Ropes Wealth Reads into Fed Rhetoric

This week I had the opportunity to attend a Boston Economic Club luncheon with special guest speaker Minneapolis Fed President Neel Kashkari. In a room of economists and investors longing to hear any signal to the contrary, he emphasized the Fed's focus is squarely on reducing inflation to their 2% target rate. He went so far as saying the Fed has learned from past mistakes about slowing hikes too fast, and the confidence-buster it can be to pause and restart a hiking cycle. Instead, he argued, it would be better to get to the Fed Funds target rate that will set the tone of 2% and have the firepower to cut interest rates if the economy slows too much (i.e. recession ensues).

It was a reasoned argument, but not the one that room wanted to hear. It was the same argument we heard repeated all week from other Fed speakers as well. For example, New York Fed President John Williams was clear the indications of a tight labor market span well beyond one data point – referring to the outsized January increase in jobs we reviewed last week – and include a multi-decade low in the unemployment rate, low jobless claims, millions of job vacancies, as well as a low level of people leaving or quitting jobs. He argued that with at least half of the Fed's dual mandate – full employment – seemingly satisfied, the Fed can and should entirely focus on taming inflation. Williams did concede everything will depend on the performance of inflation, but he also reinforced that most FOMC members anticipate a Fed Funds rate above 5% and perhaps as high as 5.5%.

Likewise, in an interview with Bloomberg News, Atlanta Fed President Raphael Bostic said, *"We have to do a little more work…And I would expect that that would translate into us raising interest rates more than I have projected right now."* Fed Governor Christopher Waller also said this week *"I want to be clear today that the job is not done,"* adding a *"tight stance of monetary policy [will be needed] for some time."* And finally, Federal Reserve Chairman Jay Powell himself spoke on Tuesday at the Economic Club of Washington. The key takeaway from his remarks was further hikes to come, potentially resulting in a higher-for-longer scenario. Powell reiterated the view there is still more work to be done with the latest nonfarm payroll report supporting the need for more increases beyond the 25bp hike in March already priced in at near 100% certainty.

With that, this week was notable in the interest rate markets as interest rates at the front-end of the yield curve swung higher, and the yield curve inversion was reinvigorated such that the difference in yield between the 2-year Treasury note at 4.47% and the 10-year Treasury note at 3.68% is the most extreme since 1981. These interest rate moves are coupled with an earnings season that is skewing less than impressive, with pressure building for downward revisions and gloomy outlooks. Profits have not been apocalyptic by any means; in fact, they have overall been more positive than perhaps envisioned. But no doubt we are shaping up for a contraction in earnings growth rates this year, and investors are trying to gauge if that will be on the order of negative 2-3% or notably worse.

All told, investor sentiment is uneasy, as we are hearing from the Fed that rates need to go higher, and we all have a sneaking suspicion that the transmission mechanism of higher interest rates has yet to be fully reflected in the economy due to lag effect that may be cresting by the summer. We therefore reiterate to you the importance of staying liquid with short-term cash needs and staying focused on your plan. This year's strength in smaller-cap domestic and overseas markets continues to support the argument and benefits of diversification. Now is not the time to put your eggs in one basket, but to spread your dollars into the very best companies and funds of companies from the U.S. and abroad, led by management teams who are experienced in navigating rising rates, recessions, and risk of all kinds.

On a final note, for those of you football fans in the audience, I wanted to acknowledge that this is Superbowl weekend. Leonard Koppett, a sportswriter for The New York Times, in 1978 introduced the Super Bowl Indicator which has a more than 90% success rate. The theory is that a Super Bowl win for a team from the American Football Conference (AFC) will result in a declining stock market in the coming year, while a win from a team in the National Football Conference (NFC) means the stock market will rise in the coming year. For this reason, I will sign off with the following: Go Birds!.

Thank you as always 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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