The Weekly Market Update – 9/18/23: Federal Reserve Meeting Expectation and Another Budge Battle

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,450.32	-0.16%	0.00%	15.91%	12.52%	4,796.56	7.8%
Dow Jones Industrial Average	34,618.24	0.12%	0.61%	4.44%	9.86%	36,799.65	6.3%
NASDAQ Composite	13,708.34	-0.39%	-0.58%	30.97%	16.01%	16,057.44	17.1%
Russell 2000	1,847.03	-0.24%	-2.21%	4.87%	0.16%	2,442.74	32.3%
MSCI EAFE (USD)	2,108.22	1.65%	-1.10%	8.45%	14.55%	2,398.71	13.8%
MSCI Emerging Markets (USD)	984.99	1.14%	-0.45%	2.99%	-0.92%	1,444.93	46.7%
Bloomberg Commodity Index	107.47	1.31%	5.90%	-4.73%	-11.65%	237.95	121.4%
Barclays U.S. Aggregate Bond	87.68	-0.33%	-2.35%	-1.35%	-4.59%	112.07	27.8%

Source: FactSet

The U.S. Federal Reserve Bank (Fed) meets to discuss interest rates and monetary policy; we will focus on its Summary of Economic Projections (SEP). The Fed's Open Market Committee (FOMC) meeting on 9/20/23 is the sixth of eight scheduled events in 2023. After a break in August, this will be the first FOMC meeting since 7/26/23. At that July meeting, the Fed raised its overnight bank lending interest rate target range by 0.25% to 5.25% to 5.50%, reflecting a rate hike after a June meeting pause (no hike). Investors expect another pause this week, according to the CME Group FedWatch Tool which calculates interest rate target probabilities using the fed funds futures market. As of 9/15/23, it shows a 99% chance of no rate hike this week, which we believe reflects investor expectations that the Fed is at or near the end of its restrictive (higher) interest rate policy and might be ready to begin lowering its fed funds target in 2024. While a pause in rates is considered uneventful, the FOMC will publish its SEP, also known as the "dot-plot," which is updated quarterly (every other meeting). We look for markets to react to changes in the estimates. The SEP reflects economic projections from Fed board members and presidents (usually 18-19 submissions) and gives a range of individual estimates for U.S. economic growth, employment trends, and inflation. While not an official Fed forecast, the SEP provides an inside look at estimates from senior officials. We expect changes to those estimates since June, especially with regard to economic growth and fed funds levels. In June, the median SEP estimate for 2023 and 2024 economic growth (as measured by inflation-adjusted gross domestic product) was 1.0% and 1.1%, respectively. With the U.S. economy continuing to reflect strong consumer activity through August, we believe that the estimates for 2023 will be revised higher. Perhaps more important will be the estimates for the mid-point of the year-end fed funds target. In June, the SEP showed a median estimate for 2023 of 5.6%, which would reflect one more 0.25% interest rate hike this year. If the fed funds target remains 5.6%, it will maintain uncertainty on the timing of the next hike, and also would reflect a Fed view that inflation concern lingers. Perhaps more important will be the fed funds level at year-end 2024; the estimate in June was 4.6%, which reflects 0.75% of fed funds target cuts from current levels. This goes against recent commentary from Fed Chair Jerome Powell, which suggested that interest rates must remain "higher for longer." We continue to see elevated interest rates as a headwind for equity valuations.

Another month, another budget deadline. As the federal fiscal year ends on 9/30/23, Congress must pass a series of spending bills to fund the government and avoid a partial shutdown. Not unlike the debt ceiling debate earlier this year, a divided Congress (Democrat majority in the Senate, Republican control of the House) creates tense negotiations for all things budget related. While Republicans appear committed to driving spending cuts after a year that is expected to reflect a $1.5 trillion deficit (according to the Congressional Budget Office), the most likely outcome, in our view, is a continuing resolution that pushes the budget deadline out a month or two. We believe this adds to the risk of equity market volatility.

As we wait to digest the Fed's policy update on Wednesday, the economic data calendar continues. Last week's positive August retail sales (from the U.S. Census Bureau) report revealed still-solid consumer spending, although moderating from July. The Atlanta Fed GDPNow estimate for 3Q23 GDP growth (reflects only reported, not estimated data) showed GDP tracking at 4.9% in the quarter, well above prevailing estimates. This week's economic data calendar is mostly focused on housing, including construction starts and permits.

James D. Ragan, CFA
Director of WM Research
(206) 389-4070
jragan@dadco.com

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