Ropes Wealth Reviews How Pivoting Powell Stunned the Markets

Christmas came early this week for the markets thanks to the Fed’s stunning move to not only hold rates steady but confirm their next rate move will be a cut, possibly in early 2024. Treasury bond yields plunged, stocks soared, and market performance noticeably broadened, with share prices increasing most aggressively in financials, real estate, utilities, and smaller cap stocks.

"We're moving carefully" on assessing *"whether we've done enough,"* Powell repeated in Wednesday's post-meeting press conference. Officials, *"didn't want to take the possibility of further hikes off the table."* However, the softer forward guidance in the statement was an intentional *"acknowledgement that we believe we are likely at or near the peak rate for this cycle."* The focus *“naturally”* begins to shift to assessing when "it will become appropriate to begin dialing back" previous policy tightening. The Fed is seeing *"the things we've been wanting to see,"* Powell said, pointing to *"strong growth that appears to be moderating,"* a *"labor market that is coming back into balance by so many measures,"* and *"real progress"* on inflation.

Assuming the progress continues, and the economy evolves in line with the Fed's updated projections, *"the question of, 'When will it become appropriate to begin dialing back the amount of policy restraint in place?'"* will take center stage. *"I would say there is a general expectation that this will be a topic for us looking ahead,"* Powell said. At the same time, firmness in labor market data and other numbers propelled ideas the Fed may be able to pilot a *"soft landing"* for the economy, where inflation eases further and growth slows, but recession is avoided.
Following the FOMC meeting, the Fed released an updated economic forecast that included an outlook for slower GDP growth and suggested the central bank may lower its benchmark funds rate by about 75 basis points next year, the equivalent of three quarter-point cuts. A previous Fed forecast, released in September, suggested just one quarter-point cut.

And with that forecast and full-blown pivot, the market was off to the races. Though inflation remains higher than the Fed’s target, there is no question that the Consumer Price Index (CPI) and Producer Price Index (PPI) reports from earlier this week were subdued and trending in the right direction. Meanwhile, retail sales data showed the consumer is still holding up despite high interest rates. Retail sales posted a monthly gain of 0.3% in November, according to the Census Bureau, up from a decline of 0.2% in October and above expectations for a 0.1 % drop. Compared to November 2022, sales jumped 4.1%. Finally, the Labor Department reported weekly initial jobless claims at 202,000, below the previous week's 221,000. It was the lightest weekly figure since October. Continuing claims rose to 1.876 million, still near two-year highs and up slightly from the previous week.

Despite the festive atmosphere after the Fed's meeting, there are some caution flags. First, the Fed kept its current target rate range at 22-year highs between 5.25% and 5.5%, where it's been since late July. The Fed's "dot plot" shows rates finishing 2024 down 75 basis points at between 4.5% and 4.75%, but even that's relatively high versus the pre-pandemic era, and it's unclear when the cuts may come. Some economists think they may not surface until the second half of next year. Current rates appear to already be slowing economic growth, something the Fed sees extending into 2024, when it forecasts GDP to increase only 1.4%, compared with 2.6% for 2023. Slower growth and continued high rates don't necessarily paint a bullish near-term picture.

However, and something we have been reiterating in personal meetings with you, most of the stock market, outside of a handful of companies connected to artificial intelligence and weight loss drugs, has not experienced a full recovery from 2022's market declines. Therefore, the theme of market broadening is poised to pay off as a larger array of stocks begin to appreciate in a relief rally that the Fed just might have pulled off a soft landing.

We hope the Fed will be able to thread the needle to achieve this result but feel a little uneasy that the market is now pricing in a faster change in interest rates. We would hate to see a shift to cut interest rates too aggressively and prematurely re-ignite the inflation problem like the Fed did on multiple occasions under Chairman Arthur Burns in the 1970s. Growth is just too strong to support drastic action.

In these moments, just like in the white knuckled freefall of markets in 2022, it is important to maintain discipline in your process. Our commitment to diversified portfolio management will allow you to maximize participation in the market's ebullience as performance broadens, avoiding the need to overextend allocations and remain onsides with your plan. 2024 is going to be an interesting year, with wars, elections, interest rate shifts, and growth recalibration all on our dockets. Best for us all to take some precious moments to celebrate family and friends in this holiday season before the fun begins all over again.

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

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