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CAPITAL MANAGEMENT

MACRO MUSINGS

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Fed Resets Expectations

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SUMMARY

- **macro**cast™ remains positive and suggests the risk of a recessionary bear market in 2024 is low. Our current **micro**cast™ signal remains at an aggressive allocation. Both models continue to indicate a generally optimistic outlook for the early part of 2024.
- While rate reductions are likely in 2024, the Federal Reserve is pushing back on the market's expectations for their timing and intensity. Investors originally expected numerous aggressive cuts but are now adapting to the Fed's more measured outlook.
- Economic indicators remain surprisingly strong, with GDP growth exceeding expectations while employment data remains robust. Should this trend continue, a recession is unlikely.
- The market recently hit a new all-time high. Historically, stocks have performed similarly—and in some cases, better—after reaching new highs compared to other periods.

See content within for additional information on the summary items discussed above

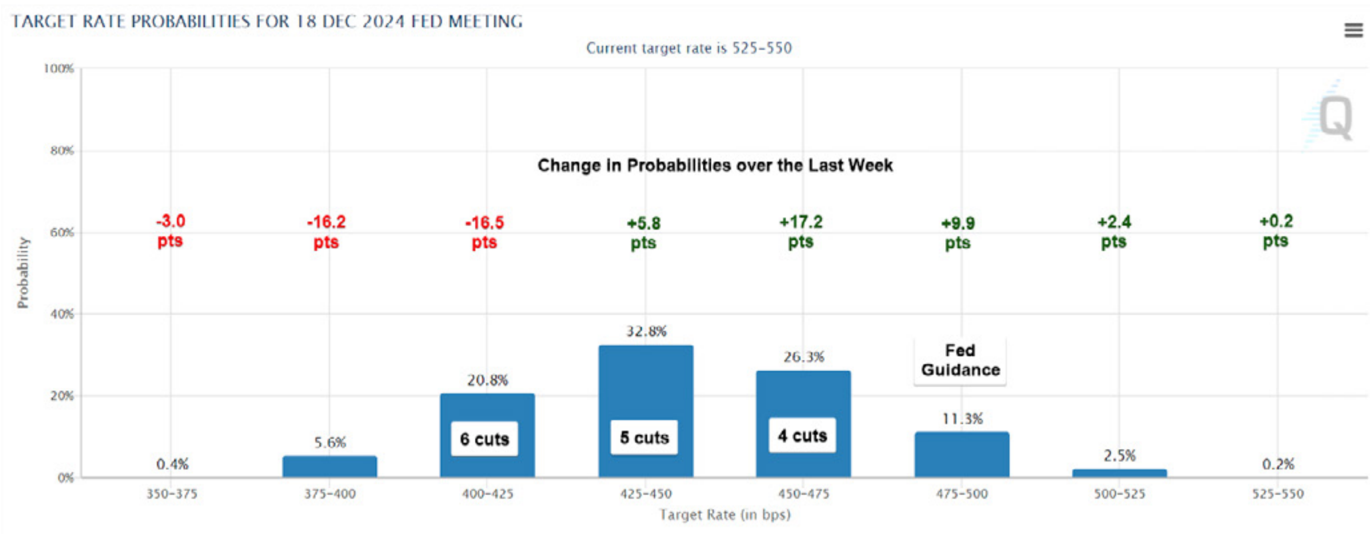
WAITING FOR THE **FED TO ACT**

The Federal Reserve is no longer raising interest rates. This shift, hinted at late last year, helped spark a major market rally over the last two months of 2023.

The spotlight is now on rate cuts, but the Fed is challenging market expectations on their timing and magnitude. Entering 2024, futures markets anticipated 6 or 7 cuts, which translated to rates being 1.5% to 1.75% lower by the end of the year.

Fed officials, including Chairman Powell in his 60 Minutes interview, have consistently communicated that while rate cuts are coming, they won't be as aggressive as anticipated.

The market is finally catching on. Over the past week, predictions for aggressive rate cuts have declined, though they still exceed the Fed's guided target of 3 cuts in 2024 (chart from CME):



Ironically, a slower pace of rate cuts might benefit stocks. Historically, slow, steady, and consistent rate cut cycles have proven most favorable for the stock market. Gradual rate cuts suggest the Federal Reserve believes the economy is doing well enough to withstand higher interest rates. Aggressive rate cuts, on the other hand, are typically a response to economic downturns. They often signal that the economy is entering or already in a recession.

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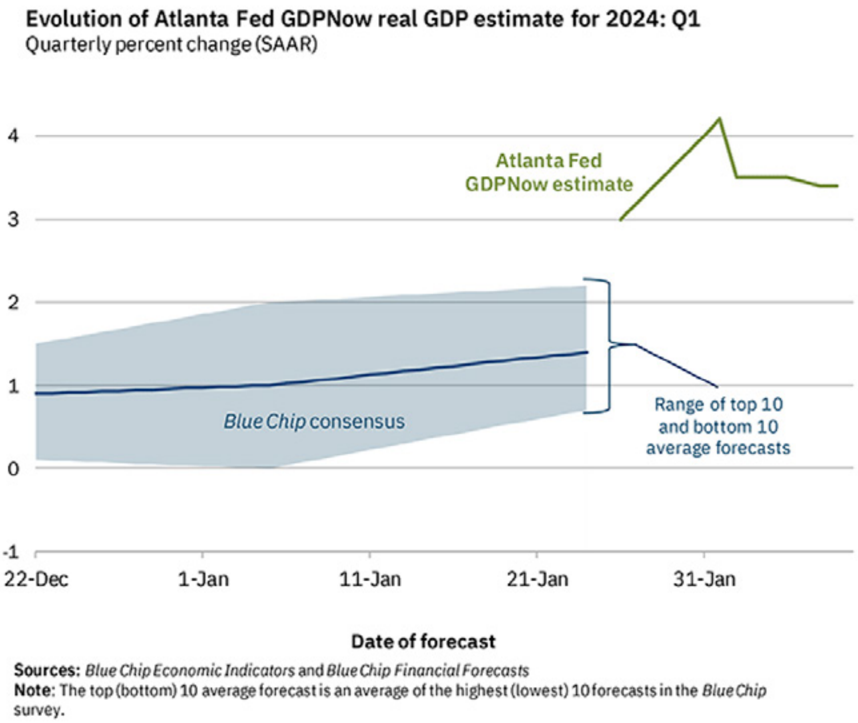
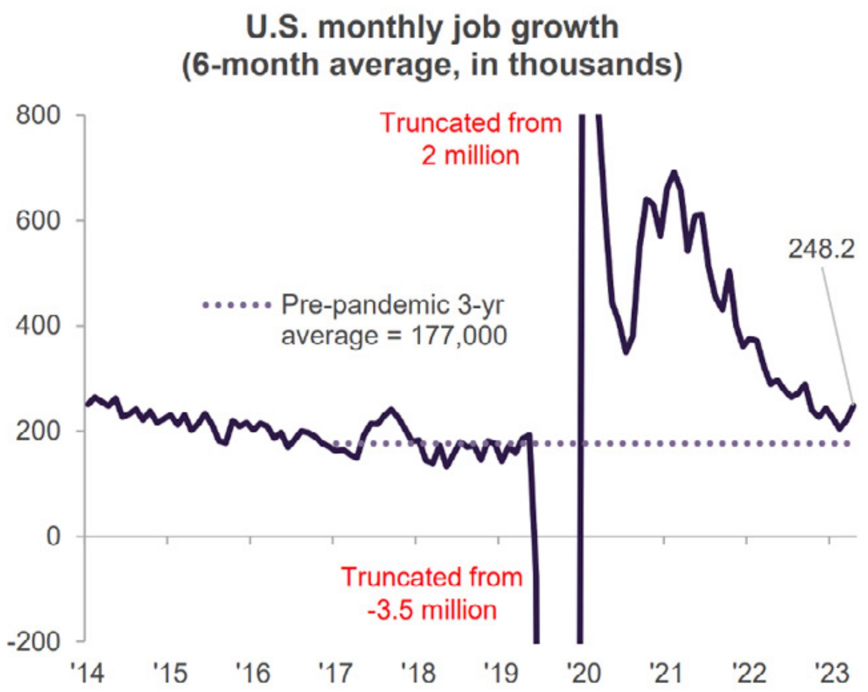
ECONOMIC GROWTH **REMAINS RESILIENT**

Economic resilience is a key reason why the Fed isn't rushing to cut rates. GDP expanded by an impressive 3.3% in Q4 2023, and the Atlanta Fed's GDPNow model suggests similar strength in Q1 2024, exceeding 3% growth. Of course, it's important to remember projections will change as new data becomes available:



We continue to believe a recession is unlikely as long as the labor market remains healthy. In a consumer-driven economy like the US, strong job growth and low levels of unemployment directly fuel spending and borrowing, which are key drivers of economic growth. The latest data indicates that job growth continues at a robust pace, even slightly exceeding pre-pandemic averages (Chart from Truist):



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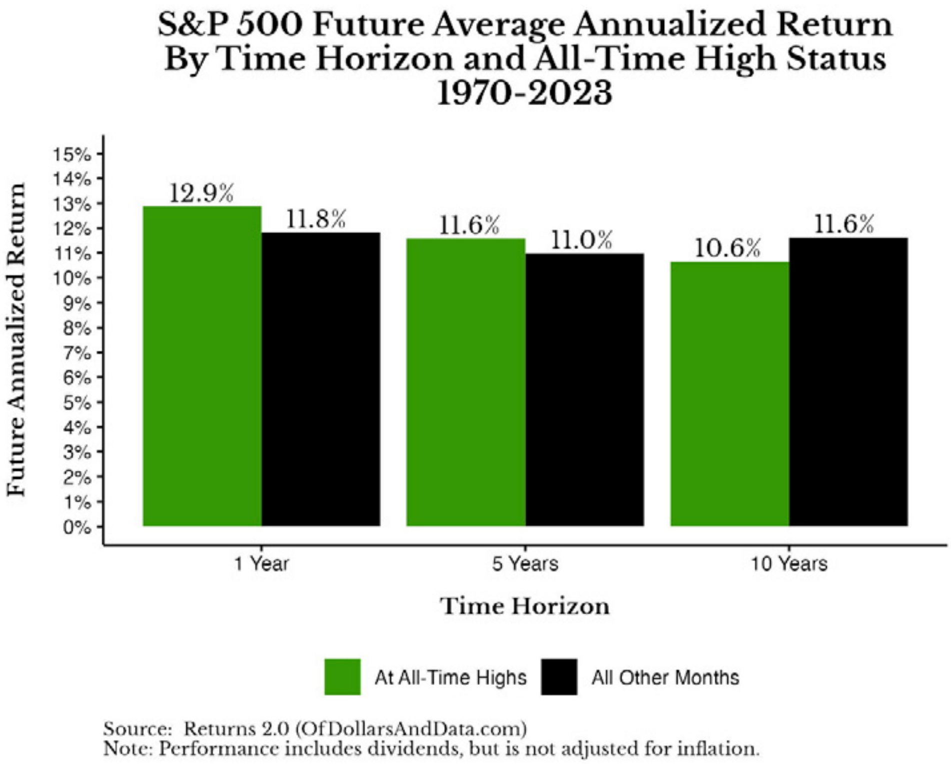
S&P 500 AT ALL TIME HIGHS:
HISTORICAL TRENDS POINT TO MORE UPSIDE

The S&P 500 recently surpassed 5,000, reaching **new all-time highs.**

While one might intuitively expect lower returns after such a milestone, historical data suggests the opposite. Studies show that, on average, stocks tend to perform better following all-time highs (Chart from OfDollarsAndData):



Returns following all-time highs were higher on average over the next 1 and 5 years. While returns were lower at the 10-year mark compared to shorter timeframes, the S&P 500 still demonstrated impressive growth, rising 10.6% per year.

While past performance never guarantees future results, historical trends suggest that investing after reaching all-time highs doesn't inherently carry greater risk. Of course short-term corrections are always possible, and individual market cycles differ. However, the market has historically trended upward over the long term, and perhaps most importantly, investors who put money in stocks after record highs have not faced a significant disadvantage compared to other periods.

In summary, the market is off to a strong start in 2024. While markets were quick to initially price in aggressive rate cuts when the Fed pivoted away from hiking late last year, rate cut expectations have tempered in recent weeks as the Fed has pushed back on

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market expectations for a fast rate cut cycle. Although higher rates are often viewed as a headwind for stocks, a slower rate cutting cycle has historically been more positive for markets as it reflects a stronger economy capable of withstanding higher rates. Recent economic data supports this view, and the market has continued to rally, reaching new all-time highs in recent weeks—a significant milestone that typically leads to further upside.

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