First Trust
Monday Morning OUTLOOK

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Focused on the Fed

The Fed meets this week, which means investors and analysts will be sifting through Wednesday's FOMC statement, updated economic projections, the "dot plots," and Powell's press conference searching for any signal – real or imagined – about what our central bank will do next. In particular, the market is on tenterhooks about when rate cuts will start, how fast those rate cuts will come, or if the Fed will simply hit the "pause" button on the prospect of rate cuts until deep into 2024.

We think this obsession with the Federal Reserve is unhealthy. Instead of an obsession with slight policy shifts out of Washington, DC, we think investors need to be focused on more important matters, like the process of innovation, entrepreneurial risk-taking, and corporate profits. In the end, it's these factors that will drive stock market valuations the most, not the vagaries of the short-term interest rate target by the mandarins of money.

Things have changed a great deal since the last Fed meeting on January 31. Back then, the futures market expected about six rate cuts of 25 basis points each this year, with the first cut coming in March. As of Friday's close, the market was expecting only three rate cuts this year, with the first one coming in either June or July.

No wonder the shift in rate expectations given recent reports on inflation. The two CPI reports since then show consumer prices up at a 4.6% annual rate in the first two months this year. And no, this was not food and energy; "core" prices, which exclude those two volatile categories were also up at a 4.6% annual rate so far this year.

Even worse for the Fed is that the newly made-up slice of the CPI that the Fed and others call the "Super Core" measure of inflation, which includes services only (no goods) but also excludes food, energy, and housing rents, rose 0.8% in January and 0.5% in February. That's a growth rate of 8.2% annualized so far this year. Notice how you used to hear a lot about this measure a year or so ago when it was indicating lower inflation and now few dare speak its name when it shows inflation re-accelerating! Meanwhile, overall producer prices are up 5.4% so far this year and "core" producer prices are up at a 4.5% annual rate.

None of these figures are remotely close to the 2.0% inflation goal the Fed claims it's still targeting.

The problem for the Fed is that there are signs that the economy may be slowing. Although retail sales rose 0.6% in February, after factoring in downward revisions to prior months, retail sales rose a tepid 0.1%. "Core" sales, which exclude volatile categories such as autos, building materials, and gas stations — and is a crucial measure for estimating GDP — increased by 0.1% in February, but was revised significantly lower for previous months, down 0.5%. If unchanged in March these sales will be down at a 0.7% annual rate in Q1 versus Q4, which would be the first quarterly decline since the COVID lockdowns.

Industrial production rose a tepid 0.1% in February but that follows declines of 0.3% and 0.5% in December and January, respectively. We like to follow manufacturing output excluding the auto sector (which is volatile) and that is down 0.9% from a year ago. Not a good sign.

As always, we will be watching the press conference following Wednesday's meeting for any mention of the Fed looking more closely at the money supply, but we won't get our hopes up. The M2 measure of money is down 2.0% in the past year, which would not be good for the economy if these figures are accurate and if they continue.

Another key issue is whether the Fed will publicly abandon it's 2.0% target to make it easier on themselves to achieve their goal. We think that will happen eventually, but that's several years from now, not soon. The Fed likely thinks it would lose credibility if it announced a higher target for inflation, and could send long-term interest rates spiraling upward; that's not a risk the Fed would take, particularly in an election year.

Our advice to investors: listen to and watch the Fed but don't obsess about it. The changes in monetary policy from meeting to meeting don't matter nearly as much as the productive capacity of the American people.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-19 / 7:30 am	Housing Starts – Feb	1.430 Mil	**1.465 Mil**		1.331 Mil
3-21 / 7:30 am	Initial Claims – Mar 16	215K	**209K**		209K
7:30 am	Philly Fed Survey – Mar	-2.3	**-8.6**		5.2
9:00 am	Existing Home Sales – Feb	3.940 Mil	**4.150 Mil**		4.000 Mil