Ropes Wealth Reviews the Fed Decision, Q2 GDP, and Restless Markets

What a week! As expected, the Fed opted to raise interest rates by 75 basis points at their July meeting, taking the target range to 2.25-2.50%. Also, as anticipated, the Fed statement maintained language suggesting "ongoing increases in the target range will be appropriate." The size, however, of additional rate hikes going forward is now the question, and the market has so far voted that the Fed will blink and slow, stop, and even cut interest rates by next year in the face of a recession.

We are not so sure. Chairman Powell was clear in his message that rates will need to rise further, and the Fed's own projections reflect 3.75%-4.00% is the expected range for interest rates a year from now. As a reminder, the current yield on a 2-year bond is 2.91% (notably the yield for the 30-year Treasury bond isn't much higher at 3.05%!). Chairman Powell was insistent that the Fed is committed to bringing inflation back under control, and would not rule out another outsized hike (i.e., 75 basis point increase) at the upcoming September meeting. In other words, the Fed is not prepared to mess around and Powell has a legacy to protect.

Under questioning, Powell conceded that in order for the Fed to slow the pace of interest rate hikes it would need to see both growth and inflation slowing. Growth is already notching down, with yet another negative quarter of GDP growth announced this week. Inflation is widely expected to start to slowly come down, at least from a statistical/base effect position. But Powell said the Fed would need to see "compelling evidence" of slowing inflation, and we suspect, an intolerable increase in unemployment before they pivot. But markets saw what they wanted to see in the messaging and found the silver lining such that bad news is now good, and stocks are going higher the worse the slowdown gets.

Don't get me wrong—we are pleased the markets have shaken off a cloak of despair and started to make a comeback. But we are cautious on a "bad news is good" rally and prefer share prices to increase based on fundamentals. On that front, there is mixed news to report. Stocks that rely on marketing/ad revenue are in the absolute doldrums, with revenue declines that were heretofore unimagined. That has weighed down shares of Snap, Meta, Pinterest, The Trade Desk, and Shopify in this week's most recent trading. But others, like Amazon, Google, and Apple, showed that despite supply chain pressures and waning consumer and business confidence, things are not quite as dire and perhaps their stock prices had overshot to the downside.

Related to this week's disappointing second quarter U.S. GDP, it was reported that real output fell by -0.9%, following a -1.6% decline in Q1. Weakness was very widespread with declines in both residential and non-residential construction, capital spending on equipment, inventory rebuilding and government spending at the federal, state and local levels. This was only partly offset by modest gains in consumer spending and an improvement in trade. Moreover, with massive fiscal drag, a higher dollar hurting exports, and higher mortgage rates slowing the housing market, GDP growth may continue to be very soft for the rest of the year.

While commentators often define recession as being at least two consecutive negative quarters of real GDP growth, the National Bureau of Economic Research's definition is a broader one and includes declines in employment, which clearly have not occurred so far this year. However, today's report is further evidence that the U.S. economy is quickly losing momentum and increases the likelihood that even the broadest definition of recession will be met before the end of the year.

Taking all the pieces together, we continue to urge you to practice a combination of restraint and commitment to your investment plan. There are further risks to process in the forward period, and the market's swings, both up and down, should always be calibrated to your broader financial goals. We know that a lot of bad news is reflected in today's share prices, but companies are also telling us that the challenges of inflation, rising interest rates, global supply chains, etc. are forcing a reboot of corporate strategy that needs time to bear fruit (and profits). We also know that our central bank has a mission. Just as it was always critical not to fight the Fed in periods when they were stimulating the economy, so too must we remember not to fight them when they are responsibly seeking to slow it down in their pursuit of price stability. For all these reasons, we remain committed to balance in your investment plans, and are focused on implementing shifts to your underlying investments that prioritize quality, resilience, management team experience, and balance sheet fortitude in the companies you own directly or through our recommended funds. That is our best thinking in this period of extremes, and we remain as ever grateful for the confidence and trust you place in us and for your patience and steadfastness with the market.

Thank you for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

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