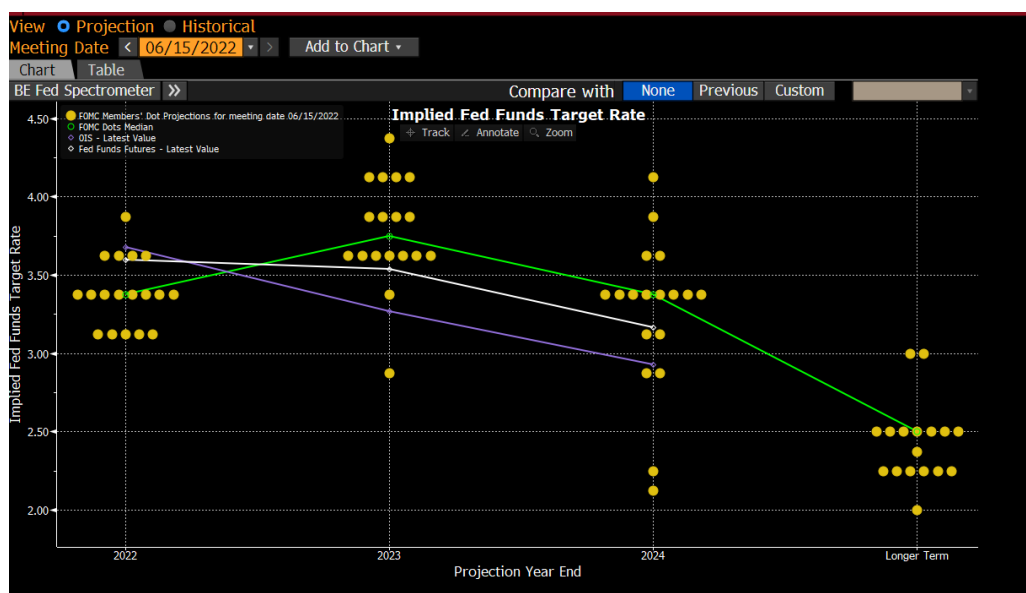


Did the Fed finally take control of inflation?

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The Federal Reserve lifted rates by 75 basis points as was partially expected. This is the largest increase since 1994 and Chairman Powell promised potentially the same at the next meeting. In essence, what the Fed promises is a more rapid set of rate hikes to a terminal rate that is almost exactly priced into Fed Fund futures (see dot plots graph below). The Fed tried to put a positive spin on growth to anchor expectations amongst households with a focus on a still strong labor market, but its forecasts have been revised lower, a point professionals will have noted. As a consequence, US equities and bonds rallied amid profit taking and possibly because the Fed was seen as finally reining in inflation – however there is little evidence of this in break-even inflation. The Fed may have properly timed excessive bearishness in the US equity market, but the question is whether its guidance can survive the coming growth and inflation mix.



Source: Nordea Investment Funds S.A. and Bloomberg

The problem is whether the terminal rate will convince the market, when in reality it is hard to forecast. The next thing to watch for is if consumption slows and if surveys (such as the business Beige Book or University of Michigan Index of Consumer Sentiment) adjust rapidly. This is a cyclical view of an uncertain business cycle but one key source of uncertainty is what happens with the real estate market, where an enormous amount of wealth is stored and leverage is high. That would affect consumption in discretionary and higher added value products. Given that real estate prices have surged sharply on scarce supply, house prices have by definition significantly overshoot the mark. There is already evidence of less competition amongst buyers faced with much higher mortgage rates. The question is when will the house of cards come down? Is it slow and delayed or rapid? The odds are that prices adjust lower fairly rapidly but settle down as this shouldn't be anywhere close to the subprime crisis.

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What does it mean?

It is touch and go to see if the Fed can really stabilize growth and inflation expectations and it will take weeks to figure it out, very likely needing another 75bp rate hike at the next meeting. This is a reminder that in such a complex environment, diversification across styles found in some flexible solutions can help to wait out the next investment phase when we see greater clarity. That should come when inflation expectations come down worldwide supporting fixed income (e.g. investment grade) and eventually equities once leading indicators rebound – a classical result of asset allocation.

Any investment decision in the sub-funds should be made on the basis of the current prospectus and the Key Investor Information Document (KIID).

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**Source: Nordea Investment Funds, S.A., 31.03.2022*

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