The Client Letter

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2024.Q2 PERFORMANCE

2nd Quarter Recap

We are pleased to present the quarterly investment report for the second quarter of 2024. The Team at Andrew Hill Investment Advisors, Inc. has been diligently monitoring the markets and adjusting our strategies to capitalize on emerging opportunities, particularly in the realm of **Artificial Intelligence** (AI).

Highlights

- Strong performance in most client portfolios in 2nd Quarter and YTD
- Economy growing at a moderate rate led by consumer spending
- Rate of inflation is moderating at a slow pace
- Equity market trend watch, may lower equity exposure for fixed income
- Healthcare stocks are starting to look interesting

Nvidia's new Blackwell chip is significantly more powerful than its Hopper predecessor

Equity Performance Highlights

During the second quarter of 2024, our clients' portfolios have shown remarkable performance, significantly outperforming their benchmarks. This success is attributed to our strategic investments in emerging technologies and robust market trends.

Notably, our holdings in **Nvidia, Apple, Dell, and Constellation Energy** have yielded substantial returns, surpassing the S&P 500 Index.

The S&P500 Index is near all-time highs but short-term trends look tropid.

Small Cap Success Story

A standout achievement this quarter was our investment in American Superconductor, our sole small cap holding, which saw an **impressive 78% increase in value**. The company's rapid growth is a testament to the rising demand for its innovative energy grid products.

Fixed Income Overview

While our fixed income holdings experienced a slight downturn, they remained resilient in the face of market fluctuations. Our preferred stocks lagged slightly behind the Bloomberg US Aggregate Bond Index, but we are confident in their potential for long-term growth. Our high-dividend income holdings in corporate and municipal bonds did appreciate as interest rates fell during the quarter as investors reacted positively to the moderation of inflation.

10-Year Treasury Yield is trending low, bond price up, but trend looks weak.

Economy Showing Signs of Slowing

The economy grew by 1.3% in the 1st quarter as measured by Gross Domestic Product (GDP), lower than 3.4% in the 4th quarter of 2023. The most recent estimate for the 2nd quarter GDP is 2.8%, according to the Atlanta Federal Reserve.

Consumer spending is showing signs of moderation as the impact of higher interest rates on inflation may be impacting the overall economy. Consumer spending accounted for 68% of GDP, a growing engine of the overall economy. Retail sales growth is 1% in May.

The employment market remains tight, although the demand for labor and available workers is improving. From a long-term perspective, the demographic change of too few workers to replace new retirees poses a major economic and social challenge. Immigration and productivity growth, possibly aided by AI, offers hope to fill the gap.

Inflation is moderating, but the rate of decline remains stubbornly slow. The pulse is frustrated by the increase in the cost of services and products compared to pre-covid prices. For people with homes **that have doubled in value** and investors with portfolios **that have soared** in value, the "wealth effect" is boosting their spending power, contributing to the overall economic growth. The challenge for the economy is if wealth gains begin crashing the cost of basic living expenses is a challenge, incidentally, tariffs on imported goods will only increase the cost borne by the consumer.

The Federal Reserve's preferred inflation index,
Personal Consumption Expenditure (PCE), is trending lower

Another factor making inflation sticky at high levels is the global disruption from military conflicts and climate change. Brazil's experiencing a 500-year flood, Panama experiencing a drought, and the Suez Canal experiencing disruption from Houthi rebels in Yemen. All of these are increasing shipping costs and delivery times. These factors contribute to supply chain issues, which ultimately increase inflation.

Weehawe Gas Emissions, greenhouse gas, as monitored by NOAA
Weehawe gas is a primarily contributor to climate change.

The Federal Reserve has a tough job steering the economy towards full employment while maintaining stable prices (often defined as 2% inflation).

The tools to combat inflation are been used for excessive demand, not weather or war induced disruption of the production of goods. As a result, we expect few, if any, interest rate cuts for short-term borrowing until unemployment materially rises. The political and social pressure on the Federal Reserve as people are losing their jobs will be the most important factor in changing monetary policy to lower interest rates.

Fixed Income

Expecting Rates to Trend Lower; Someday

Interest rates are an important factor influencing the value of stocks, real estate and most directly bonds. At present, short-term interest rates are yielding more than long-term interest rates. When the Federal Reserve changes monetary policy, reduce short-term interest rates (Fed Funds), we anticipate the 2 year Treasury note will fall from a 75% to 6.3% while the 10-year Treasury yield may creep lower from 4.3% to possibly 4.0%. The timing of the Fed's actions will be critical and important for investors to watch. Our concern is that by the time the data necessitates a cut, the economy may already be in economic decline.

In positioning fixed income portfolios, the first allocation is to meet expected distributions over the next five to seven years subject to clients' specific needs. Residual fixed income allocations will migrate to longer term bonds given the improved interest rate of the market outlook. Longer term bonds will benefit from a drop in rates and will provide a higher yield than short-term bonds and money market funds. We, of course, high grade corporate bonds and plan to fill the high grade long-term bond ladder, as rates and attractive yields improve. In addition, we continue to invest in high quality preferred stocks that offer yields above 6%, which also offer more favorable tax treatment.

Equity Portfolio Positioning

Although most portfolios are similar, there are some differences since we manage client portfolios individually. Across all clients' accounts we hold about 30 equity positions with the top 10 holdings representing 50% of assets. The intent is to have the most prevalent holdings from the enablers to the users.

The top core holding **Nvidia** has 50% of the data center semiconductor market share. At present, **Nvidia** has significant competitive advantages that would take years for market competition to catch.

Microsoft has developed for the masses under its Copilot product that works alongside their Office 365 suite of productivity apps. *MM has been using Copilot for a few months with great success.*

Apple has incorporated the data to support and branded it as **'Apple Intelligence'**. Recently, we increased our exposure to Apple in most portfolios.

The data in these portfolios being accomplished with AI; the data those Nvidia guide the data center to the user. This is the mission for **Arista Networks**, a leading data networking provider.

To complete our AI investment theme, we anticipate that the consumer continue to do well. **Garmin** reported first quarter earnings up 40% and significantly above analyst estimates. **Chipotle Mexican Grill** reported another steady quarter with same store sales up 7%. **Amazon** is slowly increasing profit margins and our investment thesis is that a strong their stock price to at-time highs while **Costco** is/has/ of being the bargain store for the upper middle-class continues to drive earnings growth.

Now holdings this quarter include **Dell, Eaton, Flagstar Financial, Constellation Energy, American Superconductor**. Dole, with a 4% dividend yield, projects growth from a growing commercial base as data centers and redesing of manufacturing bring new customers. Highwoods is a REIT focused on the Sun Belt with a 5% dividend yield and a P/E of 12. Flagstar Financial is a Michigan based bank. American Superconductor, which is rapidly growing, and their products are critical to the electrical grid and power delivery.

One sector of client portfolios we are looking to increase is in the healthcare sector. The earnings outlook is improving across the sector as medical procedures are increasing due to demographics and investigational new drugs are coming into pipeline. The largest healthcare holding in client accounts is **Eli Lilly**. Lilly has the best portfolio of new drugs in comparison to the other major pharmaceutical firms. Lilly's GLP-1 drugs, Mounjaro and Zepbound, used for weight loss, sales for Q1 exceeded $1.6 billion in sales in the first quarter (92% leading in consolidated sales growth of 29% year-to-date for first quarter of 2024. In addition, we continue to hold **Verona Pharmaceuticals** which is the leading provider of drugs to treat Cystic Fibrosis, with the development pipeline in treatments for stroke of disease and several other related drugs.

Intuitive Surgical continues to experience healthy demand for their DaVinci surgical system. A new advanced generation console began selling last year that has increased the speed for surgeons and new system sales. Since most medical schools educate residents on the DaVinci system, Intuitive surgical has one of the largest barriers to entry in the medical industry. Also, we have taken a small position in **Johnson and Johnson**, who has been in the "penalty box" for years dealing with legal issues that now appear to be close to resolution.

While our comments provide our optimistic views of our core holdings, the equity market analysis does have risks. First, the calendar is approaching "Sell in May and Go Away" period. Second, the Fed is on hold for now, but the market is anticipating rate reductions in September when a full dozen of trades are present. Second, sentiment in the short-term appears to be too enthusiastic. The Put/Call ratio is at a very low level, indicating option traders are betting on stocks heading higher, which is a contrarian indicator, suggesting caution is warranted. Third, the electoral "noise" will start in the fall, and the rhetoric will be off the charts. Fourth, the geopolitical environment is fraught with risk conditions. Offsetting these concerns corporate America is generating record profits and is leading the AI revolution. Earnings are expected to continue to grow despite a slowing economy that bodes well for the equity markets.

We will continue to monitor changes in stock sectors and core holdings as the first hints of a change in trend usually start with the stock price trend, not an earnings report.

Apple's Leap into AI & Succession Planning with Legacy Contacts

On June 10th Apple hosted their biggest event of the year, *World Wide Developer Conference*, where they unveiled new features and shared their plan to incorporate Artificial Intelligence into their products. The iconic "hard hitting" Apple Keynote Video of OS18 is worth a watch if released. This new feature will place together information across your device and apps to make planning, communication, and everyday use more convenient. We increased exposure to Apple in client accounts leading up to the event which proved to be a positive catalyst for the stock.

Another feature that may be of use to iPhone users is adding a "Legacy Contact". This feature allows you to add one or more of your contacts and give them access to your phone in the event you are incapacitated or pass away. This is a great way to share photos, documents, or anything else you have on your phone with a family member. **Make an article with a step-by-step guide on how to add a Legacy Contact.**

The Perils of Delinquent Property Taxes

Homeowners who are delinquent in property taxes may not realize that they are unintentionally "listing" their home for sale to investors who are looking to purchase real estate at a discount.

Property taxes for single family homes in Florida have increased to 20% over the last five years. Collier County has one of the highest property taxes in the country, with an average yearly tax equivalent to approximately 35% of one's annual income. It's not uncommon for people who have lived in their homes for many years to be unable to afford the property taxes. Many of these people are "accidental" landlords because these homeowners are at risk of losing their homes to real estate investors who are actively searching for tax liens as a very inexpensive way to invest in real estate.

Here is a summary of how it works in Collier County, Florida:

- When a homeowner does not pay their property taxes, the amount due becomes a lien on the property. The Tax Collector is required to put the homeowner and the public on notice of the amount of delinquent taxes, including a statement that a Tax Certificate may be sold on the property.
- An investor who is interested in the possibility of owning the property will pay the tax lien and receive a Tax Certificate which gives them the right to collect tax, including interest, from the homeowner.
- The homeowner has a 2 year redemption period in which to pay the tax to redeem the property, otherwise the holder of the Tax Certificate can force a sale of the property through a Tax Deed Sale via public auction.

According to the Collier County Clerk of Courts there were 2,000 Tax Deed Sales that occurred in 2023. However, with the increasing costs of homeowner's insurance, assessments, expenses, and real estate taxes, it is possible that Tax Deed Sales will be on the rise over the next few years.

Florida provides certain property tax benefits to qualified homeowners. For example, additional exemption up to $50,000 for homeowners ages 65 and older who have been long-term residents and meet certain income requirements. Also, homestead property owners who are totally and permanently disabled may receive a discount from tax on property owned as homestead. Under the Fuller Heroes Family Tax Relief Act, a surviving spouse of a first responder who died in the line of duty may receive a total exemption on homestead property. Real estate used and owned by totally and permanently disabled persons may be exempt from taxation subject to gross household income limitations. Eligibility for property tax benefits and discounts depends on certain requirements based on the property appraiser's office in the county where the homeowner owns a homestead property.

Firm Updates

Temporary Office Closure: Due to extensive water damage, our office space is in CLOSE-to-USED-to-LIVE-and-further-review. Thanks to Chris Lynch, the building manager, we immediately contacted our temporary office options in SW FL. We will be glad to visit with you in our temporary office, just don't mind the folding table that is our new conference table.

HIGHLIGHTS

New Advisory Content on YouTube

Spend a minute with us to learn about **the need for financial organization** in a bite sized video! Follow along as we discuss more of what our firm offers.

New videos will be posted weekly covering topics such as our investment philosophy, our firm's mission statement, and more! Find the videos by visiting our **website** or on our **YouTube channel**.

SUBSCRIBE

New Addition to the Team

Sean Gray joins the firm added Sean O'Brien as a full-time Associate Portfolio Manager. In this newly created role, he will assist the firm's partners with expanding market research, financial planning and wealth advisory services. Sean will be working remotely from Buffalo, NY and will make frequent visits to the Naples based office.

Sean O'Brien
Associate Portfolio Manager
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VIEW OFFICIAL ANNOUNCEMENT

Andrew Hill Investment Advisors Sponsors Local Charity

On June 29, 2024, the firm participated in a golf tournament to benefit **Trinity Foundation Naples**, a non-profit organization dedicated to improving the lives of at-risk youth who have been involved in the juvenile justice system.

For more information on this cause, visit their **website**.

VISIT TRINITY LIFE FOUNDATION

OUR TEAM

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