Mo Ansari: Welcome back everyone to Market Wrap. I'm Mo Ansari and you're tuned in as you've been doing so for over 36 years now. And as always, wherever you are across the nation, you can always send me an email and I will be more than happy to share my experience with you. But for the next few minutes, hold the emails. We are going to go to our guest line. On our guest line, Dave Ellison, Portfolio Manager at Hennessy Funds. Mr. Ellison brings over three decades of investment management experience to Hennessy Funds and he's recognized by Morningstar as the most tenured mutual fund portfolio manager in the financial services sector. Prior to joining Hennessy funds in 2012, he served as President and Chief Investment Officer of FBR Funds where he launched and oversaw the line of FBR Funds. Mr. Ellison, his career at Fidelity, he started his career at Fidelity where he managed to select home finance fund and developed his investing discipline and strategy under the tutelage of famed value investor Peter Lynch. Dave, as always, welcome back to Market Wrap.

David Ellison: Hi Mo. At least it's Friday out in your neck of the woods, but it's Friday, so we're happy for that.

Mo Ansari: Yeah, it's Friday here. We are getting ready for the weekend, and it's been a rock and roll sort of a week. We did get the inflation numbers, the CPI, the PPI. We got retail sales, and now we have the University of Michigan. Let's start with the CPI numbers. They were just about as expected, no big deal, but the PPI came in a little bit stronger. What do you make of that?

David Ellison: Well, I think we just have to look at it and say, well, the economy's still reasonably good. Nothing really has changed in the last many months [inaudible 00:01:47].

Mo Ansari: Why is that? Why is that, Dave? Let me ask you this. Why is that? Sorry to interrupt, but why is that? Why is the economy doing so well? Everybody was talking about a recession in the second half of 2022, 23, it's going to be terrible. Rates have gone up, we've got a crash, and here the economy just continues to do better than expected. What's the problem with the economy here? Why doesn't it crash?

David Ellison: It's amazing how Wall Street wants a recession. Everybody else goes, what are you talking about?

Mo Ansari: Exactly.

David Ellison: What do you mean a recession? But Wall Street wants a recession because they want lower rates and they want multiples on stocks to go up so they can pitch them and make money.

Mo Ansari: Right.

David Ellison: But I think there are a number of things. One, unemployment remains low historically. There are wage gains across the board. And you hear the news about GM today, about their big wage gains. They're going to get something that's pretty noticeable.

Mo Ansari: Right.

David Ellison: The other thing is you have rates have gone up enough to make it very noticeable for people who are savers. And so you're actually making some real [inaudible 00:03:02] savings versus 0, 2, 3 years ago. And frankly, the rates are up at 15 year highs. So the savers actually have money, and I view that as akin to free money. That's quantitative easing because just to make the numbers easy, a million dollars two years ago earned your nothing. Now it's earning you $50,000. So if you're the retiree in Florida going, 'I just made $50,000 for free. I didn't have to do anything.'.

Mo Ansari: Right.

David Ellison: And that money's coming into the economy and it's offsetting whatever the Fed is doing from a quantitative tightening perspective.

Mo Ansari: Right.

David Ellison: And I also think the final thing is you've had a 40-year bull market and bonds of 40 year-ish bull market in equities. You've had a 40 year-ish bull market in home prices. Not all regions, but most regions of the country. And [inaudible 00:04:02] and buffer whatever may happen. But nothing's gone wrong yet. Rates going up have gone... I think rates going up is actually making the consumer stronger, not weaker. And yes, home prices, people trying to buy a house today, they can't because rates... But that's a very, very small percentage of the people that actually own a home. So I think all these factors are keeping the economy strong.

Mo Ansari: Do you think the biggest thing is employment? That everybody has a job and anybody who wants a job can go get a job and says, people who have a job said, look, I'll spend the money and I'll put it on the credit card. As long as I have a job, I can pay it off.

David Ellison: Well, I'm 65 years old and my first job was, I don't remember what I made for that first year. But the point is, once you have a job, you feel really good about what's happening. If you feel good, feel good about where you are, it doesn't make you go out and spend, buy a Ferrari or something, but it does generate spending. So jobs are very important to spending, but they're also very important to sort of the animal spirits and how you feel about yourself. So I think we have a... The basic economy's doing well. The problem is that Wall Street is trying to present it as, well, things are a little weaker, therefore the Fed needs to lower rates so I can make money.

It's been a long time where Wall Street is actually fighting a good economy. Wall Street wants a good economy, now they don't. They want a bad economy so that rates can go down, and they're fighting every little tick of, 'oh, well, inflation's down two basis points from where it was weeks ago. So that means inflation's going to fall and we're fine. The Fed can lower rates.' They're looking at the wrong thing because they're basically in the wrong neighborhood. [inaudible 00:06:03]

Mo Ansari: Let's talk a little bit about the Fed and interest rates. Do you think they will continue to raise rates now the probability has gone up to about 60% that they're going to raise between now and December? What are your thoughts? Are they done? The ECB came out yesterday and Christine Lagarde said, 'Hey, we're done.' She just about said that. Do you think the Fed is done raising interest rates?

David Ellison: They've been data dependent the whole way, which I think has been helpful in terms of not surprising the market and not surprising the consumer. I think if they're done, the question now is when are they going to cut? If they do or how long is it going to be before we have lower rates? I think that the Fed's going to stay restrictive until there's a reason, and the reason's not going to be a little bit here, a little bit there. I think the Fed's going to lower [inaudible 00:07:02]. I don't see that in the foreseeable future. So I think that rates are going to be flat to up, and that's where it's going to be, but it's not going to have that much of an impact on the consumer because of all the things we've talked about.

Mo Ansari: With inflation, do you think it's going to continue to come down? So the Fed do you think is going to hold rates higher for longer basically or where they are now?

David Ellison: Yes.

Mo Ansari: [inaudible 00:07:31] contrary to what everybody thinks that they're going to cut rates and bring rates down, unless the economy goes off a cliff, which it doesn't seems to be doing. What is your current view of the financial sector, Dave? It came down with the SVB, it took off to the upside when the rest of the banks didn't collapse, and now they're sort of going sideways. What is your view of the financial sector?

David Ellison: Well, from a valuation perspective, they're on the cheap side. From a [inaudible 00:08:04] perspective, they are fighting through the rise in rates, fighting through getting their deposit rates, having to raise their deposit rates probably more than they would like. But they're doing it, it's having a positive impact on inflows of deposits. They're obviously having to wait for the loans to reprice, that it will drive the asset yields up, so they'll get a margin. The margin will improve. So I think you're going to see them slowly improve. And it's a slow boat, it takes a long time for these big portfolios to adjust on the upside and on the downside. So I think you're going to see much the same. But once I think people feel comfortable about where rates are going to be, if it's five or five and a half or maybe a little high, whatever, then people will say, "Hey, we know where rates are going to go. We can manage that." And then I think you'll see a reasonably good performance group.

Mo Ansari: Do you think we'll see another government shutdown, and how will that impact the financial sector?

David Ellison: Well, I'm not a politician like most people. Hopefully, I think they'll realize it's more troublesome than it's worth in terms of whatever political gain they're going to get. But it's always there. They use it as a bargaining chip. I don't think it really matters long-term. There's plenty of money to pay the bills. People get afraid, back and forth. But I don't think it's going to be a factor in terms of what the market does and what the Fed does.

Mo Ansari: Where do you see the best opportunities right now as far as investments go in the financial sector, large cap, mid-cap, regional banks? What are you looking at?

David Ellison: Well, I think it's kind of bifurcated. The largest banks I think are best positioned to see the benefits of the rise in yield on assets. Wall Street's been fairly [inaudible 00:10:01], that will help them. And then I think the very small ones basically have gotten hurt the most from the rise in rates and the inversion of the curve, and they're struggling to get back. But they'll have the biggest increases in terms of their yield on assets over the next couple of years because that's the bulk of their revenue. So I think you have the big banks that have a monopoly. They've been given the monopoly and they'll continue to do well. The smaller banks that have been the most hurt are the ones, is the other opportunity. And the rest are kind of in between, and they're okay, but you want to buy where the biggest changes are.

Mo Ansari: So you're looking at the small cap that have got beaten down. Do you think that's a good value right now if you're looking to pick up some over the next, for the next year or two?

David Ellison: Yeah. Yeah, I think the fundamental improvement's going to be pretty noticeable there the next year or so.

Mo Ansari: Let's talk a little bit about the economy as a whole. Where do you see it this year? Where do you see it next year? Do we get the recession, we get the slow-down? Or do we accelerate from here, which no one is talking about, that we might see an acceleration in the economy compared to the recession and the slowdown and all of that? What is your view?

David Ellison: Well, I think what we have now is a good economy. Wall Street doesn't want to admit to it. I think there's a lot of balance in the economy. The returns on CDs and the returns on the market and the returns on real estate are all more in balance than they've been in a long time. My feeling is that the Fed has to be careful not to reignite things. If they come out and say, 'well, we're done, and all of a sudden the market takes off and the Dow's at 38,000 and things. You'd think home [inaudible 00:12:01] go up or down, right?

Mo Ansari: Right.

David Ellison: Have a real big run on inflation as everybody realizes, well, the coast is clear, I'm going to get a big raise and a promotion, and my stocks are up, my bonds are yielding good, my real estate is up, so I'm going to go spend more money, and therefore there's more inflation. So I think they have to be careful not to reignite the animal spirits and generate more inflation, which what I think would be a long-term not a good thing.

Mo Ansari: Yeah, if they do that, that... But do you think there's any chance that the Fed will say, 'look, we're done, but we're still worried about the inflation. It's at 3% or whatever. We still want it down to two.' They'll keep talking about their 2% inflation, but sort of live with 3% and let things go a little bit. Do you think that might be the case? They might talk tough and not do anything.

David Ellison: Well, that would be a tough position for them to be in because if they do that, then they have the credibility issue. It's sort of like the mother's saying, if you do that again, you're going to your room, and they do it again and she doesn't send them to the room. And so then you have a chaotic situation where the Fed doesn't really have any, it doesn't have any perceived authority, and the market does makes up the story. So I am hoping that the Fed stays hawkish because so far the hawkish has not hurt. They've raised rates. They talked hawkish. Where's the big blowup? Where's the big end of the world event?

Mo Ansari: Right.

David Ellison: Right. Nothing has happened. So my point is that to become, to say, well, we're okay with inflation at 3%, then you've changed the whole metric of what you look at. And so I think you have to be careful not to change your tune. [inaudible 00:14:01]. If they become less than the parent in the room, then you're potentially going to breed chaos and it's bad parenting.

Mo Ansari: Dave, as always, thank you so much for taking the time to be with us today, share your thoughts with us, and sort of give us an overview of what you're thinking about the economy and the financial sector. Have a wonderful weekend. Thank you again.

David Ellison: You're welcome, Mo.

Mo Ansari: That's Mr. David Ellison. He is Portfolio Manager at Hennessy Funds. Always a pleasure to have him on the broadcast. If you want to go and take a look at his funds, go to hennessyfunds.com. Or if you want a fact sheet, just call us or go to compact.com and request one and we will send it to you. It's absolutely free. Stay tuned. We are going to take a short break and I will be right back.