The Weekly Market Update – 6/20/23: Fed Pause Comes With a Caveat

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,409.59	2.58%	7.31%	14.85%	6.71%	4,796.56	8.8%
Dow Jones Industrial Average	34,299.12	1.25%	3.08%	3.48%	3.97%	36,799.65	7.3%
NASDAQ Composite	13,689.57	3.25%	12.01%	30.79%	13.31%	16,057.44	17.3%
Russell 2000	1,875.47	0.52%	4.05%	6.49%	0.61%	2,442.74	30.2%
MSCI EAFE (USD)	2,170.84	2.86%	3.74%	11.67%	6.52%	2,398.71	10.5%
MSCI Emerging Markets (USD)	1,030.03	2.76%	4.01%	7.70%	-4.42%	1,444.93	40.3%
Bloomberg Commodity Index	105.14	4.14%	-0.35%	-6.79%	-19.95%	237.95	126.3%
Barclays U.S. Aggregate Bond	89.95	0.19%	-1.24%	1.21%	-4.59%	112.07	24.6%

Source: FactSet

For the first time since January 2022, the Fed's Open Market Committee (FOMC) left its fed funds (overnight bank lending) interest rate target range unchanged at 5.00% to 5.25%. This was largely expected as consumer inflation (as measured by the consumer price index, CPI, from the Bureau of Labor Statistics, BLS) reflected a lower year-over-year (Y/Y) increase for 11 consecutive months. Since peaking at 9.1% in June 2022, the Y/Y CPI increase decelerated each month, and most recently was measured at 4.0% in May 2023. As the Fed's dual mandate is to foster stable prices and maximum employment, the fear is that recent inflation improvement could reverse. After raising the fed funds rate at 10 consecutive meetings, the new pause (no hike) gives the FOMC time to "assess additional information," which could lead to a resumption of fed funds increases at future meetings. The Fed's Summary of Economic Projections (SEP), which comprises the range of economic and policy estimates from 18 Fed Board members and bank presidents, reflected a median year-end fed funds estimate of 5.6%. This suggests that most at the Fed predict an additional 50 basis points of interest rate hikes this year. We believe this is due to stubbornly high core CPI (excludes food and energy), which was still 5.3% in May (vs headline CPI's 4.0%) and has decelerated much more modestly. Inflation pressures remain for rents, wages, and many travel-related service sectors. But at the same time, since rate hikes often take months to restrict some consumer spending, there could still be a lag from prior rate hikes. No SEP voter estimated the fed funds rate below 5.0% at year end. If interest rates remain "higher for longer", investors may need to adjust expectations that assume lower rates ahead. We expect volatility, especially if recent trends of moderating economic growth continue.

Retail sales increased more than expected in May, but consumption growth is moderating. The Census Bureau's monthly retail sales report reflected sales at retailers (includes restaurants) that increased 0.3% in May vs. April (month-to-month, M/M) and grew 1.6% vs. May 2022 (year-over-year, Y/Y). The three-month Y/Y increase was 1.7%. Overall sales were hurt by lower gasoline prices, but in general, overall retail sales have not kept pace with inflation, and unit sales are likely lower. One notable exception was restaurants and bars, which increased 7.7% in May Y/Y and 9.6% over the prior three months. To us, this indicates that spending on services continues to be far more robust than spending on goods.

Amid a mid-2022 equity market rally, Fed leader Jerome Powell will make scheduled Congressional testimony on Wednesday and Thursday. The widely followed S&P 500 equity index remains near a more than 12-month high and has posted a gain for each of the past six weeks. Investors remain optimistic that economic activity will stay positive and support earnings gains ahead. Chair Powell will likely be asked about economic growth expectations if the Fed keeps interest rate targets higher for longer.

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