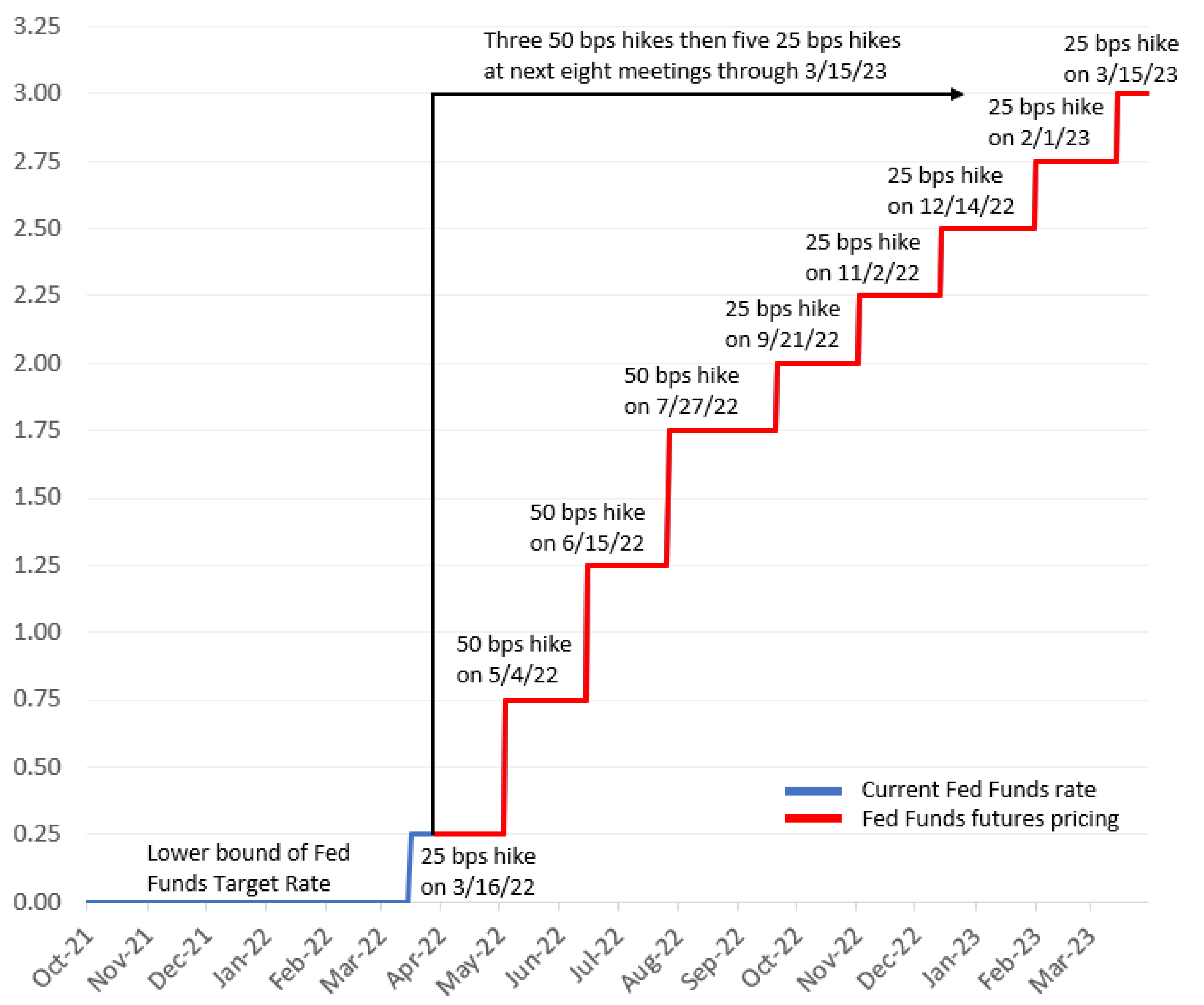
Chart of the Month

April 2022

Most Likely Fed Funds Rate Path Through March 2023 Based on Futures Pricing



Source: Bespoke Investment Group and CME Group

While today is April Fools' Day, the chart above is no practical joke. As shown, the fed funds futures market is now pricing in three consecutive 50 basis points (0.50%) hikes at each of the next three Federal Open Market Committee (FOMC) meetings (scheduled every six weeks), followed by five straight 25 bp increases. If the market is correct, the lower bound of the fed funds target rate will rise from its current level of 0.25% to 3.00% in less than a year.

The FOMC voted to increase the fed funds rate by 25 basis points on March 16 for the first time since December 2018, citing strong job gains and "elevated" inflation as the reasons. Federal Reserve Chair Jerome Powell subsequently said the Fed must move "expeditiously" and "more aggressively" to raise rates to a "more neutral level," suggesting the possibility that 50 bp hikes could be on the table for the first time since May 2000.

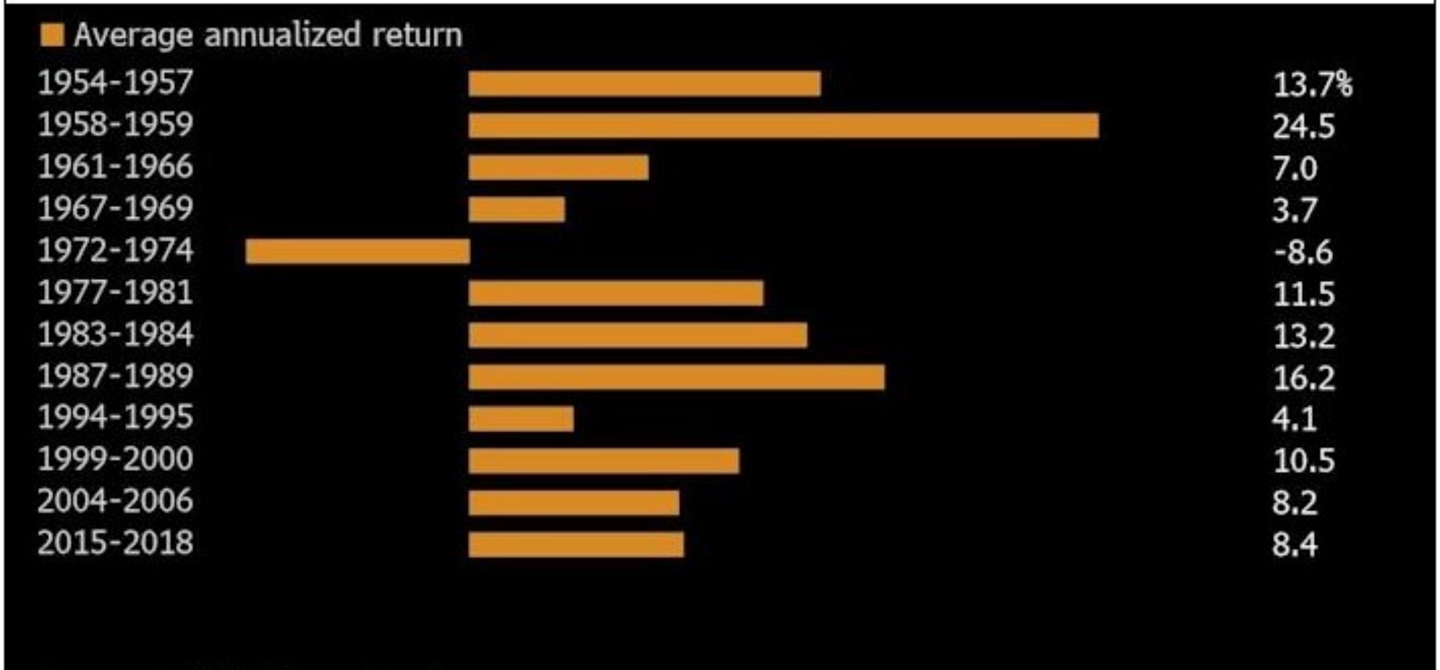
After more than two decades of never raising rates by more than 25 basis points at a time, the Fed, which has a dual mandate of stable prices and maximum employment, is now confronting the highest inflation rate in 40 years. If the central bank proceeds too slowly, it will jeopardize its credibility and run the risk that inflation will become more permanently embedded in the U.S. economy.

In addition to being a tool to fight inflation, the fed funds rate matters because it affects the annual percentage rate on credit cards, home equity lines of credit, auto loans, and adjustable-rate mortgages, as well as yields on money-market funds, certificates of deposit, and savings accounts. Higher interest rates hurt borrowers and help savers.

As it relates to the stock market, the S&P 500, as displayed below, has advanced in each of the past seven Fed rate-hike cycles with an average annualized return of 10.3%. The index has produced a positive return in 11 of the 12 rate-hike cycles since the 1950s. Including the one down period in 1972-1974, the average annual return has been 9.4%.

Meanwhile, the S&P 500 is up 8.6% from its recent low on March 14 with the calendar heading into the market's most favorable month of the year. The S&P 500, in fact, has gained in 15 of the past 16 Aprils with average and median returns of 3.1% and 1.6%, respectively. While the past is no guarantee of the future, history appears to be on the side of the stock market for the period ahead.

How the S&P 500 Performs in Fed Rate-Hike Cycles



Source: Truist Advisory Services

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