Morgan Stanley
Private Wealth Management

The Novelli Group
At Morgan Stanley
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New Digs

The Novelli Team is on the move! We're excited to announce that the Houston Morgan Stanley Private Wealth Management office is planning a move to Texas Tower this spring! Conveniently, Texas Tower is located at 845 Texas Avenue directly across the street from our current location. After 14 years, we're looking forward to a change of scenery and hosting you at our new office space.

Summer Cut?

The US and Global Stock Market continued to rally through the first quarter of the new year, returning approximately 25% from the October 2023 low[1]. In our view, a key factor driving the market recovery was investor expectations that the Federal Reserve would begin cutting the Fed Funds Rate as early as this summer. The Fed uses the Fed Funds Rate as its principal policy tool to achieve stable prices and fuel employment in the US economy. To combat inflation, which had reached 40-year highs after the COVID-19 Pandemic, the Fed raised the Fed Funds rate 11 times for a total of 5% from March 2022 through July 2023, from a range of 0.25 – 0.50%, to a range of 5.25% - 5.50%. Remarkably, inflation had decreased considerably by the end of last year from around 9% at the June 2022 peak to 3.4% by the end of 2023[2]. In addition, the US economy's rate of growth has slowed but continues to be positive, and Unemployment remains below 4%[3]. With these developments, the Fed began to signal that inflation risk and recession risk were more balanced, which seemed to clear a path for cuts.

However, inflation measures in 2024 have generally been coming in above expectations, causing markets to reconsider the timing of the first cut. Last week's March Consumer Price Index (CPI) report showed headline inflation rose by 3.5% year-on-year, while core CPI was up 3.8%, well above the Fed's 2% target. According to Morgan Stanley's Global Investment Office, "super-core" inflation, which strips out housing prices as well as food and energy, accelerated to 4.8% year-over-year – the highest level in 11 months[4]. Where Futures markets were forecasting cuts as early as March at the start of the year, and then June as recently a few weeks ago, investors are now contemplating the probability of no cuts or delayed cuts.

We expect that the Fed will remain data dependent in timing the first cut, while investors will continue to debate the speed and magnitude of such easing. The risks of higher-for-longer rates include headwinds to both stock and bond valuations and pressure to households dependent on consumer credit, governments and businesses reliant on debt financing, and on the housing market where higher mortgage rates have cooled home buyer demand. On the other hand, the Fed could proceed with gradual, incremental rate cuts as early as the summer given the progress already made on inflation, and to mitigate the risk of a hard landing due to the tightening effects of a higher real interest rate on the economy (i.e., the difference between the Fed Funds rate and the Inflation rate).

Earlier cuts would be bullish for markets, but we think the Fed will move cautiously, and in the event the Fed did not proceed with cuts this year, we would anticipate increased volatility and a potentially more difficult environment for investors.

Munis and Gold

Suffice it to say that the Fed's policy tightening has had implications for Bond investors. Indeed, the US Investment Grade Bond market return was -3.32% annualized from 2021 through 2023, punctuated by a 13% loss in 2022. Though this was a painful period for investors, with inflation cooling and eventual rate cuts still in play, we now see significant opportunities in Municipal Bonds. We also think investors with excess Cash Reserve balances should consider implementing Municipal Bond strategies this spring to lock in current higher interest rates before the Fed begins their eventual cutting. Generally, bond prices rise when interest rates fall, suggesting future rate cuts could also present capital appreciation potential for longer-duration bonds.

Finally, despite lower inflation, gold prices have been hitting record price levels as of late. Historically, Gold has been considered a hedge against inflation, economic recession, and capital markets volatility in general. Although inflation has cooled, the road to 2.00% could be a long one. In addition, as interest rates fall, the opportunity cost of owning Gold vs. holding Cash decreases.

With the stock market trading near all-time highs, record amounts of Federal debt, a massive fiscal deficit, and potential for the November election cycle to spark volatility, we think investors should consider allocations to Munis and Gold not only for their return potential, but as a hedge against volatility that could take shape.

As always, we welcome your questions and feedback, and wish you the best for the spring season!

[1] ThomsonOne
[2] Inflation and Prices, EconoFact, February 12th, 2024
[3] The March jobs report was as good as it gets – here's why, Axios, April 5th, 2024
[4] Two Paths for the Fed, Lisa Shalett, April 16th, 2024
[5] Bloomberg US Aggregate Bond Index