U.S. FEDERAL RESERVE BOARD ANNOUNCEMENT

July 27, 2022

What happened?

- In the face of historically high inflation, the U.S. Federal Reserve Board (Fed) today increased its target overnight interest rate by 0.75%, to 2.25%-2.5%. This increase has brought Fed tightening to its fastest pace since early 1981.

- The increase was in line with expectations, and forward-looking markets are already debating whether the expected rate hike in September 2022, will be 0.5% or another 0.75%. While recognizing softening in spending and production, the Fed announced it anticipates rate hikes and balance sheet reductions to continue and reaffirmed its commitment to returning inflation to its 2% objective.

Looking back, looking forward

- China’s zero-Covid policy, Russia’s invasion of Ukraine, and excess monetary and fiscal stimulus have led to supply chain disruptions, commodity shortages, and elevated demand that have ignited inflationary pressures not seen since the 1970s.

- The Fed—and central banks globally—are focussed on combating elevated inflation, which remains above desired levels, while limiting the impact on employment.

- In prioritizing the fight against inflation, central banks are trying to balance the impact of higher rates while minimizing consequences on the economy.

- Nevertheless, the interplay between inflation control, Q2 earnings announcements, and economic activity remains a potential source for ongoing market volatility.

- Looking forward, it’ll be a difficult balancing act for the Fed. The path to a soft landing is particularly narrow. If the Fed raises rates too fast and too high, it could very well involuntarily push the U.S. economy into recession. The runoff of the Fed’s balance sheet is an additional headwind in the current environment of tightening monetary policy.

CIBC Asset Management reaction

- “To ensure a more lasting economic recovery, central banks will have to win the battle against inflation for financial markets to be able to deliver less-volatile returns.” – Luc de la Durantaye, CIBC Asset Management Chief Investment Strategist, CIO and Managing Director, Multi-Asset & Currency Management

- As investors navigate concerns over recession and inflation in financial markets, the Fixed Income team expects volatility to provide opportunities to take advantage of higher credit spreads (the yield differential between corporate bonds and government bonds) and higher overall bond yields.

- Amid the equity market volatility, the Equity team is selectively identifying opportunities to add high-quality securities to portfolios and taking advantage of opportunities to buy attractive securities at a discount.

Keep it in perspective

- While volatility has the potential to continue a little longer, history shows that such periods of volatility never last indefinitely. Financial markets always stabilize and recover over time.

- In periods like this, it's best to put aside emotions and behavioural biases, which can lead to poor decisions that can erode wealth over time.

- It's nearly impossible to time the markets. For most investors, the best way to navigate market volatility is to stick to their long-term, systematic investment plan. Before making any decisions, investors should first work with their advisor to evaluate their investment portfolios against their long-term objectives and risk tolerance.