BARRETT CAPITAL

MANAGEMENT, LLC

Quarterly Investment Letter

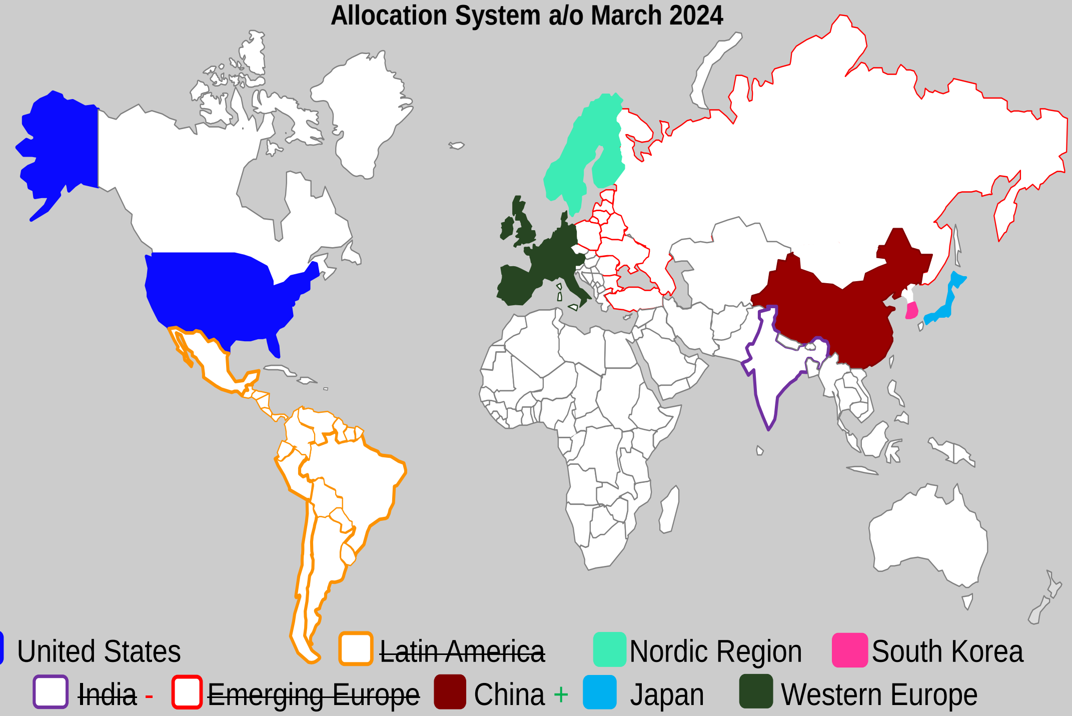
First Quarter 2024 | Vol. XXIII Issue 1

Key Takeaways

- High expectations surrounding potential Fed interest rate cuts and AI related tech stocks drove markets higher in the first quarter.
- We believe that our emphasis on flexibility and adaptability in portfolio positioning will play a crucial role in navigating the U.S. stock market, especially amid investors' close scrutiny of interest rates and inflation data.

GLOBAL AI®
ALLOCATION INTELLIGENCE

Regional Equity Exposure of Portfolios Using our Proprietary Global AI® Allocation System a/o March 2024



- Indicates position that was eliminated during the quarter + indicates position that was added during the quarter

Country/Regional Outlook

= Positive **Global AI** signal (indicates a current position as of quarter end)

= Negative **Global AI** signal (indicates positions that were eliminated, or not owned during the quarter)

Rate of Return represents the rate of return of the fund(s) for the period during the quarter that the fund was held by a standard portfolio using our proprietary Global AI® program.

South Korea	• Rate of Return up **+1.1%**
Developed Europe	• Rate of Return up **+3.1%**
Emerging Europe	• **No position held during the quarter**
Latin America	• **No position held during the quarter**
U.S.	• Rate of Return Range up **+5.2** - **+11.4%**
China	• **Entered new position during the quarter** • Rate of Return up **+9.6%**
India	• Sold Position during the quarter • Rate of Return down **-2.1%**
Nordic Region	• Rate of Return up **+7.0%**
Japan	• Rate of Return up **+15.5%**

First Quarter 2024

Did you fill out a March Madness bracket this year?

If you did, or if you ever have before, you know what a challenge it can be to predict what will happen during the annual NCAA Basketball Tournament. Maybe you should just pick the higher-seeded team in every game. After all, they're seeded higher for a reason, right? Or maybe you think a lower-ranked team will surprise everyone and beat one of the favorites. It happens every year, doesn't it? Or maybe you'll just look to see which teams enter the tournament on a "hot streak" and bet their winning ways will continue.

Or maybe you'll just pick whichever mascot you like best.

Whatever strategy you use, every decision forces you to question what you think you know. Is that top-seeded team's record for real, or does it hide the real story? If that underdog David manages to slay the heavily favored Goliath, will it continue winning, or will its story end in the next round? Does Team A's superior shooting outweigh Team B's better defense? The fact is that there are a million ways to guess, but there's no single way to know.

The reason we mention all this is because many investors are facing a similar March Madness-style dilemma with the markets right now.

Last year, the markets surprised many experts who had predicted a recession by finishing the year higher. That momentum continued in 2024 with additional gains during the first quarter. U.S. equities gained 7.9% in Q1, while developed international equities gained 5.4%, and emerging market equities gained 1.7%[1].

In U.S. equities, this performance was largely driven by one thing: Expectation.

Now, expectation always drives the markets, more or less. Market performance is dictated by what investors expect will happen in the future based on data they're seeing now. In a sense, every investor, expert or amateur, is filling out their own version of a March Madness bracket whenever they make a decision, but for individual companies rather than individual teams…or for the markets as a whole.

What's less common is when such high expectations are centered around two very specific things:

1. That the Federal Reserve will lower interest rates sometime in the near future.
2. That the potential of AI will yield major profits for companies down the road.

Because many investors expect that one or both of these things will happen, they want to be positioned to take advantage of them when they do. So, more money flows into the stock market – especially into companies that would seem to benefit most from these developments – and we experience the kind of quarter that we just saw.

But now, that leaves investors with questions. Questions that are eerily similar to what sports fans ask themselves when filling out a bracket.

- *Is this performance real…or is it a mirage?*
- *Is it sustainable, or just temporary?*
- *Are we in a bull market…or a bubble?*
- *Does Metric A matter more than Statistic B? Or should I only pay attention to Indicator C?*
- *Should I just invest based on whichever company logo I like best?*

Okay, that last one isn't real. But the rest are real questions that investors – expert and amateur – are asking themselves.

And just like with your bracket, there are a thousand ways to guess the answers. For example, here are a few arguments – all based on statistics – for why the market's Q1 performance is "real." (Which is to say, sustainable.)

Inflation is much lower than it was last year, and the Fed has specifically said it wants to cut rates this year. By the end of February, the Consumer Price Index was at 3.2%, whereas in February of 2023, it was at 6%.[2]

The economy remains strong. Corporate earnings appear healthy, the most recent unemployment rate was 3.9%[3], and the Fed's latest estimate was a 2.5% increase in GDP during Q1.[4]

The market's performance is actually broadening. It's an open secret that a major portion of the market's gains last year were driven by just a small handful of tech companies. (Most of which are major players in the AI race.) But that portion broadened significantly in Q1. Approximately 23% of the companies in the S&P 500 reached 52-week highs.[5] In other words, more companies are driving the markets rather than just a few. And that's good!

But there are equally compelling arguments for why the market's performance may *not* be sustainable. For example:

Inflation actually ticked up in Q1 and the Fed has said they're in no hurry to cut rates. Consumer prices increased by 0.4% in February after rising 0.3% in January.[6] This was largely due to seasonal factors – prices usually go up in winter, partially because fuel tends to be more expensive – but it means the Fed must be even more cautious about lowering interest rates prematurely. If investors stop expecting rate cuts in the near future, the markets may well pull back.

Stocks may be overvalued. When you divide the size of the U.S. stock market against the size of the economy, you can see how fast the stock market is growing compared to GDP. If the ratio is heavily skewed in favor of the stock market, it suggests stocks are overvalued relative to how much the economy is actually producing. Right now, that ratio is near a two-year high.[5]

The hype around AI may be overblown. Recent technological advances have investors salivating at the possibility that AI will help companies produce more at lower cost…and by doing so, return more value to their shareholders. But this hype has been going on for well over a year now. How much AI has actually contributed in terms of tangible results is an open question. Developing AI technology is extremely expensive, so if investors decide the return is not worth the expense, the hype may die out.

So, like with a March Madness bracket, how do we decide what to predict? Which argument, which data, actually matter?

The answer: All of them…and none of them.

Here at Barrett Capital, we pay attention to all this data (and more), but are beholden to none. We developed our proprietary Global AI platform to analyze vast amounts of data in an effort to be alert to any possible opportunities *and* to be wary of any potential pitfalls. In other words, we use data to help us be prepared for possibilities…not to make predictions.

You see, what really matters is that we *don't actually treat investing like March Madness.*

When you fill out a bracket, you are then locked into whatever choices you made. If you make a wrong choice, you just have to live with it. It's too late to change anything. But *our* strategy is far more flexible. Imagine you filled out a bracket but could then make adjustments in *real time* depending on how different games were trending. Furthermore, imagine you could exit *out* of your bracket altogether, if necessary, and then start participating again at a later date.

That's what we are able to do with the markets. Furthermore, we're able to focus on the metrics that are *proven* to matter: Primarily, the law of supply and demand. As a result, we don't have to make predictions, hope we're right, and then hold on no matter what. We measure how various data – or teams, in March Madness parlance – are moving. When Global AI's analysis of the data points to a risk-on environment, we play offense with your portfolio. When the analysis of the data gives a risk-off signal, we play defense. Experience has convinced us that this approach – being flexible and adaptable – is the surest way to your destination.

As always, though, let us know if you have any questions or concerns. While we're hardly qualified to give bracket advice, we are always here to help you with a different sort of Big Dance: The one that happens at the time and place of your choosing, and in the company of the people with whom you want to share it.

Best Regards,

Russell E. Lundeberg Jr., CPA

Principal & Chief Investment Officer
Barrett Capital Management, LLC

1 Emerging markets stocks, Developed International stocks, U.S. Stocks, and U.S. Bonds represented by Vanguard FTSE Emerging markets ETF, Vanguard FTSE Developed markets ETF, S&P 500 Equal weighted Index, and iShares Core U.S. Aggregate Bond ETF respectively. Source: Bloomberg LP.

2 "12-month percentage change, CPI," *U.S. Bureau of Labor Statistics,* www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.htm

3 "The Employment Situation – February 2024," *U.S. Bureau of Labor Statistics,* www.bls.gov/news.release/pdf/empsit.pdf

4 "GDPNow," *Federal Reserve Bank of Atlanta,* www.atlantafed.org/cqer/research/gdpnow

5 "Warren Buffett's favorite market indicator is flashing red," *CNN Business,* www.cnn.com/2024/03/27/investing/premarket-stocks-trading/index.html

6 "Consumer Price Index – February 2024," *U.S. Bureau of Labor Statistics,* www.bls.gov/news.release/cpi.nr0.htm