Oct. 4, 2024

# Fed Cuts Fifty: The Easing Cycle Has Commenced

On Sept. 18, the Federal Open Market Committee (FOMC) cut interest rates by 50 basis points (bps), commencing its first easing cycle in nearly four years with a bang.[1] Most analysts expected 25 bps, as "jumbo" cuts are generally reserved for periods of clear economic stress. To this point, Federal Reserve Governor Michelle Bowman became the first FOMC member to dissent since 2005, arguing that 25 bps would have been more appropriate given the strength of the U.S. economy and that inflation remains above the Fed's 2% target.[2] For his part, Fed Chair Jerome Powell rationalized the larger move in his post-meeting press conference, explaining the committee's growing confidence that inflation is moving sustainably towards 2%.[3] The 2.2% year-over-year read on the personal consumption expenditures price index (PCE) last Friday, the Fed's preferred measure of inflation, certainly lent some credence to this argument. Powell also noted that while the labor market is cooling, it is still strong and that "our intention with our policy move today is to keep it there." He explained that the "time to support the labor market is when it's strong and not when we begin to see the layoffs."

Given this rationale, the FOMC appears firmly committed to future policy easing. According to the Fed's updated summary of economic projections, an additional 50 bps of cuts are expected in 2024 and 100 bps in 2025.[4] The Federal Funds futures market is slightly more aggressive, calling for 75 bps this year and between 100 and 125 bps next.[5] Regardless of the exact path, the destination appears clear – baring a significant surprise in inflation or employment data, rates will likely be lower moving forward.

The charts below summarize the yield and performance of select fixed income indices and tenors as of September 2024.

**U.S. Treasury Yield Curve**

| | | Change (Basis Points) | |
|---|---|---|---|
| **Maturity** | **Yield** | **Month-to-date** | **Year-to-date** |
| 2-year | 3.642 | -27.7 | -60.9 |
| 5-year | 3.559 | -14.5 | -28.9 |
| 10-year | 3.782 | -12.2 | -9.8 |
| 30-year | 4.196 | 0.0 | 16.7 |

Source: Bloomberg, 30 September 2024 (US On/Off The Run Sovereign Curve)

**U.S. Corporate (Investment Grade) Yield Curve**

| | | Change (Basis Points) | |
|---|---|---|---|
| **Maturity** | **Yield** | **Month-to-date** | **Year-to-date** |
| 2-year | 4.319 | -27.7 | -66.9 |
| 5-year | 4.458 | -7.0 | -28.4 |
| 10-year | 4.837 | -18.8 | -23.0 |
| 30-year | 5.212 | -16.5 | 5.3 |

Source: Bloomberg, 30 September 2024 (USD US Corporate IG BVAL Yield Curve)

**Municipal (AAA) Yield Curve**

| | | Change (Basis Points) | |
|---|---|---|---|
| **Maturity** | **Yield** | **Month-to-date** | **Year-to-date** |
| 2-year | 2.387 | -9.2 | -11.6 |
| 5-year | 2.371 | -10.0 | 15.6 |
| 10-year | 2.63 | -6.8 | 36.1 |
| 30-year | 3.55 | -10.4 | 14.7 |

Source: Bloomberg, 30 September 2024 (BVAL Muni AAA Yield Curve)

**Index Characteristics and Returns**

| | | | Returns (%) | |
|---|---|---|---|---|
| **Index** | **Yield (Worst)** | **Modified Duration** | **Month-to-date** | **Year-to-date** |
| U.S. Treasury | 3.78 | 6.32 | 1.224 | 3.979 |
| U.S. Agency | 3.95 | 3.45 | 0.933 | 4.452 |
| U.S. Corporate Investment Grade | 4.75 | 6.86 | 1.723 | 5.762 |
| U.S. Corporate High Yield | 6.98 | 3.33 | 1.634 | 8.031 |
| U.S. Mortgage Backed Securities | 4.50 | 5.30 | 1.233 | 4.655 |
| U.S. Broad Market | 4.26 | 6.09 | 1.338 | 4.672 |
| Global Broad Market | 3.48 | 6.47 | 1.127 | 3.231 |
| Emerging Market Corporate | 5.53 | 5.04 | 1.454 | 7.869 |
| Municipal Investment Grade | 3.37 | 5.74 | 1.057 | 2.659 |
| Municipal High Yield | 4.73 | 5.15 | 1.157 | 8.291 |
| Municipal Taxable | 4.69 | 7.94 | 1.206 | 5.261 |

Source: ICE DATA INDICES, LLC ("ICE DATA"), 30 September 2024. Past performance is no guarantee of future results. U.S. Treasury = ICE BofA US Treasury Index, U.S. Agency = ICE BofA US Agency Index, U.S. Corporate Investment Grade = ICE BofA US Corporate Index, U.S. Corporate High Yield = ICE BofA US High Yield Index, U.S. Mortgage Backed Securities = ICE BofA US Mortgage Backed Securities Index, U.S. Broad Market = ICE BofA US Broad Market Index March 2020 Regular Rebalance, Global Broad Market = ICE BofA Global Broad Market Index, Emerging Market Corporate = ICE BofA Emerging Markets Corporate Plus Index, Municipal Investment Grade = ICE BofA US Municipal Securities Index, Municipal High Yield = ICE US High Yield & Non-Rated Municipal Securities Index, Municipal Taxable = ICE BofA Broad US Taxable Municipal Securities Index.

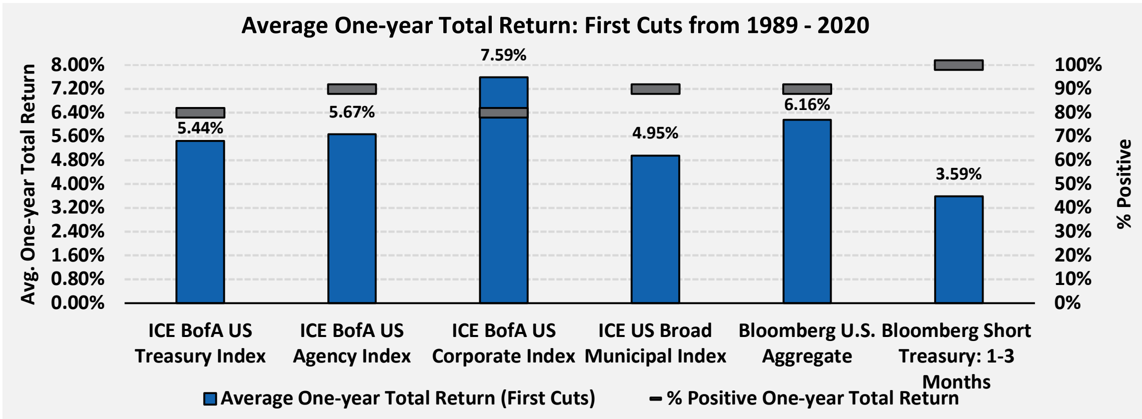
**Federal Open Market Committee (FOMC)**

| | | | |
|---|---|---|---|
| Fed Funds Rate - Upper Bound | 5.00 | Last FOMC Meeting | 18-Sep-24 |
| Fed Funds Rate - Lower Bound | 4.75 | Next FOMC Meeting | 7-Nov-24 |
| Fed Funds Effective Rate | 4.83 | | |
| Discount Rate | 5.00 | | |

Source: Bloomberg, 30 September 2024

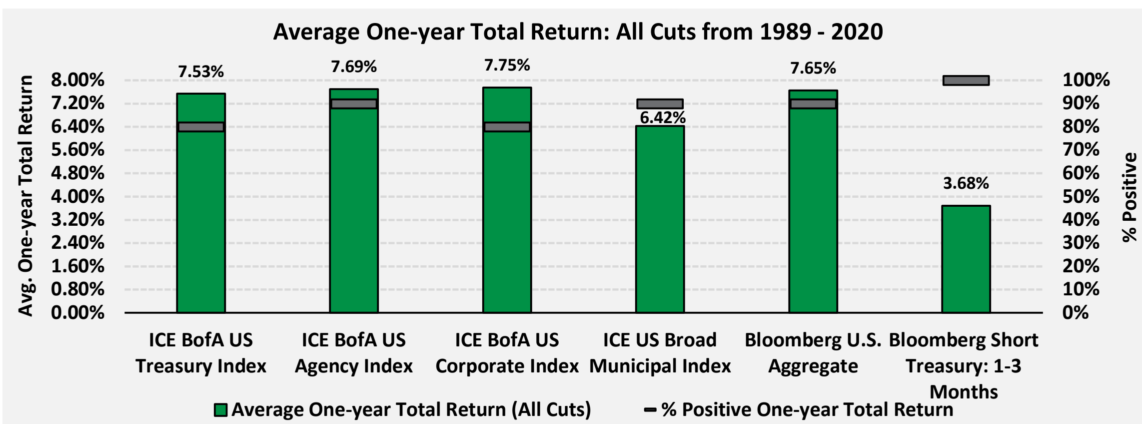
*Past performance is no guarantee of future results.*

Fixed income generally performs well when the Federal Reserve cuts interest rates. Looking at the previous ten easing cycles since 1989, buying bonds at the beginning of a cycle (first cut) has largely resulted in positive one-year total returns across fixed income asset classes. For instance, the Bloomberg U.S. Aggregate index has an average one-year total return of 6.15% during these periods, and was positive nine times out of ten, as shown in the chart below.




*Source: ICE BofA Indexes, Bloomberg. Past performance is no guarantee of future results.*

Broadening the scope to include all fifty-seven rate cuts since June 1989, the return potential during easing cycles appears even more compelling. The Bloomberg U.S. Aggregate index, for example, has averaged a 7.65% one-year total return after each cut and was positive 94% of the time (53/57). Since this trend is largely seen across fixed income asset classes, it would suggest that on average, the trajectory of interest rates may be more important than perfect timing.




*Source: ICE BofA Indexes, Bloomberg. Past performance is no guarantee of future results.*

It is also important to note that cash and short-term money market instruments generally underperform in falling rate environments, as demonstrated by the Bloomberg Short Treasury Index in the tables above. Short-end investments have higher reinvestment risk, and their yields usually track the Federal Funds rate closely. The yield on a three-month Treasury Bill, for instance, has fallen 66 bps in the last 60 trading days (5.09% to 4.43% as of 9/30) and now sits roughly 32 bps below the lower bound of the current Federal Funds target range (4.75 – 5.00).

For investors contemplating an allocation to fixed income, especially those who are overweight cash, missing the first cut doesn't necessarily mean missing the opportunity. Yields are still attractive, and fixed income has historically performed well across easing cycles.



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A prudent approach to fixed income investing calls for diversification across both credit and duration exposure. As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

*Bill Smith serves as president, Portfolio Management & Trading, of Harmont Fixed Income in Phoenix.*

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[1] "Federal Reserve Issues FOMC Statement," Board of Governors of the Federal Reserve System," Sept. 18, 2024, https://www.federalreserve.gov/newsevents/pressreleases/monetary20240918a.htm
[2] "Recent Views on Monetary Policy and the Economic Outlook," Board of Governors of the Federal Reserve Board System," Sept. 30, 2024, https://www.federalreserve.gov/newsevents/speech/bowman20240930a.htm#
[3] "Federal Reserve Issues FOMC Statement," Board of Governors of the Federal Reserve System," Sept. 18, 2024, https://www.federalreserve.gov/newsevents/pressreleases/monetary20240918a.htm
[4] "Summary of Economic Projections," Board of Governors of the Federal Reserve Board, Sept. 18, 2024, https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20240918.pdf
[5] "Projections Reveal a Sharp Divide in 2025 Rate Cute Projections," Barron's, Sept. 30, 2024, https://www.barrons.com/livecoverage/stock-market-today-093024/card/projections-reveal-a-sharp-divide-in-2025-rate-cut-predictions-dhXZoXsJFxOXLgp8tmBs





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