Q&A

The Fed Potentially Pauses Rate Hikes as We Move Into 2024

Three questions our Outsourced Chief Investment Office (OCIO) Investment Committee is getting from clients as they face an uncertain rate environment

As OCIOs plot the course for 2024, our OCIO Investment Committee is faced, once again, with an uncertain rate environment. Brian Dana, Director of OCIO Services, and Orray Taft, Risk Manager and former Manager of Treasury Markets for the Federal Reserve Bank of New York, contemplate three questions as they face dynamic markets while working to efficiently position client portfolios.

BRIAN DANA, CAIA
DIRECTOR OF OCIO SERVICES

ORRAY TAFT, CAIA, FRM
CONSULTANT & RISK MANAGER

Given the Federal Reserve's Federal Open Market Committee's current stance on rates, how might investors adjust their strategies to mitigate risk and find investment opportunities?

Orray Taft ("OT"): There are a couple of things at play. The FOMC is signaling three cuts for 2024, versus the nearly seven priced into interest rate futures' markets as of this note, which is a recipe for volatility in both the equity and fixed income markets. From an investment perspective, when we look holistically at implied and realized volatility measures, they have both been decreasing, but it would be a mistake to think volatility won't be present as potential rate cuts get priced in or out as the economic data unfolds. There is also the added volatility of an election year.

Brian Dana ("BD"): Orray, that's an incredible point regarding the volatility of an election year. With respect to portfolio risk management, this is when portfolio diversification is highlighted as a tool within an investor's toolkit to manage downside risk. But it's important to also think about how diversification can add upside as well. For example, the Inflation Reduction Act (IRA), a major fiscal spending Act that will continue for many years, may provide investors with additional opportunities that can be taken advantage of by having allocations to private market strategies.

What opportunities may investors see in private market investments and how might rate changes impact those opportunities?

BD: First and foremost, it's important to think about the consistency needed in deploying capital to private market allocations. Vintage year performance won't always be consistent, but continuous investment can mitigate random poor vintage year performance issues over long periods (e.g., 10 years). When we design private market investment allocations as an OCIO, we're thinking about the pacing of investment and what's needed to maintain overall portfolio allocations.

OT: The point about consistency is an important one. While the FOMC has signaled for rate cuts, which may make borrowing cheaper and therefore make it easier for private market investment managers to lever businesses or make additional capital improvements to companies, those cuts are not guaranteed, and the environment may change.

BD: It's possible we may see an improved environment for transacting in 2024, but we believe it's important for investors to control what they can control. Consistency wins because market timing is incredibly difficult to get right in all asset classes, let alone one that you engage a manager for more than a decade.

How might investors think about optimizing their investment portfolios?

BD: In this environment, it's critical to think about why an asset class or investment strategy is in your portfolio to begin with. What is the intended function of that asset class or investment strategy? Is it still fulfilling that role? Most importantly, and critical to our firm's approach to OCIO relationships, is the understanding that we work directly with our clients to align the assets and investment approaches to meet specific plan objectives. Our bespoke model allows us to collaboratively design what's is needed, and then utilize our deep resources to implement.

OT: For us as an Investment Committee, that's part of the value in having a functional allocation framework over a traditional asset class based framework. Being able to label an investment strategy as a growth strategy and have the clarity as to what role it is intended to play in the portfolio removes the guesswork when attempting to optimize an investment portfolio.

To explore a year one review of the Inflation Reduction Act, learn more about functional allocation frameworks, or to review our primers on private market asset classes such as private equity, venture capital, and infrastructure, please visit the **Thought Leadership** section of our **website** or click the links here to learn more.

Inflation Reduction Act
https://meketa.com/leadership/the-inflation-reduction-act-year-one-review/

Functional Allocation Framework
https://meketa.com/leadership/functional-allocation-framework/

Private Equity
https://meketa.com/leadership/private-equity-primer-2/

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