On The Mark

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Fed Rate Cut—Now What?

Key Takeaways

- The Federal Reserve cut the Fed Funds rate by 0.5% at their September 2024 meeting.
- An interest rate cut signals the environment of unusually high inflation is likely over. This is a good thing for consumers and investors.
- Investors should use this as an opportunity to align their investment portfolios with their long-term goals.

Why Is the Fed Cutting Rates?

The Fed has a dual mandate of promoting low inflation and full employment. In many ways, those two mandates are at odds with one another. The Fed seeks to *balance* low inflation and full employment by adjusting short-term interest rates.

When the Fed raises interest rates (like they did in 2022), demand generally falls, typically leading to lower inflation and higher unemployment. Conversely, when they cut rates, demand generally rises, typically leading to higher inflation and lower unemployment. With the Fed's long-term inflation target in sight and labor markets still relatively healthy, the Fed cut interest rates in hopes of avoiding a recession in the future.

How Will This Impact Investors?

In previous rate cycles, the Fed has tended to keep interest rates high for too long, causing a recession. This time, the Fed cut interest rates while the labor market is still relatively strong. While there are signs of slowing, that slowing is coming from a very healthy overall level. In our view, cutting interest rates while the labor market is still healthy increases the probability that we will avoid a recession.

More importantly, the start of a rate-cutting cycle is a sign that the period of unusually high inflation is likely over. From a big-picture perspective, this is very good news for both consumers and investors.

What Should Investors Do?

We suggest investors consider three actions:

1) Ensure their **cash allocations** are aligned with their long-term investment plans. Recently, the yield environment favored cash over bonds; we expect this to move towards bonds as short-term interest rates fall.

2) Revisit their **asset allocations** to ensure they are aligned with their long-term goals. While this economic environment is associated with a higher risk of recession, it has also been associated with healthy returns for stocks and bonds over three- to five-year time horizons.

3) Get invested and **stay invested**. With an increased risk of recession and upcoming elections, market volatility is likely. Investors who can stay disciplined could be rewarded with above-average investment returns.

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