Market Commentary Blog

# Cash Flow *and Carey*

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# Standing On A Knife-Edge

### 60/40 Blend 1 & 3-Year Total Returns Post Calendar Year

| Calendar Year | Initial Federal Funds Target Rate (Upper Bound) | 60/40 Blend Total Return +1 Year | 60/40 Blend Total Return +3 Years |
|---|---|---|---|
| **2022** | 0.25% | ? | ? |
| **1980** | 14% | -0.45% | 46.05% |
| **1979** | 10% | 20.58% | 49.77% |
| **1978** | 6.5% | 11.94% | 34.14% |
| **1994** | 3% | 29.92% | 89.14% |

Source: Bloomberg. **Past Performance is no guarantee of future results.**
The 60/40 Blend is comprised of the S&P 500 Index (60%) and the Bloomberg U.S. Aggregate Index (40%).

## View from the Observation Deck

Today's blog post builds on our last one (Click Here for "Uncharted Waters"), where we discussed how the increase in the unprecedentedly low federal funds rate impacted the equity and fixed income markets in 2022. Tuesday's post got us thinking: how did the markets perform in the wake of the rate hike cycles we highlighted? The table above shows the federal funds target rate at the start of the calendar year, as well as the total returns of a 60/40 blend over the one-year and three-year time frames that followed.

**Significant reductions to the federal funds target rate (upper bound) combined with favorable U.S. fiscal policy enabled above-average total returns for the 60/40 blend in each of the time periods in the table (excluding the year after 1980).**

The federal funds target rate experienced significant declines within the each of the three-year time periods represented in the chart (with the exception of 1995-1997). Over just three months (March 31, 1980 to June 30, 1980), the rate plummeted by 10.5 percentage points, falling from 20% down to 9.5%. In the latter half of 1981 through the end of 1982 the rate fell again, dropping by 11.5 percentage points, from 20% on May 29, 1981 to 8.5% on December 31, 1982. As indicated in the table, the Federal Reserve's ("Fed") looser monetary policy acted as a catalyst, producing positive total returns for the 60/40 blend in all but one of the time periods represented.

**Even after a 425 basis point increase in 2022, the federal funds target rate (upper bound) still sits below its historical average.**

The federal funds target rate averaged 4.89% over the past 50 years (12/29/1972 to 12/30/2022). As we discussed in Tuesday's blog, 2022's initial federal funds target rate was the lowest the rate had ever been at the start of such a steep tightening cycle. The resultant 17-fold increase in the federal funds target rate, while massive, only increased the rate to 4.5%. If the Fed is forced to tighten further, it is our opinion that the financial markets will continue to wallow. Conversely, the Fed does not have the cushion they did in the late 1970's and early 1980's should they need to loosen monetary policy.

## Takeaway

The 60/40 blend posted positive total returns in nearly every one of the time frames represented in today's table. Not surprisingly, the Fed was in the process of implementing looser monetary policy in almost every one of those time periods.

We're standing on a knife-edge. Further Fed tightening will add pressure to an already battered financial market. Conversely, the Fed cannot lower rates by the same 10.5 and 11.5 percentage points as the early 1980's without adopting a negative interest rate policy.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. The Bloomberg U.S. Aggregate Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

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