CLAYTON
WEALTH PARTNERS

MARCH 2023

MARKET PERSPECTIVE

Quicker and Higher

By James M. Walden, CFA

DASHBOARD

- Business Cycle (red)
- Valuation (green)
- Trend (yellow)

Since Fed Chairman Powell came around to the idea that inflation wasn't transitory after all, he has been laser-focused on bringing it down. That hasn't changed. What does look to be shifting is his tactical approach.

Some historical perspective is useful. After bringing the Federal Reserve's benchmark rate to a range of 0% to 0.25% in the wake of Covid, the Fed began to raise rates with a modest hike of 0.25 point in March 2022, followed by a 0.5-point hike in May 2022. With inflation concerns rising, the Fed started hiking more forcefully, with four consecutive 0.75-point rate increases through November 2022. To observe the impact of earlier rate hikes and to reduce the risk of overtightening, the Fed began to then taper its increases: a 0.5-point hike in December 2022 and a 0.25-point increase at its first meeting in 2023.

During recent congressional testimony, Powell raised the possibility, if not likelihood, of going back to a 0.5-point hike at the Fed's March meeting. Further, he indicated that rates would likely end up higher than previously expected. This is because of what Powell likely sees as a stubbornly resilient economy, particularly with the unemployment rate the lowest since 1969.

The market hasn't always bought into Powell's hawkish rhetoric. But it appears to this time. According to data from CME Group, on the day after Powell's comments, interest-rate traders assigned a 78% chance of a 0.5-point hike at the Fed's March meeting. Just one month earlier, the probability had been less than 10%. Further, as shown in the exhibit on the next page, traders now expect the Fed's target rate to be at least 5.5% to 5.75% after its December 2023 meeting. (The current target range is 4.5% to 4.75%.) A month ago, the market assigned virtually no chance of a range that high.

Right now, it seems unlikely the Fed is looking to pause rate hikes any time soon, let alone to start cutting. We think follow-through on this hawkish rhetoric increases the chance of a recession in the near term. As we've noted before, that doesn't appear to be priced in, so we remain cautious and are holding on to more cash than we normally do.

Exhibit: Target Rate Probabilities for the Fed's December Meeting

TARGET RATE (BPS)	PROBABILITY(%)			
	NOW *	1 DAY 8 MAR 2023	1 WEEK 2 MAR 2023	1 MONTH 9 FEB 2023
400-425	0.0%	0.0%	0.0%	0.4%
425-450	0.0%	0.0%	0.0%	4.7%
450-475 (Current)	0.1%	0.1%	0.5%	19.2%
475-500	1.9%	1.0%	5.5%	35.0%
500-525	10.8%	7.3%	21.8%	29.0%
525-550	28.8%	23.5%	37.5%	10.4%
550-575	35.6%	36.2%	26.7%	1.3%
575-600	19.0%	24.8%	7.4%	0.0%
600-625	3.7%	6.8%	0.6%	0.0%
625-650	0.1%	0.4%	0.0%	0.0%

* Data as of 9 Mar 2023 11:18:02 CT

Source: CME FedWatch Tool, Clayton Wealth Partners.

Bullish

- Significant pent-up consumer demand
- Reasonable equity valuations
- The most attractive yields for fixed income in years
- Fed progress toward reducing inflation
- China's lifting of Covid restrictions, which could provide a lift

Bearish

- Slowing global economic growth with recession pressures mounting
- High global inflation
- Ongoing deterioration in housing
- The Fed and other global central banks tightening
- Russia-Ukraine war and other geopolitical concerns

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As Partner & Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner & management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.

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