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Market Update – *One for the Record Books*

by David A. Jaffe, M.D.

Let's launch this quarter's commentary with a superlative: the third quarter of 2024 was a great period for the financial markets and the economy overall. Major stock market indexes including the S&P 500, Dow Jones Industrial Average, and the NASDAQ Composite logged new all-time highs in September. Even the equal-weighted S&P 500 joined the party as investor enthusiasm over Artificial Intelligence (AI) waned a bit, and the rally broadened, boosting returns in industries as diverse as financial services, industrials, raw materials, consumer goods, and real estate. Interest rates fell and bond prices rose (they move in opposite directions) reflecting investor confidence that inflation is subsiding.

The obvious catalyst for the rally occurred on September 18th, when the Federal Reserve lowered short-term (Fed Funds) interest rates by 0.50%, beginning the eagerly anticipated process of reversing the rate hikes initiated in March of 2022. Aside from a couple of monthly bumps, the Consumer Price Index has fallen steadily from a high of 9.1% (June 2022) to a reading of 2.4% in September of this year.

While inflation and interest rates have grabbed the headlines, other economic measures are likewise quite positive:

- Job Market: Employment for people ages 25-54 is holding at 80.9%, the second-highest rate in U.S. history (the highest being 81.9% in 2000).
- Labor Productivity: Real GDP output per hour worked is higher than it was throughout the 2010s and the best seen since the early 2000s.
- Wages: Real average hourly earnings for production and nonsupervisory workers – a good proxy for the median worker's wages – are growing at a 4.0% annual rate, exceeding inflation by a comfortable margin thus boosting purchasing power. It's important to note that curbing inflation is not the same as *deflation*. Prices in many areas which spiked due to the pandemic such as food, energy, and automobiles are moderating,

but most encouraging is that the rate of wage growth is exceeding inflation, and will ultimately improve affordability of goods broadly.

- GDP: Quarterly U.S. Gross Domestic Product (GDP) growth has remained strong since the pandemic-induced first quarter decline in 2022, most recently 3.0% year-over-year. The U.S. leads other developed countries by a wide margin, including France, Germany, Italy, Japan, Canada, and the U.K.

Reflecting moderation of investor enthusiasm for companies linked to AI, the more broadly diversified equal-weighted (EW) S&P 500 advanced 9.60% this quarter, while the widely quoted market cap weighted (MW) S&P 500 rose a more modest 5.89%. The PASI composite stock portfolio added a healthy 6.90% in the quarter, standing up 15.00% for the year.[1] This compares to the tech heavy MW S&P 500, up 22.08%, and approximates the EW S&P 500, which posted a gain of 15.16% year-to-date (all cited returns include reinvested dividends).

It may be too early to declare victory, as the impact of high interest rates often lags for as much as a year, but there is widespread confidence that the Federal Reserve has indeed pulled off what investors refer to as a "soft landing," slowing the economy enough to curb inflation while preserving employment and growth and side-stepping a recession. While risk always lurks around the corner, the U.S. economy continues to demonstrate remarkable strength and resilience.

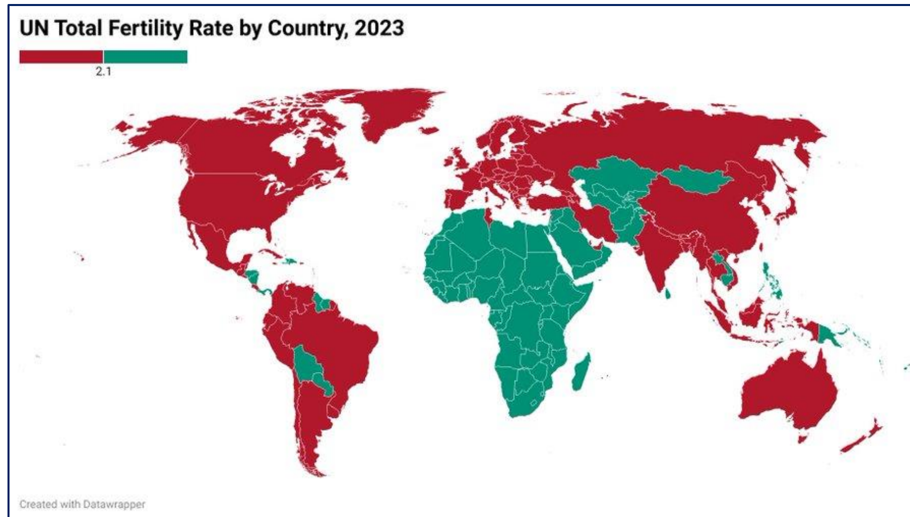
Demography is Destiny

by Nathan Polackwich, CFA

A global tectonic shift is afoot that promises to rival the Industrial Revolution in historical impact. It's a change that won't be particularly noticeable for a number of years, but within a few decades the world will look astonishingly different politically, economically, and culturally. Surprisingly, I'm not talking about advances in artificial intelligence but rather collapsing birth rates that are poised to end global population growth much sooner than expected and result in the oldest society in history.

In 1968 the biologist Paul Ehrlich published the highly influential book, *The Population Bomb*, which detailed the significant ecological and civilizational risks of overpopulation should the extraordinarily high global total fertility rate (TFR) continue. At that time the average woman had five children. Ehrlich's fears proved unfounded, as the TFR fell to 3.7 in 1980, 3.3 in 1990, 2.8 in 2000, 2.6 in 2010, and 2.25 as of 2023. Given that the replacement fertility rate needed to sustain the global population is around 2.1, there doesn't seem to be much of a problem yet. Unfortunately, the decline in births is accelerating, and most of the world is already well below that 2.1 replacement rate – in many cases, alarmingly so.

[1] Please see additional PASI Performance and Index disclosures on page 10.



In Asia, China's TFR more than a decade after the relaxation of its one child policy is still just 1.03. South Korea's fertility rate is a catastrophic 0.72, among the lowest in the world, and even Japan at a relatively better 1.21 isn't coming close to replacing its population. All three countries are already experiencing total population declines that will only speed up in the coming decades.

In the Eurozone, 3.88 million babies were born in 2022 (most recent data). This represents a significant decline compared to the 5.1 million births in the region back in 1990. The EU's average fertility rate is now just 1.46, with some countries like Spain (1.16), Italy (1.24), and Poland (1.18) doing far worse. The total EU population is still growing slightly, but this is due to significant foreign migration, particularly the more than 6 million Ukrainian refugees who've settled in Europe since the war with Russia began in 2022.

The most surprising drops in fertility have been in developing countries. For example, take a look at Brazil (1.59) and Mexico (1.60), which now shockingly have lower fertility rates than the U.S. at 1.62! Latin America overall is already below replacement fertility.

Even India and the Middle East are seeing plunging fertility. A *Lancet* study in 2021 estimated that India's fertility rate was already below replacement at 1.91. Given global trends, it's likely declined further since then. Or how about Iran with a TFR of just 1.67 or Turkey at 1.51?
One of the only places in the world that still has a relatively high fertility rate is Africa, where the average TFR is about 4.2. However, like everywhere else, African fertility is on a downward trajectory. In addition, the continent's replacement TFR is likely around 2.5-3.5 given its much higher child mortality and lower life expectancies. Thus, even Africa may not see as much population growth as demographers expect in the coming decades.

South Korea is a case study in how while overall population numbers aren't currently suggesting much to worry about (very modest declines), the generational data under the hood looks catastrophic. For instance, the number of 1-year olds in South Korea is currently just 25% of the number of 50-year-olds. Assuming the country's TFR remains 0.72 and there's no change in life expectancy or immigration, a back of the envelope calculation projecting South Korea's population (currently about 51 million) going forward would look something like this: 2045 – 43

million, 2065 – 29 million, 2085 – 15 million, 2105 – 6 million. If something doesn't drastically change, South Korea as a country and people basically won't exist in 80 years. Much of the rest of the developed world is facing a similar prospect although on a slower timeline.

From an investment standpoint there are two questions: Will fertility rates keep falling, and what does this mean for the global economy?

I expect that fertility will continue declining and that the TFR rates around 1.0 in Asia and southern Europe foreshadow where much of the rest of the world is headed. My pessimism stems from the cultural changes of the last 50 years that have elevated material wealth and consumption, as opposed to large families, as the primary indicators of social status. In fact, having lots of children makes it practically and financially impossible for most parents to do the things – like travel or dining out – society now deems essential for achieving "the good life."[2]

Relatedly, marriage, if it occurs at all, is now considered something to pursue *after* financial and professional stability is achieved. But historically marriage would have been one of the first steps towards adulthood where a young couple would then build a life and family together. The shift to later marriages dramatically shortens the reproductive window, which studies show has a profoundly negative effect on the number of children most couples have.

Governments from Norway to Hungary have already passed incredibly family friendly policies like extensive parental leave, subsidized childcare, tax breaks, and even outright payments, but nothing has meaningfully moved the dial. As global cultures become increasingly interconnected, I expect this shift in values towards materialism and fewer/later marriages to reinforce the trend of declining fertility everywhere young people have access to the Internet.

What does this mean for the economy and by extension the financial markets? Economic growth is just a function of increases in the number of workers and improvements in their labor productivity. We've always lived in a world marked by a rapidly growing global population, which has consistently fueled economic expansion. Once the supply of workers stops expanding, however, growth will become entirely dependent on rising productivity. When the number of workers starts contracting, the historic population tailwind we've enjoyed since the Industrial Revolution will turn into a headwind. Economies will need productivity growth just to keep from shrinking, let alone continuing to expand. Notably, the working age population is already contracting in many Asian countries and Europe. The U.S. would be in the same boat without immigration.

It might be tempting to believe that humanity would be better off with fewer people on the planet. In the 14th century, after the Black Plague killed 30-60% of the European population, those that survived did indeed grow richer. Farmland became cheaper, and labor shortages significantly boosted the wages of surviving workers and artisans. But this isn't a good analog for plunging fertility in the modern world because 1) The Black Plague hit the elderly harder making 14th century European populations somewhat younger while today's plummeting fertility makes our society much older, and 2) intellectual capital, not scarce natural resources like

[2] Interestingly, both the very poor and the wealthiest in the U.S. have the highest fertility rates. For the poor, children have minimal impact on their already limited lifestyle, while the wealthy can afford the costs and additional support.

farmland, is the biggest driver of wealth in the modern world. As the economist, Bryan Caplan, explained in his book *Selfish Reasons to Have More Kids* (2011):

> "The total number of people on Earth and the average standard of living skyrocketed over the last two centuries. The world has never been more populous or more prosperous than it is today. By historical standards, almost everything is cheap. This would be an amazing coincidence if population growth were an important cause of poverty. Indeed, it makes you wonder: is our population a cause of our prosperity? The answer is almost certainly yes. The main source of progress is new ideas. We are richer today than we were 100 years ago because we learned so much. We learned ways for one farmer to feed hundreds of people, we learned how to fly, we learned how to make iPhones. The sweetest thing about ideas is how cheap they are to share. A million people, or seven billion, can enjoy the latest discovery. If seven castaways wash up on a desert island, how many will be creative geniuses? On Gilligan's Island the answer is one ("The Professor") but few groups of seven random strangers would be so well endowed. As the population of the island grows from seven to 7,000 or 7 million the chance that Thomas Edison, Bill Gates, Beethoven, or the Professor resides there sharply improves. Once you hit a population of 7 billion – the island will be home to 7,000 innovators who are literally one in a million."

Even before significant population declines occur, the aging of our society will impact our potential for innovation and the vitality of our culture. Consider that on July 4, 1776, the ages of some of our Founding Fathers were as follows: James Monroe (18), Alexander Hamilton (21), James Madison (25), Thomas Jefferson (33), John Adams (40), and George Washington (44). Shakespeare was already a successful playwright by his mid-20s. Mozart composed his first symphony at 8 and died at 35. Alexander the Great was just 21 when he crossed the Hellespont with almost 100,000 men and destroyed a Persian army at the battle of Granicus. When thinking of historical figures, we may picture wise old kings and queens, distinguished statesmen, or perhaps curmudgeonly inventors and artists. But the individuals we read about in the history books were often shockingly young. Changing the world requires a lot of energy, something in shorter supply as we age.

From a financial perspective, in the not-too-distant future as investors we need to start rethinking our models of how the world works. There won't be an ever-increasing supply of new workers and consumers to buoy the global economy. Birthrates in emerging markets are nearly as bad – and in Asia's case worse – than developed countries. When valuing most stocks, we can no longer assume perpetual growth. Some other possible implications that come to mind:

- Secular growth companies' stocks (those not reliant on underlying economic expansion for revenue growth) will be in high demand. Industries that benefit from aging populations (e.g. healthcare, travel, and entertainment), companies with innovative business models and products, and those that help increase labor productivity will outperform over the long term. But the average company will struggle to expand.
- Slower economic growth and older investors searching for yield will increase demand for bonds and likely drive interest rates back down to rock-bottom levels again (when bond prices rise their yield to maturity falls).

- Real estate in areas losing population (basically everywhere except premier cities where the young congregate and luxury destinations like beach or skiing towns) will be poor investments. They're already, for instance, giving houses away for free in places like the Italian and Japanese countryside.
- With wealth concentrating in an aging/increasingly retired population, young people will have a tremendous opportunity to bargain for higher wages or start new businesses (though finding employees themselves will be difficult).
- Crime is going to fall, as it's disproportionately committed by the youth.
- Relatedly, political violence and wars should become less frequent, as rigid ideologies and the willingness to physically fight for them are more common with the young.
- Climate change, resource depletion, and other environmental issues will become less pressing concerns with little or negative population growth.
- Youth culture will exert less influence on society, leading to a slowdown in the sort of rapid cultural shifts we saw in the 20th century. This trend has actually already begun. Think of how different music and fashion were each decade from about WW2 through the 1990s. There's been far less change over the last two decades. I can only think of a couple music and movie stars under the age of 30 that today would be considered household names.

In general, a rapidly aging society will lead to a more stable but also less energetic and exciting world. Seeking opportunity, the smartest and most enterprising youth will likely migrate from other countries to the U.S., negatively impacting progress in those regions. For America, the ability to attract and assimilate the best and brightest from around the world, as well as its relatively stronger fertility rate, will help it not just maintain but grow its economic and geopolitical dominance.

A Newcomer's View of Professional Advisory Services

by Donald H. Sienkiewicz, JD, CFP®

In twenty-two years of practicing law – the first half in commercial real estate, the second half in trusts and estates, with a bit of small business and general litigation sandwiched in between – clients would occasionally ask if I could refer them to a good "financial advisor." I always felt a bit sheepish when this happened, because although I had met *many* people who held themselves out to be financial professionals, *I had no idea what they did*. Furthermore, I suspected many of them of being salespeople who didn't really know that much about financial planning or investing.

Tired of practicing law, tired of running my own firm, and, frankly, envious of the deeper and longer-standing relationships many of those "financial advisors" seemed to have with their clients, in 2018 I started investigating financial-professional education courses, eventually arriving at the Certified Financial Planner® program. It took me a couple of years of study to earn the credential (*easily* as difficult as the two state bar exams I passed), and a couple more years to find my way through the thicket of "financial management" companies to a little one in Vero Beach, Florida whose view of client service matched my own.

One benefit of being new to PASI is that its qualities may be clearer to me than they are to folks who've been here for a long time. In no particular order, here's a list of those that have stood out to me in the six months I've been in Florida:

Investment Management: When you invest your money with PASI, you have access to a dedicated investment team managing your portfolio with the same care and expertise found in institutional investment funds. Senior Research Analyst Nathan Polackwich is the lead fund manager, and the other seven of us on the Investment Committee are his collaborators and sounding board. Nathan's job is to find and recommend to us thirty "great companies [that can be bought] at fair prices," as Charlie Munger once recommended to Warren Buffett. With a manageable set of companies, we can get to know them deeply. Our goal is to hold stocks for the long run, but we're not afraid to change course if a company's prospects change dramatically or a competitor strides ahead. Diversification and discipline are the watchwords here: the first manages risk and protects client capital while providing meaningful participation in a growing stock market, and the second means we are constantly watching your portfolios, taking profits for you when the market, a sector, or an individual stock runs hot, and looking for opportunities to buy low when they cool off.

Experience: A review of the biographies on our website and some arithmetic show that within the walls of PASI we have 198 person-years of investment and related-industry experience at your service. That's a ton of experience! I can only guess at how many conversations there have been between our portfolio managers, our clients, their lawyers, accountants, and family members over the years. It is hard to imagine a market phase or a client situation arising that someone in the office hasn't seen before.

Education and Training: Another skim through the website reveals six undergraduate degrees and two graduate degrees (Jeremy Goldberg and our Senior Bond Manager, Chris Brown) in economics or finance! Even our chief operations guy, Chris Connett, has a degree in finance and worked in real estate investment before coming to PASI. Jeremy and Nathan are Chartered Financial Analysts (the people trained to dig deep into the books of public companies to find value, expose corporate baloney, and crunch numbers to reveal unrecognized investment opportunities). Chris Steele, Jeremy and I are Certified Financial Planner® Professionals (trained in all areas of financial life, including budgeting, saving, taxes, insurance, investments, retirement planning, and estate planning). Chris Steele has deep experience in insurance and estate planning, and four members of the Portfolio Management team worked for Wall Street or other advisory firms before joining PASI.

Comprehensive Financial Planning: Combine the aforementioned two centuries of experience with the capabilities of eMoney, an industry-leader in financial planning software, and we can provide in-depth financial projections covering retirement, Roth conversions, estate planning, and tax optimization (income, estate, and capital gains). **Our financial planning capabilities are robust, and backed by real knowledge and experience**. Along with your lawyer, accountant, and insurance professionals, you have an all-pro team available to support your financial well-being.

Technology: In addition to our investment in comprehensive financial planning software, PASI has something unique and frankly, really cool: our own investment management software, custom-built over the years to the needs of our Portfolio Managers and maintained by a dedicated programmer, IT guru Jim Wiles. Each manager gets half a dozen automated client reports every morning that let us know when your money has come in or is about to go out, review your holdings for company and industry allocation, and provide several other metrics that help us manage your accounts with personal and individual attention.

A Well-Oiled Machine: Every law office, investment firm, accounting firm or beer-and-burger joint has a "back of the house" staff that keeps the place running. In our industry we refer to these folks as "the back office," "support staff," or "operations" (here at PASI we call them as the "Data Processing" team). They are the glue of the business, and they usually get less recognition than they deserve. In a way, that's as it should be – they work quietly behind the scenes to keep things running smoothly, making the client experience better every day. In addition to Chris Connett and Jim Wiles, Barb Stenger, Robin Thompson, and Mary Tatro have been serving our clients for a combined forty-two years! THAT'S institutional knowledge.

We Were Fiduciaries Before It Was Cool: From my view as an outsider (and a recovering lawyer, with all the pessimism about human nature that career tends to breed) the personal finance and stock-brokerage industry has finally been dragged, kicking and screaming, into a state of affairs in which clients have realized WE should be working for YOU, not the other way around. How was PASI so far ahead of the curve as an independent fiduciary? From where I sit, it looks like Ron Jaffe MD and Ken Ligon II wanted an investment company that would treat its clients the way THEY wanted to be treated as clients. Since they couldn't find one, they built one.

As an independent Registered Investment Advisor, PASI and its staff don't sell any products or push our own "proprietary" funds. Our focus is on making well-informed investment choices by assembling and maintaining a carefully-vetted portfolio of stocks and bonds with a history of strong fundamentals and long-term growth potential. We make financial planning, tax optimization, and our deep knowledge about the other big areas of financial life available to you as an integral part of our client service.

Finally, a Note on Your Estate Plans: When I worked as an estate-planning lawyer, I would send new clients a thirty-page questionnaire and then sit with them for a two-hour initial consultation because understanding the family, its dynamics, and the client's wishes was a critical part of estate planning. Still, I envied the long-term relationships clients had with their financial advisors, which allowed those advisors to really know their clients, and allowed the clients to deeply trust their advisors. Financial advisors like us, who know our stuff AND know you, can work with lawyers and accountants to design plans that make sense *now*. It is our privilege and good fortune to have been given the opportunity to get to know you and your families.

If you think you might want to make a trust; if you have a trust but haven't looked at it in years; if you haven't recently confirmed the beneficiary designations on your accounts with us (or elsewhere); or if there's been an important change in your health, employment, family or

financial situation (or that of someone you love), call your PASI Portfolio Manager. The biggest cause of estate plan failure is failure to plan (which includes failure to update). Let us help you. *It doesn't cost anything extra for us to facilitate those conversations with you, your family members (if you wish), and other professional advisors.*

Donald H. Sienkiewicz grew up in Washington, D.C., son of a federal employee/cold warrior father and a quilter/author/teacher mother. He went to college and law school in Boston, where he met and married Katja Hock, a German native and his wife of twenty-eight years. Together, they raised four wonderful human beings in a small town in New Hampshire. Donald loves to fish, sail, and just plain be outdoors in nature.

News Flash! – *PASI Joins the CNBC FA100 Again for 2024-2025*

The Professional Advisory Services team is thrilled to announce that we have been ranked #37 in the country and #3 in the State of Florida among CNBC's list of the Top 100 Financial Advisors for 2024. Working in partnership with data provider AccuPoint, CNBC applied proprietary methodology to cull the FA 100 from more than 40,000 Registered Investment Advisers. This was our third consecutive year for inclusion in CNBC's Financial Advisor 100 list, which entails no monetary incentives.[3]

Disclosure

Professional Advisory Services, Inc. may, from time to time, have a position in securities mentioned in this newsletter and may execute transactions that may no longer be consistent with this presentation's conclusions. Reference to investment performance of the PASI composite stock portfolio is made gross of expenses. For formal performance disclosure with net returns please contact our office.

[3] Detailed information can be found on CNBC's website. Please search "CNBC FA100" or enter the following link: https://www.cnbc.com/2024/10/02/fa-100-cnbc-ranks-the-top-rated-financial-advisory-firms-of-2024.html

Performance Disclosure

To obtain a detailed analysis of Professional Advisory Services, Inc.'s (PASI) historical performance, inclusive of gross and net results from our balanced accounts and performance data for our segregated asset classes, please contact our office at 800-847-7274. It is important to note that PASI performance data presented in this newsletter is stated before the deduction of fees and in the context of each article. For a clearer understanding of the impact of fees, please refer to the following disclosures including a hypothetical example based on the maximum PASI investment management fee.

The **PASI Stock Portfolio** includes the reinvestment of dividends; and is reduced by brokerage commissions but is gross of Professional Advisory Services, Inc. fee, which is described in Part II of form ADV, available upon request. Our fee is a maximum of 1% and decreases based on assets under management. As an example of fee impact, over a ten-year period, $100,000 invested in stocks growing at 8% per year would increase at the end of ten years to $205,419 net of 1% fee versus $220,804 gross return.

PASI Stock Portfolio Benchmark: The ***S&P 500 Index (Market-Cap-Weighted)*** is an unmanaged index of the 500 leading publicly traded common stocks in the U.S., including reinvestment of dividends. This index is weighted according to the market capitalization of each participating company. As a result, companies with larger market capitalizations exert greater influence on the index's overall return, reflecting their proportionate size to the overall market.

Other Indexes
The ***S&P 500 Equal Weight Index (Equal-Weight)*** is an unmanaged index of the 500 leading publicly traded common stocks in the U.S., including reinvestment of dividends. Designed to be size-neutral, it assigns equal weight to each participating company, irrespective of their market capitalization. This approach equally captures the influence of each company on the index's overall return relative to its individual performance, providing a balanced reflection of the collective market activity.