Weekly Market Insights

September 23, 2024

They did it!

Financial Markets

As expected, the Federal Reserve lowered interest rates this past week. While the cut was widely anticipated, the magnitude of the cut was a bit surprising. The Fed cut rates by 50 basis points, a large move by historical standards. There was some market volatility around the announcement, but major equity indices finished the week higher.

	Total Return (%)		
Index	**Prior Week**	**Year-to-Date**	**1-Year**
S&P 500	1.39	20.78	31.45
S&P 500 Equal Weighted	1.36	13.55	23.51
Dow Jones Industrial Average	1.62	13.21	24.57
NASDAQ Composite	1.49	20.21	34.27

	Total Return (%)
S&P 500 Sector	**Prior Week**
Energy	3.80
Communication Services	3.73
Financials	2.36
Consumer Discretionary	2.30
Industrials	2.03
Utilities	2.00
Materials	1.56
Information Technology	1.00
Health Care	-0.51
Real Estate	-1.15
Consumer Staples	-1.18

It will be interesting to see how the real economy responds to the move. The Fed hopes cuts will stimulate the housing market. If this comes to fruition, it will act as a powerful force throughout the economy and may lead to the creation of a new cycle.

The Economy

Although not terribly robust, the United States economy was not in trouble when the Federal Reserve stepped in and made a 50 basis point move last week. It seems possible that investors should be thinking, at worst, about a soft landing and, at best, the start of a new cycle. In an earlier paper, we wrote that the pandemic had thrown the economic cycle out of kilter and that it is just now coming back into order. We still think this is an interesting thesis and not out of the question.

Overall, the U.S. economy is on solid footing, but pockets are still struggling—the longstanding housing shortage and the nascent labor market slowdown are the first that come to mind. Lower interest rates should offer support to both. For the housing market in particular, if lower rates can stimulate construction, it would boost the rest of the economy and perhaps encourage the start of a new cycle. If a new cycle does not develop, easier monetary policy should at least prolong the current cycle and make the "landing" much softer.

Conclusion

There are a lot of moving parts at the moment. The United States economy is slowing, as are the economies of most of the developed world. However, a recession is not imminent, and the Fed is now taking steps to accelerate growth. The same cannot be said for China. The country remains in a challenging financial condition, all well published. Besides an immense amount of underwater debt, much of the population is uncertain about the country's future, and they are holding back spending as a result. This position puts China in a trap between bad monetary and fiscal policies. It seems only a short time ago that western central bankers were concerned about a new intergovernmental organization, with China at the lead, known as BRICS. We expect to see escalating competition between India and China.

Yield Curve Update

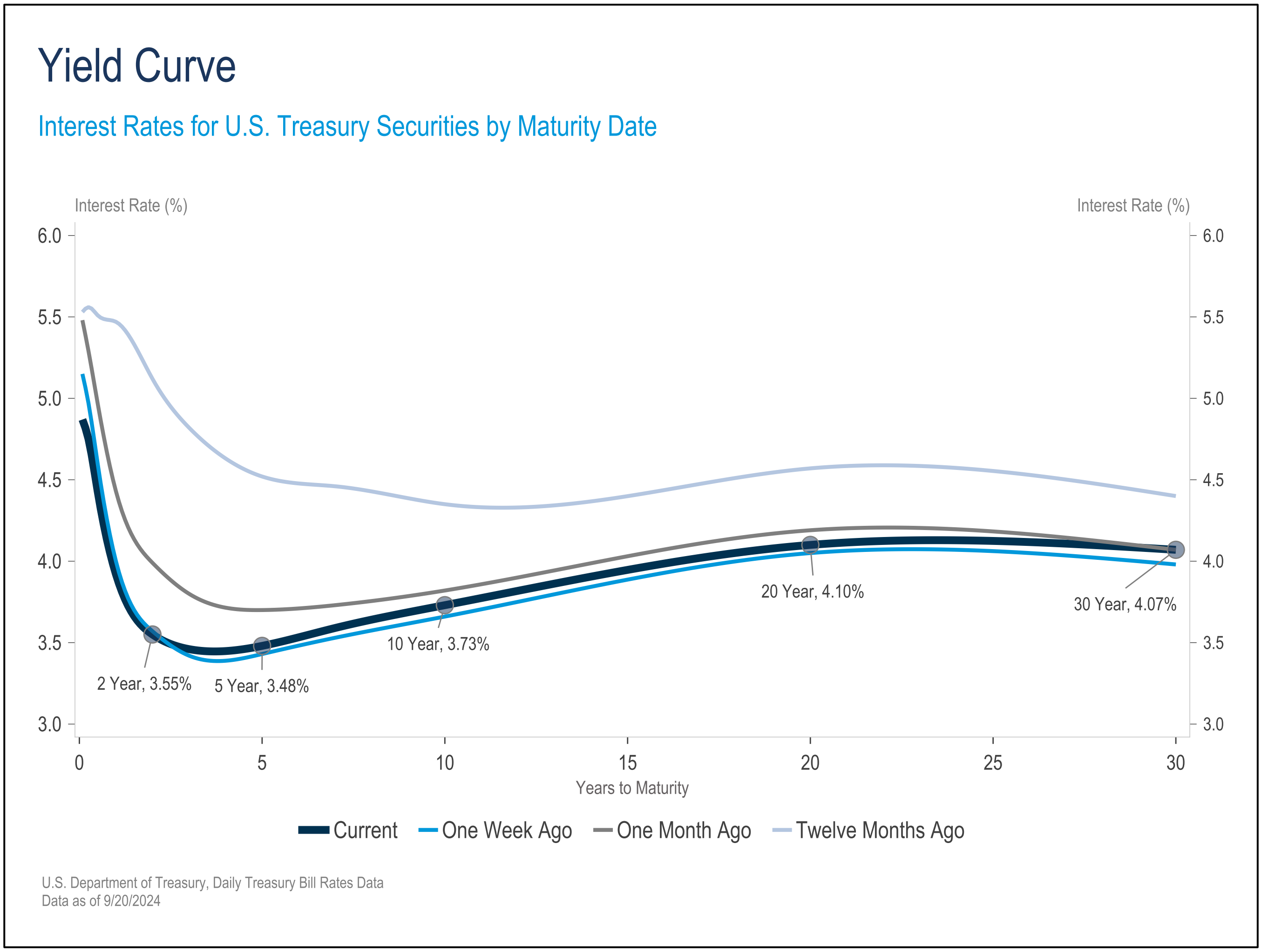
After much anticipation, the Fed moved forward with a 50 basis point cut on Wednesday, its first policy move in over a year. As the Fed governors gathered for their September meeting, whether or not they would cut was never in question. However, the magnitude of the cut, 25 vs. 50 basis points, most certainly was. The Treasury yield curve experienced a steepening move on the decision, with shorter-term yields falling and longer-term yields rising relative to the prior week. Heavily influenced by monetary policy, yields with the shortest maturities saw the most significant movements lower. 3-month yields declined 23 basis points, 6-month yields declined 17 basis points, while 2-year yields were unchanged. Yields rose for maturities 3 years and longer, with the 10-year yield increasing 9 basis points week-over-week and the 30-year increasing 10. The 2-year/10-year yield spread steepened to +15 basis points.

The Fed's rate decision was undoubtedly the highlight of the week. However, the Committee's updated Summary of Economic Projections (SEP)[1] and Chairman Powell's post-meeting press conference garnered much attention. Regarding the former, the Committee's updated forecast implied another 50 basis points of cuts before the end of the year, 1 more cut than they saw in June. Importantly, this update was consistent with their lower year-end inflation and higher unemployment projections. As Chairman Powell would later emphasize, this reflected the Committee's view that the upside risks to inflation had come down while the downside risks to employment had risen. In other words, the Fed's dual mandate of stable prices and maximum employment had come into better balance after a prolonged period of focusing on inflation.

Yields declined in the immediate aftermath of the announcement but later turned higher when Chairman Powell made his post-meeting remarks. Despite the "jumbo" cut, Powell pushed back against 50 basis points as the new pace in the future, stressing that the Committee is in no rush to cut rates. Instead, he repeatedly referred to the decision as a "recalibration" of policy with the risks to inflation and employment now "roughly balanced." Powell acknowledged that labor market conditions have cooled but added that

[1]Also referred to as the "dot plot," the Summary of Economic Projections (SEP) offers insights on each participant's assessment of the appropriate path for monetary policy given their respective economic outlooks.

levels are still at or close to maximum employment. On price stability, the Chairman reiterated the Committee's confidence in inflation moving sustainably towards their 2% target but refrained from declaring "victory." Overall, Powell assured that he and the Committee are not seeing anything in the economy right now that would suggest the risks of a downturn are elevated. Looking ahead, Powell reaffirmed that the Fed will be making decisions meeting by meeting based on the incoming data, the evolving outlook, and the balance of risks. As always, we will keep readers updated on all of these fronts.



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