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A Fed credibility-induced bounce

The Fed’s hawkish stance is helping restore its inflation-fighting credentials, stabilising long-term bond yields.

Fed moves to restore credibility

The Fed’s decision to hike rates for the first time since 2023 and pencil in another hike by December, confirms the expectations – flagged in the last two weeklies - of a central bank willing to establish its independence against political pressure. The policy pivot followed Chair Warsh’s hawkish Jackson Hole speech and recent economic data prints, namely: a pick-up in job creation and inflation over the summer and a sharp rebound in oil prices due to the re-escalation of the Middle East conflict. This pivot probably would help the Fed rebuild credibility as an inflation fighter.

Buying the equity dip as focus turns to fundamentals

History suggests a 25bps rise in Fed rates (the discount rate) typically impacts the S&P500 index and global equities by 3-4%. Nevertheless, a hawkish Fed is largely priced-in and expects fewer rate hikes than currently priced by markets. The headwind of higher rates is to be offset by strong corporate earnings growth, driving positive performance for global equities. Meanwhile, concerns over AI industry leaders slowing the pace of development are overdone.

Modestly bullish JPY; rangebound GBP

JPY remains constructive amid narrowing rate differentials with the US as the BoJ potentially hikes rates by 25bps once per quarter until Q2 2027 to curb rising inflation pressures. The narrowing rate differential is likely to reduce the attractiveness of JPY-funded carry trades over the medium term. For the BoE, rates are expected to remain unchanged for now as the domestic job and housing markets slow. This is likely to keep GBP rangebound.

US earnings continue to drive equity outperformance

Cooling economic data softening bond yields, coupled with still strong reported earnings, equities continue to deliver positive returns. The equity rally appears to be broadening out.

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