ICON Insights

Market Commentary - April 2024

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The Fed

The Federal Reserve (Fed) and its monetary policy is one of primary the topics of speculation on Wall Street, to the point many investors are basing their investment decisions on guessing what the Fed will do. To help understand this activity, we will devote this issue of the ICON Insights to the Fed.

Year-over-year (Y-O-Y) inflation, as measured by the Consumer Price Index (CPI), hit a high of 9.1% in June of 2022. When the Fed began tightening monetary policy, by raising its Federal Funds target rate in March of that year, it stated that it wanted to get inflation down to an annual pace of 2.0%. At the time we at ICON believed that goal was possible. Given our country’s allocation of resources (land, labor and capital), productivity gains, and our demographics, we believe 2.0% inflation along with lower than historic average unemployment was realistic. Two years after tighter monetary policy was implemented, the trailing 12-month CPI through February 2024 was 3.2%, obviously not yet down to the Fed’s goal.

While the Fed stated a 2.0% goal for inflation, it never stated a pace or time horizon, therefore, causing investors to guess. Could it get from 9.1% to 2.0% in one year? Two years? Four or five years? Nobody knew the Fed’s goal with regard to timing. It’s now been two years, and CPI is still only down to 3.2%. A survey of economists reported on Bloomberg has them calling for Y-O-Y CPI of 2.4% in 2025 and 2.3% in 2026. Another measure of inflation used by the Fed, Personal Consumption Expenditures, is forecasted to be 2.0% in 2026. If those economists are correct (and they have been relatively accurate over the last two years), it suggests the Fed had about a four-year objective to reach the 2.0% inflation goal. Given inflation was 4.7% in 2021 and 8.0% in 2022, it will be roughly a six year stretch where inflation was above the Fed’s goal of 2.0%. That seems excessive to ICON, especially when the Fed had the tools to curb inflation faster. Last summer (2023) the Fed paused two months and didn’t raise the Federal Funds target rate; June and August. We believe it should have raised the rate at least one of the months, if not both.

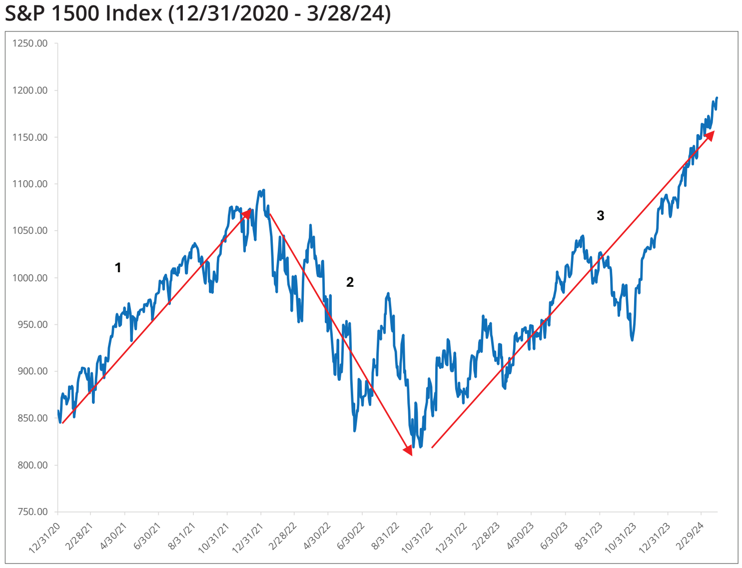
The Fed has the dual mandate of price stability and full employment. The slow pace of inflation reduction taken by the Fed suggests to us it is mindful of the full employment mandate more than we expected. In other words, if the Fed had been more aggressive fighting inflation, the unemployment rate would potentially be higher than the 3.9% rate posted in February of this year. Apparently, the Fed chose not to go that route.

As for the stock and bond markets, last fall investors were expecting up to seven reductions in the Federal Funds rate in 2024. ICON was not in that camp. We wrote to investors at the time, we thought the stock market could move higher, but not based on the expectation of seven rate reductions. We wrote that “value alone justified cautiously participating” in the market. Now, the popular view is for three rate cuts in the second half of 2024. Again, we are not in that camp, but believe the market can inch higher based on value.

We’ve seen a theme change in the stock market over approximately the last two months. Information Technology and Telecommunication Services have lagged recently, while Energy, Materials, Utilities, Industrials and Financials have led. This rotation and broadening may help the market continue moving higher.

The graph, at right, shows the S&P 1500 Index from 12/31/2020 through 3/28/2024, and the arrows highlight three phases. Phase 1, in 2021, was the recovery from the pandemic-driven crash of March 2020. In phase 2, investors feared the Fed would be very aggressive in fighting inflation and have a one-to-two-year horizon for hitting the 2.0% goal. Such aggressive monetary policy would have increased unemployment and slowed the economy. In phase three, investors have realized the Fed is taking a slower approach to reducing inflation to its 2.0% target. Apparently, investors like that slower approach with less of a negative impact on employment and the economy. We are trying to participate in the bull market but are still proceeding with caution.

S&P 1500 Index (12/31/2020 - 3/28/24)



The data quoted represents past performance, which is no guarantee of future results.
Source: Bloomberg

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The unmanaged Standard & Poor's Composite 1500 (S&P 1500) Index is a broad-based capitalization-weighted index comprising 1,500 stocks of Large-cap, Mid-cap, and Small-cap U.S. companies.

The 10-year yield is the benchmark 10-year yield to maturity reflected by the current issue 10 year U.S. Treasury note.

The Consumer Price Index (CPI) is a measure of the average change in prices over time of goods and services purchased by households. The CPIs are based on prices of food, clothing, shelter, fuels, transportation fares, charges for doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living.

Personal Consumption Expenditures (PCE) includes a measure of consumer spending on goods and services among households in the U.S. The PCE is used as a mechanism to gauge how much earned income of households is being spent on current consumption for various goods and services.

Sources: Bloomberg

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