The Long Run

INVESTMENT LETTER
FEBRUARY 2024

REYNDERS, MCVEIGH CAPITAL MANAGEMENT, LLC

"Tried to run, tried to hide, break on through to the other side."

—The Doors

IS GOOD NEWS ACTUALLY GOOD NEWS AGAIN?

Though they may seem like conflicting statements, we believe that 2023 will be remembered both as a year of financial speculation and a return to normalcy. And no, we don't believe that speculation is normal—or healthy.

Last year began with widespread predictions that high inflation and interest rates would shock the economy into a recession. The most startling outcome of this outlook, in our estimation, is that investors concentrated their assets in just a handful of large technology companies, with a preference for those with some connection to the emerging field of artificial intelligence. Dubbed the Magnificent 7, these stocks accounted for essentially all of the stock market's returns through the first ten months of the year. While all excellent companies, they also share the same characteristics of being expensive, over-owned and somewhat risky. The S&P 500 is now more concentrated than it has ever been. Over the last 35 years, for example, the average weight of the top 10 stocks in the S&P 500 has been 20%. Today, it stands at 32%.

While narrow leadership is generally a cause for concern, we believe it represents opportunity in 2024. After fifteen years of an abnormal zero-interest-rate environment to help the economy dodge its way through a Great Recession and a pandemic-induced shutdown, it appears we have returned to the other side. We now find ourselves in a place where capital once again has a cost and markets should behave more rationally.

For the coming year, the economy is on more stable footing and inflation doesn't appear to be a concern. Many indicators, such as the Citi Economic Surprise Index, the OECD Composite of Leading Indicators, and estimates of corporate profits, show an economy that is stronger than expected. Declines in inflation have come quicker than expected, leading to the likelihood that we will see a stretch of continued disinflation or, possibly, outright deflation over the coming months. Under such a scenario, we look for a broadening of stock performance and believe the S&P 493 will outperform the Magnificent 7 this year.

Citi US Economic Surprise Index

Source: Bloomberg Finance L.P.

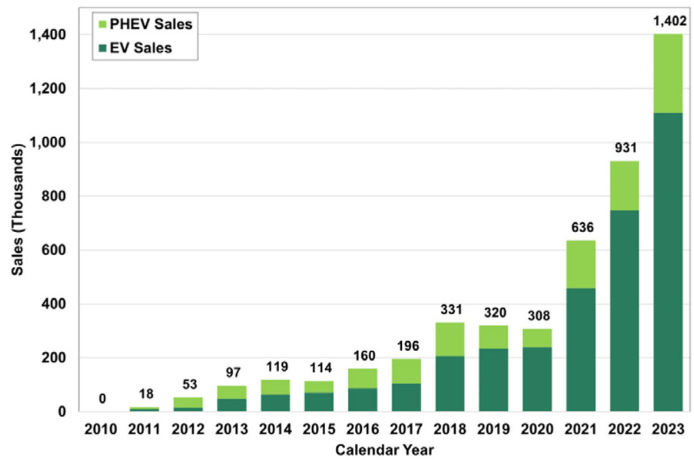
PEOPLE ARE STRANGE

While the direction of the economy provides more than enough fodder for debate, the real sideshow this year will be the election cycle. Get ready for everything to be politicized. Already we are being told that climate change isn't happening, that we need more fossil fuels, that being concerned with the ethics of corporate management is hurting performance, and that no one wants electric cars. Without spending too many words on predicting what may happen politically between now and November, the likelihood of a split government seems high. Republicans have a viable path to winning the Senate, and Democrats have an equally possible opportunity to take the House. A divided Congress is generally a modest positive for financial markets.

The one action we are taking in regard to the election is asking all the firms we have invested in to establish a policy of not spending shareholder's funds on political candidates. Some firms that you may see in your portfolios, such as Danaher, Veralto, and IBM, have such policies. We hope we are able to convince others to join them.

As for the other topics, our belief is that there is often opportunity when the herd is going in the wrong direction. Perhaps the most important economic story that received no attention this past quarter was that Sinopec, a major Chinese oil company, announced in October that China had reached peak oil demand many years earlier than expected. Along with the U.S. and Europe—who already have experienced peak oil demand—approximately 67% of the world is now no longer in need of producing greater quantities of this fossil fuel. No doubt this is why Saudi Arabia just announced it was abandoning its plan to boost oil output capacity. What is growing is the demand for electric vehicles and the use of electricity. Interestingly, a new report from the International Energy Agency said that all the expected growth in electricity demand is expected to be covered by renewable and nuclear generation. As for no one wanting electric vehicles, we will point out that Tesla makes the number one and number three top-selling cars in the U.S., and sales of all electric vehicles have been growing nicely. The increasing electrification of our economy—particularly through the greater usage of renewable energy sources—is a major investment theme in our portfolios.

Plug-in Vehicle Sales by Calendar Year, 2010–2023



LOVE HER MADLY

Thirty years ago we wrote an outline for a book on sustainable investing. One of the planned chapters was to discuss why there are no heroes in the business world and ways we have worked with clients to change that.

Though we never wrote the book, we were reminded of this chapter when watching the Netflix movie, "Bank of Dave." It tells the true story of Dave Fishwich, who created a community-based bank against great odds in Burnley, England.

We recommend you watch this movie, but as you do so, it is worth reflecting on how many of our clients have provided critical financial assistance to start and grow several community-based financial institutions in just this past year. These include Walden Mutual Bank, a New Hampshire-based bank focused on sustainable food production; Founder's First, a venture capital firm that lends to minority- and women-owned businesses; and Latino Community Credit Union, which has 15 branches across North Carolina. (Our mutual fund, Reynders McVeigh Core Equity, has certificates of deposit with Walden Mutual Bank and Latino Community Credit Union. It is one of the few equity mutual funds in the country that will participate in impact investments.) There are plenty of heroes in these organizations. We encourage you to speak to your portfolio manager if you would like more information on any of them. RM

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