Fed Takes Forceful Approach to Inflation

As the Federal Reserve (Fed) committed itself to battling inflation this year, one question looming large was how aggressive a tack it would take. In June, we received a second, clarifying answer.

In light of continuing high inflation, the Fed took a more forceful approach than it had indicated just weeks earlier, raising the federal funds rate by 0.75% – the largest single bump to interest rates since 1994, and the third hike this year.

Raising the rate affects the cost of lending across the economy, through which the Fed hopes to cool the economy and put downward pressure on inflation – currently its top priority. If inflation persists, expect further increases in the benchmark interest rate.

This means that, unless some key narratives change, we should expect some challenging months ahead as the economy slows and we navigate what has become a bear market.

"However, there are some signs that the Fed's actions are working," said Raymond James Chief Investment Officer Larry Adam. "We've seen weakness in some of the data, particularly in housing and manufacturing, and economically sensitive commodities such as copper are declining. Bloated inventories are plaguing retailers, which is likely to lead to more discounting. An easing of price pressures is necessary to allow the Fed to be more patient and not raise rates as much as the market expects."

There is other light in the gloom as well. Strong job growth, wage gains and abundant savings support consumer spending – approximately 70% of the U.S. gross domestic product. Even as consumer confidence has decreased and retail sales have recently signaled a slowdown, consumers have shown a willingness to spend on services like air travel and hospitality this summer. That's a good sign.

Still, uncertainty remains high, which means volatility will also remain high.

Before we dive deeper into some of the underlying issues, let's review where the headline indices stood at the end of June.

	12/31/21 Close	6/30/22 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	36,338.30	30,775.43	-5,562.87	-15.31
NASDAQ	15,644.97	11,028.74	-4,616.23	-29.51
S&P 500	4,766.18	3,785.38	-980.80	-20.58
MSCI EAFE	2,336.07	1,873.48	-462.59	-19.80
Russell 2000	2,245.31	1,707.99	-537.32	-23.93

Bloomberg Aggregate Bond	2,355.14	2,102.75	-252.39	-10.72

*Performance reflects index values as of market close on June 30, 2022. Bloomberg Aggregate Bond and MSCI EAFE reflect June 29 closing values.

Now, onto the details:

The recession question

Rising interest rates increase the possibility of a recession, but Raymond James Chief Economist Eugenio Alemán said it remains unlikely the U.S. economy will experience one in 2022. He projects, however, a 60% chance the economy will experience a very minor recession in the middle of next year.

World leaders attempt oil relief

Oil prices remain near eight-year highs at $120 per barrel as the European embargo and other restrictions against Russian oil are being felt across the global market, creating political pressure for policymakers to provide price relief. Major economies are urging OPEC nations to increase production, but the effect may be limited. The U.S. and other nations continue to release barrels from their emergency reserves to try to blunt the impact of diminished Russian exports. Meanwhile, countries such as Germany are subsidizing public transit as a way of reducing fuel demand.

A cornucopia of global difficulties

Outside the United States, the global economy is on course for weaker growth, persistent inflationary pressures – albeit to varying degrees in varying locations – and divergent approaches to monetary policy. In short, the world's largest economies are suffering, but for different reasons: cost-of-living spikes in Europe, China's "zero COVID" lockdowns, Japan's weak yen, and dissipating exports prices for Latin American commodities.

Corporate bonds stand out

Yields on corporate debt had a strong month through June, giving income buyers another boost. Further, corporate BBB-rated, A-rated and high-yield 10-year spread indices were well above their five-year averages and wider for the month. In Treasuries, as the Fed continues to tighten monetary policy, it's likely that the yield curve will continue to flatten.

The bottom line

June, as has been the story for much of this year, was a tale of too many headwinds. It's not hard to imagine, however, that a change in one of the contributors to this environment – including the Russia-Ukraine war, inflation and central banks' response to it, or China's lockdown policy – could offer an off-ramp from what otherwise promises to be a difficult, volatile period for the market. That said, periods of broad-market misery can provide opportunities for long-term investors to accumulate quality stocks.

While down markets are deeply unpleasant, my experience has led me to believe that vigilance, adaptability and a cool head will see us through and position us for the future. Thank you for your continuing trust in my guidance. If you have questions about your investments, the market or your financial plan, please reach out at your earliest convenience.