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Princeton Capital Management LLC

THE VIEW FROM PRINCETON

Market Commentary ⬧ August 27, 2024

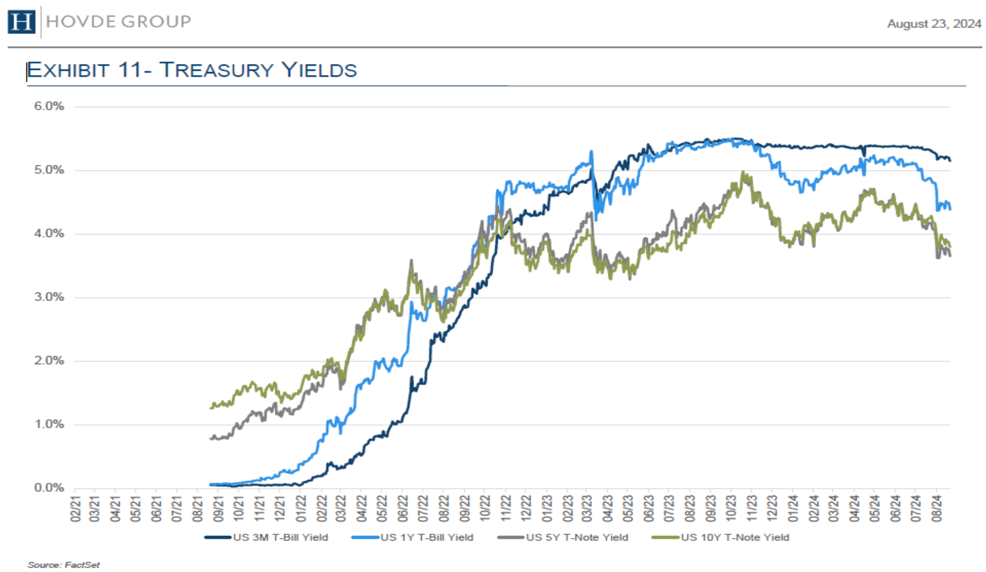
Words Matter

- **Fed chair Jerome Powell spoke last week, and stocks applauded**
- **A September rate cut is a start along an uncharted path**
- **Soft landing, hard landing, or no landing remains the big unknown**
- **Nvidia's earnings report this week pushes the Fed off the front page**

The verdict is in, but the jury is still out. That's how it feels after the big windup to Fed chair Jerome Powell's speech last week at the Federal Reserve Bank of Kansas City's Economic Policy Forum. Rather than a satisfying *denouement*, despite what the positive market reaction might suggest, Chair Powell's remarks may as well have ended with a simple "to be continued." And what comes next could be the difference between a relief rally and the next leg to a bull market enjoyed by many but perplexing to some. For now, the Fed chair has spoken for the data, and the data has informed him and his fellow governors that the moment has arrived. The verdict is in: September rate-setting should be the time when our post-pandemic rate wave crests.

Source: 2004 Bloomberg Finance L.P.

At the same time, the jury is still out on the question of whether the US economy skirts a recession or, if recession remains in the cards, how long and how deep any slowdown may become. Even secular growth companies, reliant as they are on billions of dollars of revenue from future-investing customers, believe all of this is very topical as they plan, strategize, and (dare we write) guide investors to their sales expectations. One graph represents the persistent unknown: is the Fed ahead of or behind the (yield) curve? The gap between short-term and long-term rates is hardly a place of equilibrium. A "data-driven" Fed implies a follower not a leader. Thus, that recent episode of spiking market volatility may portend more instability ahead, which we manage with high quality growth-oriented investment strategies.



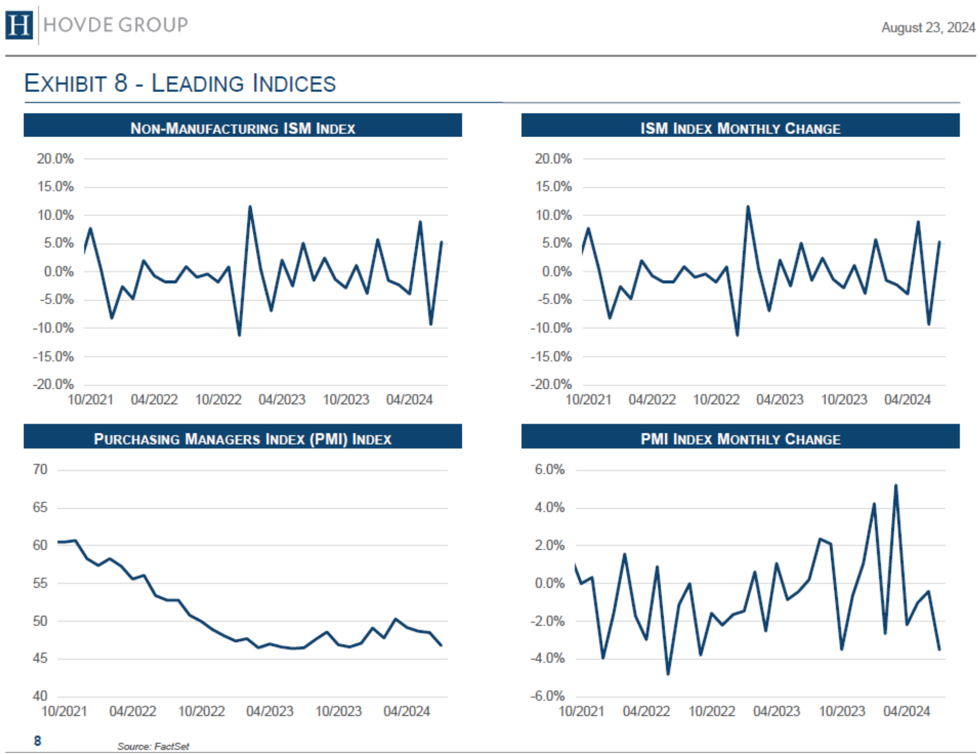
Source: FactSet

Unsurprisingly, market commentators have been harmonizing around the theme of rate relief, pace and degree. We book-end the conversation beginning with a back to the future reminder of the origins of the Federal Reserve and legislation that is more than 100 years old. It established a governing framework to bring order to the banking system and create a central bank to administer the nation's monetary policy. There is an enduring elegance in the commonsense mandate from Congress to the Fed, no ifs, ands, or buts about it. The Fed is accountable for promoting macro conditions conducive to sustainable expansions (and for dealing with inevitable crises and panics along the way).

> ***Section 2A. Monetary policy objectives.*** *The Board of Governors of the Federal Reserve System and the Federal Open Market Committee* ***shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.***
>
> *[12 USC 225a. As added by act of November 16, 1977 (91 Stat. 1387) and amended by acts of October 27, 1978 (92 Stat. 1897); Aug. 23, 1988 (102 Stat. 1375); and Dec. 27, 2000 (114 Stat. 3028).] Emphasis added.*

These are the words that confer relevance on discussions of monetary policy and interest rates, even for secular growth investors like us. When consumers and business leaders have confidence in the future, our exceptional economy has the fuel it needs to expand and support innovative investments that propel society forward. If policymakers miss their marks, which history shows is possible, the promise of secular growth can take a back seat to cyclical instability for a period of time (remember the bear market correction of 2022?).

So, we are paying attention. If the Fed gets its timing right, and all the usual unknowns cooperate, a path of gradually lower rates could bolster an investment case for continued mega-cap secular leadership that combines with broader cyclical participation. While there are many cross currents and headwinds that could interfere with a Goldilocks outcome, a picture of GDP growth, stable prices, and tolerable labor markets remains in play. For now, the charts and graphs of the current business are inconclusive.



Source: FactSet

On the other side of the bookshelf, many who listened to the Fed chair's speech last week focused on his interest rate outlook, but he was also quick to remind us that Fed policy is dynamic. They are about to launch a quinquennial public review of monetary policy and strategy. In his own words, Mr. Powell highlights the "limits of our knowledge", demanding a "questioning spirit." We concur.

> *"As we begin this process later this year, we will be open to criticism and new ideas, while preserving the strengths of our framework. The limits of our knowledge – so clearly evident during the pandemic – demand humility and a questioning spirit focused on learning lessons from the past and applying them flexibly to our current challenges."*
>
> – Jerome Powell, Federal Reserve Bank of Kansas City's Economic Policy Forum, August 23, 2024

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We will await the outcome of this review with investment strategies that we believe are well suited to conditions both current and future. Our Core Equity and Growth Equity portfolios are well constructed for a time when the business cycle is in transition and potential returns from technologic and scientific investments look promising. While there may be uncomfortable moments of market volatility along the way, a market led by very large companies with strong balance sheets and prodigious cashflows is appealing for its combination of offense (growth) and defense (financial strength) that may prove valuable in the months to come.

It would not be a buried lede if we didn't save the best for last – Nvidia (NVDA) reports quarterly financial results this week. Management carries the weighty responsibility of sending US investors into their Labor Day holiday riding results from the completed quarter and reflecting on whatever is said about the future. In the run-up to the report, all we have is last quarter's guidance:

> *"Total revenue is expected to be $28 billion plus or minus 2%. We expect sequential growth in all market platforms. GAAP and non-GAAP gross margins are expected to be 74.8% and 75.5%, respectively, plus or minus 50 basis points. Consistent with our discussion last quarter, for the full year, we expect gross margins to be in the mid-70s percent range."*

Of course, the company's record in the last several quarters has been to report results well ahead of published expectations. Most important to us, however, is the long-term trajectory for AI adoption, the developing use cases (not all of which can be known), and Nvidia's lead relative to other market participants (look for hints in the gross margin). We see quarterly results as reference points not to be minimized, and we look forward to updates on the many opportunities for future growth, but we also consider this as an investment with enough runway ahead that it should withstand possible short-term volatility. The company's founder and CEO, Jensen Huang, said it best when responding to an analyst's question on Nvidia's last earnings call:

> *"And when Blackwell comes, it's going to be terrific. And then after Blackwell, as you mentioned, we have other Blackwells coming."*

This is exactly what draws us to invest in Nvidia and companies like it. They have invested significantly in the past to produce products and returns that are now visible, but the process is never-ending. The best companies have roadmaps that stretch years into the future. Our time-tested philosophy is to understand the near-term reference points and keep both eyes on the compelling possibilities that lie well into the future.

With that, we offer you best wishes for a safe and enjoyable Labor Day weekend.

Princeton Capital Management

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