

Fed Watch

Our investment committee does not put much value on economic forecasts. Ask us if we are headed to a recession, a soft landing, or continued growth in the economy and our answer is likely “we don’t know”. It is not that we don’t pay attention to weekly updates on jobs, manufacturing, retail sales, etc., but the data is often noisy with many revisions. And while the economic backdrop is correlated to market performance, forecasting that performance based on the economy is fraught with risk.

Economists are relatively accurate about predicting an economic slowdown but have a poor track record of predicting *precisely* when a recession will unfold. Since 1969, there have been eight recessions. Economists have been late in predicting the recession in six of the eight instances by an average of almost four months, meaning the recession was underway prior to the forecast.

Today the Federal Open Market Committee (FOMC) will be deciding on whether to cut the Fed Funds Rate. Jerome Powell, Fed Chair, has indicated a rate cut is imminent, but vague by how much. According to the CME Group, there is now a 65% probability that the rate cut is 50 basis points (one half of 1%) and a 52% probability of an additional 25 basis point cut at the November meeting. The day before a meeting, the odds are typically much higher (95%-100%) on the magnitude of the Fed’s move. Per Jim Bianco of Bianco Research, this type of uncertainty is unprecedented.

What does a rate cut mean for your investments? The recent rate tightening cycle to fight inflation is the longest since 2004. There have been 11 rate hikes since March 2022. Twenty years ago, the Fed raised rates 17 times, ending that cycle in December 2007, and the economy – and stocks – slumped considerably into 2008-09. But going back more than 50 years, the outlook for stocks after the first rate cut is mixed, so we don’t put a lot of value in the rate-hike-to-rate-cut cycle of ‘04-’07 as a harbinger of things to come. It is only one data point.

The performance of the stock market a year after the initial rate cut is a coin flip. There have been nine initial rate cuts dating back to 1973. Twelve months following the cut, five of those instances lead to advances in the stock market. The largest 12-month gain was nearly 30% (in 1979) and the largest loss was 32% (in 1973). Jason Goepfert of Sundial Research summarizes the research...*the imminent cut in the Fed Funds rate has been a crap shoot for investors. There was no consistent pattern in forward returns after significant hiking cycles. The last few have been major warning signs, while most of the others were not at all. They were more consistently negative for the dollar (for a while), tech stocks (ironically enough), while being good for Treasury notes and bonds, value stocks, and defensive sectors.*

Ask us what we think, and we’ll say, “not sure”. How could we be? Timing the market is a fool’s errand. Timing the market based on economic forecasts, and in this case even historical data, is completely irrational. Consider this: in September of 2023, economists assigned a 42% probability (elevated by economic standards) of a recession in the coming quarter. The S&P 500 is up almost 25% from that point.

There will be plenty of analysis and opinions in the coming days. We would not be surprised to see an increase in market volatility which is typical behavior for stock and bond prices surrounding uncertainty and major events. Unless your personal situation has changed dramatically, making a dramatic change to your portfolio based on today’s FOMC meeting is ill-advised.