FORTHRIGHT PARTNERS, LLC

INVESTMENT LETTER, 1ST QUARTER 2024

EXECUTIVE SUMMARY

Is the stock market already pricing in a perfect economic landing?

Interest rates may stay higher for longer. Does it matter if the economy remains strong?

Tributes to Dr. Daniel Kahneman.

Rebalance and rebalance often.

Cash is not trash.

A PERFECT LANDING …

When the Federal Reserve began raising interest rates from near-zero to 5%+ two years ago, many economists expected the U.S. economy to slide into a recession. Defying conventional wisdom, the Federal Reserve seems to have managed a perfect landing: the US economy and the labor market have remained strong, inflation has slowed down to 3%+. With such stellar results, the Federal Reserve sees no reason to change its course of action; it continues to expect to cut interest rates three times this year barring another flare-up in inflation.

The stock market loves it. The S&P 500 Index has set 22 record highs in the past three months. After all, continued economic growth means strong corporate earnings. Lower interest rates down the road are like icing on the cake. Let's just hope this perfect landing is going to stick.

… ON A PILE OF DEBT

The bond market, however, has been less sanguine. Inflation measures, while improved, have come in stronger-than-expected this year. With the prospect of interest rates staying "higher for longer", bond prices have come down, thus pushing both short-term and long-term interest rates higher than year-end levels. In addition to the Federal Reserve's interest rate policy, the bond market also has to contend with the increased supply of treasury securities as a result of our government's budget deficits, which are expected to exceed $1.5 trillion dollars this year. In the past three years, the bond market has had no problems digesting over $4 trillion dollars of additional treasury debt. However, if federal deficits do not start to shrink, how many more trillions of treasury debt can the market absorb? Will long-term interest rates stay higher for a lot longer because of the continued robust supply of treasury debt? It is safe to assume that 3% mortgages will not come back any time soon.

"Human Beings cannot comprehend very large or very small numbers. It would be useful for us to acknowledge that fact."

Daniel Kahneman

Daniel Kahneman, Nobel Prize Winner, noted Psychologist and Economist

Dr. Kahneman, a pioneer of Behavioral Economics, passed away in March. The Nobel Foundation awarded Daniel Kahneman and Vernon Smith the Economics Nobel Prize in 2002 for "having integrated insights from psychological research into economic science, especially concerning human judgment and decision-making under uncertainty". To oversimplify, Dr. Kahneman has demonstrated that the human decision process is influenced by cognitive biases and not strictly rational (a fact few would likely admit given human hubris). For example, *"An investment said to have an 80% chance of success sounds far more attractive than one with a 20% chance of failure. The mind can't easily recognize that they are the same."* Perhaps the stock market was celebrating the Fed's inflation fighting battle being 80% done and the bond market was fretting about the 20% still left to be completed?

"The world makes much less sense than you think. The coherence comes mostly from the way your mind works."

Daniel Kahneman, Thinking Fast and Slow

STILL CLOUDY, WITH A CHANCE OF THREE RATE CUTS?

As penned last quarter, the bond market's expectations for 1-1.25% rate cuts were unlikely given the strength of the economy. Since then, the bond market has revised its expectations to be more in-line with those of the Federal Reserve: three rate cuts this year. Should investors remain obsessed with the exact timing of interest rate cuts? If the perfect landing (continued economic growth, full employment and stabilizing inflation) is here to stay with us, does it matter if rates stay higher for longer??

What matters more, in our humble opinion, is that the stock market appears to have already priced in this perfect landing scenario. The margin of error for disappointments, therefore, can be pretty slim. We are not predicting this is the calm before the storm. However, when things are this calm, even a tiny headwind may be perceived as stormy.

Besides, even a perfect landing can have unfavorable side effects. Rates higher than longer may not be devasting for the stock market, but they will mean higher interest costs for our government. Housing affordability will unlikely improve, and there are likely other unintended consequences we have yet to think of.

"The idea that the future is unpredictable is undermined every day by the ease with which the past is explained."

Daniel Kahneman, Thinking Fast and Slow

BACK TO NORMAL?

Should investors be so fearful about "higher" rates? The table to the right displays the average interest rate of 10-year treasury bonds since 1970. 10-year rates have been well above 4% pre-Financial Crisis (2008). After almost 15 years of abnormally low interest rates, we are now transitioning back to a more normal interest rate environment. Sure, this transition involves some unpleasant adjustments, perhaps made more daunting because of geopolitical and political uncertainties. However, higher interest rates do instill more economic discipline and are rewarding for savers. There are more worthy issues to worry about than interest rates!

	Average 10-year Bond Rates
1970's	7.5%
1980's	10.6%
1990's	6.7%
2000's	4.5%
2010's	2.4%
2020-2023	2.3%
1970-2023	6.0%

PORTFOLIO POSITIONING

The US stock market enjoyed another quarter of impressive gains. While artificial-intelligence related stocks continued their meteoric rise, the broader market has participated as well (for details, please see Market Highlights on page 3). We continue to actively rebalance client portfolios, using equities as a source of funds where appropriate. We have trimmed a few technology holdings due to high valuation, but have also found interesting opportunities, especially in the technology-driven industrial area.

We continue to have an underweight in bonds as cash yields remain attractive. However, with the bond market being so volatile, we will look to add when long-term rates climb higher.

As always, please do not hesitate to contact us if you have any questions.

CONTACT INFORMATION

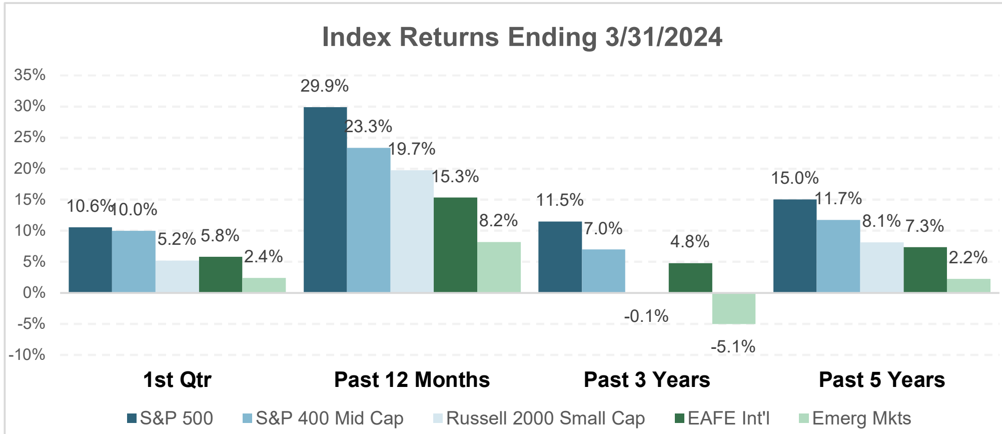
Baoky Vu, bnvu@forthrightinvestments.com

Beverly Kelly, bwkelly@forthrightinvestments.com

Hong-Tsun Simon, CFA, htsimon@forthrightinvestments.com

FIRST QUARTER 2024 MARKET HIGHLIGHTS

Stocks – Another stellar quarter!

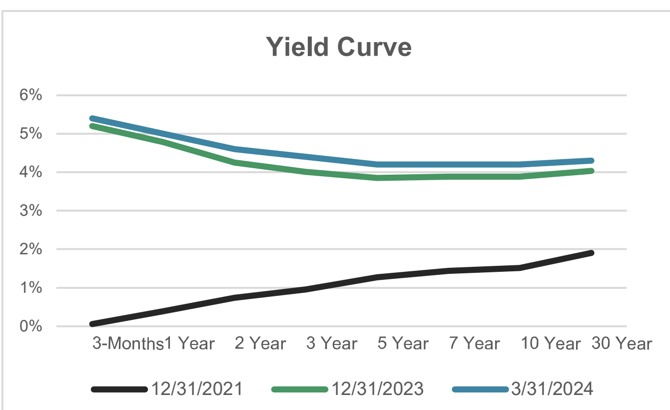


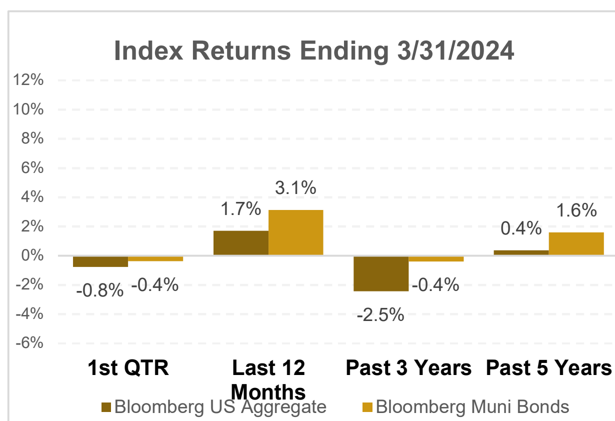
- Global stock markets posted solid gains in the first quarter, with the S&P 500 Index leading yet again.
- While semi-conductor stocks continued their meteoric rise, the stock market rally was broad-based. Only one sector (real estate) declined in the past three months.
- After two years of outsized returns, valuation is a bit stretched in the US markets. Large-cap, mid-cap and small-cap stocks all sport forward price-earnings ratios above their 20-year averages.
- International equities last outperformed the S&P 500 Index in the 2000-2007 period. Is their leadership due for a repeat?

Bonds – Volatile much?

- While stocks have marched upward without many interruptions, the bond market has been zig-zagging.
- With continued economic strength and inflation measures hovering around 3% (a full percent above the Federal Reserve's 2% target), interest rates may stay higher for longer.
- Even if interest rates do not fall in the near future (bond prices rise when rates fall), bond investors still benefit in a 4-5.5% income yield environment.
- Taxable and municipal bonds posted slight losses in the first quarter.

	2 Year Bond Yields	10 Year Bond Yields
12/31/2022	4.4%	3.9%
3/31/2023	4.1%	3.5%
6/30/2023	4.9%	3.8%
9/30/2023	5.1%	4.6%
12/31/2023	4.3%	3.9%
3/31/2024	4.6%	4.2%





Oil & Natural Gas

- According to the U.S. Energy Information Administration,
  - the U.S. has led the world in crude oil production since 2019
  - on average, the U.S. produced 12.9 million barrels of oil per day, a 20% increase from the previous year
  - we were the largest liquified natural gas (LNG) exporter in 2023
  - merger & acquisition activity in the oil & gas space reached the highest level last year since 2012