



## FIVE MILE RIVER *Investment Management, LLC*

Five Mile River Investment Management, LLC  
Client Quarterly Letter  
1<sup>st</sup> Quarter 2023 – Addendum

April 25, 2023

### PERFORMANCE

	Dow Jones Industrial	S&P 500* (Capitalization Weighted)	S&P 500 (Equal Weighted)
2023 Q1	0.38%	7.50%	2.93%

### HIGHER FOR LONGER? INTEREST RATES, INFLATION, DEBT LIMIT, RECESSION?

Uncertainty about the direction of the economy, the stock market, and the bond market abounds, and for good reasons as we have explored in past letters. Jamie Dimon, the Chairman and CEO of JP Morgan Chase, put it best: “You could have an environment of higher (interest rates) for longer (second half 2023 and into 2024) that might be better (for eliminating inflation), but remember, higher for longer comes with a lot of other things attached to it, like maybe a recession, or stagflation.”

The 3Q22 FMR client letter discussed, in some detail, the multiple mistakes the Federal Reserve Board has made over the past three years, which could increase the possibility of stagflation. Stagflation, a word coined by the British, is a blend of stagnant or low economic growth coupled with high inflation (above the Fed’s target of 2%). Not a good economic environment.

In his remarks last week, Jay Powell, the Federal Reserve Chairman, virtually guaranteed another 25-basis point (1/4%) rate hike at their May meeting. The bond market has been signaling that this 10th increase will be the last. The Chairman has said the Fed Funds target for year-end is 5.1%. Therefore, with the Fed Funds rate now at 4.75% to 5.0%, it virtually assures that there will only be one more rate increase in 2023, and that will happen in May.

At the beginning of this second quarter as both economic numbers and public companies report, there is plenty of evidence that the economy is cooling. This is because: jobless claims are rising; the manufacturing index for output has been down for seven months in a row; consumer spending is slowing with record increases in revolving credit; the leading economic indicators are pointing down; small business confidence is down. Also, recent bank failures will likely result in increasing already tight credit conditions, putting pressure on both consumers and small businesses. Slowing new jobs creation, a lagging indicator, and will probably be the last shoe to drop before a recession is “officially” recognized. **For the first time since the Fed started to raise rates, a recession, albeit “mild,” is now the forecast from the Fed’s staff.** This mild (soft landing) recession is expected later this year, again, according to Fed staff. FMR’s forecast has consistently been that the Fed will have a difficult time getting inflation down to 2% because of the \$5 trillion overspending from recently passed spending bills. The 4Q22 FMR client letter stated that a resolution of the projected stagflation environment may take several years,



requiring both responsible fiscal and monetary policies. One without the other prolongs a stagflation economy, not dissimilar to the regrettable period of 1973-1982.

**DISTORTION IN THE S&P 500 INDEX**  
**MARKET OUTLOOK and the DEBT LIMIT/BUDGET BRAWL**

The performance data at the top of this letter, purposely different from FMR's normal index performance statements, showed the wide differential in the first quarter 2023 performance of the S&P 500 Capitalization Weighted index at +7.5% compared to the S&P 500 Equal Weighted index at +2.9%!

The S&P "Capitalization Weighted" index is distorted compared to overall market performance. Why? The S&P Capitalization Weighted index performance was elevated because just *seven mega technology companies contributed 88% of the 1st quarter's performance*. However, the broader market performance, not including these seven technology stocks, was virtually unchanged in the 1<sup>st</sup> quarter.

With persistent inflation almost certainly above the 2% goal, the Fed does not have any choice but to keep rates high. FMR believes rates will not start declining until the second half of 2024, much later than the market's expectation. The FMR stock market forecast for the balance of 2023, as measured by the S&P 500, is plus or minus 10% with the S&P 500 currently trading around 4100. Surprise on the upside of this forecast would be a win/win on the debt limit/budget struggle coming shortly, out of which there must be significant cuts in the last spending bill and more growth initiatives. Surprise on the downside would come from no compromise on reduced spending and the unexpected but potential threat of default on U.S. government debt. The stock market would initially react negatively to default risk, however, FMR firmly believes this will NOT happen. Why? Section 4 of the 14th Amendment is unequivocal that the constitutional obligation to pay bond holders would trump all other statutory obligations to spend. The government collects about \$450 billion a month in tax revenue, more than enough to pay the \$55 billion in monthly debt service. The coming debate and brawl over what spending should be cut may not be pretty.

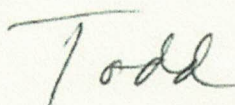
FMR continues to be cautious in 2023. FMR restructured client portfolios a year and a half ago by investing in value and defensive companies that can grow through a flat or recessionary environment. As stated in previous letters, rising interest rates not only create an uncertain environment, but could lead to the unpleasant effects of stagflation. FMR portfolio managers have experienced the effects of stagflation on the markets from the period of the late 70's to the mid-80's and have and will continue to take necessary steps to buffer stagflation's negative effects in client portfolios. To accomplish this, FMR continues the discipline to invest in those companies that have very strong balance sheets, free cash flow, very wide competitive moats, dominant market share positions, above average profitability, and shareholder friendly managements that return capital with growing dividends and share buybacks.

Thank you for your confidence in our FMR team and do not hesitate to reach out to us at any time with your questions about your portfolios, objectives, specific holdings, or current financial/economic issues.

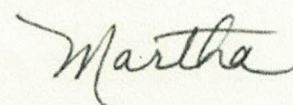
Sincerely,



Lee



Todd



Martha



*\*The S&P 500 Index is a market capitalized weighted index of 500 companies. It is a growth-biased index because the larger the capitalization of a company, the larger the weighting it contributes to the S&P 500 Index performance. The index referenced includes the dividends issued by these 500 companies. This index is used for a comparison for FMR accounts. The performance data included in this letter are not audited and have not been otherwise reviewed or verified by an outside party. While Five Mile River Investment Management, LLC endeavors to furnish accurate information, investors should not rely upon the accuracy or completeness of this information.*

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