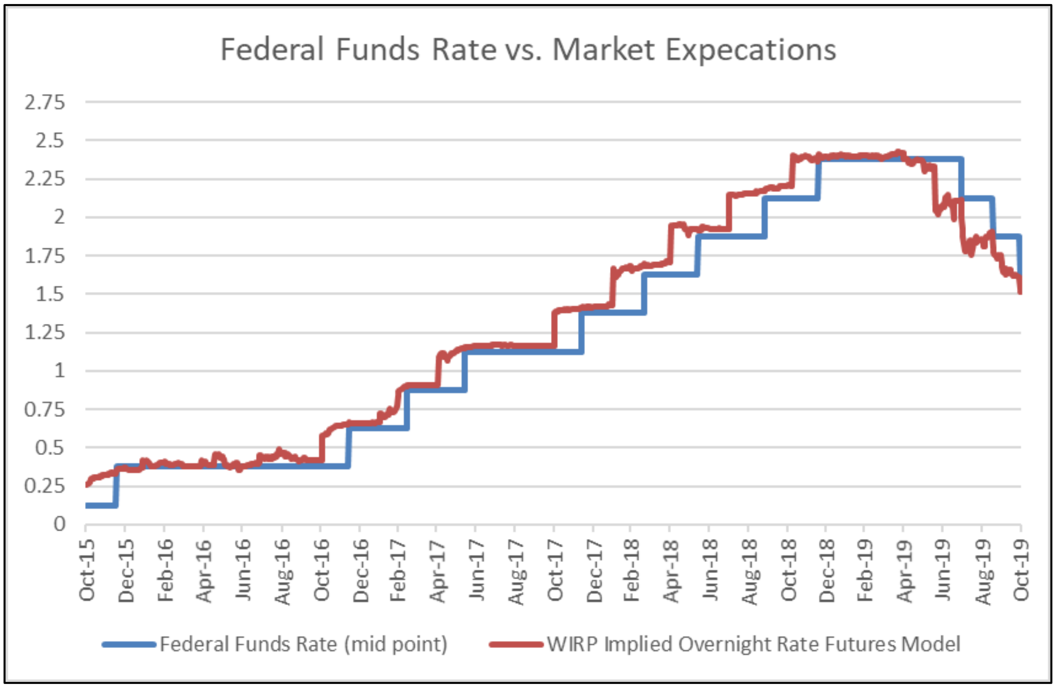
# How low will the Fed go?

**November 1, 2019**

On Wednesday the Federal Open Market Committee (FOMC) announced a 25-basis point cut in the discount rate to a target range of 1.5-1.75%. The third quarter point rate cut since the end of July was widely in line with market expectations and was conveyed as a ‘mid-cycle adjustment’ in a market environment that earlier this year became the longest economic expansion in history. In the chart below you can observe that market participants in the futures market were anticipating the FOMC raising rates steadily almost in lockstep since the later part of 2016 before reversing the trend with three rate cuts starting at the end of July. In Jerome Powell’s post-announcement news conference, he spoke with a hawkish tilt relative to what the market was anticipating by stating that monetary policy is in a good place right now after recent FOMC decisions were made as insurance cuts to help support the economy that was facing an increasingly uncertain economic landscape. Now the Fed believes some of the concerns of the economic landscape are abating. If the economy unfolds in line with the FOMC’s plan they won’t be making anymore insurance cuts.




The FOMC altered key clauses from their previous policy meeting statement that further emphasized a more conservative tone. The intentional omission of specific phrases like “act as appropriate to sustain the current expansion” were arguably more important than new phrases that were added. The market interpreted Wednesday’s events to mean that the bar has been significantly raised for additional adjustments to the federal fund rate in the near-term and that the committee will take a “wait and hold” approach before making further changes. The committee left the door wide open for the FOMC to alter their decision before they meet for the last time of the year in roughly six weeks on December 11th. As of October 31st, the market reflects the uncertainty by pricing in roughly a 30% chance that there will be an additional 25-basis point cut in December. However, the market has gotten ahead of itself before. It will be important to analyze FOMC members’ speeches alongside economic data releases until the next official meeting to offer clues on what to expect from the last rate decision of the year. Voting members of the committee remain divided, with multiple members voting to leave rates unchanged.

The Fed’s policy decisions are not on a preset course and the committee remains adamant that they are data dependent but believe that the economic outlook has become more upbeat with monetary policy helping support the economy. Uncertainty around geopolitical risks are viewed as less urgent since both the United States and China have made progress in trade discussions. Policy risks have been adding to global weakness and restricting business investment while consumer spending has proven to be resilient with inflation remaining muted. As a firm we continue to believe that geopolitical risks have contributed to investors’ fears, but fundamentals haven’t significantly changed to reflect higher risks. For diversified investors the near-term environment should provide a supportive backdrop.

*Gunnar Ildhuso III, CFA | Research Analyst*