

Fourth Quarter 2024

Economic and Market Commentary

By Ray L. Lent, Founder & CEO, The Putney Financial Group LLC

Economic and Market Commentary

Anthropologists refer to it as the “Neolithic Revolution.” It took place nearly 12,000 years ago. The last Ice Age was just ending, and the hunter gatherer societies would soon step aside in favor of those focused on agriculture and settlements. This phenomenon occurred independently in Africa, Asia and Europe and was spurred on by climate change. With the end of the Ice Age, warmer temperatures emerged that created a favorable environment suited to agriculture and a more reliable and abundant food supply, one that was necessary to feed a growing population that foraging alone could not provide for.

At first, through trial and error, the early settlements started to identify native seeds, wild grasses and cereals that had high caloric value and could be stored longer. The earliest farmers harvested wild growing emmer, einkorn and barley. Later on, “pioneer crops” such as wheat, flax and rye were domesticated, providing a reliable stock for future plantings.

The dawn of agriculture led to the production of a surplus in the food supply. Planning could now be deployed to ensure a food supply for an ever-increasing population. The planning required a division of labor which in turn led to a specialization of laborers, and ultimately, complex societies. These societies prompted trade of surplus goods with other societies that had their own and different surplus commodities. Their exchanges helped usher in the rise of civilizations and advancements in technologies, among these the domestication of fruits and vegetables such as figs, almonds and squash.

Pisum Sativum

Carl Linnaeus, the Swedish biologist, classified and named the seed of this flowering plant back in 1753. It is known as a cool season crop that grows best in a temperature range of 55-65 degrees Fahrenheit and does not do well in overly hot climates or high elevations. Pisum Sativum comes in two basic varieties: low-growing and vining. The vining variety can coil itself around just about anything and can grow up to eight feet tall. Originally found in the wilds of what became Anatolia, Israel, Iraq and Jordan along with other parts of the Mediterranean Basin, they are among the oldest of domesticated vegetables dating back more than 7,000 years.

Our tasty little edibles can be eaten dried or fresh and can be found in the cuisine of many different cultures. They are a rich source of vitamins C, B and K and contain negligible fat. No doubt by now the master gardeners of my readership have already figured out the everyday name

of this long-appreciated vegetable, but for the rest of us, let me share with you that *Pisum Sativum* is in fact sold in grocery stores as “green peas.”

Not Your Average Weekend Gardener

Vilfredo Pareto, Italian by nationality, was born during the waning days of the second French Revolution of 1848 in Paris, France. King Louis Philippe had just abdicated, and the French Second Republic had recently been formed. Within months, they stupidly went and closed the national workshops they had just started. These workshops provided modest income to thousands of previously unemployed workers. Parenthetically, it was the ensuing uprising that inspired the opera, “*Les Miserables*.” Within weeks of the uprising’s suppression, 4,500 French people had been killed and another 4,000 deported to Algeria. This was the world Pareto was born into, a man who was described during his lifetime as “one of the last Renaissance scholars.”

By age 10, Vilfredo’s family moved back to their native Italy. Vilfredo’s father, Raffaele, was a civil engineer and his mother, Marie, was a nurturing parent. Together they placed a high emphasis on education and enrolled Vilfredo into the recently created *Istituto Superiore Leardi*, where he became the star pupil under the watchful eye of famed mathematician, Ferdinando Pio Rosellini.

At age 23, Vilfredo earned his doctorate in engineering and wrote his dissertation, “*The Fundamental Principles of Equilibrium in Solid Bodies*.” His interest in equilibrium analysis would later be seen in his groundbreaking work in economics.

After graduation, Vilfredo worked as a civil engineer just as his father had. He worked for the state-owned railway system at first, and then later for several iron works. It took almost 20 years before this highly respected engineer turned his attention, talents and passion to classical liberal economics. By 1886, he became a popular lecturer in economics at the University of Florence. During his time in Florence, he became a political voice advocating the necessity of free markets and the perils of overly zealous government regulation.

Within a few years, Vilfredo’s life changed dramatically once again. By 1889, both of his parents had passed away, and a woman named Alessandrina Bakunina entered his life. Vilfredo and Alessandrina soon married, and a short time later, Vilfredo resigned from the University of Florence and moved to Switzerland where he would spend the rest of his life.

A New Position and a New Hobby

By 1893, Pareto had succeeded Leon Walras as the economics chair at the University of Lausanne in Switzerland. Big shoes to fill, given that Walras was the inventor/author of the “*General Equilibrium Theory*,” the bedrock of the theory of “supply and demand.” Pareto flourished in his new position, and in 1897, he authored a textbook which featured the “*Pareto Distribution Theory*,” which in a nutshell could be summed up to explain that in society, a small fraction of the population controls a large portion of its wealth.

Here's where you'll see things becoming quite interesting. Recognizing that her husband was an extreme type A personality (even though the theory would not be developed for another 60 years), Alessandrina recognized that he was wound up as tight as a spring. In an effort to give him a relaxing outlet, she introduced him to gardening. Reluctant at first, he soon embraced it with enthusiasm and remembered the joy his mother Marie would have working in her own garden when he was a child. Before long, much to the delight of Alessandrina, Pareto was growing both flowers and vegetables, and he continued with this hobby for the remainder of his life. As successful as this activity proved to be in modifying his intensity, it was not the panacea for his marriage since Alessandrina left him in 1902. It would be 20 years before he'd remarry, but some of his greatest intellectual accomplishments would be achieved in between that time, accomplishments that serve as cornerstones in modern economics and sociology.

Let Me Bring It Home

One day, shortly before the end of his marriage to Alessandrina, Pareto started to pay close attention to his green peas. At first he thought he had come across an anomaly, but after repeated examination of his crop, he recognized a distinct pattern. Through observation, he noticed that 20% of the pea pods in his garden produced 80% of the peas.

After processing his newly acquired observation, he decided to research whether this pattern might apply to other circumstances. Being a trained economist, he focused his research on finance and wealth. It wasn't long before he determined that 80% of privately-held land in Italy was owned by roughly 20% of the population.

Pareto expanded his research to a point where he recognized the ratio went far beyond land ownership to encompass the distribution of wealth in general. His conclusion was that 80% of any country's wealth was owned by 20% of its population. Soon, his research led to the accepted observation that "20% of the input contributes to 80% of the output." Today the observation is known as the "80/20 Rule," or amongst economists, Pareto's Principle.

Fast Forward 120-Odd Years

For the past two years, the equities markets have enjoyed significant growth, but true to Pareto's 80/20 rule, that growth has not been evenly distributed. The reality is that just a handful of stocks, commonly referred to as "The Magnificent Seven" were responsible for the lion's share of the growth in the major indices, so much so that, on the street, the rest of the S&P is referred to in a tongue-in-cheek fashion as the S&P 493.

This past year has seen constant press and optimism centering around artificial intelligence (AI), perhaps the most exciting breakthrough of our lifetimes. The Mega Cap companies in AI grew their earnings this past year by an average of 30%. Earnings expectations for these companies are projected, by most analysts, to come down to a still very healthy and robust 18% during the coming year, a decline of some 40%. The slower growth we've all been hearing about. Since the average forward price earnings ratio for the entire S&P 500 is somewhere around 22 or 23 compared to historic ranges of 18 or 19, it might be time to look for opportunities within the other 493 companies that make up the S&P 500.

Politics Aside, a Pretty Clean Handoff

It can be rightfully said that the American economy, at present, is the strongest of any of the largest developed nations. Inflation has come down dramatically (although that's hard to believe when you go to the pump or grocery here in California). Interest rates have declined, but perhaps not as rapidly as some were hoping for. Unemployment is extremely low, and American productivity is chugging along at an impressive rate in large part due to our advantages in harnessing AI, which is still in the very early innings.

Uncertainties and challenges still abound, geopolitically, domestically and monetarily. Our national debt is on track to increase by one trillion dollars every three months. Sooner or later, we will run out of road to kick the can down. But in spite of the challenges ahead, the American economy is the clear front runner as we enter the second quarter of the 21st century. For a new incoming administration which in many ways measures its success on stock market performance, it has been given a very healthy starting place.

The First 100 Days

Every incoming administration tries to push forward their agenda within the first 100 days of its tenure. Consider it the honeymoon period where their political capital is at its high point. Promises that have been made by the incoming administration on tariffs, tax cuts, energy and immigration most certainly present uncertainty. No, I don't think we'll buy Greenland, nor do I think we'll take over the Panama Canal, but I do think we will see heightened volatility in the equity markets, although I do believe well run companies that are growing earnings, not just sales, will do fine. It's a case of being select and not just believing we're in a market where "Rising Tides Lift All Boats."

Conclusion

There's an old adage on the street that "Bulls Do Well, Bears Do Well, and Pigs Get Slaughtered," meaning don't get greedy. Just because a strategy worked in the past, don't put it on auto-pilot and assume that it will just keep working.

With a strongly pervasive feeling that Mega Cap companies will see a slow down in sales growth which will probably pass through to earnings growth, we intend to employ specific strategies in an effort to dampen volatility and give our portfolios the best chance of success in an evolving marketplace. Throughout 2025, it is our intention to:

- Seek opportunity in mid-cap companies that are trading at reasonable valuations and have demonstrated a long track history of profitability. Why you may ask the attention to mid-caps? The answer lies in the fact that good companies can still be found at valuations significantly below the behemoth Mega Caps that have been in vogue these past several years. Additionally, if tariffs do come into play, they will not only affect the American consumer but also the large-cap companies that rely heavily on exporting their goods. Mid-cap companies typically source their raw material domestically, manufacture directly, and sell their products domestically.

- Pay keen attention to the sector rotation (which industries will be in favor and which will be out of favor) as a result of change in administration policy, e.g., alternative energy companies will suffer because of the elimination of subsidies and tax credits.
- Take profits off the table. After the past two years of outsized gains in the marketplace, taking part of our profits and protecting them in lower risk asset classes such as U.S. Treasuries and other buffered instruments. Remember the adage about bulls, bears and pigs. We don't want to be piggish.
- Continue to add to our stable of dividend-paying stocks, particularly those with a long track history of growing their dividend payout.

As we enter into a new chapter in our nation's history, it is important for us to stay engaged and informed but also to tune out the inflammatory rhetoric that comes to us across the political spectrum. With advancements in science and medicine coming to us at such a remarkable pace, there is so much to look forward to with awe and expectation.

Please continue to stay well, stay safe, and enjoy our winter months. Spring is just around the corner. As always, with ...

Best Regards,

Ray Lent
RLL/dot
Enclosures