April 11, 2021

Weekly Viewpoint

Hawkish Fed Weighs on Market

Performance for Week Ending 4.8.2022

The Dow Jones Industrial Average (Dow) finished down 0.28%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) fell 1.92%, the Standard & Poor's 500 Index (S&P 500) slumped 1.27% and the Nasdaq Composite Index (NASDAQ) closed off 3.86%. Sector breadth was mixed with 5 of the S&P sector groups higher and 6 closing lower. The Health Care sector (+4.44%) led on the upside followed by Energy (+3.21%) and Consumer Staples (+2.73%). On the downside, the Technology sector (-4.03%) was the worst performer.

Index*	Closing Price 4/8/2022	Percentage Change for Week Ending 4/8/2022	Year-to-Date Percentage Change Through 4/8/2022
Dow	34721.12	-0.28%	-4.45%
Wilshire 5000	44927.34	-1.92%	-7.29%
S&P 500	4488.28	-1.27%	-5.83%
Nasdaq	13711.00	-3.86%	-12.36%

Market Observations: 4/4/22 – 4/8/22

The major market indices finished the week moderately lower after several Fed officials called for more aggressive tightening of rates to fight inflation while the central bank's minutes from its March meeting indicated general agreement to shrink its massive balance sheet by $95 billion per month. The minutes also showed Fed officials were considering larger-than-usual rate hikes of 50 basis points after a 25 basis point hike last month, the first increase in more than three years. According to Bloomberg's World Interest Rate Probability tool, the chance of a half percent increase at the May meeting has risen to 85%. Oil prices declined for a second straight week, with West Texas Intermediate (WTI) crude finishing below $100 per barrel. For the week, WTI fell by more than 1% adding on to last week's roughly 13% decline as the U.S. announced its largest-ever release from its Strategic Petroleum Reserve and International Energy Agency member nations joined the effort to combat soaring oil and gasoline prices.

Hawkish Fed Speak: Last week, Fed Governor Lael Brainard indicated the central bank may act quicker than expected to trim its balance sheet and slow rising inflation. “Currently, inflation is much too high and is subject to upside risks,” she said at a Minneapolis Fed discussion. “The FOMC is prepared to take stronger action if indicators of inflation and inflation expectations indicate that such action is warranted.” The statement from Brainard seemed to catch the market off guard as Brainard has traditionally been viewed as one of the more dovish members of the Fed. Meanwhile, St. Louis Fed President James Bullard said he favors raising interest rates sharply to counter the highest inflation in four decades, and suggested he backs a half-point hike in May along with shrinking the Fed’s bloated balance sheet. “I would like the committee to get to 3-3.25% on the policy rate in the second half of this year,” Bullard told reporters Thursday after a speech at the University of Missouri.

March FOMC Minutes: The minutes from the March 15-16 policy meeting showed Fed officials strongly considered raising rates by a half-percentage point and neared agreement on a plan to reduce their bond holdings as part of their most aggressive effort in years to curb price pressures. Officials last month approved their first interest rate increase in more than three years, raising their benchmark rate by a quarter percentage point to a range between 0.25% and 0.5%. They also penciled in a series of additional rate increases this year to take rates closer to 2%, amid inflation that has surged to a four-decade high. The minutes revealed that many officials would have preferred a larger half-point rate increase at that meeting but judged a smaller quarter-point increase would be appropriate "in light of greater near-term uncertainty associated with Russia's invasion of Ukraine." The minutes outlined a plan by the Fed to shrink its nearly $9 trillion balance sheet by more than $1 trillion a year, which would also contribute to tighter financial conditions.

Tale of Two Halves? While the near-term outlook for the markets will remain clouded by the situation in Ukraine, elevated levels of inflation and a hawkish Federal Reserve, we think as we move forward fundamentals will ultimately outweigh fears. The US economy remains in good shape and the probability of a recession in the coming quarters remains low. Consumer balance sheets are strong and savings rates are still elevated by over $2 Trillion. Money market mutual have over $4.6 trillion in cash and corporate buyback activity has been very strong. Covid cases have plunged and many areas around the country are dropping Covid related mandates. Supply chain issues are starting to ease. Importantly, the earnings environment remains solid with high single digit growth expect this year and next. If there has been a silver lining to the recent market weakness, it’s been that valuation levels have moved lower with the S&P selling for just over 18x the 2023 estimate and 16.6x the 2024 estimates. While the market is not cheap by historical standards, equities still remain attractive on a relative basis.

The Week Ahead: Last week’s hawkish comments from Fed speakers and the release of March’s FOMC meeting minutes sent yields sharply higher around the world. In the holiday shortened week ahead, those forces will remain front and center as we get the March Consumer Price Index (CPI) and Producer Price Index (PPI) reports, which will be the last ones ahead of May’s Fed meeting. According to Bloomberg data, the headline CPI is expected to rise by 8.4% from 7.9% during February. Other economic reports of interest include; Retail Sales during March, the University of Michigan sentiment reading for April, the April Empire Manufacturing Index, and March Industrial Production. It will be a relatively quiet week on the earnings front with just 15 members of the S&P 500 scheduled to release results. Earnings will begin to pick up during the following week with 67 S&P companies scheduled to report. The Fed speaking calendar will be busy with 7 different members of the Fed scheduled to make appearances. On Friday US stock and bond markets will be closed in observance of the Good Friday holiday.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

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