November 2, 2022

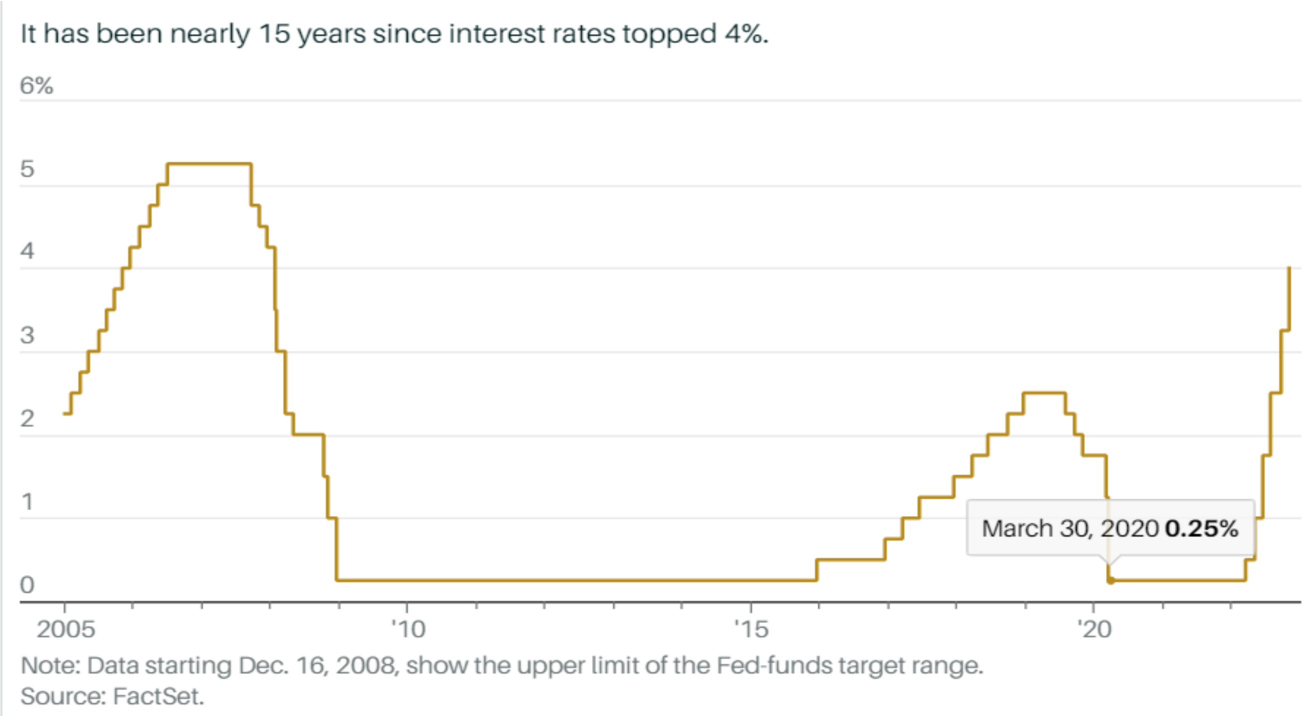
After experiencing one of the best months in over 126 years for the stock market in the month of October, share prices had surged in anticipation of the Federal Reserve Bank's (The Fed) potential announcement of a meaningful "pause" in the magnitude of their interest rate increases. The Federal Open Market Committee (FOMC) had raised rates an unprecedented three times since June, each time by a substantial 0.75%, the first time they had raised by that amount since 1994. After raising rates six times this year since March by a total of 3.75% (including today's 0.75% raise), many market participants expected the FOMC to subsequently announce today a "pivot" or the toning down of their aggressive inflation fighting tool, The Federal Funds Rate hikes.

Federal Reserve Bank Chairman Jerome Powell addresses the press today post-hike

What they received instead was a "hectoring" type of response from The Fed Chairman, Jerome Powell, warning investors that the Fed, through their rate control arm the FOMC, was not only going to continue to raise their administered interest rate (taking the optimistic "pivot" off the table), but they are also likely to raise rates aggressively for some time to come.

The FOMC statement included new language about the potential pace of rate hikes going forward: "The Committee anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time." It continued with: "In determining the pace of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the *lags* with which monetary policy affects economic activity and inflation, and economic and financial developments."

It was the anticipation of the term "lags" above that sent markets soaring higher in the weeks leading up to the FOMC announcement believing that this meant the FOMC would pause their hikes or "pivot" to a more passive pace of rate increases. Some analysts had actually predicted that The Fed might actually be close to a rate lowering phase as the risk of sending the economy into a recession has risen markedly over the last few months.



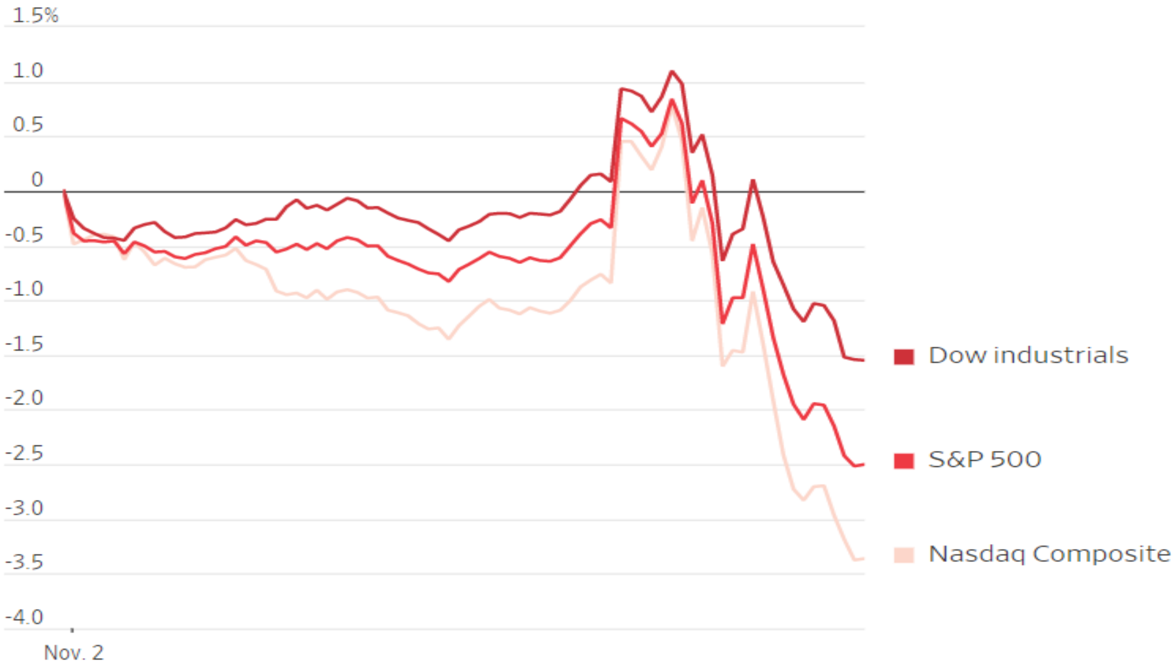
At his press conference, Powell reiterated that rates would continue to rise (emphasizing more than once that talk of a pause now was “premature”), but didn’t indicate how high they might have to go to bring inflation down. He reminded the press that the most recent inflation indicator that The Fed holds in high regard, the Personal Consumption Expenditure (PCE) indicator was a worrisome 6.2% in October. He also threw cold water on the stock market bulls by stating that he would like to see their short-term interest rate reach a point where it was higher than the rate of inflation. That’s known as the “real” level of interest rates and that would mean the FOMC would likely continue to aggressively raise the Fed Funds Rate until it was at or over 6%, provided the PCE remained elevated as it is currently.

“At some point, it will become appropriate to slow the pace of increases as we approach the level of interest rates that will be sufficiently restrictive to bring inflation down to our 2% goal,” Powell said. “There is significant uncertainty around that level of interest rates. Even so, we still have some ways to go, and incoming data since our last meeting suggest that the ultimate level of interest rates will be higher than previously expected.”

In a somewhat unexpected softening of his aggressive stance, Powell offered that “if we were to overtighten, we could then use our tools strongly to support the economy.” Continuing, “Whereas if we don’t get inflation under control because we don’t tighten enough, then we’re in a situation where inflation will become entrenched and the costs…will be much higher potentially.”

The markets anticipated a softer tone to the FOMC announcement today and the index averages hit their daily high just before the FOMC statement. Once Powell began to take the punch bowl away right in the middle of the bulls party, the averages plunged quickly closing at their session lows.

Index performance



As of Nov. 2, 4 p.m. ET

Source: FactSet

NASDAQ COMPOSITE INDEX COMP (NASDAQ)	10,524.80	-366.05	-3.36%	▼
S&P 500 INDEX SPX (S&P US)	3,759.69	-96.41	-2.50%	▼

As we have said beginning in March this year, the stock markets will have a difficult time digesting an aggressive Fed interest rate policy and today's activity reaffirms that stance.