Dave Hutchison, CERTIFIED FINANCIAL PLANNER™

1720 E Calle Santa Cruz
Phoenix Arizona 85022

HUTCHISON INVESTMENT ADVISORS
Registered Investment Advisor
Founded on a CPA Firm Background
(602) 955-7500

E-mail:dave@hutchisonria.com
website: www.hutchisonria.com
Fax (602) 955-1458

Continued Good Economy, Soaring Jobs, Despite Interest Rate Surge October 2023

Strong Economy - Thrashing Markets - Soaring Interest Rates - Bond Losses Mount

After a Summer rally, markets significantly declined in September and early October as robust economic reports threatened the Fed's fight against inflation, and interest rates soared again.

While there are headwinds, the overall outlook is mostly positive, even with higher rates for longer. US inflation has declined from a 9% peak to about 3% - among the lowest in the global economies. However, getting down to the 2% Fed target is proving difficult.

This hyperfocus on inflation-related data seems misplaced because it is easy to make the case that inflation is under control. The Consumer Price Index (CPI) and the core CPI are in the low 2% range**, excluding rent**. Yes, rent inflation matters, but inflation on new leases is winding down at 3.4% in August. "Growing multifamily supply keeps new-lease rent growth subdued," Goldman Sachs economist Jan Hatzuis says. Morningstar 10/6/2023

US Treasury yields climbed to a 16-year high as a global bond rout resumed. Bond prices worldwide have fallen sharply amid an avalanche of Treasury issuance by the US government and a growing belief among investors that central banks will have to hold interest rates at a high level for an extended period. Analysts said signs of robust growth in the US make rate cuts from the Federal Reserve over the coming years less likely, hitting Treasuries. Financial Times 10/2/2023

"Blowout" Jobs Report for September

"Bidenomics" has driven America clear of the pandemic while maintaining employment at near-record levels. Jobs unexpectedly surged in September—almost double what was expected—yielding more evidence of America's remarkably durable labor market. Nonfarm payrolls increased 336,000 last month—the most since the start of the year—after sizable upward revisions to the prior two months. The unemployment rate held at a near-record low of 3.8%, and wages rose at a modest pace. The surprising vigor of the job market suggests companies remain confident about their sales prospects. While the pace of hiring has cooled since last year, its resilience remains a crucial source of strength for household spending and the broader economy. Bloomberg 10/6/2023

Despite the overwhelming strength, however, September's data reflected notable cooling in an area on which the Fed has been most focused: wages. Average hourly earnings rose 0.2% in September, coming 0.1 percentage points below expectations and matching the pace set in August. That was the mildest monthly gain in earnings in nearly a year and a half since February 2022, and it brings wages down to their slowest annual growth rate in more than two years since June 2021.

Potential Ideal Environment for Investors

Morningstar 10/6/2023 Highlights from the article "It's time for you to take a deep breath and buy stocks."

This is an ideal environment for investors, given the favorable mix of strong growth and declining inflation, says market strategist and economist Jim Paulsen. "Through the lens of another time, we would be rejoicing," he says.

Historically, 10-year bond yields are not that high: The 10-year Treasury bond yield has moved back to the 4%-5% that prevailed from 2003 to 2007, which was a good time to own stocks. Indeed, rising rates have not hurt the US economy this time around. "This raises the possibility that the economy can live with the bond yield back to its old normal level," says Ed Yardeni of Yardeni Research.

Sentiment is extremely weak. However, analyst earnings estimate revisions suggest this reporting season will be strong. The fourth quarter should be solid, too. Strong economic growth normally means strong earnings growth.

Next Few Years Positive Outlook Potential
Re-Industrialization and Massive Infrastructure and Climate Stimulus

Over the next few years, the transformative Biden policies in the IRA, CHIPS and Science Act, and The Infrastructure Investment and Jobs Act - the largest and most comprehensive infrastructure bill in American history – should accelerate US growth. These programs should result in $trillions of private investments, partially offset by tax credits to rebuild our broken supply lines, take back high-tech manufacturing from China, and historical programs for clean energy to fight fossil fuel-caused climate warming (resulting in the current record global heat, severe storms, and droughts).

"The US appears poised for a manufacturing boom as companies tap into Biden administration subsidies with pledges to spend tens of billions of dollars on new projects, according to Financial Times research." Financial Times (of London)

An example in Phoenix is the TSMC factory being built in northern Phoenix. The massive first fabrication plant ("fab") will feature the most advanced semiconductor-process technology in the US, employing 4,500 employees and many construction workers to build it. The second will make even more advanced chips. TSMC is investing $40 billion into the projects. However, the opening has been delayed by a year due to a shortage of skilled workers. AZ Central, KTAR, Bloomberg, and many local media reports.

TSMC update 10/6/2023 from Financial Times: TSMC commands the most state-of-the-art chip production technology in operation in the world today and controls 90 percent of the global market for the most advanced made-to-order chips. But the Arizona project, where TSMC is building two fabs for $40bn, has given the company a culture shock and put it and its employees on a steep learning curve.

So far, TSMC has made its most advanced chips exclusively in massive factories in Taiwan. Research and development staff nearby jump in to fix problems, suppliers are clustered tightly around, and service providers building the company's fabs for decades respond to its every need. That well-oiled model has helped make TSMC more profitable than most other semiconductor manufacturers. However, growing anxiety among governments and industry in the US, Europe, and Japan that a Chinese attack on Taiwan could leave the world without chip supplies forces the company to spread its manufacturing footprint. Apart from Arizona, the company is also setting up a new plant in Japan and has committed to a €10bn joint-venture fab in Germany.

Whether that trial goes well could make or break the US's quest to resurrect semiconductor production on its shores. But the first two years have been rough, threatening the project's timeline and the company's ambitions. The Taiwanese company has struggled with the American approach to construction and labor. TSMC has struggled to find enough skilled workers to install critical advanced machinery [especially extreme ultraviolet lithography technology or EUV machines]. In June, the company sent 500 additional specialists from Taiwan to help. Apart from Intel's technology development center in Oregon, no US fabs have EUV installed yet.

Institutional tax loss selling to meet the October 31st deadline may hurt bonds.

Portfolio managers are sitting on huge losses in bonds. For example, the iShares 20+ Year Treasury Bond index (an ETF that seeks to track the investment results of an index composed of US Treasury bonds with remaining maturities greater than twenty years) is down almost 50% from highs in 2020 and more than 40% from the start of 2022 when investors favored bonds over stocks because of US recession fears. With the recent rate surge, the index is down over 20% since 4/5/2023. Stockcharts.com

Most money managers have until the end of October to finish tax-loss selling, which means downward pressure on bond prices. Morningstar 10/6/2023 Dave notes that retail investors can sell until the end of December.

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Large-Cap Technology Showing Signs of Exhaustion

Many previously surging large-cap technology stocks have started to see an exhaustion point. The mid-2023 soaring with the AI craze of many tech sector's largest stocks was essentially neutered into September as earnings reports for Q2 failed to justify the high valuations. The monetization of AI is likely to come gradually over many years.

So why did the mega-cap techs fall in the first place? One key driver, the strategists say, was the rise in long-term yields. "The underperformance of the largest long-duration tech stocks in the face of soaring Treasury yields is consistent with the trading pattern of the last five years." MarketWatch 10/2/2023

US Dollar Soars

Despite the chaos in Congress, the US economy is one of the strongest globally. "Greenback rises for 10th straight week, longest winning streak since 2014." Marketwatch 9/22/2023 "The dollar has bounced back with a vengeance, threatening global central bankers' tricky task of bringing down inflation while protecting fragile economic growth. A strong dollar in the US is largely good for consumers because it holds down inflation by keeping import prices in check and making trips abroad cheaper. For the rest of the world, however, the return of the strong dollar is largely unwelcome. Some global central banks are tapping into stockpiles of foreign currency to help shore up their currencies. Others are publicly threatening to do so." Wall Street Journal 10/2/2023:

Latest GDP Good News

The Atlanta Fed produces a widely followed, unofficial real GDP growth estimate. As of 10/5/2023, the estimate for the 3rd quarter of 2023 is 4.9% GDP growth. If the final GDP growth – released at the end of October - is above 3.2%, it would mark the strongest quarter since 2021, when the US was experiencing a rapid recovery from the initial shock of the pandemic.

Current Excess Savings of Consumers Revised Higher – Potentially Good for US Outlook

Responding to the new data, JPMorgan said: "The combination of a higher recent saving rate and a lower pre-pandemic benchmark for saving suggests that there is a lot more 'excess saving' left over for households than we had seen in the data before the revisions. It now appears that the leftover excess saving stood at around $1.2tr in 2Q, notably higher than the $0.4tr figure estimated based on pre-revision data. An extra $800bn, stuffed down the back of the sofa." Financial Times 10/2/2023

$90 Oil Brent crude, the global benchmark for oil, breached $90 a barrel after OPEC+ leaders Saudi Arabia and Russia extended their combined 1.3 million barrel per day cuts until the end of 2023. However, as of 10/6/2023, Brent plunged to $84 on worries about a stronger US dollar, and that persistently high interest rates will slow global growth and hammer fuel demand. Reuters 10/6/2023

The increase in US oil production and exports has made the US the second-largest contributor to oil tanker export demand, only exceeded by Saudi Arabia. In the future, the US will contribute even more. The International Energy Agency estimates the US will contribute one-third of the increase in global oil production between 2023 and 2028. BIMCO/Oceanbolt 9/18/2023

US Oil Production Nears Record as Texas Shale Output Soars

US crude production reached the second-highest level on record as output from Texas's Permian Basin soared to an all-time high. The output growth comes even as explorers dial back activity. The increased production from the US has helped fill a void in global markets left by output cuts from Saudi Arabia and Russia in recent months, with the US routinely exporting more than 4 million barrels a day.Bloomberg 9/29/2023

American crude production is on track to hit a record 13 million barrels a day in September, according to Rystad Energy projections. Wall Street Journal (WSJ) 9/22/2023

However, new drilling is down, and refining capacity is stretched. New drilling and refineries are expensive and may not be economically feasible as renewable energy is growing rapidly over the next few years. According to industry reports, there are plenty of land leases for drilling. There is a shortage of workers for more drilling and construction. For example, Exxon, one of the largest shale drillers, cut its working US drilling rigs down about two this year to 17, well below the 65 it had running in the

Permian and other fields before a pandemic-induced oil downturn in 2020, according to energy-analytics firm Enverus.

The oil giant collected a record $55.7 billion annual profit last year as the industry recovered from the pandemic. But Exxon has kept drilling subdued, trying instead to coax more oil from fewer wells and boost shareholder payouts. According to FactSet, it spent about $16.1 billion on dividends and share repurchases in the first half of the year, compared with $10.8 billion on capital investments. WSJ 9/28/2023

Global News

Though the US has the lowest inflation rate among G7 countries, investors across the pond got good news from their latest inflation report. Data showed a surprising fall in **UK** inflation growth from 6.8% to 6.7% in August when most economists had forecast a rise to 7%. Notably, core inflation - which strips out the more volatile items such as energy and food - cooled sharply to 6.2%, which far exceeded initial expectations. The inflation data raises hopes that the cool-down of price growth in the UK could start to accelerate. The Guardian 9/19/2023 This compares to 3.7% CPI and 4.3% Core in the US for August. bls.gov

The eurozone economy probably shrank last quarter, according to a survey which showed demand fell in September at the fastest pace in almost three years as indebted consumers reined in spending in the face of rising borrowing costs and higher prices. Reuters 10/4/2023

Hours after the **People's Republic of China** celebrated its 74th birthday on October 1 with fireworks and flowers, the World Bank warned that East Asia's developing economies, including China, are set to expand at one of the lowest rates "since the late 1960s," excluding extraordinary events such as the COVID-19 pandemic, the Asian financial crisis in the late 1990s and the global oil shock in the 1970s.

Before China's National Day on Oct. 1, President Xi Jinping gave a speech acknowledging that China's path ahead would take much work. "Our future is bright, but the road ahead will not be smooth," Xi told his roughly 800 guests at the Great Hall of the People in the heart of Beijing. At the reception on September 28, Xi told his guests that China must continue to climb over "obstacles," and the nation's "strength comes from unity, and confidence is more valuable than gold." Voice of America News 10/2/2023

Smaller Investors Not Wanted by Many "Wirehouse" Brokers

Investment News 9/29/2023

[Deleted name] "with 15,000 financial advisors is eliminating payouts [compensation] to financial advisors who do business with households that have less than $250,000 in assets, unless those clients meet certain growth exemptions. For decades, large Wall Street firms have pressured financial advisors to stop doing business with the less wealthy and focus on the richest, more profitable clients.

'Large wirehouses rely on complex, cumbersome pay schemes known as 'grids' to determine what percentage a financial advisor keeps of each dollar of revenue he or she generates; wirehouse advisors typically pocket about 40 cents per dollar of revenue."

In the example given, advisors, to reach the highest payout level, the required revenue is increased by 10% from $1m in client fees and commissions to $1.1m annually.

Dave Notes asset management fees ("fee-only") are the most desired revenue. As I have pointed out, this is the most expensive way to get investment advice for the long-term investor who is not an active trader.