Situation analysis

March 20, 2024

Fed keeps interest rates steady but signals cuts later this year

Key takeaways

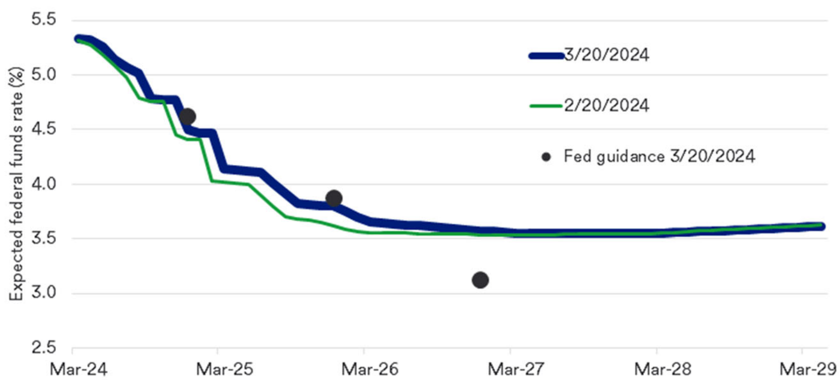
- The U.S. Federal Reserve held interest rates steady in a range of 5.25% to 5.50% today, maintaining elevated rates to bring inflation down.
- The Fed maintained projections for three rate cuts this year, while increasing core inflation and economic growth expectations.
- Investors anticipate three to four 0.25% rate cuts in 2024 starting this summer based on interest rate market pricing, in general alignment with Fed projections.

The Federal Reserve (Fed) held its target federal funds interest rate steady in a range of 5.25% to 5.50% following its regularly scheduled two-day meeting, as expected by investors and economists. The Fed uses interest rate policy to carry out its maximum employment, price stability and moderate long-term interest rate mandates.

The Fed left its official statement mostly unchanged but updated the Summary of Economic Projections (SEP), an every-other meeting release that shares Fed committee members' views on growth, inflation and the potential forward path for interest rates. The SEP indicated the median committee member expects slightly stickier core inflation and better economic growth this year. The tone of Chairman Jerome Powell's press conference suggested ongoing data dependence as members assess the timing and magnitude of recalibrating interest rates. Considerable policy tightening from a near-zero federal funds rate in early 2022 to 5.25% to 5.5% today helped drive Core Personal Consumption Expenditures (Core PCE), the Fed's preferred inflation gauge, from a peak above 5.5% in 2022 to 2.8% in January. Another key inflation metric, the Consumer Price Index (CPI), fell to 3.2% in February, though is also well off its high of 9.1% in June 2022.

The updated SEP and Powell's comments drew the lion's share of investor focus. In the SEP, the median committee member upgraded 2024 economic growth expectations from 1.4% in December to 2.1% today, while raising the 2025 projection from 1.8% to 2.0%. Members slightly lowered their projection for the unemployment rate by the end of this year to 4.0%, while increasing expectations for Core PCE from 2.4% to 2.6%. Overall, these revisions mirror investor expectations in recent months reflecting a somewhat stronger economy than many expected; consensus economist expectations for growth continue to move higher, as well. The Fed's somewhat stronger growth outlook did not lead to projections for maintaining high rates for longer to cool economic activity and inflation for this year, but the Fed did signal that rates may need to stay higher in 2025 than their prior projections. During the press conference, Powell noted that, "We are prepared to maintain the current target range (of interest rates) for longer if appropriate." Powell also addressed the Fed's bond holdings, which the Fed is currently allowing to mature without replacement up to $95 billion per month. He noted, "The general sense of the committee is that it will be appropriate to slow the pace of runoff fairly soon." We view this as an important comment that can help maintain constructive market liquidity currently in place, which has acted as a tailwind to stock prices.

Market pricing of the expected path of the federal funds rate

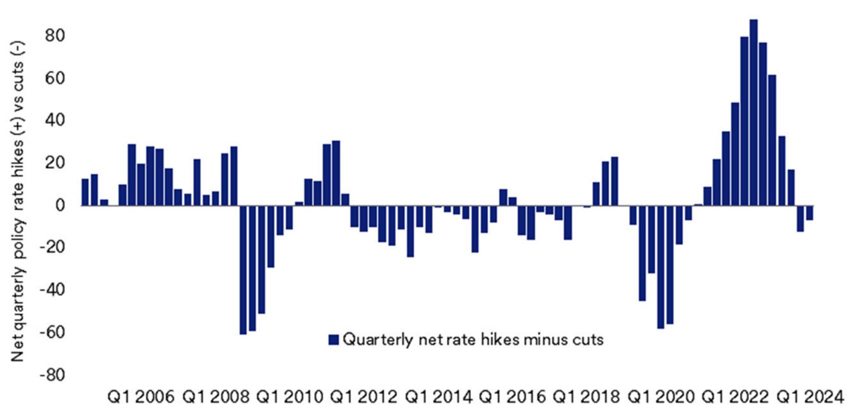


Source: U.S. Bank Asset Management Group Research, Bloomberg; 2/20/2023-3/30/2024

Stock prices rose today as the Fed's benign message and constructive economic outlook boosted investor sentiment. Shorter-term bond yields fell slightly. The S&P 500 finished the day up 0.89%, with growth-oriented sectors outperforming traditionally defensive sectors and broad-based gains evidenced across geographies and company size. Longer-term Treasury bond yields fell slightly (prices rose), with 10-year Treasury yields down 0.01% to 4.28% today, while two-year Treasury yields fell 0.07% to 4.62%.

Monetary policy, defined as central bank interest rate target decisions, remains restrictive around the globe after aggressive rate hikes. However, there were more rate cuts in the fourth quarter last year than rate hikes, as inflation across the globe continued trending lower and some emerging economies began easing monetary policy. Investors anticipate modest rate cuts from other major central banks in addition to the Fed, with three to four cuts expected in 2024 from the European Central Bank (ECB) and two to three cuts from the Bank of England (BoE).

Global net central bank rate hikes (net hikes minus cuts), quarterly



Source: U.S. Bank Asset Management Group Research, Factset; 8/31/2004-3/20/2024

2024 is marked by solid performance so far, with U.S. stocks, and larger stocks in particular, performing best, while emerging market stocks lagged relative to developed markets. The relatively narrow rally in 2023 that boosted growth-oriented stocks began to broaden late last year and continued broadening into 2024. Currently, 10 of 11 sectors in the

S&P 500 index have posted gains year to date, with most index constituents participating in higher price trends. High-quality bonds have posted slightly negative returns year-to-date but offer reasonably compelling yields.

We remain close to long-term investment policy targets. Consumer and business activity remains robust, surprising many prognosticators, while recent economic data continues to be revised higher. Stimulative fiscal policy in the form of deficit spending provides an additional tailwind to current conditions despite increasing government debt, with legislation currently being discussed in Congress potentially maintaining fiscal stimulus this year if signed. We will keep you informed of our views as incremental data becomes available and as we update our assessment of market conditions.

As always, we value your trust and are here to help in any way we can. Please do not hesitate to let us know if we can help address your unique financial situation or be of assistance.