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D|A|DAVIDSON

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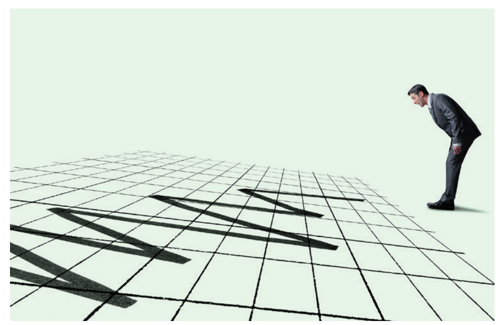
Put the armor where the bullet holes aren't

During World War II, the Statistical Research Group at Columbia University was tasked with developing strategies to minimize the loss of aircraft due to enemy fire.They initially approached the problem by examining the placement of bullet holes on aircraft that returned to bases and then reinforced those areas with additional armor. One member of the group, Hungarian mathematician Abraham Wald, pointed out that they were likely reinforcing the wrong areas because they were observing only the planes that came back. The critical parts of the plane must be those with a few, if any, bullet holes since no planes were returning with damage to those areas. This led to the strategy of putting the armor where the bullet holes aren't. It is also an example of survivorship bias, the tendency to make decisions based on things that are prominent or visible during a short period, ignoring longer term trends or larger data sets.[1]



Survivorship bias can lead to poor investment decisions in any kind of market environment. When stocks are rising, people may take on additional risks through leverage or outsized positions in one or two companies. These are the companies touted as the next big winners, usually by financial pundits with absolutely no skin in the game. When stocks are falling, it is easy to forget that the long-term chart of the S & P 500 has consistently moved up and to the right, with the occasional correction temporarily interrupting its direction.

Survivorship bias can also cause us to focus on the wrong things, like where the bullet holes are. Too many people are focused on performance relative to a random benchmark, rather than positioning assets for a long-term rate of return that will accomplish their goals with their personal risk tolerance. Additionally, people can overlook other important aspects of financial planning such as account titling and keeping beneficiaries up to date. Wills and Trusts are ignored or forgotten as life evolves. Medical Directives and Power of Attorney are not kept up to date. Realized short term gains can severely impact investment returns and emotions can cause us to make the exact wrong decision at exactly the wrong time.

During times of market stress or upheaval it is easy to focus only on the information at hand which can convince us that we must do something. Often the correct answer is to do nothing, sticking with a repeatable and disciplined process consistent with your long-term plan. Ignore the noise and put the armor where the bullet holes aren't.

[1] *Survivor Bias Risk: What it is and how it works, Peter Gratton, September 18, 2024, https://www.investopedia.com/terms/s/survivorship-bias-risk.asp*

Time to Cut Rates

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Quantitative Easing was different during COVID than during the Financial Panic of 2008. During COVID, M2 growth soared, while it was held back during the Financial Panic by much tighter liquidity controls on banks. That's why we were among the first and very few who predicted much higher inflation due to COVID policies.

After that, we remained wary of loosening monetary policy too aggressively because we feared that, in spite of a drop in inflation, inflation remained above the Federal Reserve's 2.0% target and the embers of higher inflation could be rekindled quickly if the Fed were too hasty.

But recent inflation reports suggest some modest room for loosening monetary policy, including a reduction in short-term interest rates. In spite of some new tariffs, consumer prices declined 0.1% in March, the largest decline for any month since the early days of COVID. As a result, consumer prices were up only 2.4% in March versus a year ago and it looks like the Fed's preferred measure (PCE prices) is up about 2.2% in March compared to a year ago, which is very close to the 2.0% target.

Yes, we are still above 2.0%, but monetary policy operates with long and variable lags. So, if we maintain a monetary policy tight enough to bring inflation down to 2.0%, and if we also wait until inflation hits 2.0% before ending that tighter monetary regime, then we are almost guaranteeing that inflation will fall short of that 2.0% target for some period of time and could raise medium-term recession risk.

The same M2 measure of money that signaled high inflation several years ago is only up 3.9% in the past year. By contrast, M2 grew at about a 6.0% annual rate in the ten years before COVID, and that was during a period when PCE inflation averaged 1.5% per year. In other words, there's a case to be made that monetary policy should be looser so that M2 could grow faster than it has in the past year.

Unlike some other analysts and investors, we are not concerned that tariffs will lead to much higher inflation, as inflation ultimately depends on monetary policy, not tariff or tax rates. Yes, tariffs could increase the price of the particular items being tariffed. But that means less money would be left over to buy other goods and services, so demand – and prices – typically fall, leaving the overall price level roughly the same as it would be in the absence of tariffs.

However, tariffs could temporarily depress economic growth as they leave consumers and businesses with less to spend on domestically produced goods and services. In theory, tariffs mean producers should shift some of their output toward being made in the US, but in the short-term businesses may balk at such a shift if they think the tariffs will just be repealed soon anyhow. In other words, if we are going to impose tariffs, it's better to impose a tariff system that's sustainable than one that changes year to year, much less week to week or day to day.

On balance, that suggests some modest room for the Fed to cut short-term rates when it meets in May, although we think the Fed will probably kick the can down the road and make the decision in June.

Don't get us wrong; we are not changing our view that inflation remains a long-term problem that the Fed must be prepared to fight. We expect inflation to average 2.5%+ in the next ten years, not the 1.5% like it did pre-COVID. But short-term risks are to the downside, and we think the Fed should temporarily focus on that.

We also think it's important for the Fed to move gradually. The US dollar has weakened lately, and, as a result, there is little case for a drastic loosening of monetary policy. The Fed could let up somewhat on bank regulations and capital requirements, which would help the struggling bond market. And one or two rate cuts would not be excessive.

Reminder: 2025 Retirement Plan Contribution Limits

CONTRIBUTION OR ACCOUNT TYPE	LIMIT
401(k), 403b & 457 Elective Deferrals	$23,500
Catch-Up Contribution *(age 50 or older during calendar year)*	Additional $7,500 for a total of $31,000
Super Catch-Up *(age 60 but not more than 63 during calendar year)*	Additional $3,750 for a total of $34,750
Traditional & Roth IRA's*	$7,000
IRA Catch-Up Contribution *(age 50 or older during calendar year)*	$1,000
SIMPLE IRA Deferrals	$16,500
SIMPLE IRA Catch-Up *(age 50 or older during calendar year)*	$3,500 for a total of $20,000
SIMPLE IRA Super Catch-Up *(age 60 but not more than 63 during calendar year)*	Additional $1,750 for a total of $21,750

note that the ability to contribute to any IRA may be limited by income

Team Tidbits

Brad

Guinness World Records 2025? Shariae and I had some close friends invite us to the Eagles concert at the Sphere in the middle of February. Two nights in Las Vegas with the concert Friday night. We have never been big concert fans but decided to go. The concert and the Sphere were amazing, and the Eagles did not disappoint. The sound coupled with the visuals were breathtaking. The next morning driving back to the desert our friends suggested we play nine holes around 3pm, grab a couple of pizzas and watch the Zags that evening. On the first hole, I hit a nice drive and from 144 yards I hit my 8 iron into the hole for a 2. On the six hole a par 3 my sweetheart made her 2nd hole in one! Unbelievable! Two eagles after watching an Eagles concert. World record? Bella just turned 3. This is going to be our summer of science projects.

Darin

We've discovered e-bikes and life will never be the same. We rented one for Monique and hit the Trail of the Coeur d' Alene's and I was on my human powered road bike. After about 6 miles I decided to try the e-bike and then we immediately ended the days ride and went shopping. I'll still use my road bike to get some miles in over the summer, but I won't be

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Team Tidbits

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working too hard on purely recreational rides anymore. Teagan will be done with her sophomore year soon and then back to CDA for the summer. Looking forward to hiking, boating and floating with her. Oh – I just read Steph's tidbit and it sounds like she will be riding the local trails as well. She's going to get used to hearing "on the left" from me!

Kate

I've said it before, I'll say it again…spring is my absolute favorite time of year, hands down. Even after a "mild" winter by comparison, the earlier dawn, warmer temps, budding trees and longer evenings are so welcomed. We've had several birthday and anniversary celebrations in our household so great excuses for family-time. Terry and I have a couple of fun vacations planned for late spring and then look forward to the long, hot dog days of summer surrounded by kids and grandkids. Cheers to you and yours.

Steph

Our winter activities have come to a bittersweet end. Dawson finished up ski school and is able ski down beginner runs on her own, and to say we are very proud of her determination would be an understatement. Daws and Matt spent almost every Saturday & Sunday hitting the slopes practicing and bonding. I joined a few times on skis and by the end of the season I switched back to my snowboard. Daws has also been enjoying gymnastics once a week and she seems to be enjoying the challenge. Next skill to tackle is her pedal bike, and we are pretty confident we will be riding local trails soon. I just hope I can keep up!

Scan to view our *NEW* educational videos on our website

Left to right: **Kate Absec,** FPQP®, Senior Registered Associate; **Brad Dugdale,** Senior Vice President, Financial Advisor, Portfolio Manager; **Stephanie Brunner,** Client Associate; **Darin Hayes,** CPFA, CWS®, Senior Vice President, Financial Advisor, Portfolio Manager.

Visit our website to view our updated video and learn about The Idaho Advantage.

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