Patten & Patten

March 2024

QUARTERLY INVESTOR LETTER

Market pre-occupation with Fed policy persisted through the First Quarter. One CNBC commentator claimed Fed policy debates consume ten of fourteen hours of daily airtime. Forecasting Fed policy actions, perhaps more than ever before, has become an obsession among financial media and so-called market experts.

As we thought would be the case, the market reduced the number of expected rate cuts in 2024 in response to economic data and Fed commentary during the First Quarter. Markets nevertheless continue to expect several imminent reductions in the Fed's benchmark rate. We contend the theme of 2024 will be consistent expectations for more rate cuts than the Fed is likely to deliver. Moreover, we would not be surprised if the Fed does not cut rates this year.

We do not believe economic data warrant looser monetary policy. In the event the Fed remains on hold, we anticipate higher bond yields and underperformance by long duration assets. On the other hand, the stock market has thus far absorbed shifting rate cut dynamics with minimal volatility. Equities appear to be responding to earnings growth and a rebound in manufacturing.

We have cautioned in previous missives that concentrated leadership among a few stocks has distortive effects on index performance. Note: stock market leadership has narrowed further from last year's "Magnificent Seven." In 2023, most stocks posted negative returns through the first three quarters of the year. The index's full year returns masked disappointing returns among the majority of its constituents. Despite even narrower leadership in 2024, market participation has broadened significantly. By way of contrast, most stocks have year-to-date returns in line with the index. We view improved market breadth as a healthy development.

The Fed also suggested a termination of their Quantitative Tightening ("QT") program in the near future. The end of QT would represent restoration of relatively favorable liquidity conditions. Markets have correctly interpreted the policy shift as net stimulative, and we expect improved financial conditions will buoy most asset markets. However, the market's vulnerability has not changed – i.e., premature declarations of victory over inflation. In other words, structural inflation and upside inflation surprises could prompt a change of course by the Fed. In that event, we expect volatility would remain quite elevated. Above all else, we believe the Fed seeks to avoid a second surge of inflation similar to the experience of the late 1970s.

We look forward to discussing these matters with you and reviewing your accounts. Please contact the office if you would like to schedule a virtual or in person meeting.