

Nothing to See Here

Despite limited access to reliable data due to the ongoing government shutdown, the Federal Open Market Committee (FOMC) announced another 0.25% cut, lowering its key interest rate to 3.75–4.00%.

Authors

Matthias Scheiber, Ph.D., CFA
Rushabh Amin

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Topic

Market Events

Key takeaways

- **Outlook on rates:** FOMC cut rates to 3.75–4.00%; we expect no further changes to be made for rates in 2025.
- **Labor and inflation:** Rising unemployment and sticky 3% inflation has shifted Federal Reserve (Fed) focus to labor market risks.
- **Market implications:** Equity prices may melt up with increased volatility; bonds are fair to tightly priced; commodities may offer select alternate opportunities.

Today, the FOMC announced another 0.25% cut, reducing its key interest rate (the federal funds rate) to 3.75–4.00%. The ongoing U.S. government shutdown has complicated matters for market participants, particularly due to the lack of reliable labor market data. Tax data—which is still being published—offers a fallback but remains noisy and inconclusive. Policymakers have increasingly emphasized that the balance of risks has shifted toward the labor market, despite inflation running above target. Recent speeches by Fed Chair Powell and Governor Waller highlighted the unusual dynamic of rising downside risks to employment alongside stronger-than-expected growth. This could suggest a productivity boost; data indicates that improved supply-side conditions are also contributing.

Inflation has remained sticky, with the headline rate at 3%—higher than its 2% target. While inflation accompanied by solid growth is not inherently negative for markets, it poses a messaging challenge for the Fed. The emphasis on labor market conditions is understandable, especially amid rising jobless claims and a creeping unemployment rate. Inflation expectations remain elevated, and we believe this risk will continue to rear its head from time to time in the markets—particularly in the context of stretched valuations, ongoing economic uncertainty, and bond markets priced for a near-perfect cutting cycle. Over the long term, we believe the Fed will tolerate inflation above 2% if growth remains resilient, acknowledging the risks of overly precise inflation targeting.

U.S. growth appears robust. We expect the central bank to remain on hold for the last meeting of the year in December. The interest rate market currently anticipates a federal funds rate reduction to around 3.5% by year-end 2025. We have seen a tendency for pricing to become overly aggressive in both directions during this cycle, and we see risks skewed firmly to a hold stance until March (absent any surprise in the data) when it eventually gets published.

We believe markets appear priced for perfection across bonds and equities in the U.S. We expect a continued melt-up in equities, albeit with higher volatility, through year-end. In fixed income, we view U.S. 10-year yields around 4% as fairly priced. We find corporate spreads

across investment-grade and high yield unattractive for most new positions and are largely comfortable earning the carry. The U.S. dollar presents a more nuanced picture. While structurally we remain underweight, we see the currency regaining its role as a diversifier following the structural break observed in the first quarter. Commodities may present an opportunity for adding exposure to the alternative side, leaving aside precious metals but across industrials and parts of the energy complex.

Yield carry (or carry) refers to the income received from holding a financial instrument, relative to its cost, assuming the price stays the same. Specifically, it is the difference between the yield on a position and the cost of financing it.

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