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Mid-Quarter Update

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Since our last update, there have been meaningful shifts in the way investors are looking at the state of the economy. It is too early to know for sure if these shifts are temporary or of a more lasting nature, but they have caused significantly increased volatility in the financial markets.

Even though the economy is still growing, the most recent unemployment report seems to confirm that the U.S. economy is slowing down. Far fewer new jobs were reported and the unemployment rate jumped up to 4.3%, its highest rate in some time. It has been slowly rising from its low of 3.4%. Despite some mitigating factors in the employment report, investors began shifting away from the widely accepted soft landing scenario. Now, consensus expectations call for a higher likelihood of near-term Federal Reserve (Fed) interest rate reductions and an increased probability of recession.

Investor reactions to these economic developments have reinforced a trend that has been emerging over recent weeks in both the stock and bond markets. Bonds seemed to be anticipating these developments as interest rates have been declining. Equity investors saw a widening of interest beyond a very few large capitalization, dominant companies to a broader range of stocks. And importantly, amidst the volatility, quality as an investment characteristic has been gaining currency and performing relatively well.

Where do we stand on the outlook? We are very pleased that inflation seems to be continuing downward, and we remain of the opinion that the Fed's target of 2% is attainable. The fact that the economy is slowing down is making the achievement of the target easier. We conclude that recent developments heighten the risk of a recession. This is not a prediction, but we note that there are warning signs.

All of this reinforces our belief that the best way to be invested today is in very high-quality securities. The potential outcomes today, as always, are uncertain. Quality helps us narrow the range of these outcomes and enjoy a better chance of a favorable result. History has taught us that in periods of market drawdowns investors migrate to the strongest companies, the ones most likely to endure. Under such circumstances, investors prefer companies with the ability to consistently produce higher earnings and dividends.