Stocks are fed up at the prospect of more rate hikes

- Markets were jolted back into reality last week. The Fed raised interest rates by 75 basis points (bps) for a fourth straight meeting, while continued strength in the U.S. labor market provided evidence that the Fed's job of cooling the economy is far from over. The S&P 500 Index fell 3.4%, giving back a substantial portion of its gains from the prior two weeks.[1]
- Expectations for more Fed interest-rate hikes increased after Chair Jerome Powell hinted that the ending point for the federal funds target range rate next year could be substantially higher than the level forecast by the Fed in September. Investors now believe the Powell and his colleagues will raise interest rates to well above 5% by the middle of 2023. Against that backdrop, the yield on the bellwether 10-year U.S. Treasury note rose by 15 basis points, to 4.17%, for the week.[2]
- The Bank of England (BoE) took a different approach at its meeting last Thursday. Although the BoE also raised borrowing costs by 75 bps, its guidance made clear that the market's expectations for future tightening appear to be too aggressive. The U.K. economy may already be in recession, putting the central bank in the unenviable position of deciding between lowering inflation or avoiding a surge in unemployment.
- On this week's U.S. economic data docket, consumer price index (CPI) data will be in focus on Thursday. With gasoline prices bottoming at the end of October, headline CPI may well tick up from September's 8.2% year-over-year rate. Core prices, which have been driven by higher rents and demand for services, could begin to decelerate after reaching a 40-year peak.[3]
- And, of course, Americans go to the polls on Tuesday. While stocks often rally in the year following the midterms — regardless of which side wins — the market's various headwinds, including high inflation, rising interest rates and geopolitical tensions, give us pause. We're approaching this cycle with a great deal of caution.

Each week, we present our featured topics in the context of major themes from Nuveen's most recent global investment outlook:

- **U.S. economy**: A deep or prolonged recession is unlikely, but expect inflation to come down slowly.
- **Global economy**: Countries with lower personal income levels and greater energy dependence are more vulnerable to harsher downturns.
- **Policy watch**: Central banks worldwide remain firmly in tightening mode.
- **Fixed income**: Still too early to extend duration, but yields across segments of the bond market look attractive.
- **Equities:** Favor U.S. stocks (especially large caps) over non-U.S. developed and emerging market shares. Keep expectations in check.
- **Asset allocation**: Diversification benefits remain elusive, but fixed income is valued more attractively than equities for the first time in years.

Quote of the week: “And I’m on my way/I don’t know where I’m going/I’m on my way/I’m taking my time/But I don’t know where.” ─ Paul Simon, “Me and Julio Down by the Schoolyard.”

The Fed forges ahead

Last week, as expected, the Federal Reserve approved a 75 basis point increase in its policy rate for a fourth consecutive meeting, to a range of 3.75% to 4.00% — the highest level since 2008.[4] (Back then, though, the Fed was in the process of cutting rates to spur the economy amid the global financial crisis.) The Fed decided a hike of this magnitude was needed to combat still-hot inflation, which remains well above the Fed’s 2% target.

In its policy statement, the central bank indicated it would “take into account the cumulative tightening” implemented so far, in addition to “the lags with which monetary policy affects economic activity and inflation.” This allows officials to monitor how their hawkish moves have slowed the economy. To date, the interest-rate-sensitive housing market has felt the most pain from the Fed’s actions due to soaring mortgage costs.

Chair Jerome Powell suggested that policymakers would entertain the possibility of a smaller move at their next meeting on December 14 “or the one after that.” However, he tempered those remarks by warning that the Fed might ultimately have to lift rates to a higher level than previously expected and keep them there for quite some time.

Recent public comments from the Fed have emphasized lower inflation as a condition for large rate hikes to cease, implying a pivot towards stable, let alone easier, policy is not around the corner. Yet trends in many of the drivers of rising prices — lower rent and declining wages, for example — provide reasons for optimism that inflation should moderate in the near term.

Across the Atlantic, the Bank of England (BoE) matched the Fed (and the European Central Bank the week before) with a 75 basis point increase, as U.K. inflation soared 10.1% year-over-year in September, equaling July’s 40-year high.[5] At the same time, the BoE issued unusually strong guidance that markets may be pricing in more tightening than will be needed, partly because it forecasts a painful, prolonged recession.

A “split decision” on U.S. employment will leave investors scratching their heads

U.S. employment reports have become something of a formality lately, with non-farm payroll gains routinely coming in stronger than expected, average hourly earnings growth decelerating and other indicators more or less treading water.

As if on cue, employers added a healthy 261,000 jobs in October, outstripping consensus forecasts for 193,000, while revisions to prior months were positive, on net.[6] And average hourly earnings for nonsupervisory workers rose just 0.3% last month, contributing to the year-over-year slowdown from 6.7% during the first quarter to 5.5%.[7]

But there was a hitch in this report, one we’ve seen before. For the third time in the past seven months, the household survey, which polls individuals about their employment situation and is used to calculate the unemployment rate and labor force participation, *declined,* this time by a whopping 328,000 jobs. Since April, this job creation measure is essentially unchanged.[8]

In comparison, according to the establishment survey, which estimates payroll and compensation changes derived from employer data and produces the headline job creation number (261,000 in this case), payrolls have *risen* by nearly 2.5 million over that same seven-month stretch.[9] Although discrepancies between the two surveys are common, such glaring mismatches muddy the waters for both the Fed and investors.

There were a few other less-than-ideal details in the household survey.

- The employment-to-population ratio among prime age (25-54 years old) workers dropped by 0.4%. Although this data can be "noisy" from month to month, it's now flat to slightly down since the spring.[10]

- The unemployment rate increased as the number of unemployed workers rose while the number of employed workers fell.

That's a lot of data to digest, so here's our take. The preponderance of job-related statistics suggests that the labor market is loosening — but only very slightly and very slowly. In analyzing October's release, the Fed will find evidence that its rate hikes are cooling the economy, but not nearly enough to consider taking its foot off the brake entirely.

SOURCES:
1.Marketwatch
2.Federal Reserve via Haver
3.Bureau of Labor Statistics (BLS) via Haver/Trading Economics
4.Federal Reserve via Trading Economics
5.Office for National Statistics via Trading Economics
6. Bloomberg, BLS
7.Bloomberg
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