The Investment Institute
by UniCredit

Coffee Break

Coffee Break is our daily publication, offering topical insights as an intellectual ingot to start the day.

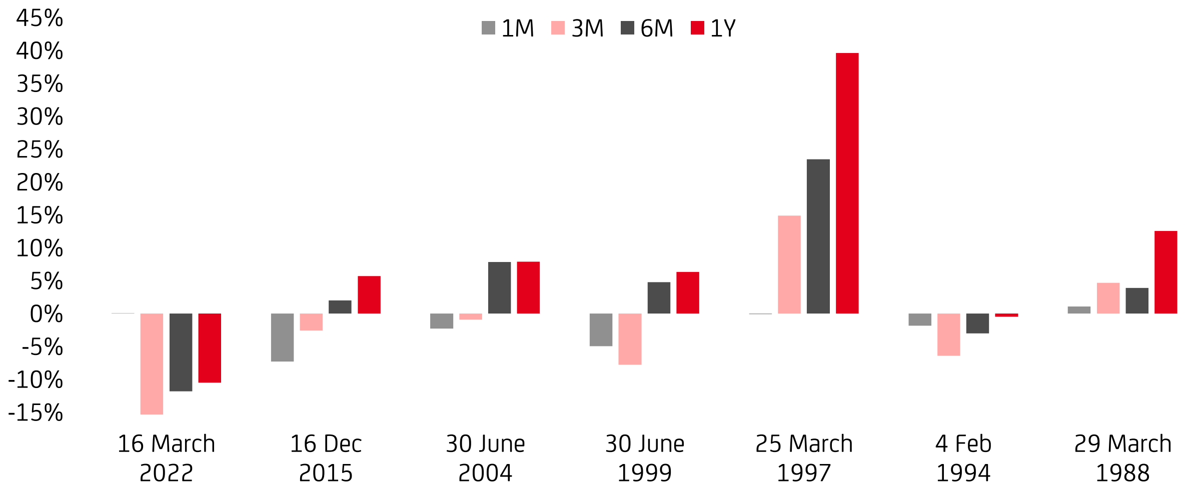
When the Fed hikes, patience often pays

10 September 2026

With the Fed meeting just days away, investors are wondering whether US interest rates are headed higher. Higher rates are typically regarded as bad news for equities. However, history suggests that the relationship is less straightforward. Although stocks often weaken during the first one to three months of a tightening cycle, six-month and one-year returns have generally been much stronger, with markets frequently recovering initial losses and moving on to new highs.

STAYING INVESTED HAS OFTEN PAID OFF

S&P 500 PRICE PERFORMANCE FOLLOWING THE FIRST FED HIKE AFTER A PAUSE



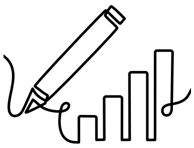
Source: LSEG Datastream, The Investment Institute by UniCredit
Note: Historical episodes are defined as the first Federal Reserve rate hike following a period of at least six months without monetary-policy tightening. The analysis begins in 1988 to ensure comparability across modern Fed tightening cycles and excludes the Volcker-era policy framework of the early 1980s.

THE CONTEXT

Today's ECB decision, with a 25bp rate hike widely expected (see also Central Banks Watch ECB Preview – Hike a done deal, mission not yet accomplished, 7 September), serves as a reminder that the fight against inflation may prove more persistent than investors had anticipated. In the US, where a resilient economy, a labour market operating close to full employment and the inflationary consequences of higher energy prices have all contributed to a more hawkish policy debate, attention is increasingly focused on next week's Fed meeting. The prospect of Fed tightening is no longer viewed as a tail risk but as a realistic policy outcome.

THE DATA

Investors tend to associate Fed hikes with weaker equity markets, and historical data initially support that view. Following the first rate hike after a pause, the S&P 500 typically struggled over the subsequent one to three months as higher rates weigh on valuations, tighten financial conditions and heighten concerns that policymakers may eventually over-tighten. Nevertheless, the broader historical pattern remains instructive: returns generally improve as the investment horizon extends. Six months after the initial hike, the S&P 500 was higher during five of the seven episodes shown in our chart. One year later, equities delivered average returns of roughly 8%. The two exceptions, 1994 and 2022, shared a common feature: monetary policy became significantly more restrictive than markets had expected.



OUR VIEW

We have recently revised our forecast and now expect the Fed to deliver two 25bp hikes, one in September and in December. The change reflects resilient economic growth, a labour market operating close to full employment, slower progress on inflation and financial conditions that remain relatively accommodative. The inflationary impact of the Iran conflict has further strengthened the case for a cautious approach by policymakers. However, a more hawkish Fed need not be inconsistent with a constructive equity view. The key question is not whether rates move higher but whether the economic backdrop that prompted tighter policy remains intact. So far, the answer appears to be yes. Growth has proven more resilient than expected, labour markets remain healthy and corporate earnings continue to surprise to the upside.

While Fed tightening may weigh on markets in the near term and rate hikes may create periods of volatility, particularly in more richly valued areas of the market, we continue to view the broader earnings backdrop as supportive. To the extent that rates move higher, market leadership may broaden beyond the narrow group of long-duration growth stocks that has dominated returns in recent years. However, we would view this primarily as a shift within the market rather than a challenge to the broader equity story. Provided the Fed's hiking cycle remains broadly in line with current expectations, and growth and earnings remain resilient, investors should be careful not to confuse short-term volatility with a deterioration in the medium-term outlook for equities.

TODAY'S DATA RELEASES

Time (CET)	Country	Data	Period	UniCredit	Consensus	Previous
10:00	IT	Industrial production (% mom)	Jul	-0.3	-	-1.0
14:15	EZ	ECB depo rate (%)	-	2.50	2.50	2.25
14:15	EZ	ECB refi rate (%)	-	2.65	2.65	2.40

Source: Bloomberg, The Investment Institute by UniCredit

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