Clark Capital Management Group

Commentary

Navigator® Market Update

Out with the Old (Rate Hike Cycle) in with the New (Rate Cut Cycle)

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The Federal Reserve finally acted on the long-anticipated, and hotly debated, first rate cut, which ended the tightening policy that saw the fed funds rate upper bound at 5.5%. The Fed cut the overnight rate by 50 basis points (bps) to 4.75% - 5.0%. The decision was not unanimous! The FOMC voted 11-1, with the dissenting vote in favor of a smaller quarter-point cut, and the first dissent by a governor since 2005.

In our opinion, a half percentage point rate cut was warranted and consistent with Powell's dovish comments from the August Jackson Hole Symposium when he stressed that they didn't desire to see further weakening in the labor markets. However, the unemployment rate is up 0.8% from its recent low and Core (Personal Consumption Expenditures) PCE is running less than 2% annualized since May.

In the post-FOMC meeting press conference Chairman Powell said, "This decision reflects our growing confidence that with an appropriate recalibration of our policy stance, strength in the labor market can be maintained in a context of moderate growth and inflation moving sustainably down to 2%." His use of the word "recalibration" is exactly the language we used in our Annual Market Outlook. In January we stated, "The Fed will cut rates to recalibrate monetary policy due to slower inflation, not because economic activity is collapsing. We see full year economic growth of 2.25% along with 4 rate cuts as the Fed recalibrates monetary policy."

The market is now also expecting two more 25 bps rate cuts before year end, one at each of the November and December FOMC meetings. If realized, that would be the equivalent of four rate cuts this year.

The median dot in the Summary of Economic Projections showed 50 bps more cuts in 2024 to a fed funds rate of 4.375%, 100 bps of cuts in 2025 to 3.375%, and 50 bps of cuts in 2026 to 2.875%, which is the median participant's estimate of the neutral rate.

Fed officials also updated their quarterly economic forecasts, raising their median projection for unemployment at the end of this year to 4.4% from their 4% forecast in June (note that the unemployment rate, which is currently at 4.2%, is already above where they thought it would end the year. The median forecast for inflation at the end of 2024 declined to 2.3% while the median projection for economic growth ticked down to 2%. Policymakers still don't see inflation returning to their 2% target until 2026.

Ironically, it was the first 50 bps cut to start a new rate cut cycle since September 18, 2007… exactly 17 years ago.

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How will the market respond? History shows that no recession results in gains. Of the last 11 rate cut cycles, six occurred while the economy was in expansion and 5 occurred while the economy was either in recession or shortly thereafter tipped into recession. In the six expansionary rate cuts, the S&P 500 posted gains during each period 1 month, 3 months, 6 months, 9 months, and 12 months later.

As far as the immediate outlook is concerned, the presidential election is now less than 50 days away. Polling suggests a very tight race that likely will come down to the wire. We expect some level of heightened volatility. As long as credit trends remain resilient and supportive, which they have all year, we would view any volatility and associated market weakness as a buying opportunity and a pause that refreshes.

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