and friends,

During the first quarter of 2024, the S&P 500 index delivered a total return of 10.6%. The U.S. Aggregate bond index decreased 0.8%, due to rising interest rates and despite its 4.9% yield. International equities, as represented by the EAFE Index, advanced 5.9% as measured in US dollars. While these figures provide a frame of reference, our investment approach does not attempt to replicate these indices.

It is worth noting that US federal government spending will total $6.5 trillion in 2024. Nearly 25% of it will be funded by borrowing. Half of the proceeds from that borrowing will be used to pay interest on outstanding debt. Given the combination of higher interest rates and continued debt-financed spending, the Congressional Budget Office estimates that annual net interest expense will total more than 35% of US federal government revenue in 30 years. To put this in context, interest expense may eclipse Social Security and Defense spending, which together represent 36% of the federal budget today.

Currently, the nominal yield on the ten-year US Treasury bond is roughly 4.4% and inflation (CPI) was 3.8% as of March 31, 2024. The difference between these two figures is the real yield. In our view, neither the nominal yield nor the real yield provides adequate compensation for lending money to Uncle Sam for ten years given the country's financial condition – especially after-tax! That said, the United States issues debt in its own currency and "owns the printing press," so Treasury debt is nominally risk-free. The US can always print more, but as we have been reminded recently, more money without commensurate increases in production of goods and services causes inflation, which is effectively a regressive tax. In light of these conditions, we continue to favor shorter-dated bonds that offer a yield advantage and mitigate the risk of reversion to a positively sloped yield curve (bond prices and yields are inversely related).

With respect to domestic equities, we are certainly aware that "the market" appears to be expensive, but we view it as "a market of stocks," not as "the stock market." Security selection matters, especially in the aftermath of a prolonged period of easy money. Having honed our investment approach over decades of investing, reading, and engaging like-minded investors, we have developed a proprietary equity portfolio that is comprised of roughly 25 companies we believe will be "compounding machines." Our security selection approach seeks to mitigate the risk of permanent loss and to deliver exceptional investment results over the long term. We aim to maintain a rational collection of extraordinary businesses that tax-efficiently and cost-effectively creates value for our clients. We imagine that Charlie Munger would have called it a "sit on your assets portfolio" – the approach certainly worked for him!

Please let us know if you would like to learn more about our thought process, services, and portfolio holdings. We look forward to hearing from you!

Respectfully,

Paul Stropkay, CFA

Sources

- J.P. Morgan Asset Management *Guide to the Markets®* U.S. 2Q 2024 as of March 31, 2024

Disclosures

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