

Client Letter – January 2024

[Editor’s Note: the late, great and always honest Brooks Ragen once read one of my client letters and remarked, “It’s quite good, but it’s far too long.” He wasn’t wrong, and it made me laugh... I am glad he doesn’t have to read this letter! My sincerest apologies for the **lack** of brevity, but I had much to say after not producing a letter in the second half of last year. Readers should however be warned that they may want to divide their consumption of this missive into digestible chunks, and make sure to consume plenty of fluids while attempting to reach the conclusion.]

What a Difference a Year Makes

After the wipeout that was 2022, in which the best asset class was “cash” because it didn’t lose value, this past year was a great one to own the largest US companies. If you held primarily the “Magnificent Seven” stocks (MSFT, AAPL, META, GOOG, AMZN, TSLA & NVDA) or the Equity Indices they dominate, like S&P 500 or NASDAQ, your equity portfolio likely did tremendously well.¹² While our client portfolios are more broadly diversified by market cap and sector than simply owning the largest 7-10 publicly traded domestic stocks, our heavy skew towards the Magnificent 7 (save for META & NVDA) as well as other US Mega Caps (COST, JPM, some BRKB) kept us very much “in the game” over the course of the past year. Given how gloomy the expectations were heading into 2023, it was a surprisingly pleasant year for equity investors, as well as a “return to normalcy” for fixed income holders.

Stock market returns in any given calendar year are often *inversely related* to the level of optimism entering it. Take 2023 for example, which followed an abysmal 2022 in which a 60% equity/40% bond portfolio lost 16%.² Performance for nearly all investors was terrible, and the vibes may have been even worse: Russia invaded Ukraine in February; the inflation sparked by the post-COVID Lockdown “adjustment” of 2021 became undeniably entrenched in the US economy; the Federal Reserve responded to the worst inflation since the 1970s by raising the Fed Funds rate from effectively 0% to almost 5%, and; just when it appeared the skies were clearing in early 2023, investors had to contend with regional bank failures as February gave way to March. The confluence of these events made an imminent recession in the US economy look inevitable, and those who doubted it were dismissed as non-serious stock market cheerleaders. Return expectations, which were rather low, were relatively easy to exceed.

Last year was a great example of the Wall Street maxim that “Bull Markets climb a Wall of Worry”. Concerns about the regional banking system subsided in mid-March, following extraordinary bank balance sheet assistance from the Federal Reserve, which led to a nearly 15% rally in the S&P 500 through the end of July. Conditions turned on a dime from August 1st through Halloween, with the S&P dropping 10% as a result of a spike higher in 2 > 10-year interest rates to north of 5%. Had the year ended *right there* we might have anticipated above average equity returns over the next

¹ The S&P 500 and NASDAQ returned 26.3% and 44.6%, respectively (Strategas – “2023 Review in Charts”)

² was the worst year for a typical 60/40 portfolio since 2008, and was the worst year for bonds since 1977, perhaps much longer (tracking fixed income performance as a category is spotty prior to 1977)

calendar year, but a sharp reversal lower in interest rates fueled a surge in risk assets into the New Year.³ Any of you who experienced whiplash in tracking the progress of your portfolios during this period can be forgiven, as your mistake was simply paying attention.

Where does this leave us? The S&P 500 is currently valued at 22X last year's profits, which constitutes a high bar to clear. According to a recent piece from our partners at Strategas, the historical average annual S&P 500 return for any calendar year that begins with a valuation greater than 20x earnings is 3.9%, and the 3, 5, 10 year forward returns are 4.5%, 5.5% and 2.5%, respectively. For those of you who don't follow these things closely, that's not very good.

Now to be fair, history is not saying you are going to *lose money* in 2024, but it is saying that you may want to moderate your expectations. If your spending habits in retirement require annualized returns to meet or exceed 10% over the next 5-10 years to support your cashflow needs, you will likely need to monitor developments carefully. The advice here is to control what you can control. Past events are never entirely predicative of future outcomes, so one can certainly *hope* that forward equity returns will exceed the annualized 8.4% the S&P 500 has delivered over the last 50 years.⁴ But hope is not a strategy, and the historical evidence suggests that the "Smart Money" should expect some reversion to the mean for equity returns. Some comfort should however be taken in the return to normalcy for the fixed income market, which allows us the opportunity to sell into equity rallies and purchase short-term, investment grade bonds. This discipline helps to smooth out the negative effects of stock market volatility, and no longer resembles the "Fool's Errand" of shifting assets from stock to bonds in the Zero Rate environment of early 2020 - mid 2022.

Enormous Cash Balances

Speaking of bonds, do not be alarmed if there are currently sizable cash balances in your portfolios. When the world began shifting on its axis in early 2022, we sought safe harbor in the T-Bill market. The intention was to shorten the duration of client fixed-income maturities and maximize flexibility in the event of a nasty recession, which surprisingly has yet to 'officially' arrive. As a result of this strategy, we held on behalf of clients \$12 million worth of treasuries that matured Dec 31st, 2023, not to mention a smattering of other issues that came due earlier in the month, the proceeds of which now sit in nearly 300 different client accounts. Many of you take large cash distributions in January (RMDs, quarterly distributions, annual gifts to family, etc.) so it is good timing for those clients to have substantial amounts of cash on hand. We plan to put the vast majority of any excess cash "back to work" by the end of this month, but please know that Baird is now paying as much as 4.1% on cash sweeps while that portion of your portfolio awaits redeployment by your portfolio managers.

³ "The S&P 500 gained 14% during the last two months of the year, while the 10-year Treasury yield fell to 3.86%" – Jan 22nd, 2024 edition of *Barron's*

⁴ "Based on price alone, S&P 500 rose 8.4%, annualized, from August 31, 1976 through November of 2023" – *The New York Times* ~ January 21, 2024 (author uses 8/31/76 as his starting point, as that was when Vanguard launched its index fund offerings)

“Who Are These Guys?!”

For those clients who have been with us for multiple decades, and in many cases started working with my late father Dr. Glen Hamilton in the late 70s/early 80s, you likely grew accustomed to dealing with the same three or four people for the better part 25 years: Glen, my older brother Robb, our former assistant Erin Danielson (later “Tse”) and me (aka “Adam”). The Hamilton Group today is not unlike many long running hit Broadway musicals: the dialogue, costumes, music and dance numbers are largely unchanged since the show debuted, but the cast is almost entirely different.

I currently serve as Lead Financial Advisor and Chief Investment Officer/Portfolio Manager, having consolidated these responsibilities in the years leading up to Robb’s retirement at the end of 2020. Each of these roles individually could itself be a full-time job, which means I have a lot on my plate these days, but I am fortunate (after some hiring fits & starts) to have a tremendous team in place:

- Cecilia de la Cruz obtained her CERTIFIED FINANCIAL PLANNER™⁵ certification in 2022 and is now overseeing our financial planning operations, which includes primarily retirement planning, but also tax, insurance, college saving & estate plan analysis. Cecilia is a highly valuable member of our operation, and I am most thankful that she agreed to return to the Hamilton Group in early 2020, after having taken a four month “sabbatical” to work for her ex-employer Key Bank. Those of you who have now collaborated with Cecilia in the formulation of financial plans, or benefitted from her expertise in helping to settle estates, know how capable she is.

Cecilia is a native of Medford, OR and graduated from the University of Oregon – which I strive daily not to hold against her.

- Glen Wright joined our team as a Financial Advisor in 2021. Prior to joining Baird and after being honorably discharged from the military, where he served in the US Army Airborne and spent time deployed in the Middle East, Glen was with Edward Jones in Bellevue, WA. He joined the Seattle Baird office in 2020 as part of the Foundations career development program, before formally joining our team as a financial adviser around Thanksgiving of that year. I credit the Seattle branch manager John Ramseyer for recruiting Glen, and Baird for the financial investment they made in developing his skills. Those of you who have worked with Glen know that he is quite capably occupying the void created when Robb retired three years ago.

Glen and his wife Sabrina welcomed their first child, daughter Maya, into the world shortly before Christmas of last year – if Glen has seemed sleep-deprived in some of your interactions with him over the past twelve months, know he has a good excuse.

⁵ Certified Financial Planner Board of Standards Center for Financial Planning, Inc. owns and licenses the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™, and CFP® (with plaque design) in the United States to Certified Financial Planner Board of Standards, Inc., which authorizes individuals who successfully complete the organization’s initial and ongoing certification requirements to use the certification marks. *VK2024-0124.*

- Allison Pond joined us around the 4th of July '22 and has steadily taken on the day-to-day activities of the Client Assistant role. All of you have likely interacted with Allison at this point, whether she reached out to you to schedule a meeting, contacted you about collecting documents, answered your questions over the phone, handled a time-sensitive cash transfer request or wire transfer, etc. Allison has become the primary point of contact for many of our clients, and I appreciate daily her professionalism & the excellent customer service she provides to our clients.

Allison is a native of Portland, OR and, on a celebratory note, became engaged to her partner Stryder Meza after he recently “popped the question” before New Years Eve - we are thrilled for the young couple, even though we wonder what took Stryder so long.

I hope clients have enjoyed meeting and interacting with these three excellent young professionals over the past few years. Their contributions are allowing the Hamilton Group to offer a level of service and sophistication in our asset management & holistic wealth planning efforts that we would have only dreamed of 5 years ago. I consider myself fortunate every day to have them on the team and I hope you do, too.

We look forward to catching up with each and every one of you as the year progresses.

Adam Hamilton



From left: Cecilia, Allison, Adam, Macky (Robb's son), Sam, Thomas (Adam's sons'), Glen and his daughter Maya at the Mariner's Game over the summer in 2023.



From left: Quyen (Adam's wife), Glen, Sabrina (Glen's wife), and Adam at the Baird holiday party.