Market Commentary 6/5/24

An Oxford Harriman & Company Market Commentary

Nearly 11 months have passed since the Federal Reserve last raised interest rates. The pause in rate hikes follows a 17-month period where the central bank raised interest rates by 5.25%. This represented the fastest and most aggressive rate-hiking campaign in decades; however, the focus is shifting to interest rate cuts as the central bank prepares to make its next policy move.

At the beginning of 2024, investors expected the Federal Reserve to start cutting interest rates in March, and many market forecasters were predicting up to six cuts this year. It's now June, and nearly half of the year has passed without an interest rate cut.

To better understand what is preventing the Federal Reserve from cutting interest rates, it's useful to review the Fed's overall mandate. The central bank has two main objectives: (1) price stability and (2) full employment. Price stability means low and stable inflation. Full employment means economic conditions that create new jobs and keep unemployment low. One of the tools the Federal Reserve uses to achieve these goals is interest rate changes. Rate hikes are used to combat inflation, while rate cuts are used to stimulate the economy.

During the 17-month tightening cycle, the Federal Reserve focused on lowering inflation. As inflation eased from 9.1% in June 2022 to 3.4% in December 2023, the central bank's attention shifted toward its employment goal. There were concerns that higher interest rates would lead to higher unemployment, but the labor market has held up relatively well.

The most recent inflation data has forced the central bank to reconsider its priorities. Indeed, minutes from the last Fed meeting indicated that policymakers were uncertain about the path forward and recent data didn't make them confident that inflation was heading toward their 2% goal in the near term. Inflation was higher than expected in the first quarter of 2024, while the unemployment rate remained below 4%. The low unemployment rate allows the Federal Reserve to focus more on reducing inflation.

With inflation remaining elevated, the market pushed back the expected timing of

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the first rate cut. As of this writing, interest rate futures indicate that only one rate cut is expected in 2024, down from six at the start of this year. Moreover, the first cut is now not anticipated until the fourth quarter. If the market's forecast is accurate and the Federal Reserve does not cut rates until December, a total of 17 months will have passed between the last rate hike and the first rate cut. Prior tightening cycle pauses ranged from four months in 1989 to as long as 15 months in 2006, and 18 months in 1997. Compared to prior cycles, the current 11-month pause is longer than expected, but history shows it's not unprecedented.

With the recent uptick in inflation, it is reasonable to question whether the next interest rate move might be a hike, and not a cut. After the last Fed meeting, Chairman Powell reassured markets with his commentary that seemed to indicate his bias was more toward easing than tightening. Further, while some of the recent inflation data have come in hotter than expected other important indicators such as job growth have shown they have been cooling. With the progress made over the last year or so, some market observers now believe that the Fed's attention is more focused on the outlook for jobs than on the inflation data. This type of push pull is impacting the short-term movements of the markets. While we are cognizant of these moves, we remain fixated on longer term trends and the broader economic cycle.

Please reach out if you have any questions,

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