US Macroeconomics

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Stock Market Performance Around Fed Pivots and No Recession

The key indicators we track are all flashing recession such as the Index of Leading Economic Indicators, housing starts, and the Treasury yield curve to name just a few. These indicators have turned over as the economy is still absorbing rate hikes and balance sheet shrinkage.

Over the past 10 months, the Fed has lifted interest rates a record 425 basis points (bps) with more hikes forthcoming. The balance sheet has declined $476 billion since April which is about three times the pace of the 2017-2019 quantitative tightening. Since monetary policy works with long lags, it is doubtful the full cumulative impact of the Fed's actions has been felt.

If a 2023 recession begins around midyear which is our base case, stock prices are likely to head lower even if the Fed pivots as we believe it will. However, if the Fed cuts rates and avoids a downturn this year, history tells us that stock prices would rise meaningfully from their current level.

The table below shows the six episodes when the Fed pivoted toward rate cuts, and the economy avoided recession. The month the Fed first lowered rates is shown in the left-hand side column. We then measured the percentage change in the stock market three-, six- and 12-months afterward. The results are impressive.

If recession was avoided, the S&P 500 was higher in every episode and for every period (three-, six- and 12-months) after the Fed initially cut the funds rate. Remarkably, there were no down periods.

The best equity performance came after the Russian debt default/LTCM crisis that began in July 1998. After the Fed cut rates in September 1998, stocks rose nearly 21% within three months and eventually went up 26% by September 1999.

The worst equity performance was following the September 1984 rate cut. The stock market was up less than 1% within the first three months but was still able to rise nearly 10% one year later, which was decent. **For all six episodes, the average increase in equities after three months was 10.2% while the returns after six and 12 months were 12.7% and 18.0%, respectively**. These are outsized gains to be sure.

But for the stock market to produce such impressive results, the economy needs to avoid a hard landing. Otherwise, the probabilities favor lower prices sometime over the months ahead. Given this binary situation — recession or no recession — it is understandable why market participants are so fixated on the macroeconomic data.

How Much Do Equities Rise After The First Rate Cut?

Month of First Fed Rate Cut	S&P 500 % Change Over Ensuing…		
	3-months	6-months	12-months
December 1966	12.3	12.8	20.1
September 1984	0.7	8.8	9.6
November 1987	16.3	13.8	18.8
July 1995	3.5	13.2	13.9
September 1998	20.9	26.5	26.1
August 2019	7.3	0.9	19.6
Average >	10.2	12.7	18.0

Source: S&P, FRB, Haver, SMBC Nikko

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