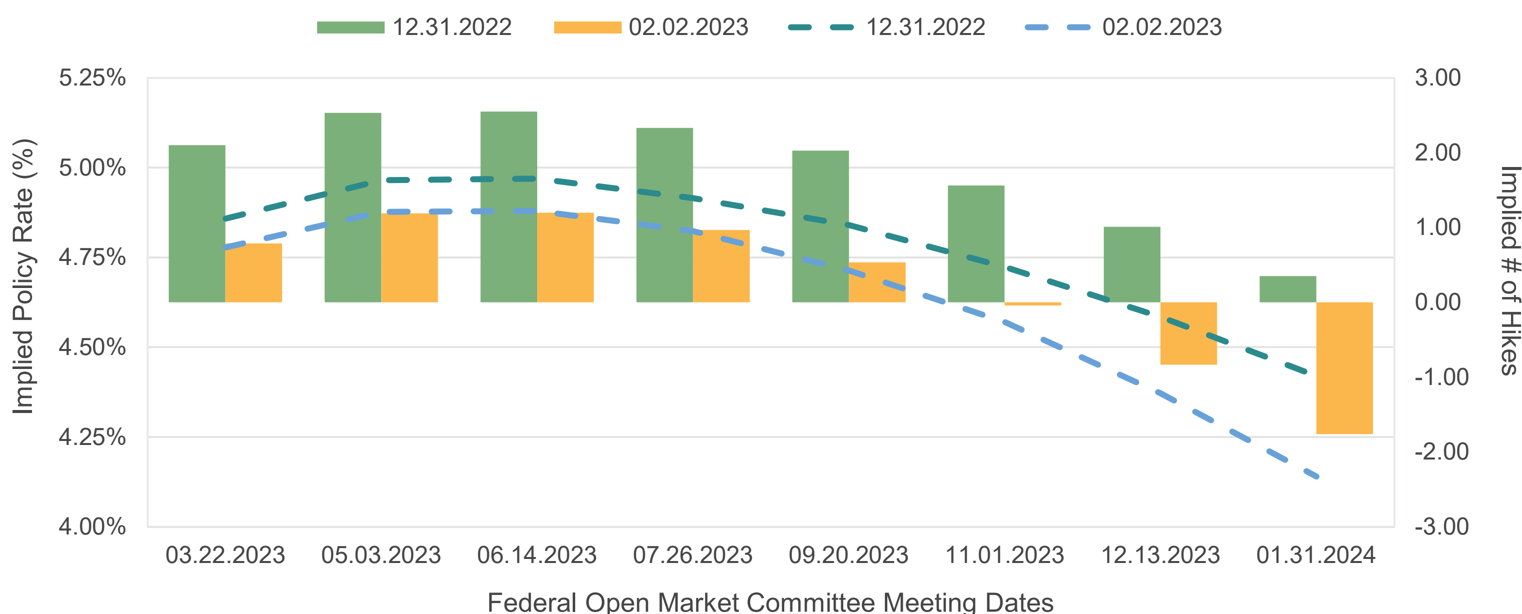
Powell's Disinflation Comments Surprise

February 3, 2023

While The Federal Reserve (Fed), as expected, once again reduced their pace of rate hikes from 50 to 25 basis points, the market's real focus was on Chair Jerome Powell's comments after the statement. During the press conference that followed, Chair Powell stated that the committee expected additional hikes and that inflation, specifically wage inflation, remained higher than they prefer. This was no different than the themes from the previous meetings. The big change was the acknowledgement of disinflation within certain sectors of the economy. In fact, Chair Powell used the word disinflation over a dozen times during his remarks. The market seized upon this change and both equity markets and bond markets rallied. The expectations now are for the Fed to raise rates one more time and then pause. Additionally, the odds for a rate cut in the latter part of 2023 have increased and the implied rate is now below 4.50% at year's end.

While we acknowledge that economic data has slowed, we believe the Fed will be wary to reverse course quickly without seeing sustained lower inflationary data. The Fed appears to be very reluctant to ease too soon and cause an inflationary spiral. The markets current expectations for the Fed Funds rate to hit approximately 5.0% appears reasonable. However, we believe the markets pricing of rate cuts later this year is still premature, and we continue to expect rates to remain higher for longer.



Our View

We have moved to a neutral duration posture as economic activity has slowed. Given the recent rally in risk assets, we believe recession risk is not being fully reflected in pricing. In this environment, our risk-off posture remains intact. We continue to reduce risk by selling into corporate credit strength. We prefer higher quality names and are focused on companies with stronger balance sheets to help weather a potential recession. We will look to tactically add to risk exposure in 2023 if spreads widen. Additionally, the possibility of a more public and contentious debate over the debt ceiling could cause spreads to widen temporarily and keep longer-term rates anchored.

Data is as of 02.02.2023. Source and textual data: 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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