

January 4, 2025

Dear Clients and Friends:

Economics likes to pretend it is a science, an academic discipline on par with, say, physics or chemistry. While it does have a few well-defined laws...Adam Smith identified three...it would be a fallacy of composition to extend the term of "science" to the entire field. In fact, it is apparent that the greatest concentration of economic academic firepower in the known universe, the Federal Reserve (Fed), has clearly abandoned any pretext of a rules-based approach and has gone with a feelings-based approach. While this has been building for many years, if not decades, we are currently experiencing the consequences of a "finger in the air" or "winging it" style. You see, the science would tell you when you drop an object it will fall, but in a world where rules and laws are ignored, as they are in the Temple, this may not be the case. Witness the outcome of a reduction in short term rates by the Fed totaling 100 basis points since September 2024. Far from falling, rates out the yield curve rose from 63 basis points in the 2-year to as much as 90 basis points in the intermediate part of the curve. Jerome Powell dropped an object, and it fell...up.

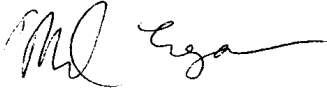
Those who do not follow the Fed for a living, and please thank your parents for doing something right, may be genuinely confused by this action. I would direct you to endure clips of the Chair of the Federal Reserve's most recent press conference, which took place immediately following their last policy action. When asked to justify a clearly unjustifiable action, one based on no known laws of economics, his stammering, stuttering, stumbling reply was truly something to see. He seems to have been, and remains, utterly lacking in a coherent thought process, leaving current policy adrift in a sea of uncertainty. The Fed has no compass and no sextant. There is no lodestar and no North Star. He seems to be a blind man in a rowboat at sea hoping for rescue, but we all know hope is not an investment strategy. So what is an investor to do? How shall we navigate going forward, now denuded of all navigational aids?

Well, just because these bureaucrats continue to beclown themselves does not mean we are doomed to the fate of Captain Powell in his dinghy. Unlike them, we continue to believe in a rules-based approach in investing. We will focus on the things that are known with certainty, or as close to near certainty as we can get. It is a fact that real rates are well over 2% and are high by the standards of the last 20+ years. The future is unknowable, but we believe these rates are currently attractive and should be captured for a longer than average time frame. Hence duration should be above whatever your benchmark is. Equity valuations and their cousins in investment grade credit and high yield credit are unquestionably expensive. Of course, they may stay or get even more expensive. Coupled with these valuations, however, we know there is a greater than average degree of uncertainty in all things economic, all things political/geopolitical, and of course all things related to the path of monetary policy. This would indicate a stance of caution with the only question being the matter of degree.

In summary, we believe a position of greater than neutral duration coupled with a significant bias to quality is the stance dictated by what we know, and not what we guess or hope for. Unlike our friends at the Federal Reserve, we believe Adam Smith was kind of genius, and we would rather follow him and

folks like Ludwig von Mises, incorporating logic and rules where possible. Perhaps after they pass through the crucible of fire that awaits them, they will come around.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Egan', written in a cursive style.

Mark M. Egan, CFA
Managing Director

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