CIO continues to see an overall healthy outlook for the US economy, and believe that rate cuts later this year support their positive view on quality bonds and quality stocks. (UBS)

The Fed’s 'dot plot' in focus

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The S&P 500 stood at an all-time high ahead of the conclusion of the Federal Reserve’s March policy meeting, while the 10-year US Treasury yield is also close to its year-to-date high. It’s widely expected that the US central bank will keep its policy rate unchanged today at 5.25–5.50%, but investors will be eager for guidance on when to expect easing to begin.

In December, the “dot plot,” which charts policymakers' rate expectations, showed a median forecast of three cuts in 2024. If this falls to two cuts, it would likely be a setback for both equity and fixed income markets, even if investors have already scaled back their expectations following stronger-than-expected inflation data over the past two months.

However, we continue to see an overall healthy outlook for the US economy, and believe that rate cuts later this year support our positive view on quality bonds and quality stocks.

The Fed is likely to tolerate a couple of months of disappointing inflation data. The details of the February consumer price index (CPI) indicated that much of the hot January print is likely to fade in the coming months. Several Fed officials have also said the path down to the central bank’s inflation goal could be bumpy. In addition, the disinflation trend remains evident globally, with core inflation measures (weighted by GDP) nearly back to 2%. We believe inflation should recede in the coming months on a more balanced labor market and slowing economic growth.

The labor market continues to see signs of cooling. The latest labor report showed a moderation in average hourly earnings growth and a higher unemployment rate. Multiple other indicators—the Atlanta Fed wage tracker, the employment cost index, quit rates, National Federation of Independent Business (NFIB) hiring and compensation plans, job openings to unemployed ratio—are also back to either mid-2020 or mid-2021 levels and trending lower. We believe the cooling labor market suggests that inflation is more likely to continue falling, instead of staying at current levels.

Economic growth has returned to a more sustainable level. The Atlanta Fed GDP tracker for the first quarter of this year has come down to 2.1%, following a smaller-than-expected rebound in retail sales. As restrictive monetary policy continues to feed through the economy, we expect the US to grow around the trend rate of 2% this year, a fairly healthy outlook.

So, we continue to believe that the macro backdrop remains benign for the Fed to cut rates this year, creating an environment favorable for quality bonds and quality stocks.

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