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Wealth Advisory FOMC Update

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Market Update

FOMC

The Federal Open Market Committee (FOMC) has officially begun the process of lowering interest rates. At Wednesday's FOMC meeting the committee lowered the federal funds rate by 50 basis points. This decision was highly debated whether it would be a 25-basis point cut, or a larger 50 basis point cut. Just last week, the odds of a 50-point cut were just 18%. That changed significantly after Wall Street Journal writer, Nick Timiraos, brought up the notion that a 50-point cut was in play. This large cut marks the first cut since the emergency cut in 2020 during COVID. The last time there was a 50-basis point cut to begin the rate cutting cycle was during the Great Recession and 2001. Recessions ensued in both scenarios. The Fed also released their Summary of Economic Projections (SEP). In this they provide updates about their forecasts for the economy. For the full year they expect GDP to be 2% after previously expecting it to be 2.1% in their June SEP. Unemployment is now expected to be at 4.4%, 40 basis points higher than what they expected in June. Core Personal Consumption Expenditures (PCE) is expected to be 2.6%, which is 20 basis points below their June forecast. The SEP also shows where they expect rates to be at the end of the year. They expect to have 50 basis points more of cuts by the end of the year. They previously forecasted only one to two 25 basis points cuts for the full year of 2024.

The press conference that ensued was interesting to say the least. When asked about why the Fed decided to cut rates by 50 basis points after Powell had said in July, they were not thinking about it, he answered very broadly. The Chairman said they received two jobs' reports, two inflation reports, a jobs revision, and the beige book. He did not go into detail about what they saw in that data. In our opinion, Powell did not provide an answer that was remotely satisfactory on their rate decision. If the economy and labor market are as strong as Powell stated in his press conference, then why are they making a half point cut which has only been done leading up to recession when the FOMC is behind the curve. Powell stated that the labor market has cooled off but remains healthy. He said the 4.2% unemployment number is healthy, participation remains at high levels, wage increases are still a bit above normal, vacancies to unemployed are normal, quits have come down to normal levels; this to him is a solid job market. If this is all true then why have an outsized rate cut?

There were also questions about the pace to expect for further rate cuts. The Chairman said they will take it meeting by meeting and that they have made a good strong start because they are confident inflation is coming down and are in no rush. Which is a strange statement to make when core inflation was hotter than expected in the last two reports. Questions also arose about the economy, and this is what I found the most interesting. Powell said that U.S. economy is fine and growing at a solid pace. He mentioned that if you talk to businesspeople, they believe the economy is in good shape. This statement directly contradicts what the Fed's beige book showed us a few weeks ago. The data from the fed districts were concerning to say the least. 9 out of the 12 districts showed declining or no economic growth. It is important to note that beige book led to his dovish pivot in December. When directly asked about a recession, he said he does not see anything in the economy that suggests a downturn is likely.

With such a large cut coming in the first reduction of the federal funds rate, it begs the question why did the FOMC decide to go large instead of gradually doing 25 basis points? History has shown us that when the Fed goes with a larger reduction, they are concerned with something in the economy. As the press conference notes show, Powell did not indicate that. Nor did he mention why they decided to go with something he said was not going to happen just a few weeks ago. The past few inflation reports were hotter than expected in the core readings. The Core Consumer Price Index (CPI) remains at 3.2%, well above the Fed's 2% target. It is our opinion that the FOMC has concerns about the economy and that is why they went with a bigger than expected cut. They are not letting on to what those concerns are. They have a history of being behind the curve just like they were two years ago on inflation. This scenario is unprecedented. The FOMC is cutting rates when the equity markets are at all-time highs, housing remains at all-time highs, market cap to GDP is over 200% and the market trading at a forward multiple of 22x with just 15% expected earnings growth. With that being said, we remain steadfast in our investment approach. We continue to have more of a defensive strategy as economic data continues to point towards a downturn and the equity markets remain extended. In fixed income, our decision to extend duration this year and lock in higher yields has worked well as rates have moved down quite rapidly the past few months.

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