PGIM QUANTITATIVE SOLUTIONS

COMMENTARY

PGIM Quant Multi Asset:
Fed Presses on Despite Banking Sector Turmoil

The Federal Reserve (Fed) hiked interest rates on March 22nd for the ninth-consecutive time in the span of a year, bringing its upper-bound target policy rate to 5%. The hike ratified market expectations going into the meeting and underscores the balancing act the FOMC is charged with to acknowledge the recent turmoil in the banking sector but also emphasize its commitment to reducing inflation to acceptable levels. The Fed backed off earlier expectations of a 50-basis point hike given the sudden failure of three regional banks since March 10th and decided to forgo a temporary pause, which was considered by the committee but not widely expected headed into the meeting.

The most significant change to the Fed statement involved the forward guidance around future rate increases, previously described as “ongoing increases” to the target rate. The current statement notes “additional policy increases may be appropriate.” Market participants generally viewed this as a “dovish hike” and the so-called FOMC “dot plot” implies one additional 25-basis point rate hike this year.

Nothing in the Fed’s actions, the statement, its published forecasts, or the press conference changes our view on the prospects for the economy, U.S. equities, or more generally, risks assets. The Fed was already faced with an incredibly difficult task in trying to engineer a soft landing with the economy at full employment and inflation running far above its target. We think the Fed is unlikely to succeed in this task. Whatever the odds of recession were before the banking sector turmoil, they have notably increased. Tighter lending standards will further crimp economic growth even if the banking crisis does not spread. U.S. equities exhibit unattractive valuation and are still at risk of significant drawdown in 2023. We remain defensively positioned across our multi-asset portfolios.

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