

December 11, 2023 – Investment Commentary

The 3 Ps (Powell, Pivot, Party)

On Wednesday, the Federal Reserve left interest rates unchanged, and U.S. central bank chief Powell said the historic tightening of monetary policy is likely over as inflation falls faster than expected with a discussion of cuts in borrowing costs coming “into view.” He said that rate increases were “not the base case anymore” and the Fed is “very focused on not making the mistake of keeping rates too high for too long.” We believe if economic data continues its current trend, with inflation cooling alongside a slowing economy, the Fed will likely be poised to cut sooner rather than later. Today, the Fed left its benchmark federal funds rate (target overnight rate banks lend to each other) unchanged at the 22-year high range between 5.25% and 5.5% at the conclusion of today’s final meeting of 2023. The dot plots (visualization of where the Fed members believe interest rates will be in the future) were updated and now indicate projections of up to three rate cuts of 25bps each next year.

The equity and bond markets ran after Powell waived the “Pivot Flag” from higher to longer, where the S&P 500 gained 1.4%, the Russell 2000 index shot up 3.5%, and the U.S. dollar dropped against a basket of currencies, and the U.S. Treasuries fell. Both the euro and yen appreciated in response, with the European Central Bank (ECB) preparing to announce its policy decision later on Thursday and the Bank of Japan coming up next week.

US Government Debt: Dramatic Price Up/ Yield Down Action

2yr US govt bonds closed -27bps/4.46% yield,

5yr -23bps/4.00% yield,

10yr -16bps/4.04% yield, and

30yr bonds closed -11bps/4.19% yield.

The yield on the 2-year Treasury note, which is tied closely to Fed policy rate expectations, declined a material 27 basis points (bps). This is essentially equivalent to a rate cut. Over the last eight weeks, the yield on the 10-year Treasury note, which is foundational to setting mortgage rates and other key borrowing costs, has declined by approximately one percentage point, an adjustment rarely seen outside of extraordinary events. Following the Fed statement, the U.S. interest rate futures priced in a 75% chance of a rate cut in March 2024, compared with 54% a week earlier. The CME FedWatch tool also raised the odds of a May rate cut to 90% versus 80% just before the announcement. In aggregate, the market is forecasting approximately 140bps of rate cuts in 2024.

What Can Go Wrong

Powell doesn’t seem concerned that the loosening of financial conditions with higher stocks and lower rates may weaken the Fed’s goal to fight inflation by stimulating more economic activity. He seems very satisfied that the economy continues to demonstrate decent growth, unemployment is stable, and inflation has meaningfully come down from 9% last year, albeit above its 2% target. Essentially, the prospects of a “soft landing” forecast are the best they have been in the last two years.

There are things that may go wrong...

1. Fed keeps monetary policy too tight for too long, and we have a weaker economy.
2. Fed could ease policy prematurely, or the market itself can ease financial conditions prematurely, stimulating the economy and inflation spikes where the Fed will be unable to cut rates as the market expects.

3. Sticky inflation (“the last mile is hard to get to 2% inflation); however, owners’ equivalent rent is trending downward, and OPEC+ seems to struggle to keep oil prices high.
4. Fundamental data that pushes back on a slowing economy.

We believe the market focus now is on the Fed cutting in 2024, where the uncertainty is only the timing and magnitude of cuts driven by the strength of the economy, energy prices, and services inflation.

We are also mindful of concerns regarding recent company guidance where rate cuts may be necessary to offset a more dramatic slowdown. In other words, while many investors are focused on the Price (P), we also consider the rate of change in the Earnings (E) as part of the P/E valuation metric.

Walmart CEO Doug McMillon said consumer spending is tougher to predict next year because of rising credit card balances and dwindling household bank accounts.

Chewy, the online pet products retailer, provided disappointing guidance for the January quarter and reduced its full-year outlook amid continued macroeconomic pressures on its business.

Lululemon Athletica provided soft holiday guidance.

Bill.com, the financial software company, posted disappointing earnings and cut its full-year sales outlook, citing a “challenging” macroeconomic climate.

\$6 trillion of Cash – step out on the risk spectrum?

There are different ways to step out of cash dependent upon an investors risk spectrum, liquidity needs and financial plan.

Consider transitions from money market funds to...

1. Front end of curve to intermediate duration 3-5 years. This provides an opportunity to lock in yield levels and potentially pick up more price appreciation to achieve total return in the context of falling rate environment.
2. High-quality equities both domestically and abroad.
3. Alternative strategies in private equity and credit.

Disclosures

Investment Commentary Sources: Bloomberg. Investment advisory services offered through Robertson Stephens Wealth Management, LLC (“Robertson Stephens”), an SEC-registered investment advisor. Registration does not imply any specific level of skill or training and does not constitute an endorsement of the firm by the Commission. This material is for general informational purposes only and should not be construed as investment, tax or legal advice. It does not constitute a recommendation or offer to buy or sell any security, has not been tailored to the needs of any specific investor, and should not provide the basis for any investment decision. Please consult with your Advisor prior to making any Investment decisions. The information contained herein was carefully compiled from sources believed to be reliable, but Robertson Stephens cannot guarantee its accuracy or completeness. Information, views and opinions are current as of the date of this presentation, are based on the information available at the time, and are subject to change based on market and other conditions. Robertson Stephens assumes no duty to update this information. Unless otherwise noted, any individual opinions presented are those of the author and not necessarily those of Robertson Stephens. Indices are unmanaged and reflect the reinvestment of all income or dividends but do not reflect the deduction of any fees or expenses which would reduce returns. Past performance does not guarantee future results. Forward-looking performance targets or estimates are not guaranteed and may not be achieved. Investing entails risks, including possible loss of principal. Alternative investments are only available to qualified investors and are not suitable for all investors. Alternative investments include risks such as illiquidity, long time horizons, reduced transparency, and significant loss of principal. This material is an investment advisory publication intended for investment advisory clients and prospective clients only. Robertson Stephens only transacts business in states in which it is properly registered or is excluded or exempted from registration. A copy of Robertson Stephens’ current written disclosure brochure filed with the SEC which discusses, among other things, Robertson Stephens’ business practices, services and fees, is available through the SEC’s website at: www.adviserinfo.sec.gov. © 2023 Robertson Stephens Wealth Management, LLC. All rights reserved. Robertson Stephens is a registered trademark of Robertson Stephens Wealth Management, LLC in the United States and elsewhere.