# An Updated Look at the FOMC and Yield Curve

September 2023

"With inflation still well above the Committee's longer-run goal and the labor market remaining tight, most participants continued to see significant upside risks to inflation, which could require further tightening of monetary policy." That was the message following the release of the Federal Reserve's (Fed) July meeting minutes.

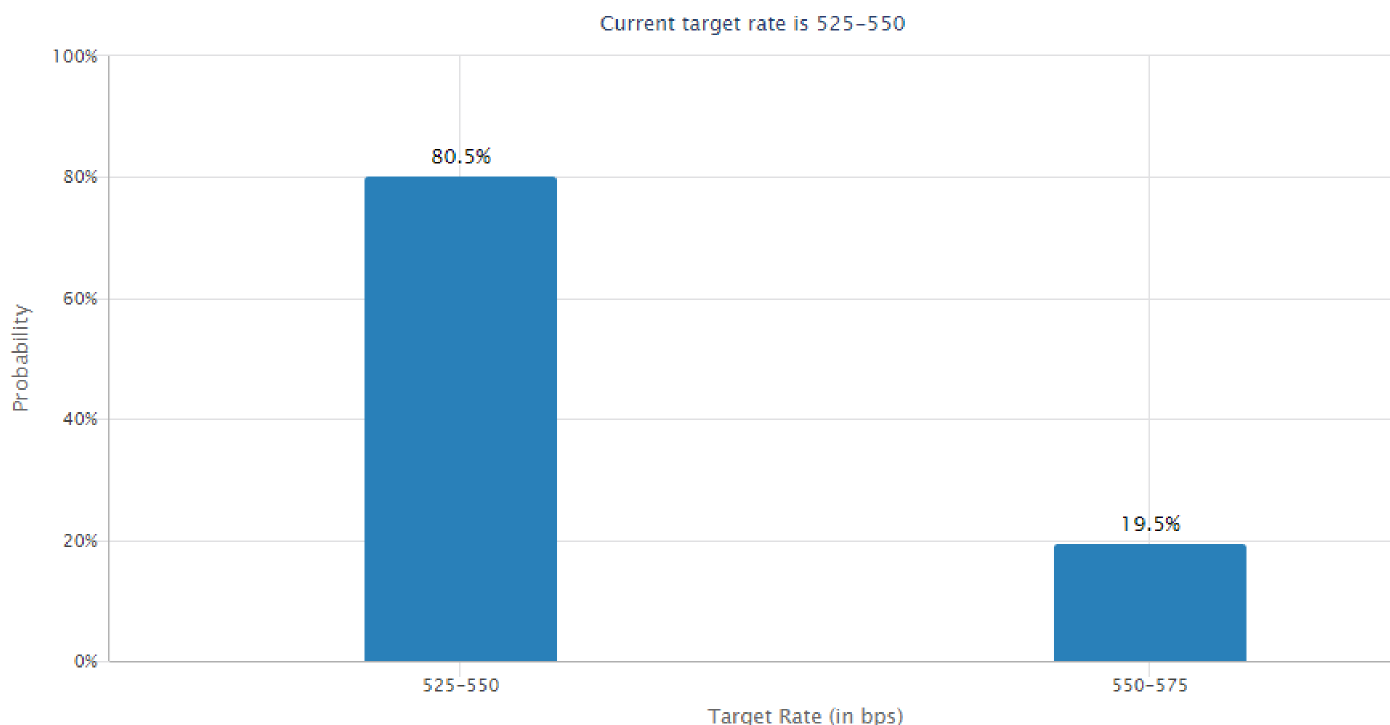
It was that same July meeting which saw the Federal Open Market Committee (FOMC) raise the Fed Funds rate by 25 basis points (bps) to a range of 5.25%-5.50%. That marked the 11th time since March 2022 that the FOMC increased interest rates (from 0.00%), and a meeting in which almost all of the participants, which includes non-voting members, were in favor of the rate increase.

Since that meeting, other macro events such as the Fitch downgrade of U.S. debt and the rising supply of Treasuries have pushed yields to cycle highs, with 2-year and 10-year Treasury yields breaching prior support levels at 5% and 4.25%, respectively.

So, what happens next? The Fed provided some guidance from the annual Jackson Hole Economic Symposium (this year's Symposium was titled "Structural Shifts in the Global Economy"). While no policy decisions are made at Jackson Hole, it remains a platform for several FOMC members – particularly Fed Chair Jerome Powell – to convey the Fed's latest thoughts to the market.

Powell's August 25 remarks reiterated his sentiments from the 2022 symposium, namely that the Fed remains intent on their goal of lowering inflation to 2%. Powell indicated that the Fed would be prepared to hike further "if" appropriate, but could afford to "proceed carefully." Shortly following his comments, the market-implied probability of Fed action at its September 20 meeting shifted to 80.5% targeting no action, as detailed in the following chart.

**Target Rate Probabilities for September 20, 2023 Fed Meeting[1]**




[1]Data is as of 08.25.2023. Chart source: CME Group. Charts are for illustrative purposes only. The views expressed represent the opinions of Sterling Capital Management. Any type of investing involves risk and there are no guarantees that these methods will be successful. Past performance is not indicative of future results.

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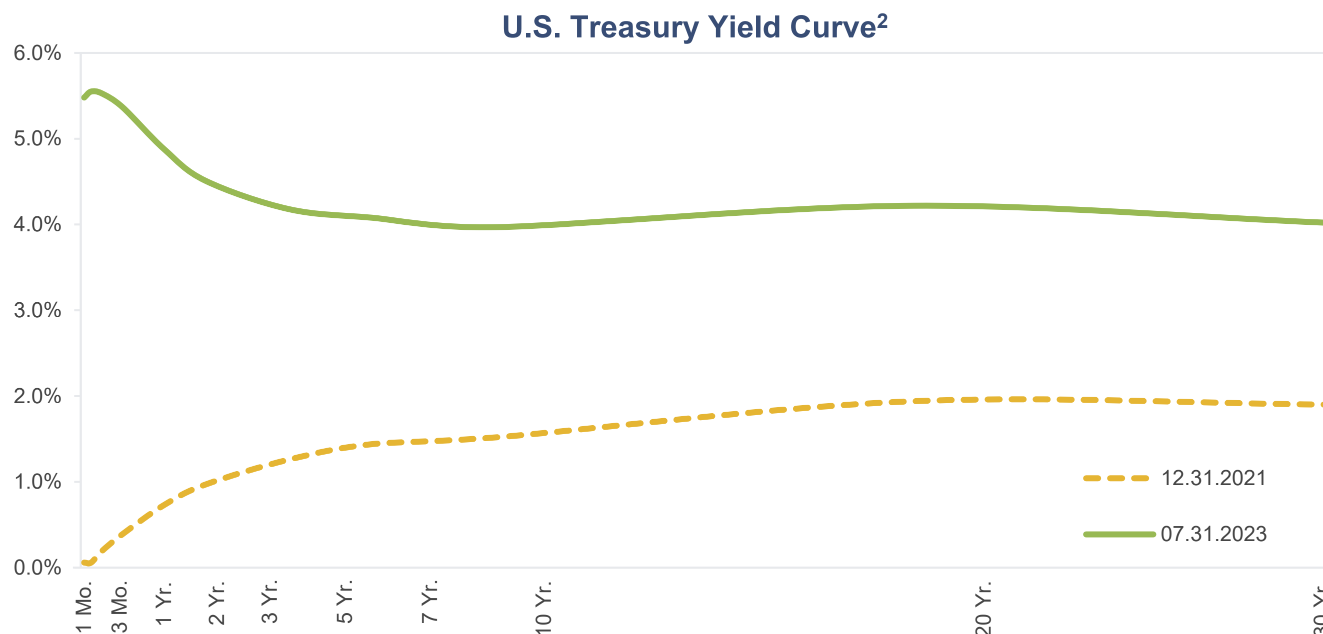
## The Inverted Yield Curve

Let's not forget about the yield curve, which has been inverted since March 2022. The curve is notably different than a few years ago, as illustrated below, which compares the shape and overall level of yields at year-end 2021 versus July 2023.




The inverted curve, which can be defined as the difference between yields on 2-year and 10-year Treasuries (known as the 2-10 spread) has historically been a reliable predictor for upcoming recessions. In fact, since 1978, there have been six dated recessions by National Bureau of Economic Research and, on average, the yield curve inverted about 14 months before the recession occurred. The table below details the time elapsed between the yield curve inversion and the start of the ensuing recession.

| 2s/10s Inversion & Recession Dates[3] | | |
|---|---|---|
| Yield Curve Inverts | Recession Begins | Months Between |
| Aug-78 | Jan-80 | 17 |
| Sep-80 | Jul-81 | 10 |
| Jan-89 | Jul-90 | 18 |
| Feb-00 | Mar-01 | 13 |
| Feb-06 | Dec-07 | 22 |
| Aug-19 | Feb-20 | 6 |
| Mar-22 | - | - |
| | **Average** | **14.3** |

[2]Data is as of 07.31.2023. Chart source: U.S. Department of the Treasury; Sterling Capital Management Analytics.
[3]Chart source: Strategas.
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The yield curve has inverted: what comes next? Will a recession occur? When might it occur? The short answer: we do not know, but in terms of market performance, we can use history as a guide, using those same inversion dates listed in the table on the previous page to dissect performance for a variety of asset classes in the succeeding 3, 6, 12, 18 and 24 months.

From a historical perspective, emerging market (EM) equities, as measured by the MSCI EM Index, have proven to be the best performers, while Oil (WTI) has been the worst performer. Only Oil and Gold have produced negative returns in the 24-months following an inversion, while EM Equities and Copper are the only two sectors that have returned more than 20%.

| Asset Class Performance After Yield Curve Inversion[4] | | | | | |
|---|---|---|---|---|---|
| **Asset Class** | **+3 Months** | **+6 Months** | **+12 Months** | **+18 Months** | **+24 Months (sorted)** |
| Emerging Market (EM) Equities | 7.3% | 5.1% | 17.6% | 34.9% | 29.2% |
| Copper | 16.1% | 10.8% | 2.3% | 22.6% | 26.6% |
| Domestic Equities (S&P 500® Index) | 3.2% | 6.9% | 8.2% | 13.1% | 19.0% |
| U.S. Treasury: U.S. TIPS | 0.4% | 3.9% | 9.2% | 11.8% | 18.7% |
| U.S. Aggregate | 0.3% | 3.7% | 6.5% | 8.6% | 16.8% |
| U.S. Treasury: 7-10 Year | -0.4% | 4.3% | 10.1% | 11.0% | 16.3% |
| U.S. Corporate Investment Grade | -0.1% | 3.2% | 5.7% | 7.0% | 15.1% |
| Nasdaq | -3.8% | 1.7% | 2.2% | 7.0% | 11.9% |
| U.S. Treasury: 1-3 Year | 0.7% | 2.6% | 5.9% | 8.4% | 11.7% |
| Global Treasury ex-U.S. | 0.1% | 0.5% | 2.6% | 5.8% | 11.5% |
| EM Local Currency Government | 1.7% | 2.8% | 3.2% | 8.0% | 10.2% |
| U.S. Treasury: Bills | 1.1% | 2.1% | 4.2% | 6.0% | 7.3% |
| U.S. Corporate High Yield | -0.2% | 2.1% | 4.1% | 6.5% | 3.6% |
| Dev. Intl Equities | 1.2% | 1.9% | 1.2% | 2.1% | 1.2% |
| Gold | 3.9% | 1.7% | -2.1% | 4.1% | -8.6% |
| Oil (WTI) | -6.4% | -1.2% | 3.7% | -8.3% | -10.1% |

## Advisory Solutions Portfolio Implications

When setting an asset allocation framework, the Advisory Solutions team employs both a Strategic Allocation and a Tactical Allocation. In terms of Strategic Allocation, we employ a long-term (20-year) investment horizon with a primary focus on aligning the expected return and risk of the portfolio using proprietary capital market assumptions.

Our Tactical Asset Allocation positioning focuses on the next 12 months and applies our quantitative analytics to exploit market opportunities, including the shape of the yield curve. Notably, the shape of the curve is only one of dozens of factors that drive our analytics but it is a key indicator, in our view.

We believe investors should continue taking a long-term focus, allowing active management within the asset allocation to seek alpha. In our view, maintaining a disciplined approach is imperative, allowing the opportunity to navigate market volatility using a risk-focused approach in an effort to seek above-market returns with below-market volatility.

[4]The average returns do not reflect the most recent inversion. Chart source: Strategas.
TIPS = Treasury Inflation-Protected Securities. WTI = West Texas Intermediate. Charts are for illustrative purposes only.
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# Important Information

**Shane Burke**
**Executive Director | Portfolio Manager**

Shane A. Burke, Executive Director, joined Sterling Capital Management in 2013 and has investment experience since 2002. Shane is a portfolio manager on Sterling's Advisory Solutions team with a focus on fixed income. Prior to joining Sterling, he worked as a senior analyst at New England Pension Consultants (NEPC) and as a portfolio accountant with State Street Corporation. Shane received his B.S. in Finance from the University of North Carolina at Wilmington and his M.B.A. from San Francisco - Golden Gate University.

**Past performance is not indicative of future results. Any type of investing involves risk and there are no guarantees that these methods will be successful. Economic charts are provided for illustrative purposes only. The information provided herein is subject to market conditions and is therefore expected to fluctuate.**

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**The Federal Open Market Committee (FOMC)** is the branch of the Federal Reserve System (FRS) that determines the direction of monetary policy in the U.S. by directing open market operations (OMOs). The committee is made up of 12 members, including seven members of the Board of Governors, the president of the Federal Reserve Bank of New York, and four of the remaining 11 Reserve Bank presidents, who serve on a rotating basis.

Technical Term: **Alpha** is a measure of an investment's performance in relation to a market index. (Technical definition sourced from Corporate Finance Institute.)

**A Note on Indices:** The volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

**The MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

**The S&P 500® Index** is a readily available, carefully constructed, market-value-weighted benchmark of common stock performance. Currently, the S&P 500 Composite includes 500 of the largest stocks (in terms of stock market value) in the United States and covers approximately 80% of available market capitalization.