FLORIDA PRIME™

Weekly Commentary

MARCH 6, 2023

Paige Wilhelm
Senior Vice President
Senior Portfolio Manager
Federated Investment Counseling

Pendulum swings too far yet again

It should come as no surprise that, after underestimating how high the Federal Reserve ultimately will take rates, the markets might now be overestimating it.

The "terminal rate" is jargon for the peak level policymakers will take the federal funds rate before eventually decreasing it. Ascending the summit in any tightening cycle is designed to fatigue the economy, but it can be overly demoralizing for consumers and businesses (measured in sentiment surveys, sales, inventory and the like) if they think the summit has been reached, only to discover there's more climbing to go.

About a month ago, traders and investors were betting the apex would be only a few ticks above 5% and that the Fed would actually start cutting rates later this year. That's understandable, as the Fed has been slowing the pace of hikes from 0.75% to 0.50% to 0.25% in the last three FOMC meetings. But after another robust jobs report, an unexpected increase in inflation readings (core CPI and PCE rose 0.4% and 0.6%, respectively, from December to January) and tough talk from Fed speakers, the fed funds futures market is now flirting with 5.50%, with no easing until 2024.

The shift certainly could be correct, but we see this as typical of the market pendulum yet again swinging too far as investors overcorrect previous views. We still see the Fed taking the target range to 5.25-5.50%, but are vigilant and willing to shift that view as data and Fed communication change. Smaller steps up the mountain make more sense than the lurching strides typical of the markets.

The opinions expressed within the Weekly Florida Prime Commentary are solely the author's opinions and do not necessarily reflect the opinions or beliefs of the State Board of Administration.

G40461-19 (3/23)