The Weekly Market Update – 12/12/22: Expect a 0.50% Interest Rate Hike at 2022's Final Fed Meeting

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	3,934.38	-3.37%	9.73%	-17.45%	-13.85%	4,796.56	21.9%
Dow Jones Industrial Average	33,476.46	-2.77%	16.54%	-7.88%	-2.92%	36,799.65	9.9%
NASDAQ Composite	11,004.62	-3.99%	4.06%	-29.66%	-29.17%	16,057.44	45.9%
Russell 2000	1,796.66	-5.08%	7.93%	-19.98%	-18.29%	2,442.74	36.0%
MSCI EAFE (USD)	1,978.88	-0.22%	19.10%	-15.29%	-11.01%	2,398.71	21.2%
MSCI Emerging Markets (USD)	978.28	0.46%	11.70%	-20.59%	-19.31%	1,444.93	47.7%
Bloomberg Commodity Index	111.73	-2.39%	0.22%	12.67%	16.63%	237.95	113.0%
Barclays U.S. Aggregate Bond	90.15	-0.49%	2.78%	-13.92%	-14.34%	112.07	24.3%

Source: FactSet

We expect the U.S. Federal Reserve Bank (Fed) to raise short-term interest rates by 0.50% when it concludes its two-day meeting on 12/14/22. It has been an active year for the Fed's Open Market Committee (FOMC), as it meets on average every seven weeks (eight meetings per year) to discuss and set monetary policy in accordance with its dual mandate to support maximum employment and stable prices. With consumer inflation running well above the Fed's 2.0% target over time, the FOMC has used increases in its overnight bank lending fed funds interest rate target as its primary tool to slow economic activity and reduce pricing pressures that contribute to inflation. One measure of consumer inflation, the consumer price index (reported monthly by the Bureau of Labor Statistics, or BLS), peaked at a 9.1% year-over-year (Y/Y) increase in June 2022, but the most recent Y/Y reading of 7.7% in October reflected a still-elevated pricing environment. An alternative consumer inflation measure, the Fed's personal consumption expenditure (PCE) price index, peaked at 7.0% in June and was 6.0% in October. The Fed sets a range for its fed funds target, which was 0% to 0.25% as recently as January 2022. Following an increase to the target at each of the last six FOMC meetings (including interest rate hikes of 0.75% at four successive meetings), the current target range is 3.75% to 4.00%. At the 9/21/22 FOMC meeting, the Fed updated its Summary of Economic Projections (SEP), which shows the median estimate of a range of economic and monetary indicators from all meeting participants. The September SEP showed a 2022 year-end estimated fed funds target of 4.4%, and 4.6% at the end of 2023. If the December rate hike is 0.50%, the fed funds range will be 4.25% to 4.50%, which is in line with the September projection. We believe that the 2023 median estimate will be higher when the SEP is updated at this week's meeting. Fed commentary (speeches and interviews) over the past six weeks have explored the view that while the pace of rate increases is likely to moderate (i.e. a 0.50% hike rather than 0.75%), further hikes are needed to stop inflation (even at the expense of a possible recession) and a higher fed funds target range could remain in place throughout 2023. We would not be surprised to see the updated SEP reflect a 2023 estimated fed funds rate close to 5.00%.

U.S. equity markets initially declined following the November Fed rate hike, as Chairman Jerome Powell indicated that short-term interest rates were likely to remain higher for longer. However, stocks have since rallied as investors see the potential for an economic soft landing despite a significant rise in interest rates in 2022. The widely-followed, large-company S&P 500 equity index has gained 5.8% on a price basis since 11/3/22 (after the post Fed meeting initial decline) and is up 9.7% in the fourth quarter (4Q22) through 12/9/22 (although still down 17.5% year-to-date). While U.S. gross domestic product, or GDP (value of goods and services produced, from the Bureau of Economic Analysis), was negative in 1Q22 and 2Q22, GDP rebounded to a 2.9% increase in 3Q22. According to the FactSet consensus estimate (from Wall Street economists), 4Q22 GDP is estimated to increase 1.0%, but uncertainty is building for early 2023.

As investors await updated Fed policy from the FOMC meeting on Wednesday, 12/14/22, the BLS will report December CPI data on Tuesday. According to the FactSet consensus, investors estimate headline Y/Y CPI of 7.3% (vs. 7.7% in November) and core CPI (excluding food and energy) of 6.1% (vs. November's 6.3%). On a month-to-month basis, both numbers are expected to increase 0.3%, reflecting an ongoing trend of moderately lower inflation data (viewed positively) but still high Y/Y inflation readings (viewed negatively).

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

Important Disclosure: The information contained herein has been obtained by sources we consider reliable, but is not guaranteed and we are not soliciting any action based upon it. Any opinions expressed are based on our interpretation of data available to us at the time of the original publication of the report. Assumptions, opinions, and estimates constitute our judgment as of the date of this report and are subject to change without notice. Investors must bear in mind that inherent in investments are the risks of fluctuating prices and the uncertainties of dividends, rates of return and yield, as well as broader market and macroeconomic fluctuations and unforeseen changes in the fundamentals or business trends affecting the securities referred to in this report. Investors should also remember that past performance is not indicative of future performance and D.A. Davidson & Co. makes no guarantee, express or implied, as to future performance. The information is not intended to be used as the primary basis of investment decisions. Because of individual client requirements, it should not be construed as advice designed to meet the particular investment needs of any investor. It is not a representation by us, or an offer, or the solicitation of an offer, to sell or buy any security. Further, a security described in a report may not be eligible for solicitation in the states in which a client resides. D.A. Davidson & Co. does not provide tax advice and investors should consult with their tax professional before investing. Further information and elaboration is available upon request.

Market Indices: The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Indices provide a general source of information on how various market segments and types of investments have performed in the past. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. You may not invest directly in an index. Past performance is not an indicator of future results. The Russell 2000® Index is a market cap weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The S&P 400 Index is a market cap weighted index comprised of U.S. stocks in the middle capitalization range, generally considered to be between $200 million and $5 billion in market value. The S&P 500 Index is a market cap weighted index that is designed to measure the US large-cap equity performance. The index is composed of the 500 leading publically traded US companies based on size, liquidity, industry, and profitability criteria. The Dow Jones Industrial Average is a price weighted index that tracks 30 large, publicly-owned companies trading on the New York Stock Exchange (NYSE) and the NASDAQ. The MSCI EAFE® Index (Europe, Austral, Asia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.