



Insigneo Weekly Dispatch

Dancing With the Stars: Thoughts on the Fed's Recent Meeting



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Companies are starting to respond to an uncertain economic environment.

Federal Reserve Chairman Jerome Powell may have proven to be a skillful dancer after his performance this past Wednesday. Had he been a contestant in the show Dancing with the Stars, he might have taken the trophy. Based on their subsequent reactions, if

the equity markets had been the celebrity judges evaluating his performance, they might have crowned him as champion. However, Chairman Powell was not performing on the dance floor, but on a stage speaking and taking questions during the press conference following the Federal Reserve's March meeting. His goal was not to win a dance contest, but to maintain a level of flexibility that allowed the Fed the ability to react to the data as it flows in. He did this masterfully.

As expected, Chairman Powell announced that the Federal Reserve was leaving the Federal Funds reference rates unchanged at a level between 4.25% and 4.5%. **What was unexpected was the fact that the Fed also adjusted its economic forecast for 2025. In doing so, it reduced its GDP growth forecast from 2.1% down to 1.7%, at the same time increasing its core PCE inflation forecast from 2.5% to 2.8%.** If we stop and think about this, lower economic growth combined with increasing inflation is the definition of stagflation, where the economy stagnates while prices continue higher, squeezing consumers and businesses alike. If left unchecked, stagflation can

quickly devolve into recession. In fact, Powell himself acknowledged that “Recession risk has moved up, but it’s not high”. After realizing that stagflation is a real possibility, while the risk of recession rises, one would think that equity markets would have moved sharply lower. However, the S&P 500 closed 1.08% higher on Wednesday, representing the highest move on a Fed meeting day since 2022. Why?

In a nutshell, the market looked past the possibility of stagflation because it was myopically focused on one thing, rate cuts. Investors came into Wednesday’s meeting fearing that the Fed was going to remove the proverbial rate cut candy bowl from the table. Having priced in two 25 basis point cuts for 2025, markets feared that Chairman Powell was going to reduce or even eliminate the possibility of further rate cuts for the year. Although Powell did acknowledge that uncertainty around the economic outlook had increased and that he saw upside risk to unemployment, he also managed to downplay these risks, stating that the “hard data shows that the economy is still solid”. While the market feared that increased inflation resulting from higher tariffs could cause the Fed to hold back from reducing rates further, Powell stated that “long-run inflation expectations remain well-anchored” and that the inflation effects resulting from tariffs could prove to be “transitory”. He later hedged this statement when he responded to a question on the stickiness of tariff inflation by saying “...we can’t know...we are going to have to see how things actually work out”. Powell managed to skillfully dance a delicate dance, balancing between the reality that stagflation is a tangible possibility, offset by the current strength of the economy and possible transitory nature of tariff-related inflation. **The Fed is attempting to create flexibility for itself, allowing it the plasticity it needs to leave the door open for different policy options.** However, we found it interesting that it chose to recognize tariff inflation as “transitory” as its base case for the

economy, considering that back in 2021 it also labeled post-pandemic inflation as “transitory”, a mistake that it cannot afford to make twice.

Another interesting dynamic arises when we examine the Fed’s dot-plot, which shows each Federal Open Market Committee (FOMC) member’s projection of interest rates for the year. Although the dot plot showed 9 members pricing in 2 cuts for 2025, it also showed 8 members pricing in 1 or no cuts, highlighting a hawkish tilt within the FOMC itself. Andrew Levin, Economics professor at Dartmouth University, brilliantly made this point during a recent interview with CNBC. Professor Levin pointed out that not all FOMC members are onboard with cutting rates, as the Fed’s supercore inflation component, which includes core services, wages, and labor costs, is still above 4%, stating that the real progress on inflation is not what we can see on the surface. However, he went one step further when he stated that it is “hard to see the Fed’s strategy”. We could not agree more. Chairman Powell is a very intelligent man who has done a masterful job navigating an everchanging flow of data. But the Fed appears to have been doing just that, reacting to data instead of following a strategy. That being said, dissent within the ranks of the Fed itself appears to be growing. In fact, Fed Governor Christopher Waller cast the single dissenting vote this week, in opposition to the decision to slow the Fed’s balance sheet run off. Granted, Governor Waller’s dissention could be politically motivated, as he could be jockeying for positioning to be appointed as the Fed’s next Chairman after Powell’s term ends next year. Regardless, markets might have to wait a bit longer to get a longer-term Fed strategy in place.

In the meantime, investors might be well served to focus instead on what companies are doing. I spent most of my career as an equity analyst at Bank of New York Mellon and dealt with a multitude of company management teams over the years. **Two things**

I learned about management teams are that 1) what management is doing is exponentially more important than what it is saying, and 2) management teams, and as a result, companies themselves tend to have a much better view of the economic and business environment than investors. In other words, follow the companies, not just the markets. To this point, we are starting to see a trend where numerous companies are reducing sales and earnings guidance for the current year based on the uncertainty in the business and economic environment. Delta Airlines, Walmart, McDonald's, Target, Dollar General, Lowe's, Kohl's, Foot Locker, and General Mills are some of the Consumer Discretionary and Staples companies that have cut guidance as consumers become more cautious on spending. Just yesterday, we saw an industrial company, Fedex, revise guidance lower when it reported earnings, stating, "Our revised earnings outlook reflects continued weakness and uncertainty in the U.S. industrial economy, which is constraining demand for our business-to-business services" (John Dietrich, Fedex Chief Financial Officer). What is more concerning is the fact that some of these companies, such as Delta Airlines, have chosen to reduce guidance outside of their scheduled earnings reports, something that

most companies try to avoid, as it normally leads to a drop in stock prices. We are not trying to be alarmists; we are simply bringing to light the reality that many companies' management teams are starting to see and adapt to. Whether tariff inflation proves to be transitory or not, monitoring how companies respond to this changing environment is important.

What can investors do? **Stay diversified.** Ensuring that portfolios are well diversified across assets is key. Within equities, having exposure across different sectors and regions is critical to balance U.S. exposure. Additionally, exposure to quality companies with strong balance sheets and resilient business models is essential. Most importantly, in the complicated dance between the Fed, the economy, and the markets, do not panic, keep your head up and your eye on the long term, and do not be afraid to lean on your best dance partner, your financial advisor. ■



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