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Markets & Economies

Five Quick Points on the Fed's Rate-Cut Decision

A brief outline of the policy and investment implications of the September 17–18 FOMC meeting.

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The Federal Open Market Committee (FOMC), the policy-setting arm of the U.S. Federal Reserve (Fed), cut the target federal funds rate by 50 basis points (bps) on September 18, to a range of 4.75% to 5%. This ended a period of intense speculation over what would be the size of the Fed's first rate cut since 2020—specifically, whether rates would be reduced by 25 or 50 bps.

The "25/50" debate reflected differing views on how forcefully the Fed would respond to two significant developments: an ongoing moderation in inflation toward the Fed's 2% target; and signs of slowing in the labor market after an extended period of strong payrolls growth and low unemployment. Uncertainty as to the extent and timing of Fed rate reductions led to volatility in interest rates across the yield curve in recent months.

Beyond the headline policy move, here are some additional observations on the September FOMC meeting.

1. The FOMC kept its asset purchase program intact. Its post-meeting statement said the economy continues to expand "at a solid pace," while the unemployment rate has moved higher but remains at a low level. Policymakers have greater confidence that inflation is moving toward the Fed's 2% target. The decision was not unanimous, as FOMC member Michelle Bowman preferred to implement a 25-bp cut; this was the first dissent by a Fed Governor since 2005, according to Bloomberg.

2. Some clues to the pace and size of future cuts were offered by Fed Chair Jerome Powell in his press conference after the FOMC meeting. While the 50-bp cut showed that policymakers weren't "behind the curve," Powell said no one should look at the September 18 rate reduction and think "that this is the new pace," signaling that a sustained run of similar-sized moves is not in the cards.

3. Further, the so-called "dot plot" from FOMC members issued on September 18 showed a median year-end projection for the fed funds rate of 4.38%, versus an expectation of 5.13% in June. The median estimate for the end of 2025 decreased to 3.38% from 4.13%. FOMC members also forecast a higher year-end unemployment rate (4.4% versus 4.0% in June) but a slower pace of core inflation (2.6% versus 2.8%).

4. Based on movements in the two-year Treasury yield on September 18, markets have priced in approximately 70 bps of cuts at the final two FOMC meetings of the year (November and December)—ahead of the Fed's own projection of an additional 50 bps.

5. We would note that this Fed easing cycle is different from previous instances in which the central bank was responding to a significant weakening in economic growth. This time, policymakers have moved decisively to forestall potential weakness in the economy. We think this is broadly supportive for risk assets.

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Investment Implications

With the first rate cut of the current policy cycle finally out of the way, where might investors focus their attention? Here are some areas to consider:

Fixed Income

Core and core-plus strategies may be particularly well positioned after the Fed's move. Current starting yields present an attractive entry point for intermediate-term bonds. Short-duration bonds continue to have a favorable risk/return profile in the current rate environment. Blending core bonds with short-term credit may provide a way to realize attractive income while mitigating rate volatility.

A "soft landing" scenario, in which the Fed's policy moves enable the economy to remain on solid footing, presents a positive environment for credit. Among the approaches to consider are multi-sector bond, short duration high yield, and opportunistic credit strategies.

Equities

We continue to emphasize investing in quality companies with durable competitive advantages. We do this in growth and value stocks, and in U.S. and non-U.S. companies. We also believe companies in the innovation space, characterized by rapid revenue and earnings growth, are also well positioned for the current environment.

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Glossary Definitions

A **basis point** is one one-hundredth of a percentage point.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates.

The **Federal Reserve (Fed)** is the central bank of the United States. **The Federal Open Market Committee** (FOMC) is the branch of the Fed that determines the direction of monetary policy in the United States.

The federal funds rate is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight on an uncollateralized basis. **Fed funds futures** are financial futures contracts based on the federal funds rate and traded on the Chicago Mercantile Exchange. These futures are considered a direct reflection of collective marketplace insight regarding the future course of the Federal Reserve's monetary policy.

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