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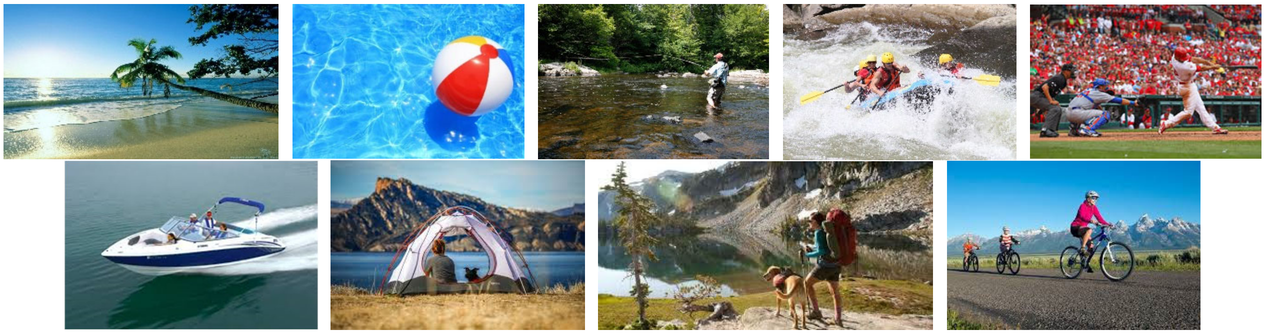
Celebrating 35 Years in 2023



Mid-Year Newsletter

"Crisis after Crisis— Nonetheless, It's Summer"

June 15, 2023

Everyday there seems to be a new crisis that is reported in the 24/7, 365 news cycle—inflation, bank failures, debt ceiling, and on…I'll touch on a few of these topics herein, but for now remember it is summer, so, after reading this newsletter, turn off the news, relax, and enjoy the beautiful weather, travel, and most of all, enjoy time with family and friends.

Memorial Day marks the beginning of summer and possibly you'll travel to one of the U.S. National Parks this summer, such as Bryce Canyon in Utah or Joshua Tree in California. Last year 312 million people visited one of the U.S. National Parks[94]. As you travel, it may be important to note that, according to both the Climate Prediction Center and National Oceanic & Atmospheric Administration, the entire U.S. east coast, deep south, and southwest have a higher probability of above normal temperatures, this summer, while the Midwest and Great Lakes Region may have higher rainfall than usual[95]. The North American Electric Reliability Corp (NERC) is forecasting 60% of the country may see blackouts this summer due to expected above average temperatures, coupled with the EPAs new 'Good Neighbor Plan,' which requires fossil-fuel powerplants in 22 states to reduce emissions, thereby limiting hours of operation[50]. Hopefully not, and especially in your area, or where you might travel.

This is graduation time of year with young high school and college students filled with joy and looking forward to the next chapter in their lives. They believe they can change the world as advanced by many keynote speakers during graduation ceremonies, just as we all did upon graduation. However, it is important that graduates remember not only to change the world for the better, but as important, to preserve all that is great about the United States[18]. Immigrants risk their lives to get to the U.S. to enjoy what we have come to take for granted: wealth and income per person that is by far the greatest in the world, property rights, freedom to enact and enforce contracts, a democratic republic with a Constitution and Bill of Rights, separate legislative, legal, and executive branches, and social programs for security[18]. Further, the U.S. has the best health care in the world and a vibrant free market economic system that fosters entrepreneurship and innovation like nowhere on the planet[18].

"Take a deep breath and give yourself permission to step back from everything that is making you feel anxious."
– Jade Mariet

Debt Ceiling

The U.S. Debt Ceiling negotiation with Congress and the Biden Administration concluded last week with a bipartisan deal to increase the debt limit until 2025 and curb spending during the 2024 and 2025 fiscal years[(87)(92)]. Non-military discretionary spending for 2024 will remain at the 2023 levels, with a 1% increase in 2025[(87)(92)]. Military spending in 2024 will increase by 3%[(87)]. The deal immediately cuts IRS spending by $1.4 billion that was earmarked for tax enforcement and technology modernization and cuts $30 billion earmarked for COVID aid that remains unspent[(87)(92)]. Last year Congress provided the IRS with $80 billion to be spent over the next 10 years, but this deal also allows Congress to cut an additional $20 billion of the original $80 billion allocated to the IRS for diversion to other Federal Programs in 2024 and 2025[(87)(92)]. The deal also requires able bodied single adults ages 19-54 (up from age 49) to be employed to receive food stamps providing no more than 3 months benefits within a three-year period unless working or enrolled in a work training program[(87)(102)(92)]. Incidentally, the number of able-bodied working age adults in the bottom 20% of U.S. households who worked has declined from 68% in 1967, to 36% in 2023[(58)]. Moreover, there are an estimated 4 million single able-bodied Americans without dependents who are currently receiving food stamps, with 75% not working, and only 3% working full time[(45)(102)]. Importantly for U.S. energy security, the deal imposes a 2-year timeline for environmental review of energy and infrastructure projects, which now averages roughly 4 ½ years to complete, plus the deal expedites the remaining hurtles for the Mountain Valley Natural Gas Pipeline through Virginia and West Virginia[(87)(92)]. Although shortening the environmental review period for energy and infrastructure projects has been championed as a breakthrough for fossil fuel energy projects, it will also benefit renewable energy projects[(119)].

U.S. debt-ceiling increases are normally routine but become contentious when Congress is divided as it is now, with Republicans controlling the House of Representatives and the Democrats controlling the Senate and Presidency[(9)(112)]. Assuming no American lawmaker wishes the U.S. to default on its obligations, the debate is used to politically maneuver for concessions and political gains, right up to the last minute before a compromise is reached[(112)(28)]. The Republican controlled Congress passed the Limit, Save, Grow Bill that attempted to take budget levels back to 2022 and cap the amount of increases at 2% per year for ten years which forced the Democratic controlled Senate and Biden Administration to the negotiating table[(90)(29)]. Democrats did not want to cut spending but instead pushed for higher taxes but held a weaker hand for higher taxes since this could not be accomplished even when they controlled Congress during the prior two years[(90)(29)]. The final deal provided concessions and compromise on both sides that left the steadfast members in each of their respective parties discontented[(90)(112)(101)(110)].

Bottom line, the Debt Ceiling fight brings to light the bigger problem facing the U.S., the lack of a balanced budget and the mounting National Debt[(17)(27)(27)(92)]. For fiscal year 2023, which runs September 2022-September 2023, the U.S. has an estimated $1.5 trillion-dollar annual deficit[(17)(19)]. This presumably means the $1.5 trillion will be added to the National Debt as new U.S. treasury securities are issued to raise money to pay obligations[(17)(19)]. The U.S. debt to GDP ratio is 123%; Japan has the highest at 266%, then Greece, Italy, Portugal, then the United States[(19)]. The current budget stands at $6.2 trillion with record tax revenues of $4.7 trillion, for the $1.5 trillion deficit[(103)].

U.S. Government expenditures are categorized as either mandatory, discretionary, or interest on the national debt[143]. Mandatory expenditures consist of programs and entitlements set in law and represent 62% of the entire U.S. Budget[21][143][144]. This includes Social Security, Medicare and Medicaid as well as all the other programs under the social umbrella such as food stamps, earned income and child tax credit, federal retirement programs, veterans' programs, agricultural and student loan subsidies, unemployment compensation, supplemental security income, and deposit insurance[21][143][144]. Since 1967, mandatory transfer payments to low-income households, which represent the bottom 20% of income earners, such as supplement security income, food stamps, and refundable tax credits, have grown from $9,677 in 1967 to $45,389 in fiscal year 2023 on an inflation adjusted basis[58].

Discretionary spending, which must be appropriated annually by Congress and the President, is comprised of U.S. Military spending, which is roughly half of this category[143][144]. The other half is spent on homeland security, education, transportation, research, food safety, science and space programs, disaster assistance, environmental protection, public housing, and federal law enforcement expenditures[143][144]. Discretionary spending makes up roughly 28% of the entire National Budget[143][144]. Non-defense discretionary spending has increased 18.8% (inflation adjusted) since January 2020 at the start of the Pandemic, while defense spending is relatively flat (inflation adjusted)[58].

The last category of U.S. government expense is interest on the National Debt which currently represents 10% of the entire National 2023 budget[143]. Current Government Budget Office estimates show the National Debt going from $31.4 trillion today to $50 trillion in 10 years under the current budget[19]. Just for comparison, if we added up all the taxable income declared for all American taxpayers in 2022 it was $24 trillion, and further, our National debt is greater than the economies of Germany, Japan, China, and the United Kingdom combined[19][144]. Consequently, simple budget accounting forecasts the interest on this amount of National Debt will greatly increase during the next ten years further stressing other areas of government spending such as the Military, Social Security, Medicare, and Medicaid[17][19].

The recently passed Debt Limit deal only dealt with roughly 15% of the entire U.S. budget and cut spending $1.5 trillion over the next ten years as Medicare, Social Security, defense spending, taxes, and interest on the debt were off the negotiation table[106]. Moreover, President Biden's legislation during the last two years remains largely intact, but with a House majority of only 4 members, the compromise Republicans negotiated with the Biden Administration has significant wins and a good first step to get the budget back in line[110].

"A compromise is the art of dividing a cake in such a way that everyone believes he has the biggest piece."
– Ludwig Erhard

Economy, Recession, and Inflation

Employment remains strong with 339,000 non-farm jobs added in May and 1.57 million jobs so far this year which is on pace for a 2.5% increase this calendar year[124][126][7]. In the past twelve months, U.S. employment has increased 2.7%; however, economists point out the U.S. gross domestic product only increased by 1.6% during the past year, which reveals less productivity per worker, per hour and consequently a slowing economy[124][126]. Productivity growth has fallen year over year for five straight quarters, the longest span since 1948[126]. Economists point out the trend to work from home as a possible cause for less productivity as the employee and employer forgo creative interaction and mentoring opportunities that are now starting to show up in productivity numbers post pandemic[126]. Employment normally falls during periods of declining productivity growth, but it is suspected that with roughly 10 million job openings and only 5.7 million people looking for work that employers are hoarding workers after struggling to attract, train, and hire people[126][107]. Productivity growth is vital to the economy, the company, and its employees; the more a company produces per worker, per hour, the more a company can increase wages, while keeping prices constant[126]. However, when productivity decreases, the company will need to increase prices to raise wages, and the inflation spiral continues[126]. Work-force participation, the share of people working versus those eligible to work, has recently increased by remains below pandemic levels[52]. Interestingly, the immigrant workforce has increased 5% from 2019, whereas native-born Americans in the labor force declined 0.5% since 2019[52].

The tight monetary policy by the Fed has been relatively successful thus far in combating inflation, which peaked last June at over 9%, and as revealed in May's CPI report, is currently down to 4%[140][147]. The main driver of the reduction in CPI from April's 4.9% inflation rate to 4% in May was the energy sector falling 3.6% in a single month, while food was up 0.2% and rents increased 0.5% in May[140]. Core CPI which excludes the volatile food and energy sectors came in at 5.3% in the May CPI Report[140]. The May retail sales report revealed consumer spending was up only 1.6% during the prior 12 months with consumers continuing to shift more of their purchases to services versus the goods sector as revealed by retail stores[42][145][48][75][123]. Interestingly, strong consumer brands continue to increase prices to offset materials and labor, despite the slowing economy and moderating inflation, possibly with an unstated objective of increasing profit margin[82]. Beef, which translates to steaks and burgers for Americans, is selling at an all-time high due to the high cost of raising cattle with drought conditions in the west, pandemic distortions, plus inflationary cost increases, and is expected to go higher with many ranchers not replacing their herd once sent to slaughter[116]. The U.S. cattle herd is the lowest in 10 years with expected production to fall by 2 billion pounds in 2024, the largest decline in production since 1979 which will likely affect restaurant prices[116].

The U.S. is winding down a period of enormous monetary and fiscal intervention to stave off the COVID-19 pandemic, and although beneficial to the economy initially, 40-year high inflation ensued as a result, and the subsequent increase in National Debt now may limit fiscal ability to address future downturns or shocks to the economy[136]. The pandemic also caused supply-chain distortions within our country, as well as countries throughout the world, that has made it hard to predict where the economy will go from here based on historically reliable predictors[130][31]. We have been hearing fears of recession since the Wall Street Journal polled economists in June of last year with 99% predicting a recession would begin within one year[130]. The case for a looming recession in the U.S. economy can be made with the Fed raising interest rates very fast to a significant level with consequent borrowing costs increasing, cracks emerging within the banking sector prompting tighter lending standards, consumer confidence down, and corporate profit margins compressing[130][7][82][107][114]. Plus, the yield on the three-month Treasury Bill has been higher than the 10-year Treasury Note, which is historically a reliable forecaster of pending recession[130][7][114]. However, many of these predictors of recession have been waving the flag for a year and the economy keeps moving forward with light vehicle sales and production rising, a strong job market, increased medium and heavy truck sales, and a housing market with strong demand[130][7][60]. Further, there are some economists that adhere to a mild recession, followed by a strong recovery, citing the case for recession combined with the case made for expansion plus adding projected lower interest rates in 2024 will boost consumer spending[114]. We believe there are even odds of recession or a continued expansion, with the former shallow if it occurs, and the latter being tame if it continues[130][7].

It is important to know that recessions and consequently the associated volatility within the financial markets are an inherent part of investing, and what may be considered the best defense is a solid financial and investment plan based on your financial goals, objectives, resources and risk preferences[2]. Investors are often motivated by wanting to do something in a potential downturn, but often trying to alleviate short-term loss and stress may end up hurting the longer-term plan, and that is not to imply that as conditions warrant an investor cannot become more defensive to preserve capital or more offensive to embrace opportunities within that plan[2]. These words of wisdom are easy to read and hard to live in the real world as markets become choppy, so it is vital to construct a plan that is tailored specifically to your goals, objectives, resources, and risk preferences[2][5].

The Biden Administration advocates U.S. national economic planning through large spending packages that include subsidies for favored industries, and regulation to prohibit or restrain investment into disfavored sectors which is designed to affect consumer choice and control business behavior[129]. This involves the government picking winners and losers such as with green initiatives and renewable energy[149]. White House National Security Adviser Jake Sullivan gave a major speech in April at the Brookings Institution where he declared that the Biden Administration is putting in place "a permanent U.S. industrial policy in which the government explicitly leads, and everyone else follows" and that the U.S. needs a "deliberate, hands-on investment strategy to pull forward innovation, drive down costs, and create good jobs", and further that a "modern American industrial strategy identifies specific sectors that are foundational to economic growth, strategic from a national-security perspective, and where private industry on its own isn't poised to make the investments needed to secure our national ambitions."[149][129]. One example is regulation in pursuit of climate change that has been proposed or finalized during the Biden Administration's first two years, just in the appliance industry, include banning gas stoves, reducing water usage in dishwashers, and several new standards for ovens, microwave ovens, refrigerators, and laundry machines[83].

The assumption by the Biden Administration is that it can continue to spend in pursuit of their goals without consequence; however, if the rampant inflation during the prior two years is not enough of a deterrent, it is important to remember that the increasing national debt, through massive annual deficit spending, will increasingly have an impact on the U.S. economy by squeezing out private investment[129]. Although the Fed is attempting to tame inflation with tight Monetary Policy at present, the Biden Administration is essentially working against this objective with Fiscal Policy that continues to deficit spend[129].

The Biden Administration could reverse course in two areas that may serve the purpose of getting the U.S. budget and economy back on track plus get on the same page as the Fed with fighting inflation; first, make the fossil fuel energy sector a priority as oil, gasoline, and natural gas are needed to make thousands of U.S. products, provide electricity, and provide fuel to move people and goods daily around the country[22][25]. The Administration does not need to back away from clean alternative forms of energy as a its priority, but both can be equally important at the same time. Second, reduce the cost of labor as it is needed to build, manufacture, deliver, install, or provide service and professional assistance in all businesses[22][25]. This can be accomplished by reducing social program eligibility for able-bodied Americans that are out of the workforce at present by choice[22]. This is not to say that we should eliminate or reduce these social programs for people truly in need such as parents with minor children or people with disabilities[22]. These two measures would help on both the inflationary and budgetary front by reducing federal social spending, reducing the cost of labor by increasing the supply of workers, and increase the supply of energy thereby reducing cost and providing American energy independence[22][25].

Bank Failures

Bank failures invoke memories of the 2008 Housing Crisis where we experienced credit problems with many loans, but the recent string of bank failures, such as Silicon Valley Bank and Signature Bank, are more like what we experienced with the 1970s savings and loan problems and the subsequent Savings and Loan Crisis of the 1980s[13][3]. In the 1970s the Federal Reserve held interest rates low for an extended period, and savings and loans, due to strict regulation on lending, held only long-term fixed mortgages at low rates[13]. When inflation increased in the late 1970s and early 1980s the Federal Reserve moved rates up rapidly to combat inflation which prompted savings and loans to pay more on deposits at the same time their low-rate mortgages were generating below market rates of return, plus the mortgage notes fell in value[13]. Today there appears not to be widespread credit problems, and further, credit markets are not freezing up as they did in 2008[13]. What we have today is bank held mortgages that generate below market rates and at a loss if sold, coupled with having to pay out higher rates on deposits like the late 1970s and 1980s[13]. The Fed has stepped in and through a new program, the Bank Term Funding Program, agrees to loan troubled banks for one-year using U.S. government securities, mortgage-backed debt, and other assets at par, as collateral verses the bank selling them in the open market at a loss, thus injecting a new form of quantitative easing for troubled banks[13][4][16]. This enables banks to obtain liquidity without selling securities which have declined in value due to rising interest rates[4].

At the heart of the problem, the Fed originally discounted inflation stating it was transitory, and then needed to reverse course and raise rates much higher, very quickly to stave off inflation[13]. Basically, the Fed is solving the bank problem that the Fed itself caused[13][15]. The Fed should also increase FDIC limits to constrain the flow of deposits out of smaller and regional banks to the "to-big-to-fail "mega-large banks that may exacerbate smaller and regional bank problems if not addressed[13][29]. Online banks, such as Ally Financial and Goldman Sachs Marcus, as well as credit card banks, such as Discover Financial, American Express, and Synchrony Financial, have all attracted and increased savings deposits during the past year[128]. These non-brick and mortar banks typically offer higher yields versus their regional bank counterparts due to less overhead expenses such as rent, equipment costs, and employee wages needed to run the branch network[128]. The current bank failures should work to make the Fed more cautious as they contemplate continuing to raise interest rates as continued rate hikes would be expected to reduce lending further and reduce economic growth[3][4]. Smaller banks are already having a tough time getting lending in addition to having to pay higher financing costs as lenders have cut lines of credit, are putting forth stricter terms, and taking longer to underwrite new loans[117]. The Federal Reserve released a survey in June that indicated about half of all banks are reporting stricter underwriting standards in the wake of the recent banking failures[117].

Interest Rate Hikes

Despite interest rates increasing 5% in roughly a year, U.S. economic growth has been resilient, and inflation has broadly trended lower over the past year but remains sticky and elevated, especially with housing[6][48]. Although the labor market is strong there are signs of some softening in recent months[6]. The Fed held interest rates at current levels during their June 13-14 meeting to allow for more time to review the lagging economic effects of 10 straight rate hikes, moving rates more than 5% since March of 2022[105][6][148][150]. This was a tough decision for the Fed as inflation has decreased, but not as quickly as anticipated, and bank problems have signaled caution, but the Fed indicated a few more rate hikes may come later this year[43][6][148][150]. Additionally, Fed minutes from the May meeting reveal the Fed believes recession may be forthcoming in the 4th quarter of 2023 from the cumulative effect of rate increases and reduced bank lending[43]. The silver lining of interest rate increases during the past year is that short-term interest rates for savers have now risen for the first time in 20 years to between 3-5% for short-term fixed income securities such as CDs, U.S. Treasury Bills, and money markets[10][26].

The Fed increased the U.S. M2 money supply by 41% in 2020 and 2021 to reduce financial stress from the pandemic lockdowns[134]. The sharp rise in money supply resulted in 40-year high inflation which the Fed has been combating with interest rate hikes and a reduction of the money supply, which is down 4.6% during the last 12 months[134]. Money supply, as Nobel Prize winning economist Milton Friedman posited, is the most important factor impacting inflation and the government controls the money supply[135].

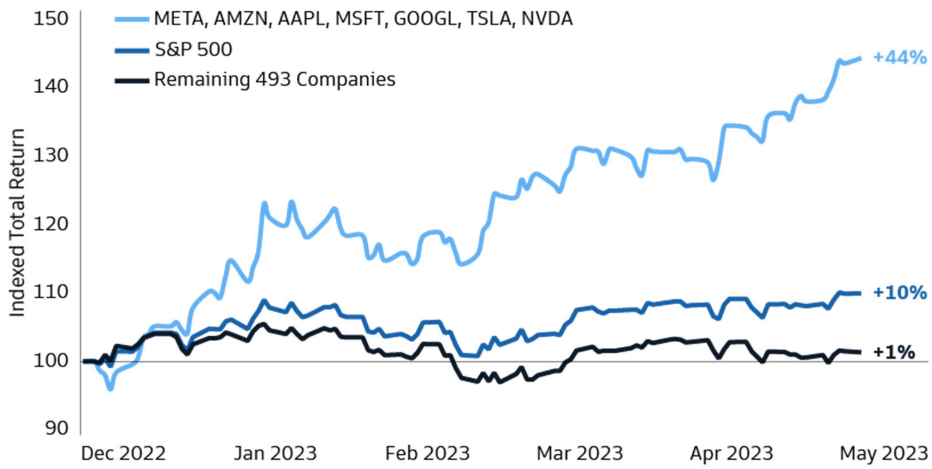
Europe and other world economies are anticipating a pause to rate increases in the U.S. for good reason; interest rate increases in the U.S. elicit higher interest rates overseas[86][67]. This is done so their currency does not depreciate against the U.S. dollar or lure investment out of their country and into the U.S.[86]. However, just as in the U.S., when foreign Central Banks raise interest rates, it increases internal borrowing costs and would be expected to slow economic growth[86]. The U.S. Dollar as the world's reserve currency has recently been debated with Saudia Arabia, Russia, and China beginning to trade in other currencies[86]. However, the U.S. dollar as the global currency has remained the preferred medium of exchange worldwide with the dollar involved in 90% of foreign exchange transactions despite the U.S. only being directly involved in 10% of all global trade transactions[86].

"Embrace uncertainty. Some of the most beautiful chapters in our lives won't have a title until much later."
– Bob Goff

Markets

The S&P 500 index is about the same level as it was in the peaks of August 2022 and March of 2022, yet investors seem to be more optimistic, as depicted by the AAII Sentiment Indicator, than they were during those months[137]. The AAII Sentiment Indicator is a survey of individual investors on their thoughts about where the market is heading in the next six months, and it is currently at highs not reached since January 2022, indicating bullish sentiment[138]. Keep in mind that the AAII Sentiment Indicator has also been utilized as a contrarian indicator for investors that wish to buy when sentiment is perceived low and sell when sentiment is heightened[138][26]. Bearish investors warrant caution as the average rent in the U.S. today is $1,999 per month, the average monthly car payment is $800, and the average monthly credit card payment is $433[137]. Another concern for markets is that credit is getting more restrictive under the Fed's interest rate hikes and tight monetary policy to combat inflation, which has caused turmoil in some regional banks[111][96]. This may indicate less funds will be available to lend to businesses, consumers, and real estate developers, and further slowing of the economy with consequential lower corporate earnings[111][96].

Seven big technology stocks have led this year's resurgent stock market, most likely due to being out of favor in 2022, cutting costs, improving profitability, and the optimistic anticipation that Artificial Intelligence (AI) will increase efficiency and corporate profits going forward[124][93][26]. All seven big tech companies depicted below year-to-date through May 2023, Facebook, Amazon, Apple, Microsoft, Google, Tesla, and Nvidia, are involved directly with AI or will benefit from the new technology[93][96].



Source: GS Global Investment Research and GS Asset Management

An advancing market concentrated in seven stocks within the technology sector carrying the market rally is generally not a good sign, unless the breadth of stocks advancing improves[146]. However, in June market breadth improved with stock advances into other sectors such as the industrial, materials, energy, and financial as well as small caps[146]. Many attribute the stronger than expected market at present to the U.S. economy's strength in the face of all the financial headwinds, others believe it may be prudent and remain cautious of pending recession[146][140].

Woke and Investing

It had appeared to many CEOs that investors, customers, and employees expected their companies to embrace societal issues such as gender and sexual orientation, immigration, voting access, racial justice and equity, and abortion, referred to by opponents as 'woke'[133]. However, that seems to be changing[133]. Controversaries at Target, Anheuser-Busch InBev, North Face, and Disney have spotlighted for companies that not all their customers, employees, and investors agree with the trend over the last decade for corporations to take a stand on various social issues that may be considered progressive or offensive to moderates and conservatives[133][57]. While it would be easy for CEOs to just run a successful business and provide value for stockholders, and not get entangled with social issues as many CEOs would prefer, it is not practical to remain on the sideline on every issue, especially if affects their business, its employees, or its customers[133][30]. However, many CEOs are internally developing processes or hiring outside consultants to assist with vetting statements, policies, and marketing plans before deploying as well as a crisis plan to deal with any backlash that may ensue[133].

New York City's three big public pensions managing collectively $150 billion for city workers, teachers, and the board of education declared climate change an investment goal by divesting fossil fuel investments within 5 years under then Mayor, Bill de Blasio in 2018[33]. The mayor, city officials, and union representatives who sit on these three pension boards complied with the mayor's request but are now in a major lawsuit as underperformance of the pension funds in costing the city millions of dollars to make up the shortfall[33]. Incidentally, the New York City Police and Firefighters Pension Fund Board did not go along with the mayor's request citing a fiduciary duty to beneficiaries using care, skill, prudence, and diligence where social or political issues cannot cloud investment decisions[33].

Many asset managers offer investment vehicles that specifically screen potential investments for inclusion within that vehicle for environmental, social, and governance (ESG) factors[80][141]. ESG governance purports to advance racial equality and protect the environment[141]. This enables potential investors to select vehicles that align with their values and beliefs, and historically has been popular with investors who hold specific religious beliefs to select specific investment vehicles that adhere to those beliefs. However, investors have pushed back during the past few years on asset managers that utilize proxy votes in non-ESG labeled investment vehicles to advance shareholder proposals that embrace ESG upon the companies they hold within the investment vehicle[80][141]. This is a big deal as many of these asset managers, such as Blackrock, hold very large stock positions within the company by way of the investment vehicle, potentially forcing what is labeled "woke" culture on a publicly traded corporation[80]. By way of example, some ESG proposals may force audits to adhere to ESG governance, or attempt to stifle certain industries or sectors, such as fossil fuels, by limiting or prohibiting investment or lending into those industries or sectors[80][141][36]. The result of companies adopting preferred social and political agendas verses focusing on making good business decisions that increase shareholder value, may be higher costs and less choice for consumers and potentially less return for shareholders[36][80][30].

At Leshnak Wealth, when we screen investment positions to include within our clients' portfolios, we do not screen for companies or investment vehicles that meet a certain minimum ESG score, nor do we exclude any investment opportunity that may be considered woke with a high ESG score. We base our investment selections on specific fundamental, risk, return, and technical criteria that have not changed much in nearly two decades. If being woke or conversely not being woke, effects the investment being considered or currently held, we would expect it to be revealed within our selection and retention process. However, specific client requests can be tailored to adhere to a discipline that screens for investments that meet religious, social, or environmental beliefs on request.

Artificial Intelligence

Artificial Intelligence (AI) has been a hot topic in 2023 with the media, the financial markets, and in a Senate Judiciary sub-committee hearing in May[77]. ChatGPT the popular AI chatbot, which was utilized by 100 million people in its first two months of rollout this year, uses deep learning to generate human-like text based on prompts from users[77][142]. Basically, AI can learn to accomplish any intellectual task that human beings can perform[142]. This transformative technology includes advanced capabilities with vision, speech recognition and generation, language understanding and generation, image and video creation, preparation, design, formulation, decision-making, and integration of vision and motor control for robotics[142]. AI is already being utilized for various products and services such as video games, medical diagnosis, logistics systems, autonomous driving vehicles, and language translation[143]. Congress is examining the new technology for possible regulation to attempt to balance innovation and moral and ethical responsibility as the nefarious applications of such a powerful technology may lead to adverse and unintended consequences[77]. We've all seen the Arnold Schwarzenegger movie "Terminator"…

China

The China Communist Party's (CCP) objective is to drive the U.S. from the Western Pacific for control of the region, but the ultimate goal of the CCP is to be the number one global military and economic power[132][127]. China hosted a summit with five former Soviet Republics from Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan), where President Xi Jinping urged closer economic and military alliances between Russia, China and the five guest nations to counter what is sees as a U.S. led push in the region to isolate China[65]. Tensions may escalate if the confrontations recently experienced get more serious[127]. For example, a Chinese naval ship came within 150 yards of a U.S. missile destroyer in the Taiwan Strait last week, and a Chinese fighter jet in late May flew within 400 yards of a U.S. reconnaissance plane flying in international air space over the South China Sea[127]. In February of this year an unmanned Chinese spy balloon flew over a good portion of the U.S. including several military bases, sending data back to China presumably about American Military Instillations[139]. Additionally, China and Cuba reached a deal for China to establish an electronic eavesdropping spy facility to be in Cuba, just 100 miles from Florida, likely to monitor U.S. military communications along the east coast[131].

Russia and China are solidifying their partnership on core mutual interests as their countries oppose U.S. and western countries' illegal use of sanctions to dictate their preference and attempt to maintain global power[44]. China has been a lifeline to Russia during the War in Ukraine and subsequent sanctions, both with trade and intelligence[44][47]. China has not condemned Russia's invasion of Ukraine, but instead has condemned the U.S. and its European allies for prolonging the war by suppling weapons to the Ukrainians with the objective to expand NATO[44]. Viewed by some as deception, China has portrayed itself as the peacemaker in recent months, visiting both European countries and Russia, to promote a peace initiative and dissuade Russia from possibly using nuclear weapons[44][47]. However, China's proposal to western countries is for Russia to retain the regions of Ukraine it presently occupies in the war[47].

Lithium is a component in the lithium-ion batteries used in electric cars and smartphones, and China is the world's largest refiner of lithium[46]. Understandably, China has moved to buy lithium mines to secure the metal for refining but has been blocked from purchasing mines in two of the world's largest lithium reserve countries, Australia and Canada, due to perceived national security concerns by those countries[46]. However, China is actively buying lithium mines throughout the emerging market countries as it believes its own lithium reserves, roughly 8% of world reserves, will be insufficient to meet demand for electric cars within China during the next decade[46]. China's economy is slowing in both the manufacturing and services sectors which may be problematic for long-term growth, coupled with internal debt mounting, an aging population and consequent shrinking workforce, an ever more authoritarian central government, and a shifting global supply chain[108][99].

Assuming the dreadful situation of U.S. war with China over Taiwan, China has 1,300 ballistic missiles that could hit American military instillations in the Asia-Pacific region, not to mention China's development of hypersonic missiles supposedly capable of confusing missile defense systems with unpredictable flight paths[122]. The U.S. is addressing this threat by increasing the number of smaller bases in the Asia-Pacific region to spread military personnel, assets, and command centers[122]. Optimistically, if U.S. military conflict with China does not come to fruition, economic implications may still emerge as demand surges and supply shocks resulting from the China and U.S. economic rivalry, and consequently, the shifting of supply chains within the global trade landscape[136].

Housing

Higher mortgage rates have made buying a home more expensive which has worked to keep home sales flat year-over-year[100]. To put that into perspective, if you bought a medium-priced U.S. single family used home in June of 2022 verses in June of 2020, the average monthly payment for principal and interest on the mortgage would have nearly doubled[63]. The inventory of homes for sale remains low as current homeowners are hesitant to sell and undertake a new higher rate mortgage[100]. Construction of new homes has slowed during the prior year with higher interest rates and inflated construction costs[100]. However, the purchase of building materials surprisingly picked up steam in May as revealed in the retail sales numbers[145]. The low inventory and continued demand for homes, often spurring a bidding competition between home buyers, has worked to lessen the decline in home prices with the National Association of Realtors reporting the median existing home price fell just 1.7% year-over-year[100]. Miami, followed by Tampa, has had the strongest annual home price increases year-over-year, with Seattle experiencing the worse decline[100]. Home prices have generally risen in many eastern U.S. markets, while most western U.S. markets have declined during the past year[69].

Crisis in America?

Many Americans feel that U.S. society and culture is in decline despite widespread economic opportunities, prosperity, freedom, legal protections, and individual rights guaranteed by the U.S. Constitution[20]. The National Opinion Research Center at the University of Chicago and the Wall Street Journal produced side-by-side surveys of preset day respondents as well as respondents from 25 years ago in 1998[20]. Basically, the surveys revealed that in the last 25 years, Americans who believe patriotism is very important declined from 70% in 1998 to 38% in 2023, religion being very important declined from 62% to 39%, having children being very important declined from 59% to 30%, and hard work as being very important declined from 84% to 67%[20]. Incidentally, the only survey question that increased in importance for Americans as being very important is money, 31% in 1998 to 43% in 2023[20].

It has been posited that American society may be in decline due to a multi-generational change from citizens who won World War II and lived through the Great Depression or learned of these struggles first-hand through their parents and grandparents, to citizens who had not known scarcity or lack of easy credit, nor taught frugality[20]. Further, it has been theorized that the migration of people to advance careers and build wealth has created tremendous economic growth and prosperity, but also less cohesive communities, families, and ultimately less patriotism, which may be characterized as an extension of community and family[20]. Additionally, social media and smart phones have played a part by reducing personal interaction while increasing anxiety and depression[20]. Finally, the U.S. educational system has placed less emphasis on instilling U.S. nationalism and civic duty in students based on a shared American history, while instead opting for a curriculum that is diverse and neutral based on ideological history imposing current day values[20].

"We are confident despite the market volatility experienced in 2022 that your portfolios are positioned to best achieve your long-term goals and that your wealth plan remains on track." *–Bob Leshnak*

LW GamePlan

The LW Portfolio Models are constructed globally with core equity positions in small, medium, and large cap equities, each straddled by momentum-based and value-based investment positions. We believe adding momentum-based investment positions using technical analysis offers the opportunity to allow current market trends to play out while also providing the flexibility to potentially alter exposure when market trends retreat. We also believe adding value-based positions us in the place of the "turtle", in the proverbial tortoise verses the hare scenario, over the long-term with equities. Value-based investment generally involves buying securities whose shares appear underpriced by a form of fundamental analysis. Additionally, we believe that by combining value and momentum strategies across diverse markets and asset classes may result in significantly higher risk-adjusted rates of returns based on the academic research conducted[97][98]. Lastly, we prescribe dividend yield from all our equity investment positions so that no matter what markets are doing day to day, we have dividends continuously coming into the portfolio.

Our fixed income blueprint for the portfolio consists of allocations to core domestic, foreign core, strategic investment grade, inflation protected, and high yield bonds. Overall, we evaluate investment positions in seven asset classes including domestic equities, foreign developed stocks, foreign emerging market equities, domestic bonds, foreign bonds, cash equivalents, and alternative assets such as real estate, infrastructure, natural resources, and commodities for inclusion within our overall asset allocation. How much of each asset class, if any, we hold in these asset classes is based on your unique risk tolerance, financial resources and personal goals and objectives. We strive to be offensively positioned while remaining defensively minded with our portfolio construction and periodic adjustments. Simply put, we adopt an investment strategy, embrace it with confidence, and endure the inevitable ups and downs in the markets.

"Truth is ever to be found in the Simplicity, and not in the multiplicity and confusion of things"
—Isaac Newton

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Our Leshnak Wealth Portfolio Models are not immune to declines in global markets as we do not have a crystal ball nor do any of the market analysts and forecasters. Our belief is that our LW Portfolio Model construction is diversified for potential resilience in any environment and may put us in a position to take advantage of market mispricing during such market gyrations. We do not modify overall asset class allocation due to market corrections unless a fundamental change in the underlying outlook for the domestic or global economy has significantly diminished or brightened verses our expectations. As the ancient Buddhist proverb states "If we are facing in the right direction, all we have to do is keep on walking". Pullbacks can be expected to last relatively shorter periods on average compared to the bull markets they take reprieve from, as the greed present turns to fear and shakes out those investors who are not fundamentally based in their convictions.

As your financial fiduciary, the Leshnak Wealth team cares deeply about your financial well-being and will monitor for rebalancing opportunities that may add value to your portfolio, or to be defensive as conditions might warrant. We know that as your advisor, the trust you bestow upon us is built and maintained on three pillars; doing what we say we will do, assisting with planning for and achieving your financial independence, and providing unbiased advice with your best interest at the forefront. As always, please call with questions or if you wish to discuss your specific portfolio or Wealth Plan in greater detail.

–Bob Leshnak, June 15, 2023

The investment decisions are those of Robert M. Leshnak, Jr., CLU®, ChFC®, CFP®, MPAS®, EA as of 6/15/2023 and are subject to change. The information contained herein is only intended for Leshnak Wealth clients invested in the Leshnak Wealth Portfolio Models. No forecasts or recommendations are guaranteed. The technical data utilized as part of the investment decisions does not guarantee future positive results. Performance, especially for short periods of time, should not be the sole factor in making investment decisions. The information contained herein does not constitute client specific investment advice or consider a specific client's particular investment objectives, strategies, tax status, resources, or investment time horizon. No investment strategy such as asset allocation, diversification, momentum, value, tactically overweighting sectors, or utilizing fundamental and technical analysis can always assure a profit, nor always protect against a loss. The information presented is not intended to be a substitute for specific individualized tax, legal, or financial planning advice. The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time. Investing involves risks regarding all the investment products mentioned in this commentary, including the potential loss of principal. International investing involves additional risks including risks associated to foreign currency, limited liquidity, government regulation, and the possibility of substantial volatility due to adverse political, economic, and other developments. The two main risks associated with fixed income investing are interest rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the insurer of the bond will not be able to make principal and interest payments. Investments in commodities may entail significant risks and can be significantly affected by events such as variations in the commodities markets, weather, disease, embargoes, international, political, and economic developments, the success of exploration projects, tax and other government regulations, as well as other factors. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance is no guarantee of future results. Please note that individual situations can vary. Therefore, the information presented here should only be relied upon when coordinated with individual professional advice.

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