CARDEROCK
CAPITAL® MANAGEMENT, INC.

July 13, 2023

Resilience has been the prevailing theme in markets over the past year. Not only has the economy avoided a highly anticipated recession despite suffering through downturns in Housing and Banking, the S&P 500 Index has soared off its 2022 lows to start the year up **16%**. As we are now firmly on the other side of the pandemic and the bulkheads of Labor, Consumption and Investment have kept the US economy afloat, we believe optimism is warranted that growth can accelerate from here.

Despite narrow leadership in Stocks to start the year, we currently see a broad range of opportunities not restricted to any one segment of the market and have been allocating accordingly. While inflation continues to decline, labor markets remain strong and reinvestment in US manufacturing continues unabated, we are encouraged that the U.S. can continue to shirk off the Federal Reserve's unprecedented pace of interest rate hikes. Looking to the second half of the year and beyond, we are positive on our portfolio and would point out a few key elements of our strategy:

- At 15%, cash reserves are running significantly below levels reached last Fall, as buying activity has exceeded selling at a rate of nearly 3 to 1 over this time.
- From here, we are in "wait and see" mode with respect to lowering our cash target further, as Stock prices may take a pause after a fast start.
- Our allocation to the Industrial sector has increased substantially, as we have added stable, highly profitable businesses where we are seeing signs of a nascent turnaround.
- We remain vigilant on buying Treasury Bills with excess cash in portfolios, as yields remain attractive, as the Federal Reserve continues hiking rates.

Furthermore, we are focused on the following themes driving our investment process:

- Capital Investment is booming in the United States, as companies aim to depend less on foreign manufacturing to fortify supply chains and national security.
- The Federal Reserve is unlikely to return to a low interest rate environment in the near term, and reinvestment opportunities in fixed income portfolios should remain attractive over time.
- Capital availability has become increasingly scarce, curtailing speculative activity in alternatives such as crypto currency, Private Equity and Initial Public Offerings.
- Investment in green energy – such as battery technology, electric vehicles, Electric power generation is still in its early stages, providing a long runway for our stocks tied to these spaces.
- Inflation continues to decelerate toward the Federal Reserve's target of 2%, however it remains an open question how much economic damage will occur to reach this goal.
- Future US growth opportunities remain more attractive than the rest of the world, justifying our focus on domestic versus foreign stocks.

We welcome the market's shift towards Quality Growth stocks to start the year and have been rewarded for our patience in putting money back to work when things seemed most dire. Looking forward, we see better things to come while remaining conservative in our approach.

As always, feel free to give us a call to discuss any changes in your objectives, circumstances, or any questions you may have.

Warmest Regards,

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In compliance with Rule 204-2(a) of the Investment Advisors Act of 1940, we hereby offer our current Form ADV Part II as filed with the Securities and Exchange Commission through notice of its public posting on our website (www.carderockcapital.com). The Securities Exchange Commission's Investment Adviser Public Disclosure database can be accessed at their website (www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx). With reference to Rule 206(4)-2 Carderock urges you to compare the information on your statement with the statements received from your custodian. Please call if you have any questions.

Random Gleanings

"In reversing course to beat back inflation, the Fed has effectively cut its assets by 30% from the pandemic's peak. It has raised interest rates to 5.25% from a low of 0.25% over the past year, and it probably still hasn't hit its terminal rate, since the core inflation rates have run for six months at an annualized 5.1%. If the Fed can't constrain consumer spending, it risks provoking a serious recession to get inflation under control. The central bank has no good choices in the struggle between inflation and financial stability, but mandating higher capital requirements for lenders would only make the situation worse." Jeb Hensarling and Michael Solon, "*Regulators May Sink America's Banks*", **The Wall Street Journal**, June 22nd.

"The expected plunge of the US economy into a recession later this year is perhaps the most anticipated downturn on record. The last two years have been a chronicle of a recession foretold. Some, like Jonathan Golub, don't see the slowdown unfolding until June 2026. And if we really have three more years of economic growth to look forward to first, risk assets look much more attractive. Taking the inverted yield curve as a guide, Golub's work indicates that recessions begin when the curve *un-inverts* (short-term rates start falling), presumably because the Federal Reserve sees that it has to cut, the recession starts — but generally not before. For now, Treasury futures imply that the curve will first un-invert in June 2026, Golub noted." John Authers, *"Waiting for the Godot Recession",* **Bloomberg**, June 28th.

"Last year's return of inflation stirred memories of the 1970's uber trauma. Yet while hawks obsessed about the threat of wage-price spirals, inflation not only failed to accelerate but is now well off its peak. With angst now shifting to 'inflation persistence', the question arises as to how the Federal Reserve crosses the 'last mile' from 4% to its 2% goal. The issue would not be so acute if we were confident monetary policy worked. Accordingly, shutting down debate with the demand that central banks do 'whatever it takes' is less likely to bequeath success and more likely to inflame populist reaction." Adam Tooze, "*Now is a time of tough choices*", **Financial Times**, June 29th.

"If you look at the so-called 'misery index' that tracks consumer stress, the picture looks more cheerful. Consumers are telling pollsters they are gloomy; but the data say they are not. Why? One potential explanation is that the data is wrong. However, a second potential explanation is that it is the polls that are skewed. More specifically, it is possible that consumers are extrapolating a wider fear of rising interest rates, geopolitical risks and/or political gridlock to their assessment of the economy." Gillian Tett, *"How American consumers lost their optimism",* **Financial Times**, July 6th.

"Steven Bogden's op-ed "Capital Is Making a Comeback" declares: 'The US economy is about to become more capital-intensive. Over the past three decades, modern innovation ranging from software to Crispr to gene editing has increased productivity, allowing tangible investment to stagnate. But new economic demands-brought on by climate goals, supply-chain pressures, shifting demographics and defense needs- will require investment in tangible capital to increase.'" Jim Grant, "*Return of the Tangible*", **Grant's Interest Rate Observer,** June 16th.

"There's no real question about the causes of the surge in manufacturing. It's being driven by two major pieces of legislation: the IRA (Inflation Reduction Act) subsidizing the green economy, and the CHIPS Act that seeks to restart domestic production of chips on the basis of national security. The ultimate impact of these two will almost surely be much bigger than the numbers suggest. For one thing, most see the CHIPS act as a downpayment with more spending in the pipeline. For another, the numbers count only construction of the factory buildings, leaving machinery and R&D to add hundreds of billions to the total business spending." Paul Krugman, "*Making Manufacturing Great Again*", **The New York Times,** June 6th.