The Way We See It

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September 2022 FOMC meeting

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At the time of writing (afternoon of 22nd September), the market in general responded negatively to the FOMC meeting that took place overnight. We wish to share our views in response to the latest development.

Key Announcements

As the media has widely reported, the US Fed raised rates by a well-anticipated 75bps to take the US cash rate to 3-3.25% p.a.

What surprised the equity and other cyclical markets on the downside, post-the FOMC meeting, can be attributed to two market-adverse announcements:

1. By December of this year, the Fed predicts that the US cash rate can be expected to rise by a further 100-125bps to reach around 4-4.25% p.a. Then it is expected to be raised further next year, peaking at around 4.60% p.a.

2. In the coming 12 months, the US economy is forecasted to slow down sharply and to show almost no growth.

The Way We See It

- Our Assessment

In brief, the Fed is predicting much higher interest rates to combat a rising and sticky inflation problem, and a slump in economic growth. Stagflation is definitely not a good macroeconomic backdrop and combination for cyclical asset markets (including stocks, corporate bonds, commodities and non-USD currencies).

Of course, the Fed has been consistently emphasising that the above cash rate and growth forecasts can change (for the better or worse!), depending on whether the forthcoming economic data will surprise on the upside or downside, relative to current expectations.

Let's assume for the moment that the Fed is correct in their economic analysis and predictions of a stagflation scenario. If so, it will thus continue to implement a very restrictive monetary policy, involving both rate hikes and quantitative tightening.

The net outcome of this scenario is that it serves to reinforce our current bearish economic forecasts and defensive investment strategy, a view which we have consistently been holding through this year. We continue to recommend it.

- Recommended Investment Strategy

In summary, as we have consistently been advising clients throughout this year, until the Fed pauses and/or eases, or that equity/corporate bonds' valuations become extremely cheap, a defensive investment strategy involving an underweighting in cyclical and growth assets and overweighting in short-dated US Treasury and Investment Grade bonds, plus selective high-quality dividend yielding stocks, with low volatility, is preferred.

Investors are advised to remain defensive in their portfolios

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