October 11, 2024

Dear clients and friends,

The S&P 500 index delivered a total return of 5.9% during the quarter and 21.6% year-to-date through September 30, 2024. Because this index is weighted by the market capitalization of its constituents, the largest companies have the greatest effect. At the end of the third quarter, the top ten stocks in the index represented over one third of the market value of the S&P 500. These stocks traded at a forward price-to-earnings multiple of 30.5x, which is roughly 50% higher than the average of the top ten stocks since 1996. That said, the current top ten companies have extraordinary competitive advantages and fundamentals that strengthen the case for lofty valuations. The remaining stocks in the index traded at a price of 18.4x forward earnings at the end of the quarter. While appearing to be comparatively cheap at first glance, these stocks are also richly valued compared to historical averages. Winner-take-all juggernauts and falling interest rates have fueled enthusiasm in the stock market this year, but current valuation multiples suggest that expected returns for domestic equities over the medium-term will be muted.

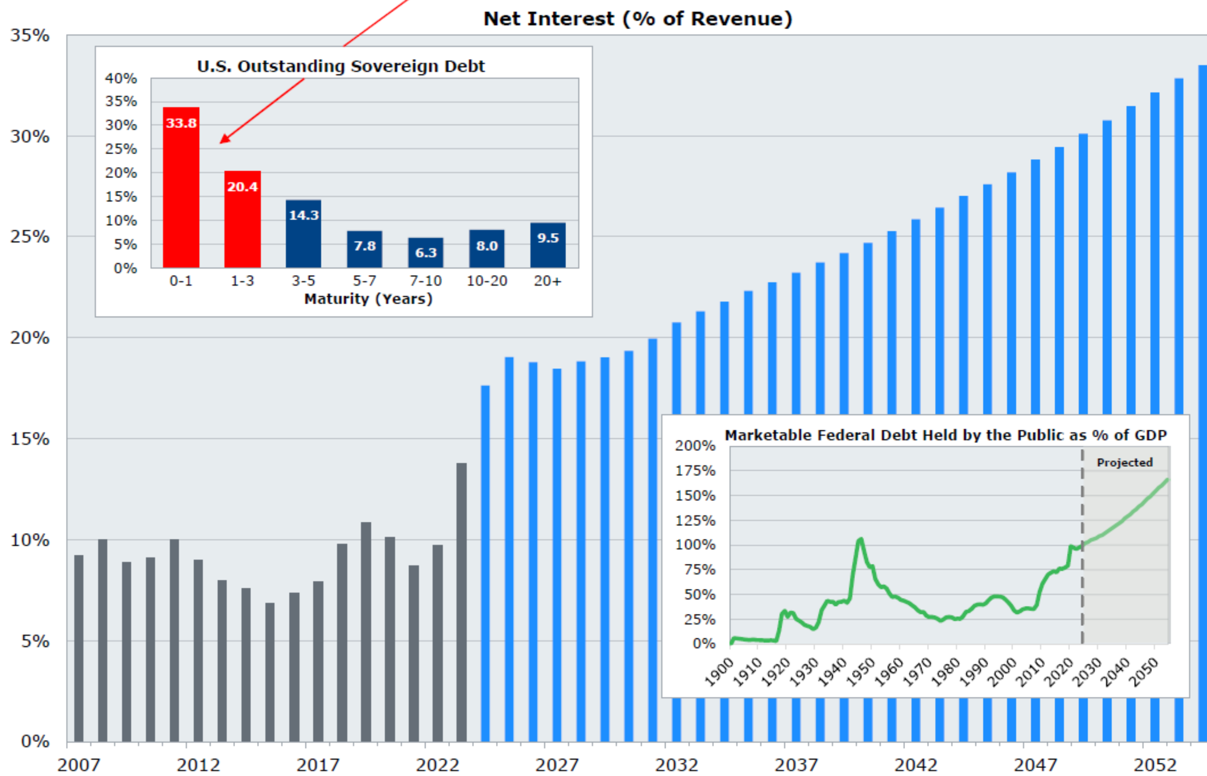
Uncharacteristically, the bond market has been a source of excitement, too. Recall the 10-year US Treasury yield of 0.5% in August 2020. As of September 30, 2024, the yield was 4.2%. At the short end of the curve, the Federal Funds Effective Rate approached zero four years ago and spiked to 5.3% in August 2023. Bonds, as measured by the Bloomberg Aggregate index, delivered a total return of 4.5% year-to-date through September 30, 2024, but are still in the red over the past three years. Bond prices and prevailing interest rates have an inverse relationship. The wild swings in rates and bond prices have whipsawed fixed income investors and are now affecting the real economy in the form of the interest expense that consumers, businesses, corporations, and most alarmingly, the US Treasury is facing. As shown in the following graphic, more than half of the outstanding federal debt will mature over the next 36 months and will need to be refinanced at materially higher rates. The Congressional Budget Office estimates that interest expense and entitlement spending will climb to unsustainable levels over the next decade. For these reasons, we are reluctant to invest in long-term fixed income securities in the current interest rate environment.

(502) 509-2568 | info@sapphirefiduciary.com | sapphirefiduciary.com

Debt Service Rising Significantly

Over 50% of U.S. Debt Matures Within 3 Years

BAIRD



Source: Congressional Budget Office, Strategas

Neither campaign for the highest office in the land is addressing this reality. As Bloomberg News recently published, "Already, the tax increases and/or spending cuts needed to eliminate the primary deficit are too big for politicians to contemplate – and, to repeat, depending on what happens to interest rates and growth, a balanced primary budget might not be enough to arrest the rise in debt. The longer action is delayed, the bigger the tax hikes, spending cuts and resulting primary surplus will need to be. At some point, an orderly resolution becomes politically impossible. *That leaves default – either explicit or in the form of debt repudiation through inflation.*" [*emphasis added*] Explicit default is unlikely, since it would hobble the global financial system and since the US owns its printing press. That leaves the prospect of rising inflation, which hurts fixed income investors by eroding purchasing power. And, as we have witnessed recently, inflation is also a brutal, regressive tax.

We appreciate your continued partnership and friendship. Should you have any questions or wish to discuss your portfolio or our views in more detail, please reach out.

Respectfully,

Paul Stropkay, CFA

Sources

- J.P. Morgan Asset Management *Guide to the Markets®* U.S. 4Q 2024 as of September 30, 2024
- https://fred.stlouisfed.org/series/FEDFUNDS
- Robert W. Baird & Co. — Baird Advisors 3rd Quarter Bond Market Review
- America's Debt Crisis Is Getting Too Big to Solve by Clive Crook of Bloomberg News – August 7, 2024

Disclosures

Past performance is no guarantee of future results. No guarantees are implied. The views in this letter are intended to assist investors in understanding the firm's present investment methodology and do not constitute investment advice. For more information including additional disclosures, please visit our website.

Advisory services are offered through Sapphire Fiduciary Advisors, LLC (Sapphire), a registered investment adviser. Investment advisor representatives of Sapphire offer advisory services through Sapphire and not through affiliation with any bank. Products and services offered by Sapphire:

are not insured by the FDIC;
are not deposits or other obligations of a bank and are not guaranteed by a bank; and,
are subject to investment risks, including possible loss of principal.