WHEN WILL THE FED CUT RATES?

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Welcome to April! Every month, we like to impart some perspective on the financial markets or shed light on a current headline or two, all to help our clients sift through the noise and become slightly more educated investors. We welcome your comments and suggestions, and as always, we invite you to share this piece with anyone you believe may find it of interest.

A question we've been getting a lot lately has been, "When will the Fed finally cut interest rates?" Given the stress higher rates can place on mortgage payments, corporate profit margins, national debt payments, and overall economic growth, the question is understandable. While we typically tread lightly in such topics, there is nevertheless some value in offering historical perspective and setting reasonable expectations. The answer to the question may ultimately be disappointing, but perhaps some context and insight can serve as a guide.

As the markets have climbed out of last October's lows, the prevailing narrative has emphasized the anticipation, if not the outright inevitability, of rate cuts in 2024. However, amidst the current murky outlook, the prevailing consensus appears to be shifting, indicating the potential that rates may now remain *higher for longer.*

Let's first ask why the so-called experts believed rate cuts were inevitable. Was it because prevailing rates have genuinely been elevated, or have prevailing narratives unfairly shaped our perceptions? Since 1954, the average Fed Funds rate has been 4.6%; today it sits at 5.33%[1], so today's rates aren't materially out of line with historical norms. And while they may seem relatively high when compared to the era of near-zero rates following the Global Financial Crisis, it is not excessively disparate from historical norms.

But to determine when the Fed might cut rates, we need to understand why they would do it in the first place. Typically, rate cuts are like adrenaline for a sluggish economy[2]. However, existing economic indicators paint a contrasting picture, characterized by low unemployment, higher wage trends, robust economic growth, and inflation that is approaching the Fed's targeted threshold. The economy certainly isn't humming along, but neither is it languishing. So, the question of whether the Fed should opt for rate cuts becomes a rather complex one. And as much as the pundits want us to think they know, even the Fed isn't sure. But there's good reason for that.

Should the Fed decide to cut rates – especially if it happens too hastily – there's a distinct possibility that doing so could overstimulate the economy, potentially reaccelerating inflation and creating a whole new set of headaches. We all remember the 1980s.

But in the grand scheme of things, does it really matter when or if the Fed makes a move? Howard Marks, renowned investor and founder of Oaktree Capital Management, once questioned the obsession with timing Fed decisions, and he had a point:

In late 2015, virtually the only question I got was "When will the first rate increase occur?" My answer was always the same: "Why do you care? If I say 'February', what will you do? And if I later change my mind and say 'May,' what will you do differently?" If everyone knows rates are about to rise, what difference does it make which month the process starts?" No one ever offered a convincing answer.

So, returning to the question posed earlier, we have no idea if or when the Fed will act....and if they do, how low they may ultimately go. Even the so-called experts are grasping at straws. Remember their confident assurances that the Fed would raise rates *slowly* in 2022? We all know how that worked out. Perhaps it's best to ignore them and tune out the noise.

Making rational decisions amidst uncertainty is the very reason we plan. So, plan we will. And to quote Marks one more time, "if we are prepared, there's no reason to predict".

As always, there's more to come.

[1]Historical Fed Funds Rates [2]St. Louis Fed

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