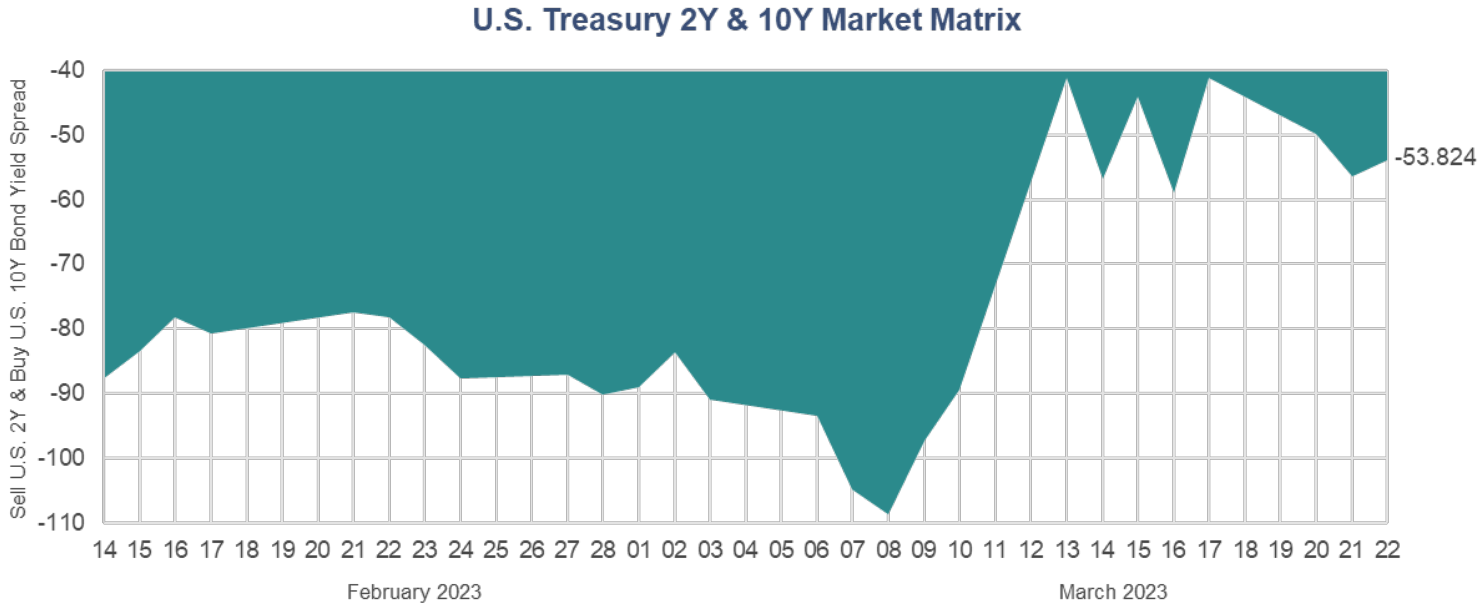
Federal Reserve Raises 25 Basis Points but Downshifts Additional Policy Hikes

March 23, 2023

The Federal Reserve (Fed) continued their hiking campaign by lifting rates up another 25 basis points (bps) to a range of 4.75%-5.00%. The Federal Open Market Committee (FOMC) shifted the terminal rate down slightly to 5.10%, and expectations continue for zero cuts in 2023. The Summary of Economic Projections was largely unchanged from December's numbers, but Chair Jerome Powell did acknowledge two key points. The recent developments in the banking sector are "likely to result in tighter credit conditions for households and businesses and to weigh on economic activity", and key language on additional hikes shifted from ongoing increases in the target range to **some** additional policy firming **may** be appropriate.

Recent economic data has been stronger than expected. Chair Powell continued to stress that the labor market remains too tight but acknowledged that some signs of wage growth are easing. While labor supply is not keeping pace with demand, he expects that to equalize as the year progresses. Goods inflation and housing, which make up 44% of inflation index, have begun to slow, but demand and labor remain strong. The Core Personal Consumption Expenditure Index (PCE) accelerated to a 5.5% pace in February, leaving the FOMC's projections for Core PCE in 2023 still well above the 2.0% target at 3.3%. Chair Powell acknowledged that growth remains well below normal with a median estimate of 0.5% for full year 2023.

Rates have shifted dramatically as the banking crisis has unfolded. During the press conference after the announcement, Chair Powell stated that the Fed did consider a pause as these recent events should weigh on economic activity, including loans and economic growth. At this time, the committee couldn't measure how soon or to what extent this would curtail economic activity. The 2-year U.S. Treasury note yield has fallen over 100 basis points since March 7 and is currently below 4.0%. The yield curve inversion has become less pronounced as well. The spread between 2-year notes and 10-year notes has fallen from over 100 bps to 50.



While we do expect the Fed to end their hiking cycle sooner rather than later, we still believe the market is too dovish in pricing in multiple cuts in the second half of 2023. Despite the Fed expectations for growth to be well below potential and recession odds moving higher, inflation remains too high and sticky for the Fed. We think inflation, absent new exogenous events, needs to come down significantly from current levels for the Fed to consider rate cuts. However, as Chair Powell stated, banking concerns will weigh on economic activity and this could expedite this process.

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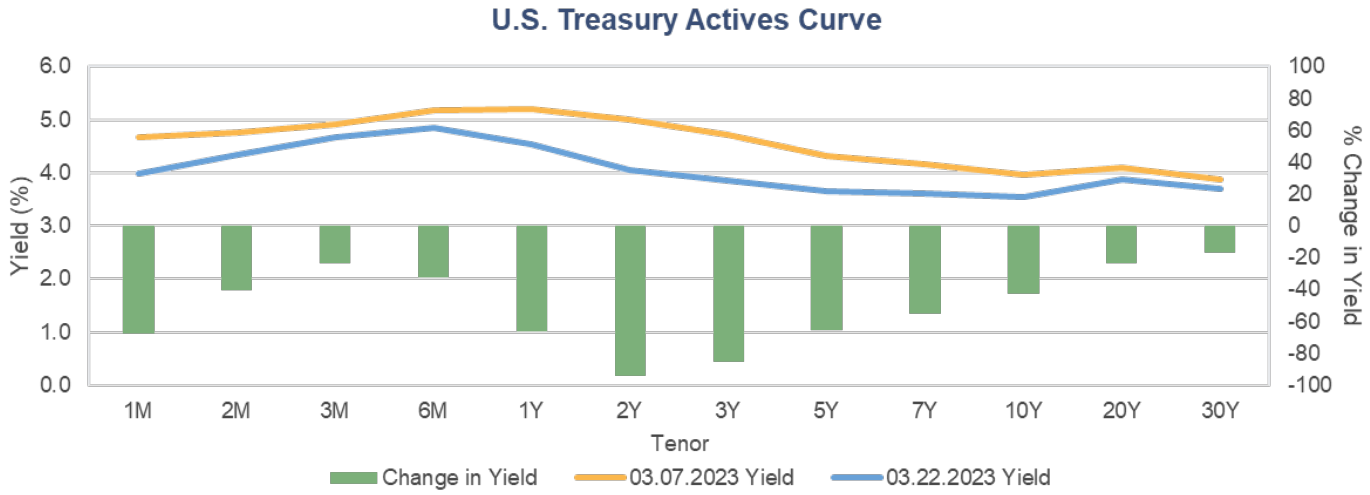

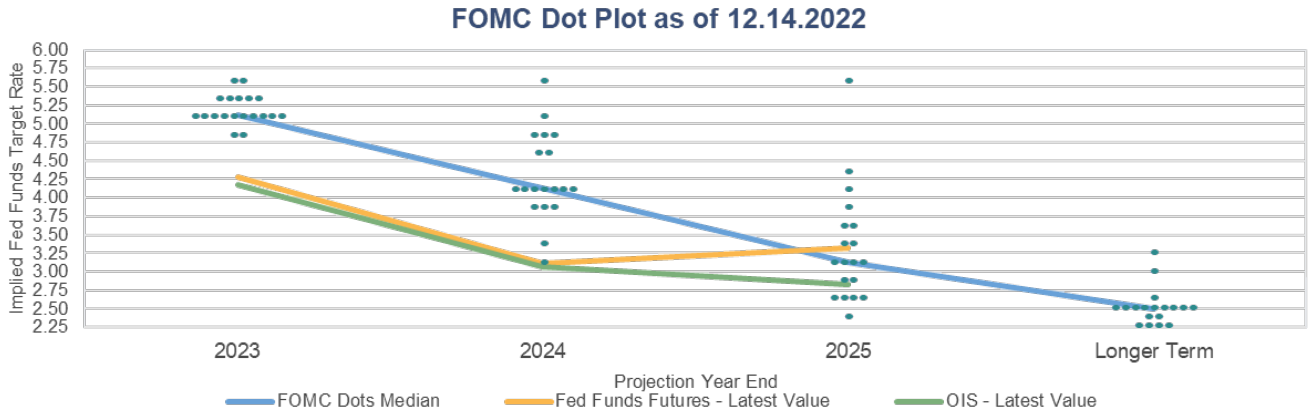

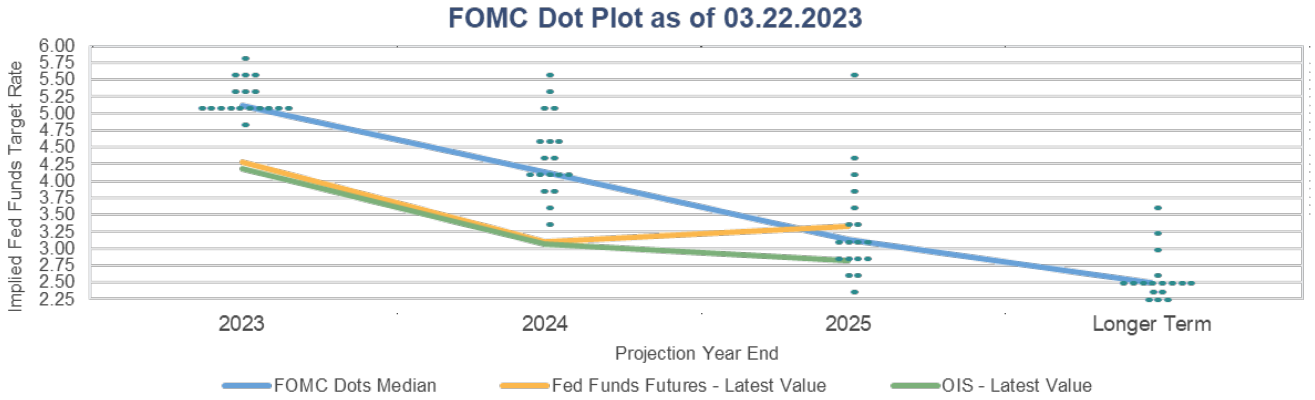

Our View

Even as rates have rallied strongly in March, we maintain our neutral duration bias as the odds for a recession later this year continue to move higher. We became more defensive on credit early in 2022. However, given the recent sell-off, we may opportunistically add to specific names as volatility and spread widening increase. We prefer higher-quality names and are focused on companies with stronger balance sheets to help weather an economic downturn.

Important Information

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 volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

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.