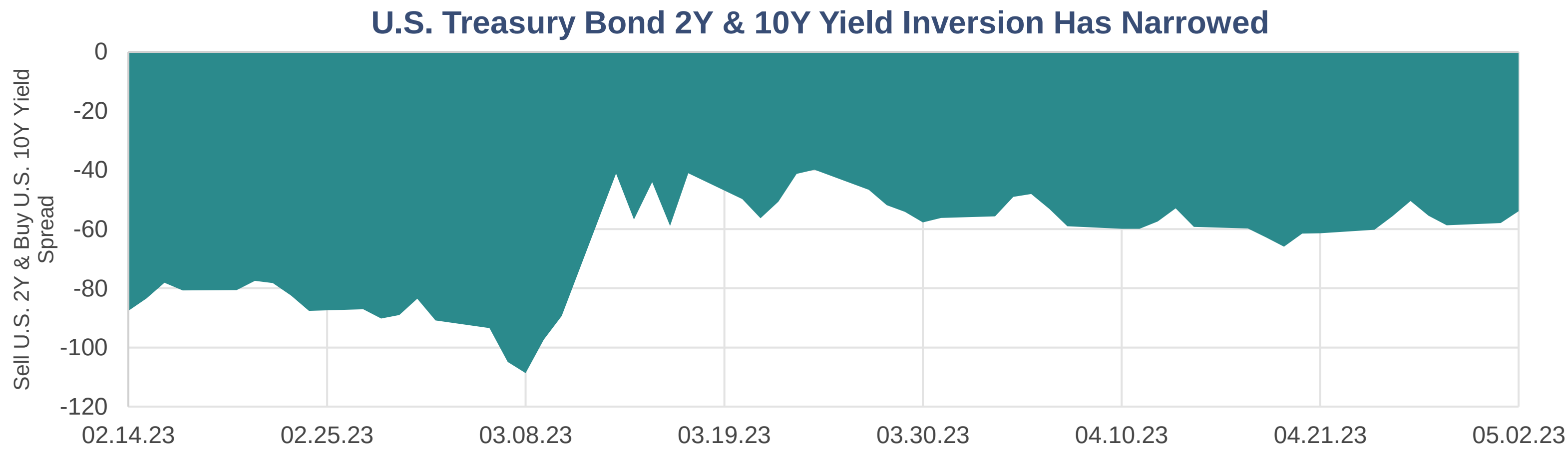
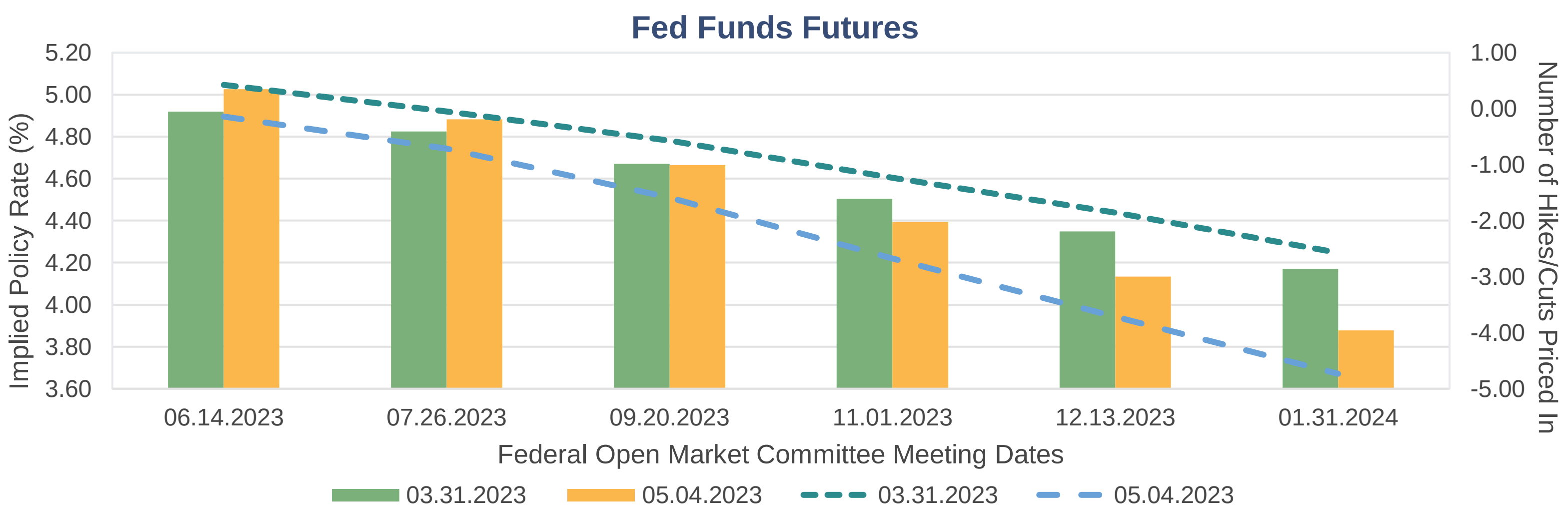
Fed Raises 25 Basis Points But Sets the Table for a Possible Pause

May 4, 2023

In a move widely anticipated by the markets, the Federal Reserve (Fed) raised rates an additional 25 basis points to a range of 5.00% to 5.25%. This is the highest in over 15 years and a 5.0% move in a little over 13 months. Of note the statement removed the language that some additional policy firming may be appropriate and replaced it with “in determining the extent to which additional policy firming may be appropriate”. This was viewed as a potential pause in the hiking cycle that began in March 2022. Chairman Jerome Powell also acknowledged that the recent banking failures should constrict lending and weigh on economic activity, housing and inflation. Additionally in his press conference he acknowledged that growth, which came in below expectations in the first quarter, will be below trend and unemployment may rise from today’s strong levels. Rates fell slightly after the announcement with the two-year U.S. treasury note yield down approximately 15 basis points to 3.81%.



While the statement was in-line with expectations and sets up a possible pause in the hiking cycle, Powell stressed that inflation remains above target and the committee remains focused on bringing it down. This leaves room for further hiking if economic activity does not slowdown and inflation remains high. The market moved up their expectations for cuts this year to a total of three, and the odds for a cut by July are over 50%. They would effectively reverse yesterday's hike. Increased bank stress is weighing on the market and the belief that credit availability will continue to diminish.



Data is as of 05.02.2023. Source: Bloomberg L.P. **Past performance is not indicative of future results.** 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. Charts are for illustrative purposes only.

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Our View

Durations will be managed neutral to slightly long versus benchmarks. We remain overweight securitized products and taxable municipals, but we have reduced exposure to corporate bonds. Although fundamentals remain strong, corporate spreads could widen further due to near-term recession risk. Agency MBS cheapened meaningfully during the first quarter amid elevated rate volatility and concerns surrounding bank liquidations. Valuations on production coupons are attractive and we are biased to add exposure to the sector.

The Core Personal Consumption Expenditure (PCE) Price Index measures the changes in the price of goods and services purchased by consumers for the purpose of consumption, excluding food and energy. Prices are weighted according to total expenditure per item.

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