October 3, 2023

"It all comes down to interest rates. As an investor, all you're doing is putting up a lump-sum payment for a future cash flow."
-Ray Dalio

Last January most market prognosticators were predicting declining bond yields by the Fall. Instead, the opposite is happening as the anticipated recession has yet to emerge and economic data remains stable. Yields on long-term U.S. Treasury bonds—which serve as a benchmark for many home mortgages and other key borrowing rates—have risen to their highest level since October 2007. The U.S. Treasury 10-year note has hit a new high of 4.8%—up from 4.09% at the end of August and 3.79% at the start of 2023. This has led investors to believe that higher rates could persist for some time.

Several issues have been driving bond yields higher. Most prominent is the continued strength of the U.S. economy, especially the jobs market, and elevated consumer spending. This is a big change from the first half of the year, when many investors and market strategists expected an economic slowdown. We have been wary of those predictions and kept bond maturities very short in order to capture rising interest rates.

Much of the equity sell-off in September can be attributed to the concern of "Higher for longer." Although corporate earnings estimates have not been revised lower, the stock market declined 3.65% in the third quarter as Price/Earnings multiples have contracted. This occurs because the market multiple contracts as interest rates increase, lowering the value of future cash flows.

We have been taking advantage of higher rates by purchasing short-term bonds in client accounts. During the quarter we added two new stocks to client portfolios. We purchased a position in Eli Lilly following its publication of two positive phase 3 drug trials. One is a treatment for Alzheimer, called donanemab, and the second is for a weight management drug, called tirzepatide, which is already approved for treatment of type 2 diabetes. Treatment for obesity is an untapped market with enormous potential. We also added a position in Moderna, a company on the cutting edge of mRNA technology. Moderna's successful Covid vaccine not only validated its mRNA science, but also provided a financial windfall that management is redeploying in advancing its research. Moderna has developed a pipeline of more than 20 clinical candidates currently in various phases of clinical development for a broad spectrum of applications, including infectious disease prevention, cancer therapy and rare-disease treatment. The stock has sold off materially over fears that they will struggle to replicate the revenues generated over the past couple of years from the COVID vaccine. We believe that the current stock price presents a compelling valuation for a long-term investment in an innovative company.

While autumn is often a volatile period for the stock market, we are confident in the financial health of the businesses owned in client accounts. Thank you for entrusting Ayrshire Capital Management LLC with the management of your money. We look forward to speaking with you soon.

Sincerely,

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