June 7, 2023

Dear Friends and Clients,

Every so often Washington likes to remind us how hard it can be to get things accomplished. The most recent example is the debt ceiling—the amount Congress can borrow to pay its bills. It seems like we have this debate every few years and in the end a deal is made, which is just what happened this time. Considering equity markets never really reacted to the drama, perhaps this is a good reminder that focusing on long-term objectives is the best strategy, even amid a fair amount of market noise.

With the debt ceiling drama behind us, markets will likely return their attention to topics such as inflation, the health of the economy, and the Federal Reserve (Fed)—who is scheduled to meet June 14-15. Expectations are that they will not raise short-term interest rates for the first time in 10 meetings. The Fed has done a lot of heavy lifting already—raising short-term interest rates by 5% in just over a year. Since rate hikes tend to have a long and variable lag, the Fed wants to see how those rate hikes more fully flow through the economy before its next move.

The Fed's goal has been to elevate the fed funds rate and make the cost of borrowing money prohibitively expensive, to slow aggregate demand. While this has exposed some cracks in the regional banking sector, it should allow inflationary pressures to abate. But then what? After winning its fight with inflation, the Fed is expected to start cutting rates early next year. Just as the aggressive rate-hiking cycle took Treasury yields higher, interest rate cuts will take Treasury (and other bond market) yields lower. Both lower inflation and an end to rate increases could be welcome news for core bonds, especially intermediate core bonds, which have tended to perform well after rate-hiking campaigns. Investors may be better served by locking in these higher yields before they're gone.

Only time will tell, but it feels like we're finally on a path to lower interest rates and the end of this inflationary cycle. Of course there will be other challenges to deal with, that's just the dynamic nature of the market. But in the meantime, returning to the familiar—lower rates and the end of inflation—is something we can all rally around.

Please reach out to me if you have any questions.

Best regards,

Victor

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All data is provided as of June 6, 2023.

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