Weekly Market Perspectives

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Investors Should Remain Patient as Markets React to the Fed's Rate Hike, Plans for July Increase

Stocks continued their aggressive slide lower last week, with the S&P 500® Index falling 5.8% — its worst weekly performance since March 2020. All eleven S&P 500 sectors declined by at least 4% or more on the week, with Energy dropping an eyepopping 17.2%, also logging its worst week of performance since March 2020.

The risk-off selling pressure was most pronounced in sub-industries tied closely to economic activity and consumer demand, including exploration/production, oil services, airlines, travel/leisure, and homebuilders. In addition, the NASDAQ Composite and Dow Jones Industrials Average each fell 4.8% on the week, and the Russell 2000 Index sank 7.5%.

Treasuries showed mixed performance last week, with the yield curve flattening on the front end, but all durations from 2 years out ended above 3.0%. The U.S. dollar strengthened against a basket of currencies, and Gold finished the week at $1,839.40 (down 1.8%). On Friday, West Texas Intermediate (WTI) crude declined by 6.3%, posting its worst day of performance since March 31 and snapping a three-week winning streak. WTI ended the week lower by 10.4% to finish at $109.90 per barrel.

Fed Moved More Aggressively to Help Address Inflation Pressures, But There's More Work for Them to Do Later This Year

The market and economic narrative continue to shift rapidly. Coming into last Wednesday's Federal Open Market Committee (FOMC) decision, fed fund futures had priced in a 90% plus chance the Federal Reserve would lift its fed funds target rate by 75 basis points. The Fed delivered as expected, raising its target rate by 75 basis points — the largest increase since 1994. As it stands today, the Fed may do it all over again at the end of July.

Just days before last week's Fed decision, the predominant market view was that the Fed would move rates higher by 50 basis points, which numerous committee members, including Fed Chair Jerome Powell, had well-telegraphed in advance. But hot May inflation reports and Michigan sentiment at all-time lows quickly changed the market tone and increased the odds the Fed would need to move more aggressively to help get on top of inflation pressures. The Fed has now raised its target rate by 150 basis points over a few short months, quickly returning the critical benchmark rate to where it stood at the onset of the pandemic. But by most assessments, the Fed still has much work to do to get inflation under control. Unfortunately, we believe the risk is growing the central bank could send the economy into a downturn to bring inflation lower. The Fed's "dot plot" shows the fed funds rate climbing to 3.4% by the end of the year, well above the current rate of 1.75%. ***Bottom line:*** **The FOMC wants to move rates to a level that restricts growth, brings down wage inflation, and helps reduce demand across the U.S. economy.**

However, the more concerning development for stocks out of last week's FOMC meeting is that the Fed really, really doesn't have investors' backs anymore. Although most investors have been coming around to this idea all year, that point should be crystal clear today. In our view, the commentary and actions from the Fed last week speak volumes. Our assessment of their high-level view? If the U.S. economy falls into a shallow recession to break inflation, so be it. Between the choice of runaway inflation pressures – which would be far more damaging to the market/economy longer-term – and the option of a shallow recession, the Fed seems willing to take their chances on the latter, in our view. Of course, that doesn't mean the Fed wants to cause a recession, but a desire to push rates into a restrictive zone communicates to investors they are willing to accept the consequences of their actions.

That also means the Fed won't run to the market's rescue if stocks continue to fall from here. The current downturn in the market this year is likely to look very different than other downdrafts in the more recent past. The stock drawdowns during COVID-19, the financial crisis, and the dot-com bust eventually prompted the Fed to ease monetary policy. This time around, markets are on their own for the foreseeable future. And if there is an eventual Fed put (i.e., the central bank stops tightening policy or reverses course and eases), we believe it would be at stock levels much, much lower than where we currently stand. That's a paradigm shift versus previous bear markets, which investors should come to grips with sooner rather than later.

Despite the Market Challenges to The Downside, Investors Can Be Proactive to Protect Their Portfolios

Downside surprises in last week's retail sales report, housing starts, and producer sentiment in the Empire State and Philly Fed reports indicate investors are beginning to see a greater probability the U.S. economy is headed for a recession. In addition, the Atlanta Federal Reserve's GDP NOW forecast for second quarter growth recently moved from +0.9% to 0.0%. That's following Q1 GDP shrinking by 1.5%. Slowing growth, weak sentiment/confidence, and a central bank focused on bringing down price pressures through aggressive rate hikes isn't exactly the most conducive environment for higher stock prices. **Yet, here are some brighter points to consider as we move through the coming weeks and months:**

- **In the throes of a bear market, investors' fortitude and patience are often tested to the extreme.** The S&P 500 Index is down nearly 24% from its high, while the NASDAQ is off 33%. In our view, there is likely more near-term pain in store for investors, even if the declines might be short-lived. The S&P 500 is down 18.6% in Q2 alone, and on pace for only a handful of quarters where the Index dropped by a similar amount. However, there hasn't been a single instance since WWII that the Index was down more than 15% in a quarter and wasn't higher a year later, according to Bespoke Investment Group.

- **Granted, the declines this year feel horrible, but it's not the end of the world.** The S&P 500 Index is still higher by over +8% from its pre-COVID-19 peak and up by over +60% from the COVID-19 bottom. The broad-based U.S. stock barometer has advanced roughly +400% from the financial crisis. And while this is the worst year for a 60% stock, 40% bond portfolio since 1976 (per Bespoke), the Dow Jones Moderate Index is outperforming the S&P 500 by over 550 basis points year-to-date and with less volatility. Further, on an annual basis, the Dow Jones Moderate Index has returned +4.2% over the last five years and +6.2% on a ten-year basis through June 17. If you've been following a properly diversified portfolio over the last decade or so and avoided the temptation to make rash/ill-timed investment decisions during times of stress, you and your portfolio have likely done very well. We advise investors to keep this year's declines in perspective.

- **That said, this is not the time to just sit on your hands and hope for the best. Be proactive but smart about the changes you make in your portfolio.** First, ensure your allocations are aligned with the level of risk you're comfortable taking. That means knowing how much money you can lose and still sleep at night. Focus your portfolio on investments that can weather a downturn in the economy. That means focusing on high-quality stocks and bonds with stable earnings, healthy margins, and strong balance sheets. Dividends can boost returns and provide income, while higher interest rates have made government bonds more attractive. Alternatives can act as a third leg in a portfolio, helping mitigate equity volatility should stocks continue to fall. Rebalancing, dollar-cost-averaging, and drawdown strategies are other helpful portfolio tools to help weather volatile periods in the market. Please speak with your Ameriprise financial advisor, who can help review, and, if necessary, make thoughtful portfolio adjustments to help you navigate market downdrafts so that you and your portfolio can be well-positioned for the eventual rebound.

The Week Ahead Will Bring More Commentary from Fed Chair Powell

This week, Fed Chair Powell will deliver his semi-annual Monetary Policy Report to Congress on Wednesday and Thursday. We expect Mr. Powell to repeat much of what was said at last week's FOMC meeting and members of Congress to grill the Chair on the inflation environment and future policy responses. In addition, a second look at Michigan sentiment (Friday) is expected to remain unchanged. Finally, May existing home sales (Tuesday) and May new home sales (Friday) are both expected to see their pace of growth slow after falling in April.

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West Texas Intermediate (**WTI)** is a grade of crude oil commonly used as a benchmark for oil prices. WTI is a light grade with low density and sulfur content.

The **Consumer Price Index** (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics

The **Michigan Consumer Sentiment Index** (MCSI) is a monthly survey of consumer confidence levels in the United States. It is a statistical measurement of the overall health of the economy as determined by consumer opinion. It takes into account people's feelings toward their current financial health, the health of the economy in the short-term, and the prospects for longer-term economic growth, and is widely considered to be a useful economic indicator.

The **GDPNow** forecasting model provides a "nowcast" of the official GDP estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis. GDPNow is not an official forecast of the Atlanta Fed. It is best viewed as a running estimate of real GDP growth based on available economic data for the current measured quarter. There are no subjective adjustments made to GDPNow—the estimate is based solely on the mathematical results of the model.

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