Ropes Wealth Rates March Market Risk

The month of February ended on a low note with stock markets down, bond yields up, and a questionable snow day here—a painful trifecta for this weary author (though her joyful school-aged sons would protest that last point). While March market activity is starting off with a better tone so far, we suggest to “Beware the Ides of March” as betrayal and misfortune could lurk around the corner as it did for Julius Caesar. March 15 may not be the date to worry about, but rather March 22, the date of the next Federal Reserve meeting when we will hear the updated consensus of the FOMC committee about the direction of interest rates.

To review, February brought with it a blowout employment report, strong consumer spending, and sticky core services inflation (excluding housing) which sets the stage for an increase in interest rates in March and more jawboning about higher rates for a longer period. While inflation was always unlikely to move in a straight line back to the Fed’s 2% target, the latest consumer price index release of 6.4% showed too little progress has been made after nearly a year of aggressive rate hikes. The stickiness seems to be the result of still-ample excess savings, tight labor markets and retail spending resistance to rate headwinds, with the implication that the Fed may need to raise rates further and keep them higher for longer than anticipated.

This “higher for longer” rate scenario has many market participants uneasy. Just a month ago, markets were predicting lower interest rates by early fall, which would likely support current or even higher stock prices from here. A prevailing and persistent higher interest rate environment suggests stocks may still be expensive in some or most pockets.

And herein lies the conundrum: while it is true that economic data remains strong, and it would appear the Fed would be derelict in their duties not to raise rates, there is risk that all of us (including the Fed) are underestimating the lag effect of monetary policy and its potential impact on consumers and companies. Why? We are in an extraordinary period, coming off of a global pandemic with all manner of pent-up demand, flush savings, and a labor market in a stage of deep reset. Nothing about the last three years has been normal, and objects in the rear-view mirror may be closer than they appear (i.e. a slowdown).

On that point, it was notable this week that U.S. home prices contracted for the sixth consecutive month in December, with all three composite indices (i.e., US National, 20-City and 10-City) declining. On an annualized basis, the National Home Price index is still on the rise, but the increase is down almost 15% points from its peak of 20.82% about a year ago. In November, San Francisco posted the first annual loss of any city during this cycle, and the decline steepened in December with Seattle joining the loss column as well. The weak results were primarily concentrated on the West Coast, while prices in Miami remain hot. With interest rates now even higher than they were at the end of last year, continued home price declines should be expected. However, given the multi-year deficit of housing stock relative to market demand, there is a floor behind how low prices will go, and this housing market cycle is unlikely to pop as in previous more bubble-like scenarios.

January durable goods orders were down -4.5% month-over-month, though it was welcome news to see the strength reported in new orders which reflects businesses unleashing capex spending in a burst of pent-up demand. Regional manufacturing surveys from Dallas and Richmond were weak, and the national index reported by the Institute of Supply Management remains in contraction territory. Consumer confidence was reported down, and reflected plans to scale back future purchases of major appliances, homes, cars, and vacations. All in all, it was a week of mixed data that demonstrates an economy in transition.

As we work with you to make the best decisions for your investment plan, it is worth noting that the risk of being on the wrong side of what can go right is in balance with being caught up in what can go wrong. Consider the possibility that recession is averted and a Goldilocks scenario unfolds featuring falling inflation, steady employment, and improving real incomes. Under that dynamic, a stock market significantly repriced from the highs of 2021 looks compelling. Ultimately, there is just too much uncertainty to stake a major shift in allocation, pay capital gains taxes to do so, and wait for an all-clear that may never come. Managing risk and market dislocations is a part of the process of being an investor, and history shows us that an investment plan with longevity has better outcomes than one that tries to time market peaks and troughs. Our single-minded focus remains on how to seek better risk-adjusted outcomes for you, which we believe will come from owning high-quality stocks with what we think offer lower downside profit risks than their benchmarks and peers. We are well-aware that the last two years' above-trend profitability is unlikely to be sustained and earnings projections still need to be reduced. For these reasons too we are more inclined towards active security selection than passive index exposure for your stock investments and remain committed to the short- and intermediate-term high quality bond markets that offer compounding yields now of over 5%.

Putting Caesar's experience aside, it is also true that March is known to go in like a lion and out like a lamb. May that be true both for the weather and stock market volatility.

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**.

The information set forth in this communication is presented by Ropes Wealth Advisors LLC ("Ropes Wealth") a wholly owned subsidiary of Ropes & Gray LLP. The contents are for informational and educational purposes only and are not intended as investment, legal or tax advice. Please consult with your investment, legal or tax advisor concerning any specific questions you may have. Ropes Wealth cautions the reader that past results are not indicative of future performance. The historical return of markets generally and of individual assets classes or individual securities may not be an accurate predictor of future returns of those makers, asset classes or individual securities. Ropes Wealth does not guarantee the accuracy and completeness of any sourced data in this communication.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600