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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **May 15, 2024**

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Last week's S&P 500 Index: +1.9%

Fixed income view and the Fed

Key takeaways

- The current "higher for longer" rate mentality would have likely been a big headwind for stocks 12 months ago.
- But market participants are hanging their hats on the themes of declining inflation over time and a Federal Reserve (Fed) that wants to cut rates.

"Higher for longer" is the current mantra that the equity and bond markets have seemed to enthusiastically embrace. We wouldn't have said that a year ago as financial markets were still expecting meaningful interest-rate cuts from the Fed and a continued rapid decrease in the rate of inflation.

Neither of those things have happened, yet the S&P 500 Index is on the doorstep of notching another new record high and the yield on the 10-year Treasury note has remained higher than many expected, crawling from a sub-4% level early in the year up to the 4.5% level at the time of this writing. This higher-for-longer mentality would have likely been a big headwind for stocks 12 months ago, but market participants continue to hang their hats on the themes of declining inflation over time and a Fed that wants to cut interest rates but likely won't have much of a chance to do so, at least over the balance of this year. It hasn't hurt equity markets that the economy and earnings continue to grow at a modest pace. A glance at the fed funds futures contracts shows the market is now pricing in just one to two cuts this year, a far cry from the six to seven cuts as we entered 2024. For now, our central bankers are on a multi-month verbal push to let the financial markets know that the hoped-for rate cuts will likely be slow to come to fruition.

That isn't to say rate cuts are not coming at all, but it seems unlikely the Fed will move aggressively as the Federal Open Market Committee meets to determine policy in coming quarters. The pace of disinflation has stalled for now, but we do see Consumer Price Index inflation edging lower as we move through late summer and into the fall, allowing for two cuts this year. Then, in 2025, we have adjusted down our projected number of rate cuts to just one, which would bring the fed funds target rate into the 4.5% to 4.75% range by the end of next year.

There are a couple of implications for investors. First, those investors who've been putting their money in CDs need to keep in mind that they'll likely get lower interest rates when they go to renew their CDs. As rates decline, the return from keeping savings in CDs is unlikely to keep up with price inflation in areas like education and health care. So, CDs are unlikely to replace other investments in a long-term portfolio. Second, looking at 5-year out to 30-year maturities, the yields are nearly the same. We do not believe investors are getting paid for taking on the risk of longer maturities. That is why earlier this year we upgraded intermediate-term fixed income in an effort to capture most, if not all, of the yield of longer-dated securities. Note that we still prefer quality investment-grade fixed income, including Treasuries, corporates, and municipals.

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Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market.

An index is unmanaged and not available for direct investment.

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