

Wentz Weekly

September 27, 2021

Fed Meeting Recap – Higher Rates Sooner?



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Jerome Powell and the Fed used the September meeting as a chance to provide advance notice that a tapering of its asset purchases “may soon be warranted,” which we believe sets the Fed up for a November meeting announcement, followed by a beginning to tapering in December. This was what we expected after the disappointing August employment report, and we even got more of an idea on how long tapering would last – Powell said he favors ending tapering around mid-2022, suggesting the Fed will reduce its \$120 billion in monthly asset purchases by \$15 billion per month until the program has ended. More of a surprise to us was the dot plot (this indicates where each Fed member sees interest rates over the next several years). The median dot sees 0.5 rate increases in 2022, and 3 more in 2023, pulling the median dot for a first rate hike to 2022, up from 2023 in the previous meeting. If tapering ends by mid-2022, we think discussion of a rate hike could begin around the fourth quarter next year if inflation remains elevated and the labor market continues its recovery, but we don’t see the first rate hike until 2023.

With the release of the FOMC policy statement, the committee released its projections for inflation, employment, and GDP as well. Overall, its inflation expectations were revised higher and its growth forecast lower. The median inflation forecast for 2021 was revised up from 4.2% from 3.4% while the longer run projections remains at 2.0%. Its unemployment rate projection was revised higher to 4.8% from 4.5% due to labor constraints. Its GDP projection was revised down to 5.9% from 7.0%, however 2022 was revised higher to 3.8% from 3.3%, suggesting supply chain disruptions will delay growth. Powell again emphasized high inflation will ultimately be transitory, although admitting it will be longer-lasting due to supply chain issues, supported by well anchored long-run inflation expectations.

Market reaction was positive with equities rallying after Monday’s selloff, while the bond market woke up, selling off Wednesday through Friday, and sending yields higher and the yield curve steeper. As a result, growth stocks lagged while values, cyclicals, and small caps outperformed, areas we have favored. As the Fed nears monetary policy tightening and the government deals with potentially more spending (i.e. issuing more debt), more supply will hit the market, increasing yields overall. We will continue to favor value, cyclical, and small cap stocks as the 10-year Treasury yield makes its way closer to 1.50% which will benefit these areas and as the economy continues its recovery from the pandemic.

A potential default for China’s largest property developer triggered a global selloff last week, reminding investors there is an increasing amount of risk in the current market. Evergrande warned it may default from not being able to make an interest payment due to bondholders on Thursday. While this has been a known and building issue, the announcement took markets by surprise, the same market that has been on an unstoppable upward trend since coming out of the recession last spring. The fear was the default could be China’s Lehman Brother’s moment that leads to a financial collapse. Much of Evergrande’s debt is in the China banking system and poses little risk to global markets. In addition, credit agency S&P said it believes the Chinese banking system will be able to absorb the default and sees no negative impact to global banking system. The reality is several potential issues are facing the markets including the upcoming debt ceiling, monetary policy and tapering, potential tax increases, elevated valuations, the delta variant, and the economy hitting peak growth, but the Evergrande situation gave the markets a reason to sell off.

Congress is busy working on the \$3.5 trillion reconciliation bill, a bipartisan infrastructure bill, government funding, and the debt limit. The decision on the bipartisan infrastructure bill is to be determined this week as the House is scheduled to hold a vote this week. Previously House Speaker Pelosi threatened the bill if the Senate refuses to pass the Democrats \$3.5 trillion reconciliation bill that includes spending on social issues and partially paid for by tax increases. However the reconciliation bill at this point does not appear to have a shot in the Senate due to its high spending figures, a number we think will come down closer to \$2 trillion to be considered acceptable by moderate Democrats. Separately, Congress needs to pass a government funding bill and increase or suspend the debt ceiling, both of which are scheduled to see a vote this week as well. One bill working through Congress has the debt ceiling suspending into next year and a continuing resolution to fund the government but is expected to not make it past the Senate. The House is working on a separate bill to fund the government without a debt ceiling suspension. Time will likely be an issue soon as the government is close to exhausting its funds with some preparing for a government shutdown.

Company News

- Uber said gross bookings will be higher than it previously forecasted, and EBITDA will turn positive in the current quarter, versus previously expecting a loss of \$100 million.
- Disney CEO Bob Chapek said at a Goldman Communication Conference that its global subscriber growth for Disney+ is expected to slow in the current quarter, blaming production delays resulting from Covid, but did call it a very short-term issue.
- FedEx reported its quarterly results that missed expectations. The miss was mostly due to “constrained labor market which impacted labor availability, resulting in network inefficiencies, higher wage rates, and increased purchased transportation expenses.” FedEx said it was unable to provide 2022 earnings forecasts because of the uncertainty.

The Week Ahead

Several economic data reports and earnings reports will highlight this week. The first economic report of the week is an input to factory orders, the durable goods orders report, released by the Census Bureau on Monday. On Tuesday the Case Shiller Home Price index and the Conference Board’s consumer confidence index are released. On Thursday we will see the final revision on second quarter GDP where economist see a 6.7% annualized growth rate in the quarter. Finally on Friday we will see many of the beginning of the month data points including manufacturing survey results, personal income and spending, construction spending and another report on consumer sentiment, this one being the University of Michigan’s monthly survey. The earnings calendar remains light for another two weeks until third quarter earnings season ramps up. Notable earnings releases this week include Micron on Tuesday, Cintas on Wednesday, and CarMax, Bed Bath and Beyond, and McCormick on Thursday. Also on the calendar are several Fed member speeches, some of which could create market headlines.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The Dow Jones Industrial Average (DJIA), commonly known as “The Dow” is an index representing 30 stock of companies maintained and reviewed by the editors of the Wall Street Journal. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index. The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. Every investor’s situation is unique and you should consider your investment goals, risk tolerance and time horizon before making any investment. Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Information contained herein was received from sources believed to be reliable, but accuracy is not guaranteed. Information provided is general in nature and is not a complete statement of all information necessary for making an investment decision and is not a recommendation or a solicitation to buy or sell any security. Investing always involves risk and you may incur a profit or loss. Keep in mind that individuals cannot invest directly in any index. Past performance does not guarantee future results. There is no assurance these trends will continue, or forecasts will occur.