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Markets & Economies

Seven Quick Points on the Fed's December Rate Cut

A brief outline of the policy and investment implications of the December 17–18 FOMC meeting.

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The Federal Open Market Committee (FOMC), the policy-setting arm of the U.S. Federal Reserve (Fed), cut the target federal funds rate by 25 basis points (bps) on December 18, to a range of 4.25% to 4.50%. This marked the third reduction in the current rate-cut cycle, after moves of 50 bps in September and 25 bps in November. Markets had expected the move, with fed funds futures pricing in a 95.4% probability of a 25-bp cut in late trading on December 17.

Beyond the headline policy move, here are some additional observations on the December FOMC meeting.

1. The FOMC kept its asset purchase program intact. Its post-meeting statement said the economy continues to expand "at a solid pace," while the unemployment rate has moved higher but remains at a low level—language unchanged from its September communique. Policymakers noted that inflation had "made progress" toward its 2% objective but "remains somewhat elevated," another identical phrasing from September. The decision was not unanimous, as Cleveland Federal Reserve Bank President Beth Hammack preferred to maintain the fed funds target range at 4.5%-4.75%.

2. Some clues on the policy outlook were offered by Fed Chair Jerome Powell in his press conference after the FOMC meeting. "We are significantly closer to neutral" on interest rates, he said, based on a Bloomberg report. "We still think where we are is meaningfully restrictive. And I think from this point forward, it's appropriate to move cautiously and look for progress on inflation."

3. As for the economy, the Fed chair said the central bank had "done a lot to support economic activity by cutting a hundred basis points." He added that that the outlook was "pretty bright … most forecasters have been calling for a slowdown in growth and it keeps not happening."

4. Powell's "caution was reflected in the so-called "dot plot" from FOMC members issued on December 18. The Summary of Economic Projections (SEP) indicated the committee expects two more 25-bp cuts in 2025 and two similar moves in 2026: the median 2025 year-end projection for the fed funds rate was 3.88%, versus an expectation of 3.38% in September; the projection for the end of 2026 was 3.38%, versus 2.88% in September. For 2025, FOMC members forecast a faster pace of economic growth (real GDP of 2.5% versus 2.0% in September), a lower year-end unemployment rate (4.3% versus 4.4%) and a faster pace of core inflation (2.5% versus 2.2%).

5. The sharply reduced expectations for rate cuts were reflected in financial markets in late trading on December 18, with major equity indexes sustaining heavy losses while Treasury yields moved higher, based on Bloomberg data.

6. As we noted in September, the Fed is still cutting rates during a period of strong economic growth. While it is still biased toward cutting rates, the final number of expected reductions is smaller, and the pace looks to be far more gradual. The Fed is catching up to the markets here, as yields have risen amid investor expectations that a resilient economy, a solid labor market, and slowing progress on taming inflation will eventually stay the central bank's hand; current fed fund futures prices reflect the expectation that the Fed will implement two 25-bp cuts in 2025 and call it a day.

7. One positive takeaway: The fact that the Fed still has a bias toward easing sets the bar higher for future rate hikes; as we have noted in the past, the fact that rate hikes appear to be "off the table" remains a supportive factor for risk assets.

Investment Implications

With the Fed expected to cut rates at a slower pace in 2025, which asset classes might merit investor attention? Here are some areas to consider:

Fixed Income

We continue to have a positive view of high-quality intermediate-term bonds. With the move in rates over the past few years, the current starting level of yields presents an attractive entry point, in our view. Short-duration bonds continue to have a favorable risk/return profile in the current rate environment. Blending core bonds with short-term credit may provide a way to realize attractive income while mitigating rate volatility.

The positive outlook for the U.S. economy remains intact, in our view, providing a positive environment for credit, as investors remain in a position to realize extra carry. Among the approaches to consider are multi-sector bond, short duration high yield, and opportunistic credit strategies.

High-quality and intermediate-term municipal bonds are currently providing attractive tax-equivalent yields. Given the positive backdrop for municipal credit, the high yield muni segment also merits consideration, in our view.

Equities

We continue to emphasize investing in quality companies with durable competitive advantages. We do this in growth and value stocks. We continue to see attractive valuations in international equities. We also believe companies in the innovation space, characterized by rapid revenue and earnings growth, are also well positioned for the current environment.

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Glossary Definitions

A **basis point** is one one-hundredth of a percentage point.

Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates.

The **Federal Reserve (Fed)** is the central bank of the United States. The **Federal Open Market Committee** (FOMC) is the branch of the Fed that determines the direction of monetary policy in the United States.

The federal funds rate is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight on an uncollateralized basis. **Fed funds futures** are financial futures contracts based on the federal funds rate and traded on the Chicago Mercantile Exchange. These futures are considered a direct reflection of collective marketplace insight regarding the future course of the Federal Reserve's monetary policy.

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The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies.

Fixed-Income Investing Risks

The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price.