July 2023

Making Sense

WHAT'S NEXT?

Watch July's full market & economic update.

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Is the Fed Hiking Cycle Winding Down?

In this month's market update, we discussed the Fed's monetary policy, the resilience of the housing market, and the expansionary nature of the market.

Federal Reserve Hikes to Highest Federal Funds Rate in 22 Years

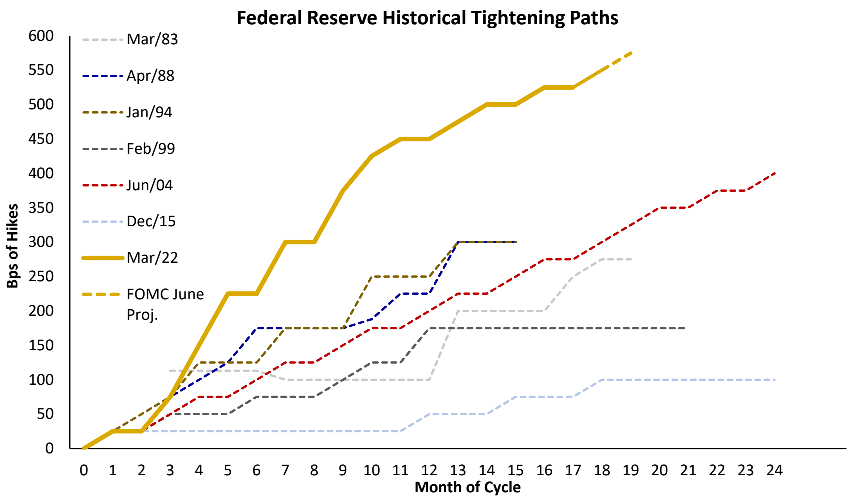
Last month, the Federal Reserve paused rate hikes giving members an opportunity to assess the lagged impact of tighter monetary policy. At the end of July's meeting, the Federal Open Market Committee (FOMC) announced it would resume increasing the federal funds rate—this time by 0.25% bringing the range to 5.25%-5.50%, the highest level in 22 years. June's consumer price index showed headline inflation at 3.0%—nearing the Fed's 2% target. But core inflation (which excludes food and energy) was 4.8% in June—above headline inflation for the fourth consecutive month, thus causing concern among monetary policy decision makers that underlying inflation persists. The FOMC and Chairman Powell left the door open to further hikes if necessary.

Policy Makers Walk a Tight Rope

The Fed's dual mandate is price stability and maximum employment. The Fed has undertaken a sharp tightening of monetary policy over a relatively short time. In fact, the current rate hiking cycle represents the most drastic monetary policy tightening since the early-1980s (Figure 1). The risk of the Fed overshooting and the economy slipping into a recession is a possibility, as the lagged impact of the Fed's tighter policy continues to feed into the system. At the same time, **the economy has remained resilient in the face of higher interest rates to this point, and the chance of a soft landing certainly exists.**

Bottom line: Tighter monetary policy takes time to feed into the economy. We are still absorbing the impact of past hikes, but inflation is clearly moving in the right direction. The US economy remains in expansion, but tighter monetary policy has slowed economic growth and could continue to do so. Before their next rate decision on September 20th, the Federal Reserve will receive several economic data releases that will provide significant guidance for their decision.

Figure 1[i]



Our Bottom Line for Markets

Although markets have outperformed the first part of this year, we believe the road to 2024 will see increased volatility in equity markets. We continue to believe finding the balance between stocks and bonds will matter in 2023 and beyond. Further, we believe diversification within a balanced portfolio will matter in 2023 and beyond. For more information, watch our latest update.

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[i] Goldman Sachs, Strategas Research, Bloomberg