Stocks and Bonds Slump on Determined Fed

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Fed Chair Powell's keynote address in Jackson Hole last week may not have broken new ground, but it's had a significant and lasting impact on the financial markets. Powell is determined to bring inflation down to the Fed's +2.0% target, and readily acknowledges *it will take some time* and won't be without pain. The lingering takeaway was *higher rates for a longer period*. There was virtually no counter-balance to Powell's hawkish stance. He did not mention the possibility of overtightening, nor did he indicate rate hikes were nearing completion.

The fabled economic "soft-landing" has been quickly replaced in the media's eye with a "growth recession," which is defined as *a lengthy period of below trend GDP growth and rising unemployment*. Rather than a full-blown recession, this scenario is milder, but more prolonged. Diane Swonk, KPMG Chief Economist, in an interview with Bloomberg News on Wednesday, described a growth recession as "a bit like dripping water torture."

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Yesterday, Cleveland Fed President Loretta Mester, a current voting member of the FOMC, told *Fox Business* that she believes it will be necessary to raise the overnight target rate above 4.0% by early next year, and maintain that level for the duration of 2023. Mester shrugged off concerns of recession, pointing to inflation reduction as the Fed's top priority.

Earlier this week, Minneapolis Fed President Neel Kashkari told *Bloomberg News* that he was not happy to see the equity markets rally after the July FOMC meeting. He believes equity investors had misinterpreted apparent moderation in several key inflation measures and falsely concluded that "inflation had been licked." Powell's speech, in Kashkari's mind, conveyed the correct message.

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It bears repeating that in order for monetary policy to be successful, the markets have to believe the Fed is serious. At this point, the markets *believe* ...and are bracing for some pain.

This morning, the ISM manufacturing survey showed the composite factory index held steady in August at a two-year low of 52.8. However, positive comments by purchasing managers outnumbered cautious comments by a 5-to-1 count, while the employment, new orders and prices paid indexes all showed improvement. Unfortunately, the ISM report might be a case of *good news-is-bad news* as it suggests the factory sector is still in position to withstand more Fed tightening.

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The August employment report will be released tomorrow morning. Payroll growth is expected to slow, but not to the degree that would give Fed officials reason to pause.

Please see disclosure starting on page 2

Market Indications as of 10:26 A.M. Central Time

DOW	Down -137 to 31,374 (HIGH: 36,800)
NASDAQ	Down -247 to 11,569 (HIGH: 16,057)
S&P 500	Down -36 to 3,919 (HIGH: 4,797)
1-Yr T-bill	current yield 3.52%; opening yield 3.41%
2-Yr T-note	current yield 3.53%; opening yield 3.49%
3-Yr T-note	current yield 3.55%; opening yield 3.51%
5-Yr T-note	current yield 3.41%; opening yield 3.35%
10-Yr T-note	current yield 3.27%; opening yield 3.20%
30-Yr T-bond	current yield 3.39%; opening yield 3.30%

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