The Fed: Mission Accomplished?

The most recent release of inflation data prompted a change of heart for many of those who had made bearish bets on the economy and the market. We saw a decline in consumer and wholesale prices that exceeded expectations and was in line with the first slowing of retail sales in six months. These combined to spark a reaction rally in the market that continues today and caught short sellers offside and TV talking heads by surprise. As we've come to expect where the market is concerned, a news-fueled reaction rally can give life to an overreaction in the narrative surrounding it.

Talk of a year-ending rally and rate cuts by the Fed in '24 have become the predominant theme. Many of the doomsayers predicting recession have assumed the stance of "upon further review…" and have leaned toward the *Soft Landing* crowd. The current narrative has now pivoted to acknowledging a successful execution of monetary policy by the Fed that resurrects the likelihood of that soft landing and the potential for a return to the good old days of the Goldilocks Economy (robust growth/lower inflation). That was reinforced by this week's preliminary Q3 GDP growth estimate of 5.2% that surprised analysts and one that we view as unsustainable through Q4, given the most recent declines in the Industrial/Manufacturing data. For some analysts, all that's missing now is the hanging of a "Mission Accomplished" banner. Our thoughts? Not so fast.

Looking ahead to the final Fed meeting of December 12, it's difficult to envision Chairman Powell standing at the podium with that banner in the background even as the treasury market is pricing in *rate cuts* by the Spring of '24. If we've learned anything these past few years, it's that the Fed is and will *remain* data dependent, not market dependent. We see the recent inflation data as too small a sample size and proof of winning only one skirmish in the long war against inflation. We're waiting to hear Powell speak of inflation being on a *sustainable path toward the mandated level of 2%.* That's the ultimate, stated goal and will require more supporting data in the months ahead.

As for rate cuts? The bearish camp sees them occurring in response to imminent recession while those bullish see rates normalizing in line with lower short-term treasury yields in the longer term once inflation is within spitting distance of 2%. Either way, the result doesn't arrive without slowing the economy to a below-trend level of growth. How that will affect earnings is the question. Results for Q3 have generally met or exceeded expectations while the outlook for Q4 is even more promising. How the economy slows and whether the robust GDP growth triggers additional rate hikes will mark the difference between a soft landing and recession.

The market will continue to react to not only inflation news, but the predicted response from the Fed. That could call into doubt the current high expectations for Q4 profits. With the S&P 500 currently just shy of its July high of roughly up 29% off the October '22 low, the market could be vulnerable to earnings falling short of those rosy expectations. For that reason, we're awaiting the delivery of a larger data sample before expanding upon our modestly bullish stance. Stay tuned.