MARKET LETTER

A QUARTERLY PUBLICATION *of* FERGUSON WELLMAN, OCTAVIA GROUP *and* WEST BEARING

INFLATION'S FLAME FLICKERS

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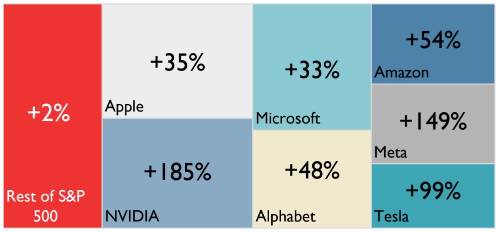
BELYING THE LOW, single digit returns of the "average" S&P 500 stock, thanks to the outsized performance of a handful of mega-cap technology stocks that has delivered almost 90% of the return, year-to-date this benchmark index has posted double-digit gains. While the Fed continues its battle to extinguish the remnant flames of inflation, the economy has remained surprisingly resilient amid a normalizing job market that still enjoys more job openings than there are unemployed to fill them.

Excessive job demand associated with unprecedented COVID-era stimulus has significantly moderated in the wake of 11 Federal Reserve interest rate increases since last spring. Given the benefit of this large cushion of available jobs, so far, the central bank is achieving its goal of taming inflation and bringing the labor market into balance without tipping the economy into recession. Gainfully employed, U.S. consumers remain the key driver of what has proven to be persistent GDP growth. However, extra savings from government handouts are now mostly depleted. As such, going forward consumption spending is likely to be more closely tied to job-related income.

Market Leadership Remains Extraordinarily Concentrated



Source: Bloomberg

Recognizing the lag with which higher interest rates impact the economy, we remain vigilant about stiffer macroeconomic headwinds in the offing. Money supply is contracting for the first time since the 1930s, banks are less prone to make loans amid scarcer deposits and the manufacturing sector is now in recession. Looking ahead, the risk for investors is that corporate profits fall victim to waning sales and weaker profit margins, which would in turn lead to job cuts, a broader economic downturn, and, ultimately, lower stock prices.

Therefore, at this more advanced stage of the economic cycle, we are paying particularly close attention to our dashboard of leading economic indicators, and such measures as weekly jobless claims, corporate earnings and credit spreads … which at the moment, are on good footing.

We remain overweight large-cap equities and underweight fixed income, but with taxable yields over 5% and stocks not inexpensive, we are moving ever closer to trimming equities and adding to bonds. For now, caution and patience are advisable as the full effects of the Fed's formidable rate hiking campaign won't be realized until 2024.

Our Ferguson Wellman logo is based on a bronze coin of Marcus Aurelius Antoninus, emporer of Rome from A.D. 161 to 180. According to historian Edward Gibbon, he was the only person in history in which, "the happiness of a great people was the sole object of government." Marcus Aurelius was the author of a series of personal writings and meditations that revealed a mind of great humanity, natural humility and wisdom.

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FOURTH QUARTER 2023

IN THIS PUBLICATION

Founded in 1975, Ferguson Wellman is a privately owned registered investment adviser, established in the Pacific Northwest. As of January 1, 2023, the firm manages $7.1 billion for 943 clients that include individuals and families; Taft-Hartley and corporate retirement plans; and foundations and endowments with portfolios of $4 million or more.

West Bearing Investments, a division of Ferguson Wellman, serves clients with assets starting at $1 million.

Octavia Group provides fee-based personal financial services exclusively for Ferguson Wellman and West Bearing clients with a minimum of $10 million managed by our firm.

INVESTMENT EXCELLENCE
LIFELONG RELATIONSHIPS

THE MARKET WHISPERER

DEAN DORDEVIC
Principal

MY WHOLE IDEA WAS TO "WAIT IT OUT" *in Treasuries until the market turned south, then put the extra funds back into the (lower) stock market. Ah, silly me. Maybe this 5% pullback will turn into a 10% correction, as is widely expected, but that only gets us back to where we started from. It would take another 10% drop on top of that for my "strategy" to really pay off. The real lesson? Stop trying to time the market."*

—Kelly Evans, anchor, "The Exchange" CNBC[1]

If you are of a certain age and had even a latent interest in the financial markets you would religiously tune into your local PBS station each Friday night to watch "*Wall $treet Week*" hosted by Louis Rukeyser, who was a Wall Street archetype right out of central casting. His show was a recap of the week in the financial markets, followed by a long-form interview with a special guest. These guests were Wall Street folks who were for the very most part … *not* household names. One got the distinct sense that you were getting a ... peek behind the curtain. That was certainly the case for me. I was an enthusiastic and reliable acolyte of Mr. Rukeyser's show beginning in high school, from the early 1970s until he departed in 2002.[2]

While I probably watched hundreds of these episodes, in retrospect it's surprising to me how few of the interviewees stood out or left a lasting impression on my psyche. Hot air it appears, is a commodity rarely in short supply on The Street! But I was recently reminded of one fellow I do remember very well, Laszlo Birinyi. Birinyi was an investor who declared he took little interest in corporate news, financial algorithms or even the economy itself, and who instead, as he put it, listened to the market. He died this past summer at the age of 79.[3]

Birinyi was a frequent guest of Mr. Rukeyser's show, and argued convincingly that the market had not only a *history* but also a *psychology*. He used this insight as the basis for his market predictions and also his stock selections. Birinyi took part in Mr. Rukeyser's annual stock-picking contests, winning many times. From 1993 to 1998, his returns were more than double that of the popular averages. "*Born in Hungary, raised in Pennsylvania, he regularly makes a goulash of most other market analysts*," said Mr. Rukeyser while inducting Mr. Birinyi into the show's Hall of Fame in 1999.[2,3]

Louis Rukeyser, host of "Wall $treet Week"

Source: American Archive of Public Broadcasting

Birinyi's study of market history led him to the paradoxical conclusion: gloomy commentary by market watchers was actually *encouraging*. "*You won't think the market is going down until everyone thinks it's going up*," Mr. Rukeyser remarked to Mr. Birinyi on an episode in 1996. "*That's exactly right*," Mr. Birinyi said.[3]

Perhaps the durable appeal of his philosophy was its resemblance to that which was chronicled in the iconic Seinfeld episode, "*The Opposite*," where George Costanza decides to correct his frequent mistakes by doing everything exactly the very opposite of what he does usually. In fact, that's precisely what makes the market so entirely *vexing* for many individual investors. Contrarians are not born, they're made.

My early introduction to contrarian thinking and the extremely difficult act of doing the very opposite of what your natural instincts might suggest were a biproduct of Birinyi's thinking. The behavior of the market this year is a near tribute to his philosophy and ironically an almost perfect example of a market environment that Birinyi would have loved. That is, if the news is so very bad, why is the market ... *doing so well?*

The Conference Board's leading index of indicators has been on a tear. The index … dropped again this past spring, marking the 14th straight month of declines. This makes this interval

The laurel is part of our Octavia Group branding. Octavia the Younger was one of the most prominent women in Roman history. She was respected for her nobility and humility. Octavia was hailed as a "marvel of womanhood" and was a political advisor between her brother and husband. She was immune from the "tutela," which placed in her the unique position of managing her own finances.

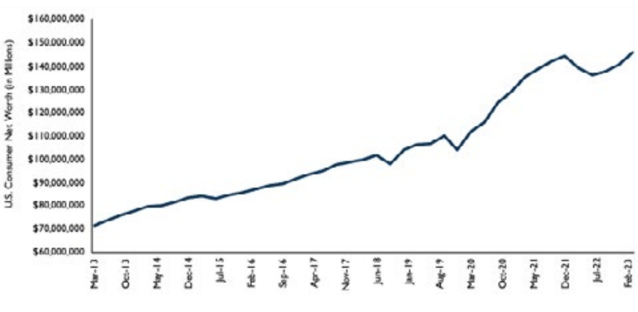
"Contrarians are not born, they're made."

the *third-longest losing streak* since the index's founding in 1959. What's more, it's only the fourth time a streak of negative prints has lasted for a full year or more. Perhaps even more remarkably, in each of those three previous examples, by the 12th month the economy was *already in a recession*. We're in month 17 now, and still no recession. What we're witnessing is unprecedented. Almost every important indicator has been flashing yellow now for a good long while, and yet the U.S. economy refuses to enter recession and the market continues to rise. What's going on?

We're now living through a post-pandemic rebound and with it, a veritable panoply of unintended consequences and distortions. These are at once, both positive and negative. As you might imagine, the extent to which they are offsetting is impossible to calibrate or predict. For example, as prospects for recession loom large in the background, there are at present, and incredibly — *nearly 1.5 jobs available* for every person seeking one. Wow.

The importance of this simple fact should not be underestimated. An abundance of employment opportunities creates both a higher wage dynamic for workers and robust consumer confidence as well. After all, if workers are highly confident with their employment prospects and job status, or if they perceive that they can easily change jobs (for perhaps more pay), consumers are far more likely to spend freely. These numbers are especially meaningful when reminded that 70% of U.S. GDP is sourced from the consumer. Amazingly,and despite all the predictions of pending recession, consumer net worth just hit an all-time high.

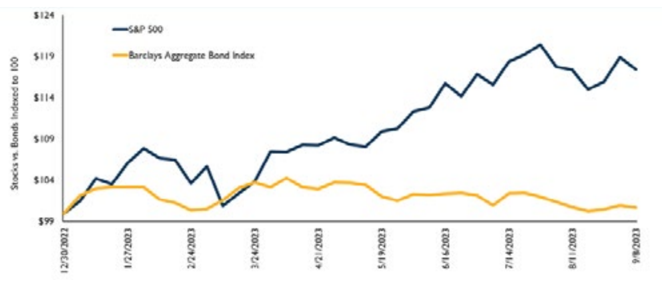
The U.S. Consumer ... Never Better!



Source: Federal Reserve Bank of St. Louis

Like an experienced sailor who develops a healthy respect for the sea, over these many decades plying our trade we've come to know that almost without exception, the very best and most reliable forecasts are not from people or pundits, but from the broad, liquid and very deep markets we trade every day. As Mr. Birinyi coached us, it's always best to "*listen to the message of the markets*."

The Pain Trade*: Greed Beats Fear This Year



Source: Bloomberg

* *A pain trade occurs when a popular asset class or investment approach quickly turns course and investors are caught flat-footed.*

What great advice that would have been for CNBC's Kelly Evans. With the financial media beating their *drum of perpetual negativity* right from the starting gun of the new year, the market has completely ignored them and looked the other way. So, while Ms. Evan's 4 or 5% return from her ultrasafe bond investment is certainly nothing to sneeze at, especially in light of the near-zero returns from bonds more recently, a very juicy double-digit return in stocks was missed by both she and her many viewers. "Ah, silly me." Market timing is a loser's game, even for CNBC anchors.

The most advertised recession of all time may very well be in our future. But that said, the market appears to be coming to a very different, and far more reasonable conclusion. As Mr. Birinyi reminded us so often over these many years, the answer is right in front of you.

Just listen, it's in the message ... of the markets.

Sources and Footnotes:

1. August 18 episode, *The Exchange,* CNBC, 2023.

2. Wall Street Week, Wikipedia, September 6, 2023, https://en.wikipedia.org/wiki/Wall_Street_Week.

3. Alex Traub, "Lazlo Birinyi, Leading Stock Picker and Market Forecaster, Dies at 79," *The New York Times,* August 30, 2023.

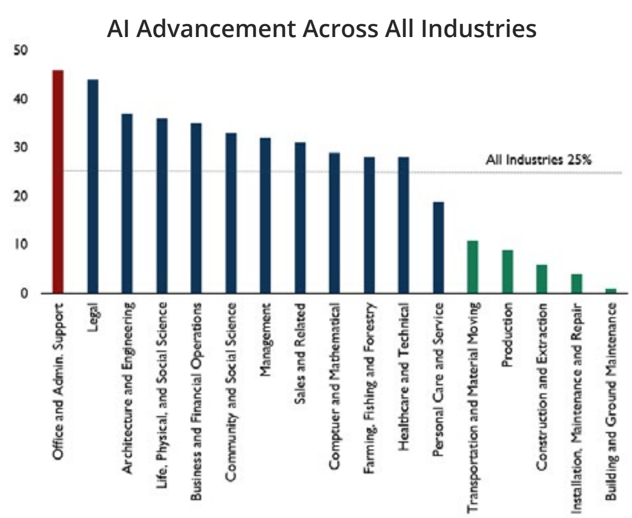
Our West Bearing logo is inspired by the American bison, an iconic creature symbolizing resilience, grace and the western path to growth and opportunity. Most animals attempt to outrun inclement weather, prolonging their exposure to the elements and, in doing so, weaken their conditions. Only bison instinctively turn to face the storm, often bearing west, to find the quickest path to clear skies.

AUGMENTING INTELLIGENCE

KRYSTAL DAIBES HIGGINS, CFA
Vice President
Equity Research

GO WORLD CHAMPION, KE JIE, was being watched by a couple hundred million people online when he took on AlphaGo, a Google-backed artificial intelligence (AI)-powered Go game. The game of Go is an ancient Chinese board game that requires "intellectual refinement and wisdom" according to Kai-Fu Lee's AI Super-Powers book. While the rules are simple, the number of possibilities are endless. Unfortunately for Ke Jie, the highly-anticipated event took a turn south as he ended up crumbling in tears in the final few minutes and was defeated by his AI opponent. While the world sympathized with the 19-year-old, scientists and engineers marked it as a new major milestone in the advancement of AI.

Since AlphaGo's victory over Ke Jie in 2016, the advancement of AI has moved at rapid speed. But just like a train leaving a station, AI is just picking up steam and is heading toward radically transforming the job market. While it is understood that AI's latest advancements will disrupt and displace various types of jobs, it's less understood how it will boost productivity and create new opportunities over the long term. Workers, investors, AI specialists, policymakers and even self-proclaimed futurists are still grappling with what it means for the job market, productivity and the global economy. Experts believe the job market will have two phases: internet AI and business AI.



Source: Bloomberg

The first phase is what we're experiencing now in which AI-powered companies, such as Google (Alphabet) and Facebook (Meta), have already impacted the job market by altering traditional industries, such as advertising, customer service, shopping and manufacturing. As most of us have experienced in the last couple of years, especially business owners, this disruption has only tightened the job market with the creation of new jobs across sectors and industries. It gave rise to the "gig" or "freelance economy", which is currently estimated to be 73 million workers and expected to continue growing as we enter the second phase.

> *"AI is just picking up steam and is heading toward radically transforming the job market."*

The second phase is business AI, which refers to the use of AI within organizations to improve efficiency, decision-making and operations. In recent months, we have seen a rapid deployment from technology firms, greatly enhancing the value to customers by extracting insights that lead to cost cutting and higher profits. The second phase is where we will potentially see an even greater disruption that will lead to dramatically improved productivity levels and new opportunities over the long term.

Goldman Sachs estimates that 40% of jobs are exposed to some degree of AI automation, particularly within the office and administrative support segment. However, exposure to AI does not necessarily mean complete replacement. Instead, it should be seen as a tool that enhances human capabilities. For example, AI can assist doctors and researchers in diagnosing diseases more accurately and allow healthcare professionals to focus on patient care rather than administrative tasks.

The potential for AI's recent advancements has far-reaching consequences. While we will see some job displacement, the potential for human-AI collaboration and the emergence of new opportunities will substantially outweigh the pain from short-term disruption.