

Take a Hike: Rate Hikes and Market Impacts

Charles Schwab · Liz Ann Sonders, Kevin Gordon · 2026-09-09 · English original

Key takeaways

- Federal Reserve tightening has historically brought near-term volatility, but equities tended to often recover after early drawdowns.
- The pace matters: slow hiking cycles have historically produced milder market declines and stronger economic outcomes than fast cycles.
- A resilient labor market and firm coincident indicators support a gradual Fed approach, with volatility potentially creating opportunities for disciplined investors.

All eyes are on the Federal Reserve in the lead-up to the mid-September Federal Open Market Committee (FOMC) meeting. As of Sept. 8, the fed funds futures market has priced in a 60% probability of a 25-basis-point increase at the Sept. 15-16 FOMC meeting, according to CME FedWatch. We currently lean toward a hike, although that view could change in response to incoming inflation data.

This month's report examines S&P 500 performance during 18 post-WWII Fed tightening cycles, using historical data from Ned Davis Research (NDR). The data reveals nuanced patterns. While the market typically advanced significantly in the year prior to the first rate hike, correction-level drawdowns tend to occur within 12 months of the initial rate hike.

Critically, the speed of tightening materially impacted outcomes, with fast hiking cycles generally produce deeper drawdowns and weaker overall performance in the first year after the initial hike, as shown below. Fast cycles were ones during which the Fed raised rates at almost every FOMC meeting, on average. Conversely, slow hiking cycles—when the Fed waited at least one meeting in between rate hikes, on average—were associated with much stronger returns a year out.

Historically slow cycles have had better performance

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The y-axis is indexed to 100 at start of first rate hike. An index number is a figure reflecting price or quantity compared with a base value. The base value always has an index number of 100. The index number is then expressed as 100 times the ratio to the base value. A fast cycle (orange) is one in which the Fed raises rates at almost every meeting, on average. A slow cycle (black line) is one in which the Fed waits at least one meeting in between hikes, on average. A non-cycle (green line) is two or fewer hikes before a rate cut. Blue line represents all first rate hikes.

Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. Past performance is no guarantee of future results.

Interestingly, the best performance for the S&P 500 historically has tended to be in the aftermath of the initiation of a "non-cycle" period. Non-cycles are two or fewer hikes before a subsequent rate cut. It's too soon to judge what this cycle will look like as an initial hike hasn't happened yet, but a forward-looking analogy might help paint a picture. A fast cycle could be thought of as the Fed taking the elevator up,

while a slow cycle could be thought of as the Fed taking the escalator up. Conversely, perhaps we think of a non-cycle as the Fed taking the stairs, with an easier process to reverse direction.

Getting more granular

The visual below focuses on maximum drawdowns during rate hike cycles historically.

- Pre-hike strength: The S&P 500 has historically gained an average of 18% in the year before the Fed's initial rate increase. Interestingly, that's almost exactly the performance of the index over this past year.
- Initial drawdown period: Following the first rate hike, the S&P 500 has historically experienced maximum drawdowns averaging -12% within six months and -14% within the first year.
- Speed of tightening matters: Fast tightening cycles have historically produced significantly steeper declines. The average drawdown for the S&P 500 during fast cycles reached -16% by 12 months, compared to -11% for slow cycles, a differential of more than 500 basis points. Non-cycles brought milder drawdowns.

The bottom line is that the historical data shows that recoveries emerged relatively quickly despite shorter-term volatility. Maximum drawdowns occurred relatively early in past tightening cycles, after which valuations stabilized and earnings expectations adjusted to higher-rate regimes. For disciplined investors, these cycles may have created some compelling accumulation opportunities, notwithstanding other market forces.

Slow cycles tend to have milder drawdowns

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A fast cycle (orange text) is one in which the Fed raises rates at almost every meeting, on average. A slow cycle (black text) is one in which the Fed waits at least one meeting in between hikes, on average. A non-cycle (green text) is two or fewer hikes before a rate cut.

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Elevators, escalators, and stairs

Below is a visual mapping out past rate hiking cycles, both in terms of the change in the fed funds rate (and the discount rate prior to 1990) over the cycle, and the process and timing for getting there. Given scant historical data prior to the 1960s, this visual starts with the hiking cycle that began in 1963. Should the Fed opt for the escalator, it would be the first time in a decade. Whereas if it opts for a stairs approach, it would be the first in nearly three decades.

Escalators vs. elevators

Source: ©Copyright 2026 Ned Davis Research, Inc., from 7/17/1963 to 9/4/2026.

The y-axis represents cumulative change in the federal funds rate. Rate indexed to 0 before first hike. An index number is a figure reflecting price or quantity compared with a base value. The base value always has an index number of 100. The index number is then expressed as 100 times the ratio to the base value.

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Not a coincidence

As mentioned, we are currently in the camp that any coming Fed tightening campaign likely won't be aggressive. Of course, inflation dynamics will determine if that changes, but for now officials have been hesitant to raise rates so fast and/or large hikes are likely off the table for now. Even with a slow tightening backdrop (hiking in 25-basis-point increments, perhaps at every other meeting), the economy likely has enough momentum to sustain a small climb higher in rates.

You can see in the chart below that the coincident economic indicators (CEI)—which are monitored by The Conference Board to determine whether the economy is in recession or expansion—have tended to maintain their upward, strong trajectory after slow tightening cycles begin. On the contrary, fast tightening cycles tend to restrict the economy's growth potential, shown via the orange line.

Historically, the economy has been fine in slow tightening cycles

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It's key to keep in mind that the coincident indicators—nonfarm payrolls, real personal income excluding government transfers, retail and manufacturing sales, and industrial production—in the post-pandemic cycle have correctly signaled that the economy hasn't slipped into a recession. That is in stark contrast to the leading economic indicators (LEI), which have continued to deliver a false signal of economic contraction, as you can see via the light blue line in the next chart.

As we've written about several times, the leading indicators' misfire has been rooted in their bias toward manufacturing, housing, goods, and consumer confidence—all of which struggled immensely as the economy reopened after the pandemic, the Fed raised rates, and spending shifted toward services. The spread between the LEI and CEI continues to close as the former catches back up, which reinforces that investors should consider placing more emphasis on the CEI to gauge the economy's health. That especially rings true if the Fed raises rates soon, not least because the components of the LEI will likely struggle more as monetary policy tightens.

Coincident with the better call

Source: Charles Schwab, The Conference Board, and Bloomberg, from 1/31/1960 to 7/31/2026.

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Central to the coincident indicators' strength has been the resilience of the labor market. More than six years since the start of the pandemic, we have yet to see a full-blown, recessionary labor cycle in the

United States. In keeping with the aforementioned weakness in the LEI, there have indeed been industries that have undergone their own hiring recessions (i.e., tech and financial services), but not enough to bring down the whole labor market. To be sure, nonfarm payroll growth stalled last year and got uncomfortably close to recession territory. Yet, as we just learned in the recent jobs report, they have maintained their bounce back from last year's low—and remain on an (admittedly weak) upward trajectory.

Payroll growth stabilizing

Source: Charles Schwab, Bloomberg, and the Bureau of Labor Statistics, from 1/31/1965 to 8/31/2026.

The y-axis is truncated for visual purposes.

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As much as the focus for Fed officials has been on the inflation backdrop (rightly so), we also think they have been hesitant to raise rates given the slow recovery in job growth. Not only that, but with the so-called "breakeven rate" for payrolls much lower today relative to history, officials are aware that supply-side factors are much more dominant in this cycle—making it at times difficult to assess the health of the labor market.

Fortunately, history is again kind to investors and consumers when the Fed tightens at a slow pace. As shown in the chart below, nonfarm payroll growth has been quite resilient during slow tightening cycles. Even in fast cycles, it takes (on average) slightly longer than a year for growth to start slowing. Two years out from the first hike, nonfarm payroll growth has averaged a gain of 1%, less than half the average 2.5% gain in a slow tightening cycle.

Jobs prefer the escalator

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If inflation remains sticky and the labor market resilient, the conversation will continue to shift toward whether the Fed will take the escalator or the elevator when it comes to rate hikes. History is consistent with the fact that an escalator approach is more favorable to both equities and the economy. Absent a major supply shock—which of course is non-forecastable but, unfortunately, increasingly common these days—we think FOMC members will be biased toward taking a slower approach to tightening policy.

In sum

Nearly 80 years of Fed tightening cycles reveal a somewhat-consistent pattern of strong pre-hike stock market advances, meaningful short-term drawdowns upon rate hike initiation, and subsequent recoveries. While volatility has been inevitable, the magnitude and speed of drawdowns—as well as the economy's growth profile—have depended heavily on how quickly the Fed was raising rates. For investors, ultimately understanding the next cycle may be essential for distinguishing between correction-driven volatility and structural market disruption. It might also help investors recognize that attractive accumulation opportunities can often emerge amid the volatility that accompanies monetary policy shifts.

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Coincident Economic Indicators (CEI) approximately track turning points in the economy and are comprised of four components: the number of employees on nonfarm payrolls, real personal income less transfer payments, industrial production, and real manufacturing and trade sales.

Source: <https://www.schwab.com/learn/story/take-hike-rate-hikes-and-market-impacts>