ClarkCapital MANAGEMENT GROUP

Commentary

Navigator® Market Update

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When is Restrictive, Restrictive? Answer: Powell Says, "We Have a Ways to Go."

The Federal Reserve continued hiking rates at the most aggressive pace in decades. The Fed delivered their fourth straight 0.75% increase in overnight rates, while signaling "ongoing increases" will likely be needed to bring rates to a level that is "sufficiently restrictive to return inflation to 2% over time," according to the Federal Open Market Committee's statement on November 2nd. The official statement was somewhat dovish, but the press conference was very hawkish, with Powell suggesting that the terminal rate will likely be higher than they previously thought and that the risk of doing too little outweighs the risk of doing too much (tightening).

This brings the cumulative hike to 375 basis points in the tightening cycle that began in March. In a new sentence in the statement, the Fed also said: "In determining the pace of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments."

Fed Chairman Powell stressed the importance of keeping longer-term inflation expectations anchored and that rates are not yet sufficiently tight to rein in inflation. He also discussed the desire to get it right, but that if The Fed overtightens, they could then respond aggressively with tools to ease policy, now more effectively given that rates are 4.0% and not at the zero bounds. Powell also said in the press conference that it is "Premature to discuss pausing and not something they are thinking about."

In our opinion the window of engineering a soft landing is narrowing with each successive rate hike, and Chairman Powell echoed that same sentiment. We know that monetary policy actions affect economic conditions with long and variable lags. While the economy grew at a 2.6% annual rate in the third quarter, we see that there are signs of the economy slowing. For example, the Conference Board's Index of Leading Economic Indicators peaked seven months ago and the spread between the 10-year Treasury and 3-month T-bill yields inverted last week.

We believe that the risk of a mild recession occurring next year continues to rise in tandem with the Fed Funds rate. We also believe that the stock market is already reflecting that economic slowdown. Importantly, corporate earnings continue to hold up well.

There are additional macro drivers to come over the next two weeks which we will be monitoring closely, including the Employment Report, mid-term elections, and October inflation statistics. We believe these headline-grabbing events will likely create additional market volatility. We are comforted by the belief that stock prices reflect a bleaker economic and earnings outlook than we foresee. Historically, stocks and bonds have started to go up before the Fed is finished raising rates. We believe that will prove to be the case in this rate hike cycle as well.

As always, we believe it is imperative for investors to stay focused on their long-term goals and not let short-term swings in the market derail them from their longer-term objectives.

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The 3 Month Treasury Bill Rate is the yield received for investing in a government issued treasury security that has a maturity of 3 months. The 3 month treasury yield is included on the shorter end of the yield curve and is important when looking at the overall US economy.

The 10 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 10 year. The 10 year treasury yield is included on the longer end of the yield curve. Many analysts will use the 10 year yield as the "risk free" rate when valuing the markets or an individual security.

The index of leading economic indicators (LEI) is intended to predict future economic activity. Typically, three consecutive monthly LEI changes in the same direction suggest a turning point in the economy.

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