The Weekly Market Update – 2/13/23: Interest Rates Trend Higher After Three Months of Declines

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,090.46	-1.11%	6.54%	6.54%	-9.41%	4,796.56	17.3%
Dow Jones Industrial Average	33,869.27	-0.17%	2.18%	2.18%	-3.59%	36,799.65	8.7%
NASDAQ Composite	11,718.12	-2.41%	11.96%	11.96%	-17.71%	16,057.44	37.0%
Russell 2000	1,918.81	-3.36%	8.95%	8.95%	-5.41%	2,442.74	27.3%
MSCI EAFE (USD)	2,085.32	-1.59%	7.27%	7.27%	-6.17%	2,398.71	15.0%
MSCI Emerging Markets (USD)	1,013.67	-2.41%	5.99%	5.99%	-16.10%	1,444.93	42.5%
Bloomberg Commodity Index	108.68	1.50%	-3.66%	-3.66%	0.75%	237.95	119.0%
Barclays U.S. Aggregate Bond	90.06	-1.46%	1.32%	1.32%	-11.90%	112.07	24.5%

Source: FactSet

U.S. interest rates have surged higher in February, as bond investors provide more support with recent Federal Reserve Bank (Fed) commentary that rates are likely to remain higher for longer. As of 2/13/23, the U.S. 2-year Treasury yield (a widely tracked measure of short-term interest rates) traded at a yield of 4.54%, up from 4.21% just two weeks earlier on 1/31/23. At the same time, the U.S. 10-year Treasury yield (an indication of long-term interest rates) was trading at a yield of 3.74% from 3.53% on 1/31/23. Since November 2022, U.S. interest rates moved lower as the Fed slowed its pace of interest rate hikes (the Fed uses its overnight bank lending fed funds interest rate target to control short-term interest rates). After raising its fed funds target by 0.75% at four consecutive Federal Open Market Committee (FOMC) meetings in 2022 (June, July, September, and November), the Fed raised just 0.50% at the December 2022 FOMC meeting, and most recently at the February 2023 FOMC meeting the increase was 0.25%. The 2-year Treasury yield peaked at 4.73% on 11/7/22, and since then moved lower despite the Fed rate hikes as investors saw the Fed not only pausing its rates hikes, but ultimately lowering rates back to a neutral level. While the current fed funds target of 4.50% to 4.75% is considered restrictive (slows economic growth), a neutral rate would be a lower level considered neither restrictive nor accommodative (stimulates growth). A major driver of the 2023 year-to-date (YTD) U.S. equity market gains (through 2/10/23, the large-company S&P 500 index was up 6.5%), in our view, has been lower interest rates, which increase the present value of future cash flows. At the same time, Fed Chair Jerome Powell continues to stress that the Fed is likely to keep rates at a restrictive level for a longer time frame than some investors have expected. The recent rise in interest rates, as discussed above, tells us that investors are not only expecting more fed funds rate hikes ahead (perhaps two more 0.25% raises, which would take the fed funds target to 5.00% to 5.25%), but also that the outlook for the Fed to begin lowering rates later in 2023 has diminished. We believe that elevated interest rates will create challenges for equity valuations in 2023, placing more pressure on earnings growth expectations, which have trended lower. As of 2/10/23, the FactSet consensus (from Wall Street Analysts) estimate for 2023 S&P 500 earnings growth is +2.5%, compared to +5.0% on 12/31/22.

Key inflation data is expected this week with the release of the January consumer price index (CPI). The CPI is a key measure of consumer inflation reported monthly by the Bureau of Labor Statistics (BLS). The current FactSet consensus estimate for the January CPI report is for year-over-year (Y/Y) consumer prices up 6.2%. This compares to 6.5% in December 2022, and would reflect the seventh consecutive lower CPI increase since peaking at 9.1% Y/Y in June 2022. While the trend of lower price increases is encouraging, investors will also look at the month-to-month (M/M) price increase, which is estimated to increase 0.5%, significantly above December's 0.1% M/M increase. In addition, the 6.2% January 2023 estimated CPI increase is on top of the January 2022 increase of 7.5%, suggesting that inflation fight is not yet over.

As 4Q22 earnings season begins to wind down, several key economic reports are due this week. With more than 70% of S&P 500 earnings reports completed, 60 index companies (12%) are scheduled to report this week. In addition to the CPI report, we are watching January retail sales (consumer data), industrial production (business activity), and housing starts (housing investment); all will contribute to 1Q23 economic growth expectations.

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