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QUARTERLY INVESTOR LETTER

The Fed initiated a series of aggressive rate hikes in 2022, from near zero to eventually terminating at 5.50% in 2023. In September, the Federal Reserve ended months of speculation with a 0.50% decrease in the target rate for Fed Funds. With this policy reversal, the Fed acknowledged policy was restrictive – a view held by some investors. Pursuant to their dual mandate of price stability and full employment, the Fed justified the shift as a necessary “re-calibration” of policy. If the Fed had not cut rates, some argue the high cost of capital would have contributed to recession. However, the Fed’s policy reversal also risks re-igniting inflation.

Historically, the Federal Reserve has not cut rates in isolation. Investors now anticipate a series of rate cuts that could further reduce Fed Funds 1.25 – 1.75%. Further rate reductions should provide relief to capital intensive sectors that rely on low cost financing, including residential real estate. However, there is over \$6 trillion in money market and deposit balances that will experience reduced interest income. That excess liquidity should support markets during periods of uncertainty, but re-allocation of those funds could also contribute to market volatility.

Cash and money markets still have higher yields than longer maturity fixed income. This reflects a market anomaly known as the inverted Treasury yield curve. With the rate cut, portions of the curve have resumed a positive slope.

However, cash and money markets continue to provide greater current income than longer dated bonds. This dynamic will dissipate as the Fed “re-calibrates” policy. We expect cash and money market yields will decline commensurate with further rate cuts from the Fed.

The S&P 500 has posted attractive year-to-date returns, with recent acceleration fueled by the rate cut. Market leadership is no longer extraordinarily concentrated. Improved market breadth is a favorable development for the sustainability of the rally. In particular, we note that interest rate sensitive sectors, such as utilities, have performed well. There are technical market conditions that warrant caution, but overall, fundamentals remain healthy with corporate earnings expected to grow.

Recent economic indicators contributed to a view among investors that recession was imminent. However, other data suggest a more favorable outlook for economic growth. We note that higher rates boosted consumption. Thus, lower interest income could dampen consumption growth going forward. We maintain a favorable outlook for the economy while vigilant for signs of resurgent inflation. While we acknowledge there are headwinds to growth, there are also tailwinds. On balance, therefore, we remain constructive. 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.