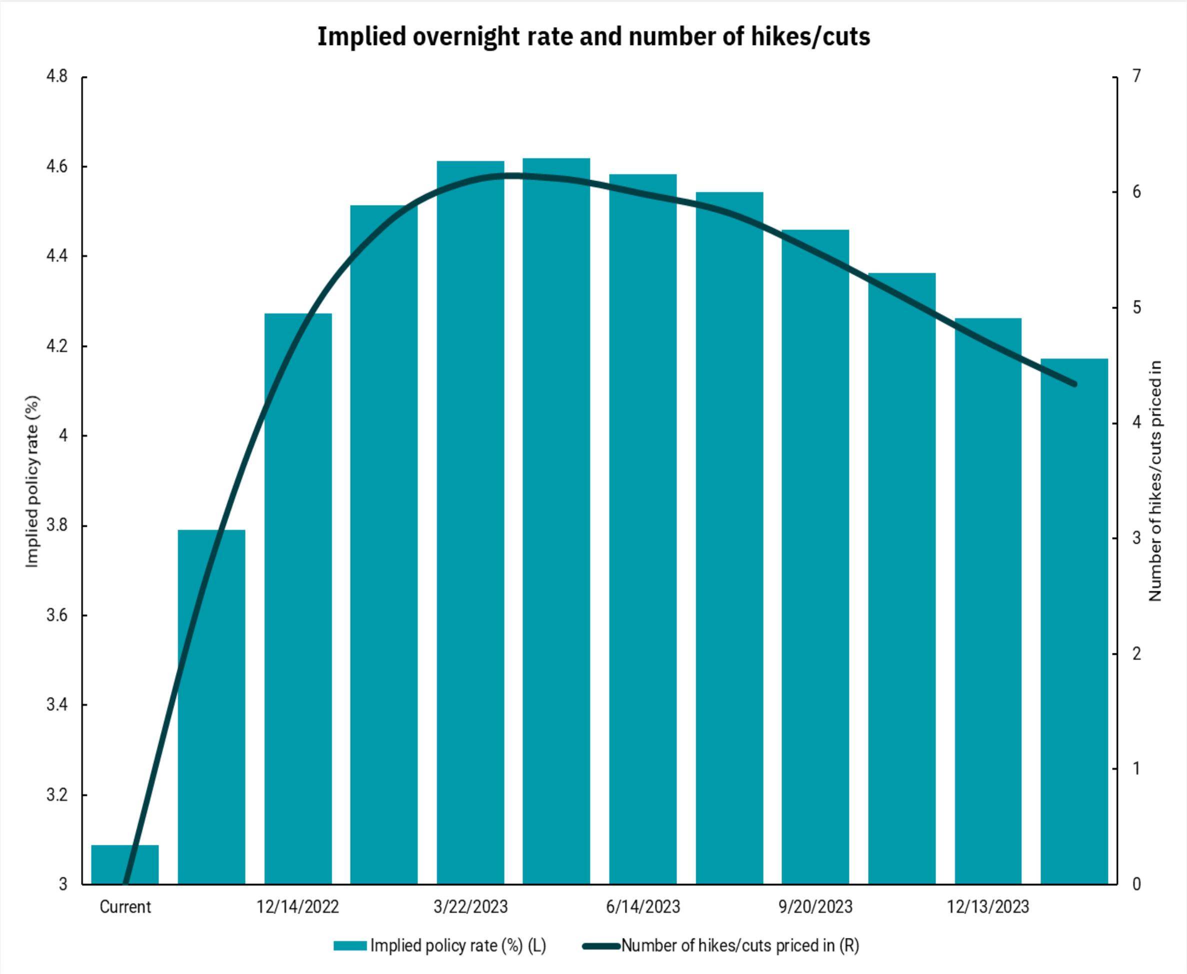
INVESTMENT MANAGEMENT

Weekly market update

Chart of the week (Sept. 23, 2022)



The rate-setting arm of the Federal Reserve, the Federal Open Market Committee, or FOMC, met last week to discuss their outlook for the economy and inflation.

It was no surprise when the announcement came on Wednesday afternoon of a unanimous vote to increase the target on overnight fed funds by 0.75% resulting in a new range of 3.0-3.25%. This marked the third meeting in a row of an increase of 0.75% as the Fed considers how they need to get ahead of current inflation rates to reduce price pressures going forward.

However, the capital markets reacted negatively. Interest rates rose across the yield curve, and stock markets swooned after the FOMC raised expectations of how rates may go in their two remaining meetings this year and into early 2023. The Fed now anticipates rates at 4.4% by year-end, implying another 1.25% of increases over the next two meetings. In 2023 a further hike to 4.6% is expected before the Fed pauses. In addition, the FOMC’s outlook is for rates to stay steady throughout 2023 before slowly falling in 2024.

Some view this extended outlook coupled with a forecast for unemployment to reach 4.4% as an admission by the Fed for at least a shallow recession before their program of higher rates and quantitative tightening is complete. This is the clearest evidence given so far that the Fed will not step in to ease policy even as the economy weakens.

Stocks took this to mean earnings estimates will need to fall further and reduced the outlook for the multiple on these now lower earnings going forward. This process is not pleasant but is necessary to assure stable prices and better growth prospects in the longer term.

Sources: Bloomberg

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BOK FINANCIAL

Commentary (Sept. 23, 2022)

Domestic Equities

- U.S. stocks sold off again this week. The S&P 500 Index is now down more than 10% from mid-August highs and is close to in line with the mid-June low, down over 20% year-to-date.
- On Wednesday, the Fed announced a 0.75% increase to the Fed Funds rate as expected, but investors found the central bank's economic outlook sobering. Officials predict the Fed Funds rate will reach 4.6% in one year, up from June's 3.8% estimate. They also expect a 1% increase in the unemployment rate; a scenario investors hoped to avoid in a "soft landing".
- PMI numbers out Friday showed economic growth outside the U.S. has been thrown off course by inflation, energy crisis, and war. U.S. PMI was strong, but 40% of S&P 500 revenues come from outside the U.S, and U.S. equities sold off sharply on the news.

Bonds

- It was a busy week for major central banks, with the Federal Reserve, Riksbank, Norges Bank, Bank of England and Swiss National Bank all hiking policy rates. As for the Federal Reserve (Fed), the FOMC raised the Target Fed Funds Rate by 0.75% to 3.0%-3.25%, which was in line with market expectations. The Fed also released its updated market expectations (dot plot), which shows the median Fed Funds Rate reaching 4.4% by year-end and a terminal target rate of 4.625% in 2023.
- U.S. Treasury yields were higher for the week as investors priced higher policy rates by global central banks. The belly of the curve experienced large jumps in yields, causing the yield curve to invert further.
- On Thursday, the Bank of Japan attempted to stabilize its foundering currency by selling down its FX reserves. This caused the U.S. dollar to weaken against the Yen, and longer-term U.S Treasury yields to rise.

International Equities

- Global investors faced a sharp rise in volatility after several of the world's largest central banks raised interest rates to combat the effects of a soaring dollar and rising inflation. Stock markets fell as fears grow that the hawkish policy decisions will drive economies into a recession.
- Foreign developed markets tumbled as European markets absorbed most of the losses. Japanese stocks faced some headwinds after the country intervened in the foreign-exchange market for the first time since 1998 to strengthen its currency.
- Emerging markets struggled for the fourth consecutive week with broad weakness seen across markets in Eastern Europe and Asia. Sentiment toward the Chinese market continues to erode over the country's sluggish economy, stresses in the property sector and the longer-term impact of its zero-COVID policy.

Economics

- Building permits for residential construction fell 10% in August to 1.52m as a seasonally adjusted annual rate and is 14% below the August 2021 level of 1.77m. Housing starts increased 12% to 1.58m and completions declined 5.4% to 1.34m in August.
- Initial claims for unemployment rose to 213k (+5k) for the week ending September 17, ending five consecutive weekly declines. Continuing claims were 1.4m (-22k) for the week ending September 10.
- The Atlanta Fed's GDPNow model indicated real GDP growth for the 3rd quarter is 0.3%, with two more updates remaining for the quarter.
- On Tuesday, the Conference Board releases its consumer confidence survey. On Thursday, the final estimate for 2nd quarter GDP and corporate profits is released. Personal income and the University of Michigan Consumer Sentiment Index will be released on Friday.

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*This chart is for illustrative purposes only and not indicative of any actual investment.
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