



Hawkish Fed, Resilient Market: HCM Market Brief

This episode of the HCM Market Brief Podcast, recorded Tuesday, September 29, features senior investment strategist Doug Johnson, CFA® and investment strategist Dan Rinck, APMA. They take what they call a "macro tour": the Fed's latest rate hike, the sharp rise in Treasury yields, the equity market's resilience, gold, and the case for fixed income.

The Fed's hawkish hike

The Federal Reserve raised rates by 25 basis points, as expected, and both hosts read the accompanying commentary as distinctly hawkish. The market agreed. They find this notable because when Kevin Warsh was nominated as Fed chair, many expected a dovish Fed friendly to the administration, especially given the president's public calls for lower rates. Instead, the committee appears to be asserting its independence. Doug questions how much a rate hike can do against current inflation, since he sees elevated energy prices from the conflict with Iran as the main driver, and monetary policy can't fix that. He acknowledges, though, that it matters for markets to see the Fed being seen to act. The hosts note that in his press conference, Warsh named oil prices and the Middle East conflict as the biggest component of inflation, which effectively put some responsibility back on the administration.

Yields break through 5%

The bond market's first reaction to the Fed was muted. The 10-year Treasury then hovered around 5% for several days until a PMI reading came in well above expectations, which sent yields nearly vertical. Dan describes 5% as having acted as a ceiling that has now been broken. As of recording, the 10-year sat around 5.25%, after touching 5.30%. That's roughly a 55 basis point jump from about 4.7% a month earlier, and the highest level since around June 2007. Dan stresses that the move is global, not just a story about U.S. debt. Commentators have offered explanations ranging from hedge fund blowups to an unwinding yen carry trade, but Doug argues the cause matters less than the fact that rates are rising quickly and will likely be the dominant macro driver in the coming weeks.

Two reports were due after recording: PCE inflation on Wednesday and payrolls on Friday. Dan expects PCE to matter more, since payroll data is often revised. Doug suspects the yield move is overdone and sees a better chance of a reversal than continued upside. He reasons that buyers will eventually find yields of 5.25% to 5.5% attractive, particularly investors running 60/40 portfolios.

Municipal bonds

The hosts point out that municipal yields have risen even more aggressively than Treasuries. Looking at 2034-maturity bonds and assuming the top marginal tax bracket, they found tax-equivalent yields around 7%, and higher still for residents of high-tax states. Yields like that, they suggest, raise a fair question about whether some equity money belongs in bonds. They also caution that if yields climb much further, they could start to weigh on both the economy and stocks.

Equity resilience and weak breadth

Doug calls the stock market's response "unbelievably resilient." The S&P 500 sits about 1% from all-time highs, and the VIX was only around 16, a level Dan associates with a quiet day. He would have expected the mid-20s given the size and speed of the yield move. This resilience comes despite being in a seasonally weak period.

Beneath the surface, however, breadth has deteriorated, reminiscent of 2024, when mega-caps carried the market. As of August 15, the equal-weighted S&P 500 was up 17.24% year to date versus 14.45% for the cap-weighted index. Since then, the equal-weighted version has lost roughly 7% while the cap-weighted index has fallen less than 2%. Small caps, the most rate-sensitive segment, have suffered, with the Russell 2000 grinding lower. Doug sees two possible resolutions: the mega-caps eventually crack and pull the indexes down, or yields ease and broader participation returns.

Dan leans toward the second outcome. He expects yields to top out soon and guesses the 10-year will be back below 5% by year-end, which would fuel an "everything rally" that helps small and mid caps catch up rather than the largest names catching down. He lists risks to that view, including further Middle East escalation pushing oil higher and midterm election uncertainty. Doug adds that the market's ability to shrug off a decisive break above 5% is itself a positive sign, since he would have expected a 5–10% pullback.

Gold and alternatives

HCM added a dedicated alternatives sleeve to its portfolios the previous summer, and it has performed well. Gold, trading around \$4,170 within a range of roughly \$4,000 to \$4,350, has come under pressure as the Fed turned hawkish. Rising real yields have historically been a headwind for gold. Doug believes, however, that many allocators now hold gold as a long-term hedge against debt and deficit levels that look nearly irreversible.

Dan offers his "crazy" take. The 2-year Treasury yield, around 4.9%, sits roughly 80–90 basis points above short-term rates near 4.18%, and the fed funds rate has historically followed

the 2-year. On that basis, he thinks the market is implying about three more hikes over six months: one in October, a possible pause in December, and two in early 2027, unless tensions with Iran ease. He expects gold to struggle during that stretch, creating buying opportunities. His ultimate scenario is one more hike, followed by a resolution in the Middle East, the Strait of Hormuz reopening, oil falling, inflation easing, and the Fed eventually cutting, at which point gold would rally. He's careful to say this means modest additions, not putting 30% of a portfolio in gold. Doug agrees and mentions a stat: the Fed has never raised rates in October ahead of a midterm election. Dan says that record may break, and Doug concedes that a hot PCE and strong payrolls could leave the Fed little choice.

The case for bonds

With the bond aggregate negative year to date, the hosts address what they call the "PTSD of 2022" and possible recency bias among investors. Dan says bonds "look great here," citing high yields, strong convexity, and the ability to lock in 5.25% for ten years. Doug clarifies that they aren't urging investors to move from stocks to bonds wholesale. Instead, they suggest that investors whose 60/40 portfolios have drifted to 65–70% equities should rebalance by taking some equity profits, since 15% equity returns can't last forever.

They also address cash holders. Money markets yield around 3.7–4%, while a 3-year Treasury offers about 4.99%. If peace in the Middle East brings oil and inflation down and the Fed begins cutting, money market yields could fall toward 3% or below, while locked-in CDs or Treasuries would keep paying around 5%. They stress the differences from 2022, when the Fed held rates near zero while CPI hit 8% and called inflation transitory. Today the fed funds rate is already above inflation of roughly 3%. Doug notes, with a nod to Sir John Templeton, that he isn't claiming "this time is different," only that the variables are.

Predictions and wrap-up

Since the episode would be published after the data releases, the hosts make predictions. Doug expects PCE to come in 0.1 hot with payrolls in line. Dan expects PCE on target and a notable payroll miss, perhaps 15,000–20,000 against an expectation he guesses at around 55,000. Both agree a weak jobs number could be good for stocks by pushing yields lower, a return to "bad news is good news." They close by noting that HCM focuses on scenario planning and reacting to data rather than forecasting. The investment committee has discussed possible portfolio adjustments, which may be announced soon. The next update will be a quarterly video webinar in about two weeks.