The Optimistic Investor

FOCUS ON WHAT REALLY MATTERS

Overview

Welcome Back

As summer fades into fall and the leaves begin to change here in Central Pennsylvania, we find ourselves in a familiar situation. Inflation is trending lower, economic data remains healthy, and equity markets have continued a very strong year. Nevertheless, as is so often the case, much of the financial media is fixated on uncertainty about the future. At this particular moment, the main topics of focus are whether the Federal Reserve will achieve its inflation goal without causing a recession, and the outcome of this year's presidential election.

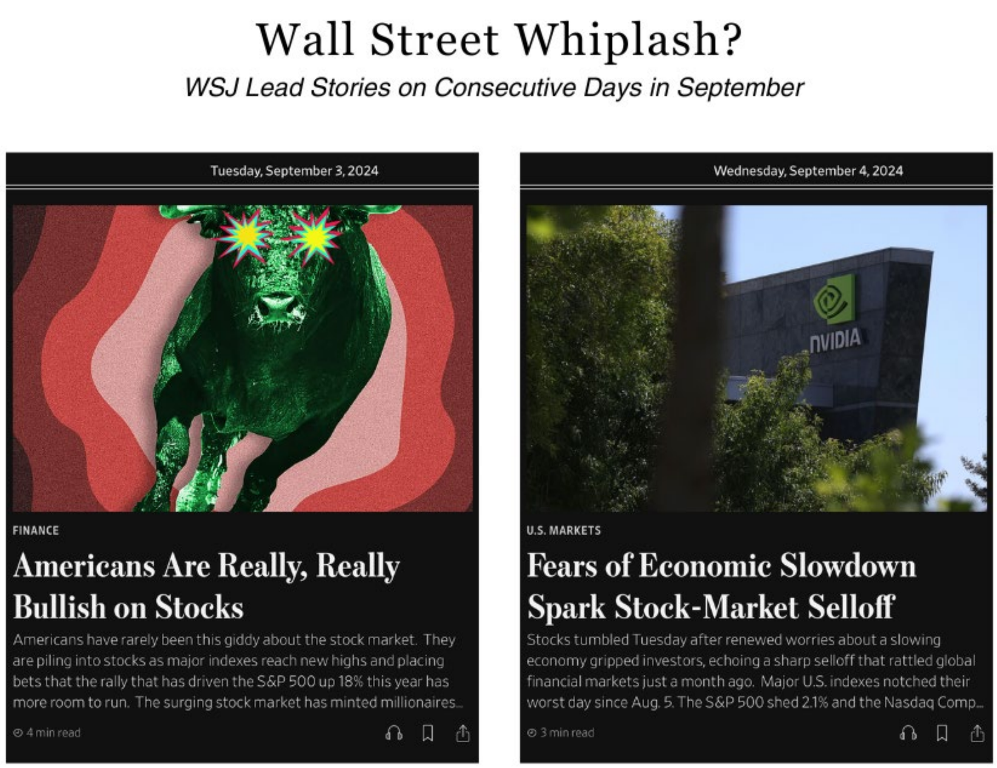
Of course, as you know, it's our willingness to bear uncertainty that ultimately drives the returns we need to be successful investors. That's why our essay this quarter is about the importance of using our long-term plan to help us endure uncertainty and avoid being swayed by the ever-shifting nature of market sentiment.

Navigating the Noise

Earlier this month, the Wall Street Journal provided a perfect setup for this quarter's essay. As we returned from Labor Day weekend, it ran front-page headlines on consecutive days that painted diametrically opposite pictures of the stock market.

The lead article on September 3rd was titled "*Americans Are Really, Really Bullish on Stocks.*"[1] It described a "surging stock market" and talked about how investors were "feeling good." After markets opened, the S&P 500 declined and closed the day down 2.1%. The following morning, September 4th, the Journal led with a piece titled "*Fears of Economic Slowdown Spark Stock-Market Selloff,*" which highlighted "renewed worries about a slowing economy."[2] You can see the contrast below in Figure 1.

Figure 1



Our purpose here is not to criticize the Journal or suggest there was anything wrong with its reporting. Rather, we want to use this example to highlight two complementary elements of sound investing – namely, recognizing that

[1] Banerji, Gunjan, "Americans Are Really, Really Bullish on Stocks." Wall Street Journal, September 3, 2024.

[2] Miao, Hannah, "Fears of Economic Slowdown Spark Stock-Market Selloff." Wall Street Journal, September 4, 2024.

markets are fickle and cannot be timed, and thus choosing to act based on a long-term plan.

Our clients and committed readers often hear us say that successful investing flows from making a long-term plan and sticking with it through the inevitable ups and downs of the market cycle. Starting with a plan is important because it tethers our investment strategy to our long-term goals. By defining our goals up front and creating the investment plan most likely to achieve them over time, we put ourselves in a position to withstand the uncertainty that constantly swirls around us in today's world. It makes the relevant question: does anything that's happening right now change my long-term goals? And, if the answer is no, we can be confident that sticking with our existing plan is always the right decision.

If our investment strategy isn't based on our long-term goals, it will inevitably end up being driven by current events and the short-term market outlook. To see why this is a recipe for disaster, all you need to do is look back at Figure 1. The two headlines shown there demonstrate how incredibly fickle market sentiment is; it often turns on a dime, and that's why people who let the short-term outlook guide their investment decisions usually end up disappointed.

Journalist and author Roger Lowenstein perfectly summarized this dynamic when he said: "the process by which markets arrive over the long term at a reasonable conclusion amounts in the short term to a series of very irrational ups and downs. No sane man could heed their every verdict."[3]

There is so much wisdom in that quote. Short-term market movements are heavily driven by emotion and sentiment (like fear and greed). Traders and speculators wager on what the future will bring and rush to judgments on how new developments might impact the status quo. These factors can result in unpredictable swings (up and down) that often seem to defy common sense and catch people off-guard. Trying to base your investment plan on these swings will drive you crazy and eventually derail your long-term goals.

Fortunately, as time passes, markets are very effective at working through the noise and distilling out the information that really matters. That's why they do an excellent job of discerning enterprise values and efficiently allocating capital in the long run. And we can see proof of that in the fact that long-term increases in share prices (and broad market levels) are almost entirely driven by growth of corporate earnings (*i.e.*, increased profits).

> ***Markets arrive at rational long-term conclusions through an unpredictable series of ups and downs that often seems irrational.***

The takeaway here is that we can be confident in markets' ability to determine value and reward great companies over time, but we can't take our cues from them in the shorter term because emotion, sentiment and speculation play too large a role.

This is where our long-term plan comes into play. The plan operates as a bridge. It connects the present with where we want to be in the future (*i.e.*, our goals), and it carries us safely past the short-term noise we can't depend on and need to tune out.

[3] Lowenstein, Roger. *Origins of the Crash: The Great Bubble and Its Undoing*. (New York: Penguin Press, 2004), 28-29.

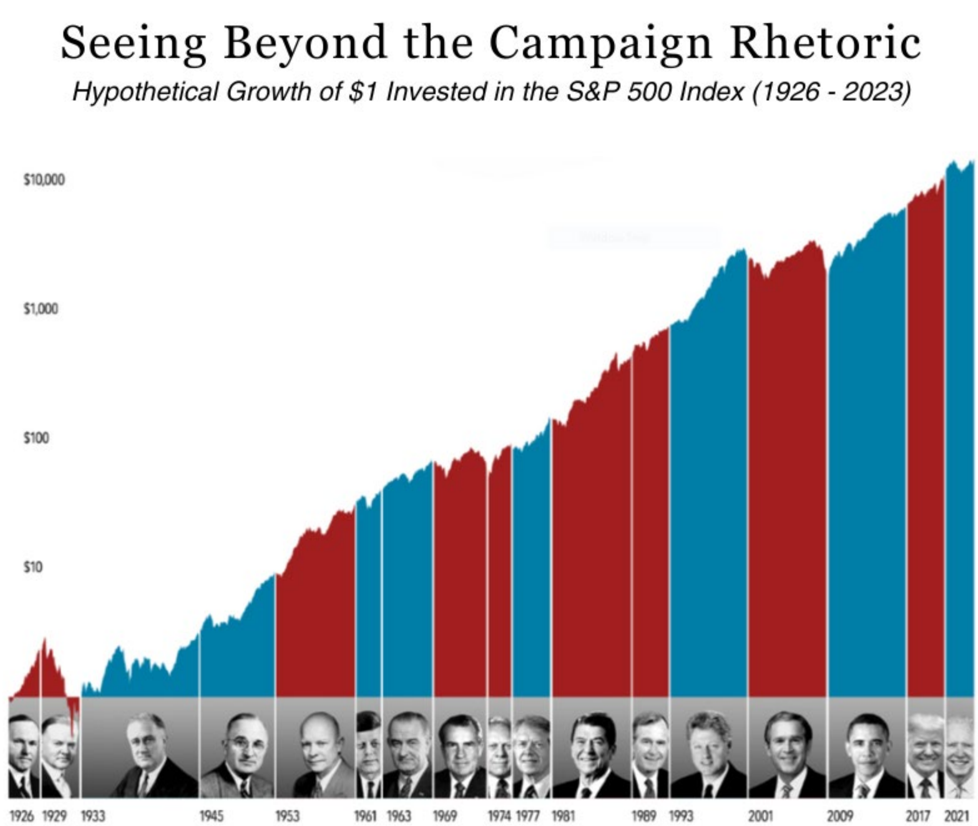
That bridge is how we stay focused and calm as investors, even when the rest of the world fixates on things that feel critical in the moment but don't really matter in the long run.

Potential causes and timelines of future recessions are the epitome of such topics. The simple fact is that recessions are a normal part of the economic cycle and cannot be forecast with any degree of reliability. Moreover, as we've discussed in the past, great companies buckle down when times get tough and they come out stronger on the other side.

Presidential elections are another classic example of current events that shouldn't concern long-term investors. Our last edition (accessible [here]) highlighted that great companies have achieved strong results and grown their profits (and thus share prices) under both democratic and republican presidents, through periods of unrest and calm alike, and despite the headwinds created by poor economic policy. And we showed that creating a long-term plan and sticking with it has produced much better long-term results than letting our political views drive our investment decisions.

We don't need to repeat that entire discussion this quarter. However, with the election so close and economic policy such a key issue, we want to reinforce the extent to which public companies have achieved success across the administrations and policy initiatives of the last 100 years. Figure 2 does that by providing a history of the S&P 500 that's broken down by the various presidential terms since 1926.

Figure 2



Looking at Figure 2, you can clearly see that the long-term trend has been substantial growth, despite the different political dynamics and challenges that existed over the years.[4] That may surprise some of you. But, as our favorite financial writer, Nick Murray, put it earlier this summer: "Presidents and their policies come and go. That pendulum swings back and forth; always has. Through it all, superior companies continue to serve their customers, increase their earnings and raise their dividends over time. That's what we're investing in. For our purposes, everything else is noise."[5]

We can't say it any better than that. So do your best to tune out the noise in the coming weeks. And, if we can help with that, please don't hesitate to call us. Our team is always here to guide you across your bridge towards your long-term goals.

Innovation & Good News

1) Living standards are increasing for American families. The Census Bureau recently reported that the ***inflation-adjusted*** median household income rose 4% in 2023. Despite the inflation we've seen the past few years, the average U.S. household's purchasing power is now higher than it was before the pandemic.

2) Last quarter we mentioned that weight-loss drugs (GLP-1 inhibitors) appear to reduce the risk of certain cancers. Evidence is emerging that they also seem to reduce heart and kidney disease. And a recent clinical trial suggests they may be effective at slowing the progression of Alzheimer's disease.

3) Scientists at the University of Pittsburgh think they may be able to use mRNA, the technology utilized in COVID-19 vaccines, to induce failing organs to repair themselves. This could potentially reduce (or ultimately avoid!) the need for organ transplants in the future, save countless lives, and meaningfully extend lifespans.

5) Our March edition highlighted the potential for "fracking" technology to make geothermal energy more reliable. This summer, the company that pioneered that technique signed a contract to provide the electricity needed to power ~ 350,000 homes in California.

6) Researchers have created a silk fabric that can prevent sound from passing through it. And it's only the width of a human hair!

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[4] The chart shown in Figure 2 was created by Dimensional Fund Advisors. You can view an interactive version that allows you to drill down on each administration, along with all the applicable disclosures, by clicking here. Bonus points for those of you who knew, without looking, that the president in 1926 was Calvin Coolidge.

[5] Murray, Nick, "The Politics of Total Chaos." Nick Murray Interactive, Vol. 24, Issue 8, pg. 3 (Aug. 2024).

Financial Planning Updates

Beneficiary RMDs – This summer the IRS finalized regulations on required minimum distributions from inherited IRAs. The final rules, which apply starting in 2025, require annual distributions for many people who previously hoped to have flexibility to defer distributions over 5- and 10-year periods.

Social Security COLA – Earlier this month the Wall Street Journal reported on preliminary estimates for the cost-of-living increase that will apply to Social Security benefits for 2025. Based on inflation data published so far this year, most experts expect the increase to be 2.5%.

Team Kooman Corner

Three members of Team Kooman recently celebrated major career milestones!

Amy Delauter celebrated 25 years at Kooman & Associates, and Stacy Anderson celebrated her 20-year anniversary.

We are beyond fortunate to have these two talented and committed ladies on our team. Thank you, Amy and Stacy, for everything you do!

Jackson Boyer passed his Series 65 exam and is now a fully-licensed financial advisor. Congratulations, Jackson!

KOOMAN & ASSOCIATES

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- If there are any changes in your personal/financial situation or investment objectives, so we can review, evaluate and/or revise our previous recommendations as needed; or
- If you would like to impose, add or modify any reasonable restrictions on our investment advisory services.

Unless and until you notify us, in writing, to the contrary, we will continue to provide services as we do currently.

Please also remember to advise us if you have not been receiving account statements (at least quarterly) from your account custodian.

