The Weekly Market Update – 3/27/23: Fed Hikes Rates Again, Future Path Uncertain

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	3,970.99	1.39%	3.42%	3.42%	-9.21%	4,796.56	20.8%
Dow Jones Industrial Average	32,237.53	1.18%	-2.74%	-2.74%	-4.88%	36,799.65	14.2%
NASDAQ Composite	11,823.96	1.66%	12.97%	12.97%	-14.02%	16,057.44	35.8%
Russell 2000	1,734.92	0.52%	-1.49%	-1.49%	-15.29%	2,442.74	40.8%
MSCI EAFE (USD)	2,017.13	1.53%	3.77%	3.77%	-7.43%	2,398.71	18.9%
MSCI Emerging Markets (USD)	972.17	2.17%	1.65%	1.65%	-17.00%	1,444.93	48.6%
Bloomberg Commodity Index	103.02	0.42%	-8.67%	-8.67%	-10.06%	237.95	131.0%
Barclays U.S. Aggregate Bond	91.55	0.52%	3.00%	3.00%	-9.23%	112.07	22.4%

Source: FactSet

The U.S. Federal Reserve Bank (Fed) raised interest rates at its ninth consecutive Open Market Committee (FOMC) meeting, but the hiking cycle is likely near its end. The Fed raised its overnight bank lending fed funds interest rate target by 0.25% to a range of 4.75% to 5.00% at its latest FOMC meeting that ended on 3/22/23. At its post-meeting statement and press conference, the Fed acknowledged that the March bank liquidity crisis will likely cause tighter credit conditions that could "weigh on economic activity, hiring, and inflation." But the Fed decided to raise rates yet again, explaining that job gains are "robust," and that inflation "remains elevated." In addition, the Fed allowed for possible additional rate hikes at future FOMC meetings, writing that "some additional policy firming may be appropriate," in an effort to fight inflation pressures. The Fed also updated its Summary of Economic Projections (SEP) for the first time since December 2022. While the SEP is not an official Fed forecast, it represents estimates from Fed Board members and Federal Reserve Bank presidents as to the path of the U.S. economy, employment, inflation, and interest rates. The March median SEP estimate for 2023 U.S. economic growth was 0.4%, a modest down tick from 0.5% in December, but the median estimate for the 2023 year-end unemployment rate (as measured by the Bureau of Labor Statistics, BLS) was 4.5% vs. 4.6% in December. Based upon data from February, the BLS reported an unemployment rate of 3.6%. A rise to 4.5% by year-end suggests 1.5 million lost jobs over the next 10 months (150 thousand per month). Given the Fed's outlook for potential labor market weakness, along with the emerging uncertainty about more conservative bank lending activity, we believe overall monetary conditions are increasingly restrictive. After raising its fed funds target from 0% in March 2022, the Fed has now raised the target range at nine consecutive FOMC meetings, representing the largest sustained period of interest rate hikes since 1979-1980. The latest SEP estimated a year-end 2023 fed funds rate of 5.1% (unchanged from December), suggesting the Fed expects one more 0.25% hike (to a range of 5.00% to 5.25%). This also suggests that after that hike, the Fed does not expect to lower rates by the end of the year. This tells us that the Fed remains concerned about elevated inflation trends, despite expected jobs pressure, and will tolerate economic weakness in its inflation fight.

U.S. Treasury interest rates reflect a disconnect between the Fed's outlook compared to that of bond investors. As of 3/27/23, the U.S. 2-year Treasury yield (a proxy for short-term rates) was trading at 4.00%, down from 5.08% on 3/8/23 (just prior to the March regional bank crisis). In addition, the CME Fedwatch Tool, which uses the fed funds futures market to assess market probabilities of future fed funds levels, as of 3/27/23, reflects an 83% chance that the low end of the Fed's target by year-end 2023 will be 4.25% or lower. This suggests that bond traders believe that the Fed will meaningfully cut interest rates later this year. In our view, this would be caused by a rapid economic slowdown and probable recession.

As the first quarter of 2023 comes to a close this week, U.S. equity indices will attempt to hold quarterly gains. Through 3/24/23, the widely followed large-company U.S. S&P 500 equity index had increased 3.4% year-to-date (not including dividends), although flat (0%) in March. If gains hold through Friday, the S&P 500 will have rallied for two consecutive quarters, following three quarters of declines. As of 3/24/23, the index was 11.0% above the 10/12/22 closing low (the lowest closing price of the current cycle), and remained 17.2% below the all-time high set on 1/3/22.

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