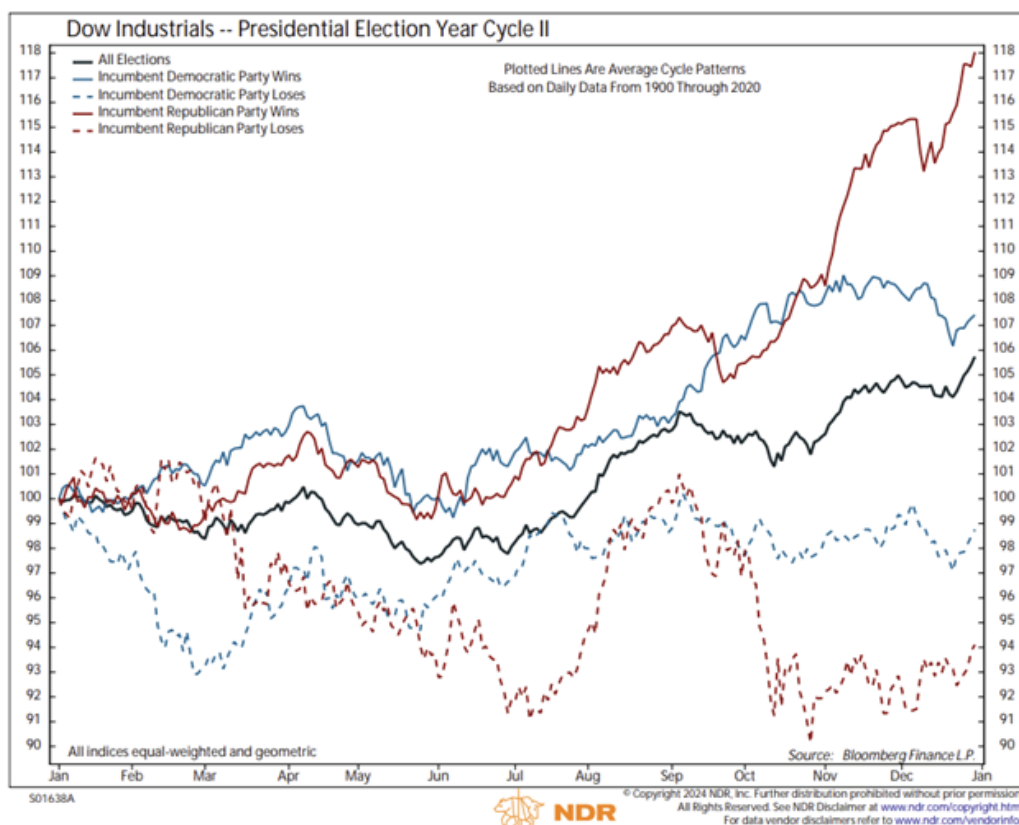


Not So Fast, My Friend

Lee Corso was born in 1935 in Cicero, Illinois, the son of immigrant parents. After a long career playing and then coaching college football, he was hired by ESPN in 1987 as an analyst for its Saturday “College Game Day” program where he has been a fixture ever since. Lee Corso may have seen more college football than any person alive. At the end of the show each week, analysts predict which team will win different games. When it’s Lee’s turn to make a pick, and he disagrees with someone ahead of him, he will often say, “Not so fast, my friend,” and then explain why the other team will win the game. He isn’t always right, but he always has good reasons and is usually worth watching and listening to.

As we observe markets today, the persistent climb through the end of August is beginning to give us that “Not so fast, my friend” sense. Make no mistake, we have been bullish for quite some time, even up to and including last quarter’s letter. What is changing for us is the level of the market versus our perception of the increasing level of uncertainty. Markets do not like uncertainty. This is why we often see them make most of their election year gains in the fourth quarter, particularly when the incumbent party wins. The uncertainty of the outcome constrains the markets. Investors are not sure if the stocks to own are the ones that would likely benefit from one party’s proposed policies. Until the outcome of the presidential race becomes more apparent, investors often sit on the sidelines. Once clarity returns, markets usually benefit. It is also worth noting that, seasonally, the October–December period is the strongest of the year.

In Election Years Markets Tend to Improve as the Result Becomes Clearer, Especially if an Incumbent is Projected to Win¹




Market did not price in election uncertainty

Earlier this year, election uncertainty seemed less of an issue. One candidate became broadly unacceptable to the electorate in general, paving the way for the other to become a presumptive winner. Markets had less election-year uncertainty and moved higher with a pretty good sense of which stocks would likely benefit from the election outcome. This all made sense to us. We were comfortable with the fundamentals, and so we remained bullish even as the market climbed to and through record-breaking highs. We also extended our fixed-income duration somewhat (to 5 years), but not all the way to the Bloomberg-Barclays-AGG level of 6.2 years. We were betting on a soft landing whereby inflation would ultimately moderate, and the Fed would be able to bring rates back down before the onset of a recession. So far, so good.

However, a seismic shift occurred in the last couple of months. President Biden, with seeming encouragement from his party, decided to drop out of the presidential race even though he had secured the primary votes to lead his party. His vice president succeeded him and has gone on to dramatically change the presidential race. While the

¹ Source: NDR, [S01638A - Dow Industrials -- Presidential Election Year Cycle II](https://www.ndr.com/S01638A-Dow-Industrials--Presidential-Election-Year-Cycle-II) (ndr.com).



press had been relatively mixed on Harris as a vice president, she has energized the party and turned the media into fans since becoming the Democrat nominee. This presidential race has gone from one candidate holding a double-digit lead, to extremely tight. It's close in national polls and, more importantly, it's tight in most of the swing states that will ultimately elect our next president.

This sudden competitiveness is a surprising turn. Never before has a party leader won his primary election and then stepped down. It is surprising to see the vice president of an unpopular president become so popular so quickly. It is also surprising to know so little about a candidate's policy priorities so close to Election Day. We have not seen the two main candidates debate and will not until tonight, after the first mail-in ballots went out in North Carolina on September 6.


Without trying to delve into all the candidate differences even handedly, we would just note that they have little in common and share very different views about the best way to lead our country. These differences exist in economic policy, foreign policy, and broadly in domestic policy. There are many individual issues that are likely to motivate different people to vote as they will, but that is for someone else to cover. The bottom line is that the citizens of our country seem more polarized than any of us can remember. This polarization is unhealthy for a nation, and, in other nations, has sometimes led to further strife. We have often lamented the lack of a unifying candidate to lead our country. We still do not seem to have one on either side, despite the late candidate change.

So, if the market does not like uncertainty, then you might be thinking that the much-greater level of uncertainty described above must have led to a decline. Surprisingly, you would be wrong. In the last two months, the S&P 500 has risen to all-time highs, +19.5% through August 31.

In our opinion, this reflects a fundamental backdrop that remains broadly firm:

- Q2 GDP was revised up to +3.0%
- The Fed's preferred inflation gauge (Personal Consumption Expenditure Price Index) is down to 2.5%, its lowest level since February 2021
- Q2 SPX earnings growth came in at 8.7%
- September jobs rose "only" 142k
- Fed Chair Powell indicated that the rate easing cycle will begin in September.

In our view, all of this is supportive of equity prices. The big change recently is the sharp tightening of the presidential race. Once this resolves, economic fundamentals will again be what drives market outcomes, and we think they remain broadly supportive.



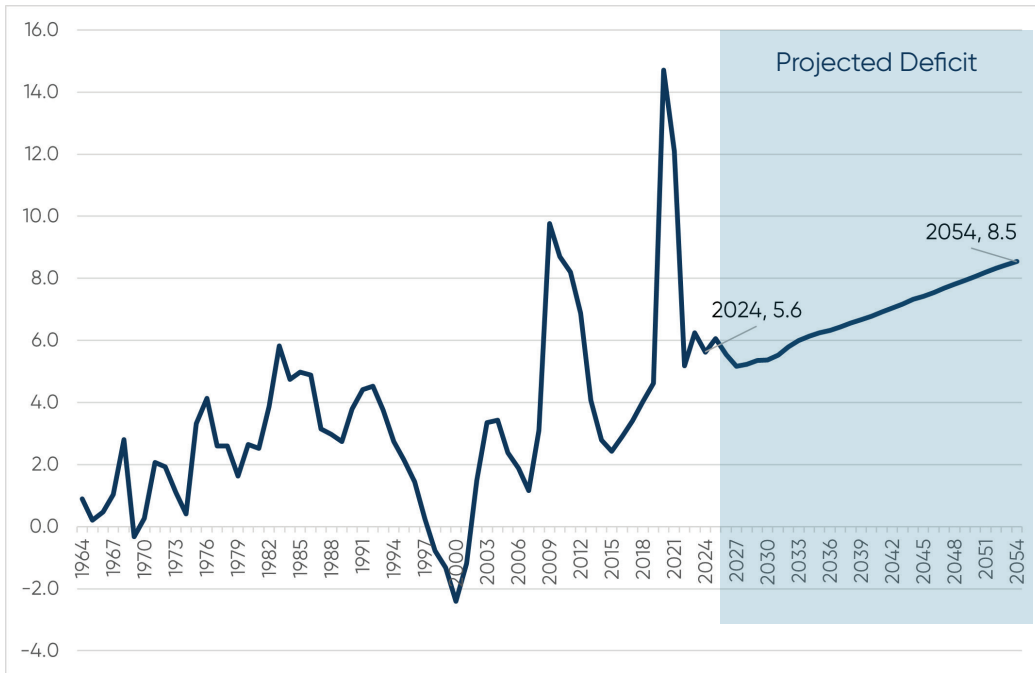
Until we learn more about each candidate's views and what they could mean for individual policies, we are adopting a more cautious, wait-and-see approach. As is typical, we expect that as Americans become satisfied that one of the candidates best represents their ideas of how to lead our country and a clear leader becomes evident, the markets can trade in a range. After it becomes clear which candidate is likely to win and the discounting of favored stocks begins, we can once again see equities start to move higher. The good news is that this is only a few months away.

While we are generally cautious about the market's current trading range and its potential for further growth, we observe an important difference compared to the period between 2009 and 2022: short-term interest rates have now risen enough that if the economy does weaken, the Federal Reserve has room to support further growth by lowering interest rates. The Fed put is alive and well. Most expect rates to be as much as 2% lower over the next couple of years. Lower rates would be supportive of economic growth and help maintain higher-level P/E ratios. We all know what faster growth and higher multiples typically mean for equities.

Under-addressed budget deficit challenges in the long run

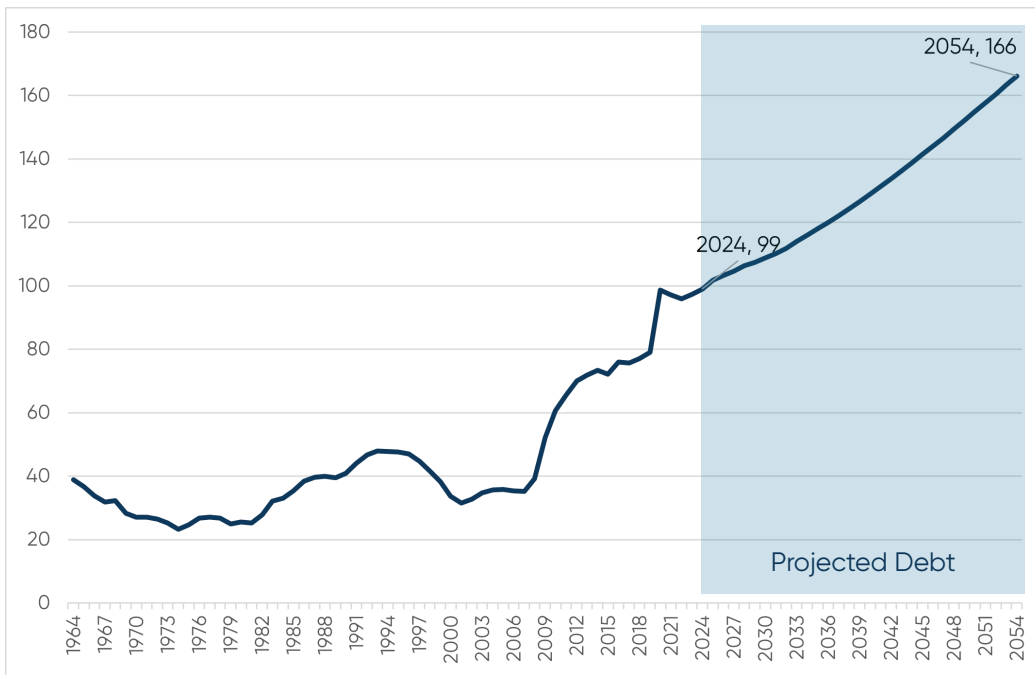
As we've said previously, we remain concerned about the long-term budget deficit. An "immaculate deleveraging" is where the economy grows faster than the debt, leading to an ever-shrinking ratio of debt to GDP. This is the least painful, most desirable way to de-lever an economy. Unfortunately, based upon all available information, neither candidate has any such deleveraging in mind. Both candidates' policies are expected to push the deficit higher in every year ahead. Estimates of future US debt by the Congressional Budget Office are not pretty. Baseline projections envision US debt to grow from \$35 trillion this year to over \$54 trillion by 2034, with only a slight difference depending on who wins. This level of spending (as a percentage of GDP) in good times is unprecedented. In fact, this level was only exceeded during very dire periods, such as war times, the GFC, and COVID periods.

The US Deficit is Projected to Keep Growing at a Nearly Unprecedented Rate...²



This will require the public to own more debt (as a percentage of GDP) than ever, starting in 2029. By 2054, the deficit is expected to climb to 8.5% of GDP annually, with debt held by the public reaching 166% of GDP and “remaining on track to increase thereafter.”

...Which Will Require the Public to Own More Debt (as a % of GDP)³



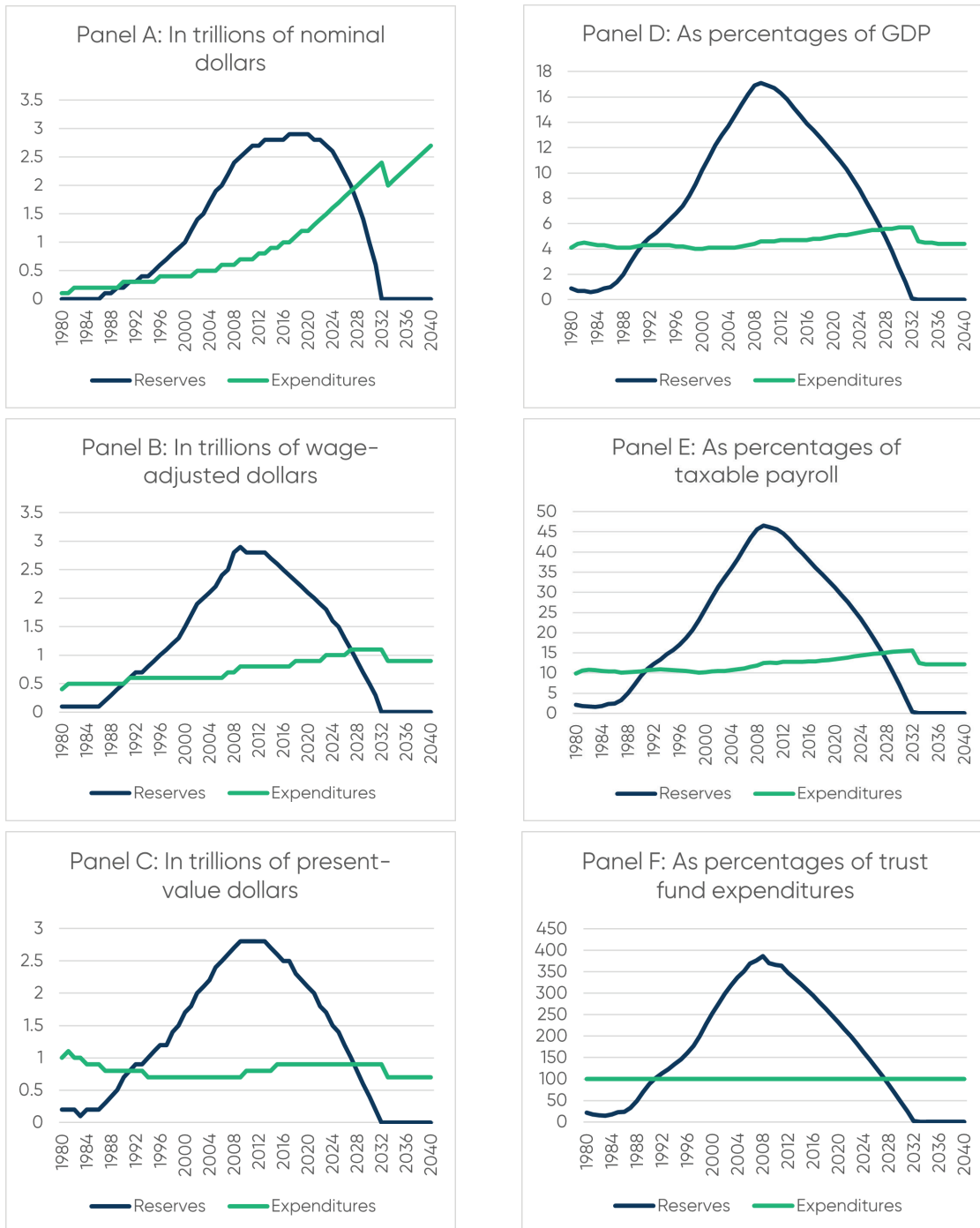
² Source: Congressional Budget Office, [The Long-Term Budget Outlook: 2024 to 2054 | Congressional Budget Office \(cbo.gov\)](#).

³ Source: Congressional Budget Office, [The Long-Term Budget Outlook: 2024 to 2054 | Congressional Budget Office \(cbo.gov\)](#).

What's happening in parallel that makes this worse is the deteriorating outlook for both the Social Security and Medicare trust funds. Estimates are for the social security trust fund to go insolvent in 2033 ([Summary: Actuarial Status of the Social Security Trust Funds \(ssa.gov\)](https://www.ssa.gov/summary)).

A Variety of Different Measures All Point to the Impending Insolvency of Social Security and Medicare⁴

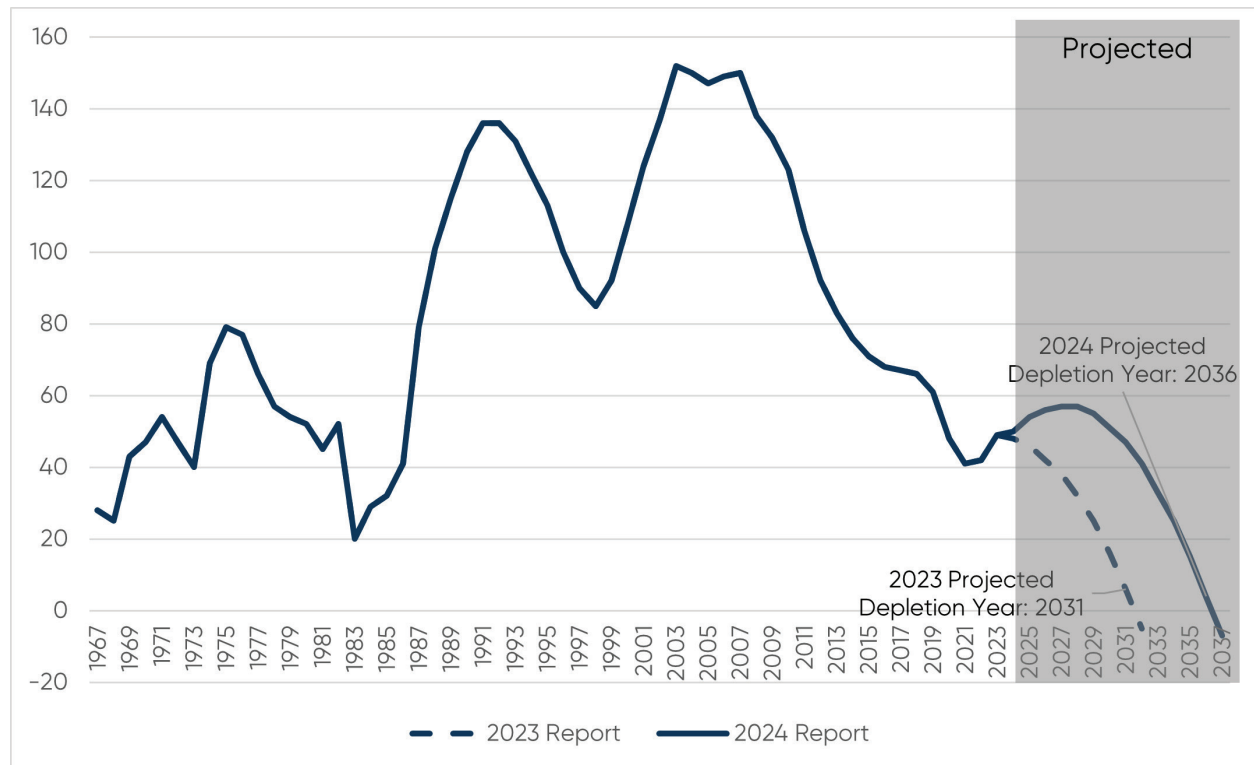
OASDI (Old-Age Survivors and Disability Insurance) trust fund reserves and expenditures under six alternative measures, 1980–2040



⁴ Source: Social Security Administration, [Summary: Actuarial Status of the Social Security Trust Funds \(ssa.gov\)](https://www.ssa.gov/summary), Annual data.

The Medicare trust fund (Part A) is expected to be exhausted in 2036 ([FAQs on Medicare Financing and Trust Fund Solvency | KFF](#)). These two important resources support many tens of millions of Americans. As citizens of this nation, it is incumbent upon us to encourage our elected officials to begin efforts to extend the lives of each of these trust funds as soon as practical. The consequences of not doing so could be quite negative if we do not.

The Actual Timing of Medicare Depletion Could Vary Based on the Level of Interest Rates⁵



To the extent that the market becomes uncomfortable with our current debt/deficit trajectory, we could see interest rates remain modestly high. Similarly, the value of the US dollar could move to slightly lower levels. Together, these would likely slow the economy, since costs to finance a business would rise along with the cost of foreign goods purchased in USD. On the flip side, it could make US goods abroad less expensive and help to rebuild our manufacturing sector here at home. While there are many conflicting cross currents here, the one certainty is that higher interest rates mean lower bond prices. This is the primary reason we remain somewhat cautious on fixed income even as investors are getting excited by the shift in Fed policy to a more accommodative stance. We have expected a Pavlovian response to Fed policy to push longer rates lower, but don't expect bonds to provide solid risk adjusted returns over time.

⁵ Source: KFF, [FAQs on Medicare Financing and Trust Fund Solvency | KFF](#).



If we are right about the USD also losing part of its global purchasing power, then stocks should do a better job of protecting capital than bonds. We say this based on our belief that cash flow streams would grow faster in a declining USD value environment as companies adjust USD prices more rapidly. Similarly, we believe global investors who hold appreciating currencies would likely find US stocks becoming more attractively priced in their currencies as the USD falls, encouraging them ultimately to become more aggressive buyers of US equities. Gold and even bitcoin could also help protect against potentially more significant USD devaluations.


The good news is that we still have time to come up with a plan (that will be painful for most everyone) to address the deficit, as well as the Social Security and Medicare programs. A country cannot survive by giving everyone tax breaks and paying for everything. Financial security is essential if we are to remain a superpower and guiding light to other nations of the world. To allow our finances to deteriorate further is irresponsible and burdens our children in a way no prior generation has ever done. Solving our financial issues as a nation should (and, in our opinion, likely will) become a top priority very soon.

Hopefully, the US Congress will read our concerns about the US fiscal and debt situation and say, “Not so fast, my friend,” and then work to implement a sustainable solution.

Conclusions

We are a little less bullish today because of the combination of increased uncertainty we see in the election environment coupled with equities pushing all-time highs. We aren't bearish. We could become even less constructive depending on what we learn about the candidates' policy priorities and how markets process this new information. After the election, if economic fundamentals remain firm—with or without help from the Fed lowering rates—we believe stocks could resume their upward trend. However, if the economic backdrop changes, we could also change our opinion. Either way, we start from a good position. We believe our roster of partners in equities and hedge funds is robust, we are not taking any meaningful exposures away from our benchmarks, and our portfolios remain quite liquid with about 15% in cash and US treasuries. If the environment improves, we can become more aggressive, and if it deteriorates, we can cut risk. With no obvious fat pitch, our bat remains on our shoulder.

Over the longer term, we think equities will become an even more important component of your portfolios. They will not only be the return generators of the portfolio, but



counter-intuitively, they may also fill a more important capital preservation role as well. If the US doesn't get its fiscal and debt situation under control, then bonds will be a long-term drag on both performance and capital preservation. A lack of return stream diversification and capital protection from bonds could suggest a more important role for very short-term fixed income and cash, to go along with hedge funds, as the primary diversifying assets. It also suggests a potentially larger role for equities. In that world, portfolio construction becomes more difficult and investing with managers who provide unique return streams will become even more critical to building a less volatile portfolio.

As always, we very much appreciate the opportunity to help manage your capital and to help you achieve your organization's goals. We are here to assist you in any way possible, so please reach out and let us know how we can help.

Your TIFF Investment Team



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