

Second Quarter 2025

Economic and Market Commentary

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Sitting at a latitude not much north of our own Bay Area lies the Gulf of Naples. About six miles east of Naples, the scenic town of Campania can be found right next to the shore. The town is surrounded to the west by a series of volcanoes. These volcanoes form an arc. Geologists refer to this arc as the Campanian Volcanic Arc. Although not tall in stature, in fact not much taller than Mt. Diablo, is the world's most famous volcano, Mt. Vesuvius.

It's been an active volcano for close to 20,000 years and has erupted dozens of times. The earliest eruption in recorded history occurred somewhere around 1800 BCE, and the most recent was 1944. Some eruptions have been so intense that the whole of southern Europe has been blanketed in ash. At other times depending on wind direction, all of Istanbul has been covered in ash and Istanbul is more than 750 miles away. Such violent eruptions are known as Plinian eruptions.

People living around Mt. Vesuvius over the centuries grew very complacent with the mountain, causing frequent ground shaking temblors and occasionally spewing tall clouds of ashen smoke. In 62 AD, the Bay of Naples suffered a serious earthquake. Many shore side structures were either seriously damaged or totally destroyed around the City of Pompeii; a flock of sheep mysteriously died from breathing "tainted air." This tainted air came from the vicinity of Vesuvius and will soon become an important component of this narrative.

In mid-October of 79 AD, a series of small earthquakes began around Mt. Vesuvius and the City of Pompeii. The earthquakes were said to last some 4 days. For those that didn't take heed and evacuate the area, their decision would prove fatal. On the fifth day, somewhere around October 18th, Mt. Vesuvius had the first of its two major eruptions. The first eruption occurred at midday and sent a towering plume of ash, pumice and rocks to a height of almost 100,000 feet. Literally the edge of space. This is the window of time in which rescues were made, and some tried to escape by boat into the Bay of Naples. Not all were successful, some perished and some were stranded.

Later that night, the second and most devastating eruption occurred sending waves of pyroclastic surges down the mountain side (pyroclastic flows are hot gases mixed with volcanic matter and carry extremely high temperatures) and fully enveloping the cities of Herculaneum and Pompeii along with all remaining inhabitants. It's estimated that the thermal energy released by Vesuvius was equal to 100,000 times the thermal energy released by the Hiroshima-Nagasaki bombings. It

wasn't long before the gases that carried that plume of pumice and rock 100,000 feet into the air started to expand. As the expansion occurred the gases could no longer support the particular matter which began to fall back earthbound and created low hanging pockets of tainted air.

Enter One of the Greatest Romans of them All

Although it's not for certain, it is believed our Roman was born somewhere near modern-day Como. His parents were Gaius Plinius Celer and his wife, Marcella. They named their son Gaius Plinius Secundus, history recognizes him as Pliny the Elder. His family was prosperous and made sure their son received a good education that included both rhetoric and grammar.

Throughout his life, he was friends with Emperors, most notably **Veslasian** and his son, **Titus**. In his 55 years of life, he served as an army commander, navy admiral, regional governor, lawyer, author and naturalist. His travels were extensive, ranging from the Iberian Peninsula to Africa and beyond. His eyewitness accounts of cultures, industry, plants and animals became much of the content for this magnum opus *Naturalis Historia* (natural history). This 37-volume work was intended to encapsulate the entire field of ancient knowledge. Among many others his topics included mineralogy, zoology, architecture, mining, archeology, art and agriculture. Most modern historians consider this work to be the first encyclopedia ever written. The work was completed in 77 AD, two years before Pliny the Elder's death. We will come back to one of his zoological observations in just a moment but first let me describe his final noble act.

Coming to a Friend in Need

By 79 AD, Pliny the Elder had been appointed *Praefectus Classis* (Admiral in the Roman Navy). At the time of the eruption, he was stationed with his fleet at Misenum, some 22 nautical miles across the Bay of Naples from the town of Stabiae. It was at Stabiae that his dear friend Senator Pomponius had fled with hopes of escaping from the Mt Vesuvius eruptions. The prevailing winds prevented his escape, but he was able, however, to get a message to Pliny the Elder that he needed to be rescued. Upon receiving his friend's plea for help, Pliny the Elder immediately dispatched a fleet of galleys to conduct the rescue. Pliny himself was in the lead galley. Just off the coast of Herculaneum both flaming pumice and cinders began to rain down on the fleet. It was at this time Pliny's helmsman advised that it was too dangerous to continue and they should return to Misenum while they still could. It was in response to this advise that Pliny spoke perhaps the most famous quote attributed to the 600-year Roman empire when he told his helmsman "*Fortune favors the bold steer on to where Senator Pomponius is.*" And so, they did. Upon coming ashore, they soon found the Senator. Once again, the winds had shifted, and the fleet was stranded for hours before conditions allowed them to depart. It was during this period of time that a plume of hot toxic gases overtook them. Remember the sheep casualties of 62 AD and the tainted air. Pliny the Elder had suffered for years from a respiratory condition. He soon succumbed to the gases and died on the beach after rescuing his friend. Three days later, the fleet returned and retrieved his body. He was brought back home and awarded a hero of Rome's final rights.

Naturalis Historia Revisited

No one is infallible. Remember I mentioned earlier we would come back to one of Pliny the Elder's zoological observations, well now is the time. In Book 10, Chapter 1 of *Naturalis Historia*, he provides a detailed yet inaccurate account of the behavior of ostriches. Here is the pertinent passage I am referring to:

“...but their stupidity is no less remarkable: For although the rest of their body is so large, they imagine when they have thrust their head and necks into a bush, that their whole body is concealed.”

This quote, of course, is often recognized as the origin of the popular but false myth that “ostriches bury their heads in the sand when they are scared.”

In actuality when ostriches sense danger, they stretch out their necks and lie as flat on the ground as possible in an effort to blend in with the landscape. This has proven to be an extremely effective defense. One need not question the resilience and adaptability of the ostrich than to trace their family tree.

Ancestors of today's ostrich date back to the Eocene Epoch of geological time. The period immediately follows the Cretaceous period, or the days of the dinosaurs. Although unintentional, Pliny the Elder's erroneous observation of the ostrich laid the basis for the untrue myth about ostriches burying their head in the sand, a fallacy that has carried over metaphorically into many disciplines including *behavioral finance*.

The Ostrich Effect

The ostrich effect, or sometimes referred to as “willful blindness” stems from the human tendency to avoid negative information and the psychological discomfort it can bring. With recent equity market uplifts in the face of ever-present world tensions and economic pressures, the question begs to be asked are investors demonstrating the ostrich effect for fear of missing out? OR on the other hand, are they making smart, informed and rational decisions which will potentially improve their long-term investment outcomes? The latter decision-making process requires sound fundamental analysis and the ability to avoid self-deception in the hope of deceiving oneself into believing something that is factually untrue.

Hand-Wringing

The Oxford dictionary defines hand-wringing “as the clasping together and squeezing of one's hands, as a gesture of great distress, especially when one is powerless to change the situation.” Certainly, these past 6 months have given people much to wring their hands over. Sometimes it's hard to keep up. Just when you're getting your arms around one significant challenge, be it tariffs, immigration or deficits, those stories find their way to the back pages of the newspaper because some new and pressing event takes center stage, whether it's a conflict in the Middle East, US bombings in Iran or continued fighting between the Russians and the Ukrainians. It's

easy to view the world as a glass half empty if one allows oneself to do so. But is that really the whole story? No, I don't think so.

Just in the past several years, there have been tremendous advancements made in the fields of medicine, energy, artificial intelligence and food production just to name a few. These innovations will prolong life and improve its quality for those dealing with conditions like Parkinsons disease, sickle cell anemia, liver damage and breast cancer along with many others.

AI-enabled microscopes have greatly advanced genomic analysis to aid in early disease detection. Medicine is adapting artificial intelligence at a tremendously rapid rate creating virtual researchers, advancing medical image analysis, helping match patients with the most appropriate trials. In 2020 there were 200,000 protein sequences known to medical science. Today there are over 200 million thanks to a leading AI program known as AlphaFold which will result in better and faster treatments. While the debate rages on over electric vehicles and their associated tax credits, great strides have been made in the field of "green hydrogen". The production of electricity through the electrolysis of water as opposed to hydrogen production derived from fossil fuels without any carbon capture. This technology, when fully developed, can greatly reduce fossil fuel dependence and help limit global warming.

Recent developments in the field of nuclear fusion have put scientists on the path of harvesting a clean and virtually limitless energy source. In December of 2022, scientists at the Lawrence Livermore National Laboratory achieved "ignition" producing more energy from the fusion reaction than was used to trigger it. France is in the midst of building a large-scale magnetic fusion center which is expected to be the first proof of concept facility producing net energy leading the way towards commercial fusion power. These are but just a few of the advancements benefiting the human condition, reminding us the glass is in fact half full.

The Ancient Practice Known as Scrying

For millennia many have sought to see the future often using the medium of a crystal ball. For those practitioners the practice came to be known as scrying. The practice started with the Egyptians followed by the Persians then Chinese. Highly polished stones were first used to supposedly give one a window onto the future. It was the Celtic Druids who were the first to start using actual crystals. The practitioners would fall into self-induced trances in hopes of communicating with the gods and looking into both the past and the future. Although the Greeks used dishes of water and polished mirrors it was the Romans that first used crystal balls in hopes of seeing a clearer future.

By the Middle Ages, the practice took on a negative connotation and was associated with witchcraft and sorcery. Fast forward 500 or so years and scrying again regained its popularity. The Roma people helped disseminate the practice and often preyed upon the weak and superstitious. Never a shortage of either.

A popular and often asked question posed to financial analysts and money managers alike often starts out: "I know you don't have a crystal ball (as though if I did it would do any good), but

what do you think will happen in the market...” My personal answer is always the same, sound investing requires discipline and adherence to tried-and-true fundamental principles.

The Power of Capitalism

It’s been my long-held belief in the power and effectiveness of capitalism. Private ownership, although sometimes contributes to some negative consequences, capitalism powers our society forward. Capitalism can be broken down in its most simplistic terms into four basic truths:

- Private ownership creates a profit motive. To succeed, businesses need to operate efficiently, innovate and create products and services people want.
- Capitalism fosters competition which creates greater value for the consumer, improves products and again supports innovation and efficiency.
- Individuals maintain freedom of choice, what to buy, who they want to work for, what they want to invest in.
- Capitalism allows individuals and businesses to own property be it land, factories or basic materials. It’s this ownership that encourages them to invest in their property and improve their offering which in turn benefits everyone.

It would be remiss of me not to acknowledge that capitalism can also lead to wealth inequality and negative environmental impact. It’s not a perfect system but it is the best one we’ve got.

Market Resilience

The past 6 months have certainly proved chaotic and equity markets have seen big swings both up and down. But, just like our 40-million-year-old ostrich, they have proved quite resilient. It’s easy to say: “But this time its different, we just bombed Iran.” It’s a sad fact that wars, if it comes to that which no one hopes it does, are not a good indicator of market direction. Markets price in uncertainty. Leading up to conflict they will typically decline and when conflict breaks out, they often rally or stabilize. Ironically, markets typically experience decreased volatility during times of war as compared to peace time. Parenthetically, U.S. stock markets rose close to 20% during WWII. We all hope further conflict will be avoided but whatever be the case markets adapt to changing circumstances. Capital is redeployed to different sectors of the economy be it defense or energy. Other factors matter more like trade policy, interest rates or inflation. Big short-term swings in the market no doubt can be jarring but should not be unexpected. Over the past 75 years, the U.S. stock market has weathered a 5% drop at one point or another every year. On average, it weathers a 10%-20% drop every 18 months and a 20% drop every 5 years or so. With that said, the stock market has always recovered. The US economy is extremely resilient. As the economy continues to grow so do the profits of well-run companies. As profits grow so will stock prices over time.

Let Me Bring It Home

As volatile as the first half of the year 2025 has been in the markets the second half will most probably demonstrate its own share of volatility with shares of well-run companies generally grinding higher over time. As the Economist recently reported; “Earnings per share for American firms have risen by 250% over the past 15 years. For any event to have a meaningful impact, at least for longer than a few days, it must harm such dynamism.” “Expected earnings of firms in the S&P 500 index over the next 12 months are currently forecasted at \$263 per share, very narrowly above where they were before President Trumps “Liberation Day” announcement. (This was the tariff announcement that sent the market into a short-term tailspin.) The article concluded with this salient comment: “...what appears to be a witless stampede into stocks, even in moments of international tension and conflict, is really an appreciation of the power of capitalism. The news that matters tends to come from the real economy of the financial system, not the world’s battlefields.”

Conclusion

The world is always in conflict. Regrettably in all of recorded history there has never been a time when we’ve enjoyed a “peaceable kingdom” as illustrated by the great 19th century painter, Edward Hicks, who’s works showed a scene of harmony between animals and humans. The challenges to society change throughout the millennia – famine, plague, war, natural disasters, man-made folly, you name it, yet the reality remains no matter what challenges are faced commerce always continues.

My best wishes for a happy and healthy summer.

As always, with best regards,

Ray