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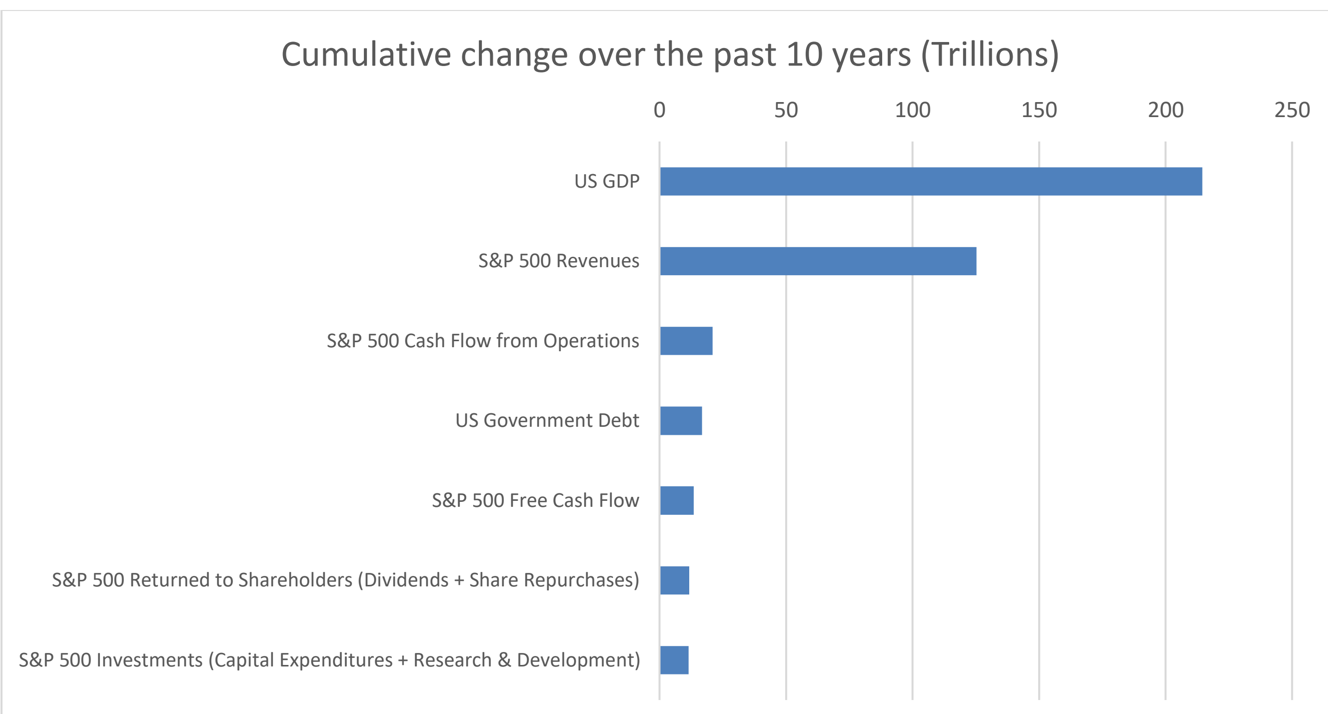
Dear Fellow Investors,

Let's face it, financial services can be a crowded field with numerous firms and professionals offering similar services. We strive to differentiate ourselves by embracing long-term thinking that drives a disciplined research process to uncover compelling investment opportunities. This is easier said than done as it's not hard to find yourself paralyzed from information overload given today's always-on connectivity and modern tools. Part of our job is sifting through the mountainous volumes of information to derive useful insights and actions. This quarter we wanted to share some of this research that we use to connect-the-dots as we develop our mosaic of long-term thinking.

There has been considerable discussion surrounding crippling government debt levels, the collapse of the US dollar, and imminent doom. These concerns should not be taken lightly. We do believe there are numerous benefits for countries that keep a rational balance between money supply and economic output, practice fiscal responsibility, and manage their finances in a prudent manner. Clearly, history has provided ample evidence of what could happen should financial discipline not be embraced. However, we do find the topic of our country's finances to always be one-sided. After all, if you're able to borrow money it implies you have some source of income. Analyzing America's income source, which is derived from the backs of American entrepreneurs, reveals some staggering statistics.



We note that over the past 10 years

- US Economy produced: $215 Trillion dollars
- US government borrowed: $17 Trillion dollars

S&P 500 companies produced

- Revenues: $125 Trillion dollars
- Cash Flow from Operations: $21 Trillion dollars
- Free Cash Flow: $14 Trillion dollars
- Returned to shareholders (dividends + buybacks): $12 Trillion dollars
- Investments made (capital expenditures + R&D): $11 Trillion dollars

The debt level grabs the headlines because it sounds like a terrifyingly large amount of money but it is dwarfed by the tremendous amount of wealth generated by our economy. Drilling down a bit further, it's interesting to note that it took our country about two hundred and fifty years to rack up $34 Trillion dollars of debt but in the past 10 years alone our economy produced $215 Trillion dollars of goods and services. Zooming out even more reveals an outrageous statistic as our economy produced over half a Quadrillion dollars in the last 50 years which hardly sounds like a real number!

Even intelligent people allow the bombardment of scary statistics and graphs to cripple their decision making. We believe sound decision making requires "seeing the big picture" and the unheralded ability to think long-term. When we do this today, we believe an exceptionally promising future comes into focus. If you think the last 50 years were impressive, keep in mind that we believe we're on the cusp of unlocking incredible productivity growth from advancements in digital and real-world intelligence. It's a potential future of abundance as productivity gains are unshackled from the constraints of human labor. It's a future that could see life change for the masses as much as it did during the Industrial Revolution. Our long-term readers recognize this as the main message from our 2024 annual letter in what we referred to as the Intelligence Revolution. We're not saying everything is perfect. We see numerous valid risks that includes reckless spending, the inability to build quickly in certain parts of the country, too much focus on "knowledge industries", not enough focus on trades, housing unaffordability, population collapse, what are people going to do as machines do more, etc. We feel the world has fear, negativity, and criticism covered. American entrepreneurs approach their mission with optimism and promise. Given their incredible track record, perhaps it's time more of us embrace this mindset too.

FORECASTS

As we're halfway through 2024, let's check in on our forecasts for the year**.** Our forecasts from the beginning of the year are in **bold** with current updates in *italics*.

- **Economy: For 2024 we forecast the US economy will continue to show a year-over-year increase and eclipse $28.5 Trillion.** *Through the first quarter, GDP was $28.26 Trillion. While the growth rate has slowed, there have been no negative quarters. Our forecast of no recession this year looks intact. We are staying with this forecast for the second half of the year.*

- **S&P 500: For 2024, we apply a P/E multiple of 17 – 19 times forward earnings estimates for 2025 ($274.17) which translates to 4,700 – 5,200 on the S&P 500. This is where we entered the year on the low-end and approximately 9% higher on the high-end. We see 2024 as a year where stock returns follow earnings growth.** *Halfway through 2024 and the S&P 500 has already eclipsed this forecast. Market sentiment has turned more optimistic as economic growth has been stronger than most forecasts and inflation has moderated, implying interest rates have indeed peaked. While we may have the magnitude of the advance wrong this year, we are pleased that our forecast was one of staying invested, allowing investors to enjoy the strong start to the year. We expect the remainder of the year to be flat to slightly up with the chance for increased volatility.*

- **Oil prices**: **For 2024, we see oil prices maintaining a range of $70 - $100 a barrel and averaging in the $80's for the year**. *The price has certainly stayed within this $70 - $100 range peaking at just over $88 on April 5th and a trough of $73 on June 4th. We continue to believe the range of $70 to $100 allows for short-term shocks driven by world events. Barring these uncertainties, we would expect to spend the rest of 2024 in the $80's.*

- **Commercial real estate**: **For 2024, we forecast a nice positive total return from REITs with stabilized interest rates. Similar to last year, we would position portfolios into the sub-sectors that still have a fundamental need in the economy – manufactured housing, industrial warehouses, data centers, and health care (but not hospitals). Overall, we see the FTSE NAREIT All REIT total return coming in at 10% or higher in 2024.** *The index has declined in the first half of the year, hitting a bottom in mid-April as interest rates continued to rise. The index has been gradually recovering ever since but still finds itself down a bit through the first half of 2024. We still believe the index may be up as much as 10% by year-end led by a few positives: #1 Commercial loans are being worked through in the regional banking sector. #2 Interest rates have stabilized and may start to decline.*

- **Residential real estate**: **We see the migration away from high tax, high-cost locations continuing. Until the demographics of the country start to reflect a shift in the population to one that is declining, we see the demand pressure for housing continuing to drive the Case Shiller Index higher. For 2024, we see the magnitude of that increase as muted and see it rising less than 5%.** *The latest Case Shiller 20-City Composite reading came through with an increase of 4.7%. We're also seeing the pace of home sales starting to decline. 7% mortgage rates coupled with high prices appears to be getting in the way of some of the pent-up demand (especially at the entry level) being satisfied. Affordability and qualification do mean something, unlike the heady days of 2006-2008 when NINJA loans were available. The price advance is muted as we forecast, and we continue to believe the year end number may indeed only be an advance in the area of 5%.*

- **Inflation**: **With our outlook for sluggish economic growth but no recession, excess money supply continuing to work through the system, and our interest rate forecast, we forecast inflation to be in the range of 3.0% to 3.5% during 2024.** *Our last inflation reading came in at 3.3% and has already achieved the rate we thought possible when we entered 2024. While it's nice to see progress, our contention remains that money supply and significant budget deficits remain the main drivers of inflation. One or both of these need to be addressed to truly "tame" inflation. To see the rate go much lower than 3% it would probably take an economic decline impacting the demand side of our economy. We do not see this happening anytime during the remainder of this year and are still very confident in our 3 to 3.5% forecast for 2024.*

- **Interest rates: We saved the best for last. We stood (seemingly alone) in a very small minority entering 2024. While consensus was the Fed would be cutting rates at least three times and possibly as many as six, we were calling for the possibility of no rate cuts. We believed if there was a cut it would probably come after the election. Our forecast was based on the belief that our economy was stronger than most realized and the fact that current rates are just about in-line with the long-term average. Given this, we saw very little reason to lower rates.** *Through the first half of the year we've seen no rate cuts and the Fed has even signaled the possibility of only one being needed. This short-term rate call has been perfect to date.* **Our long-term forecast was for the 10 year rate to drift up to 4.5% by year end.** *The first half of 2024 has played out as predicted with the 10 year rising from just under 4% to start the year, peaking at 4.7% in late April, and now sitting around 4.25%. We remain comfortable with our forecast for long-term rates to be 4.5% by the end of the year.*

We will leave the "Fun Forecasts" and progress on the "Long-term forecasts" for discussion in the annual letter.

As always, we welcome your feedback and would love to talk about these and other topics that may be important to you. We thank you for your continued confidence and the opportunity to manage your investments. We take very seriously our responsibility. ***Montecito Investment Portfolio's Mission: To provide diversified, disciplined long-term investment solutions, service and guidance to help our clients achieve, and maintain, their "Financial Independence".***

Sincerely,

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