MARKETS IN FOCUS

Fed policy insights

Thank you for holding

January 29, 2025

Key takeaways

- Market reaction to the Fed's decision and messaging was muted.
- Watch for data on inflation and the labor market to continue to be critical to the path of the rate-cutting cycle. Don't be surprised by elevated volatility around inflation reports over the next month.
- Matt Orton, CFA, remains sanguine about the outlook for the equity market and expects further broadening in earnings growth throughout the year.

The U.S. Federal Reserve (Fed) left its key policy rate unchanged at 4.25% to 4.50% with a marginally hawkish tilt to the post-meeting statement. The hold was widely expected. Still, there were some edits to the statement – removing an acknowledgment that inflation had made progress toward the 2% target and saying the unemployment rate has stabilized – that appear intended to signal the pause could be an extended one, said Matt Orton, CFA, Chief Market Strategist at Raymond James Investment Management.

Fed Chair Jerome Powell tried to downplay any hawkish signaling from the statement updates, and the market seemed willing to accept.

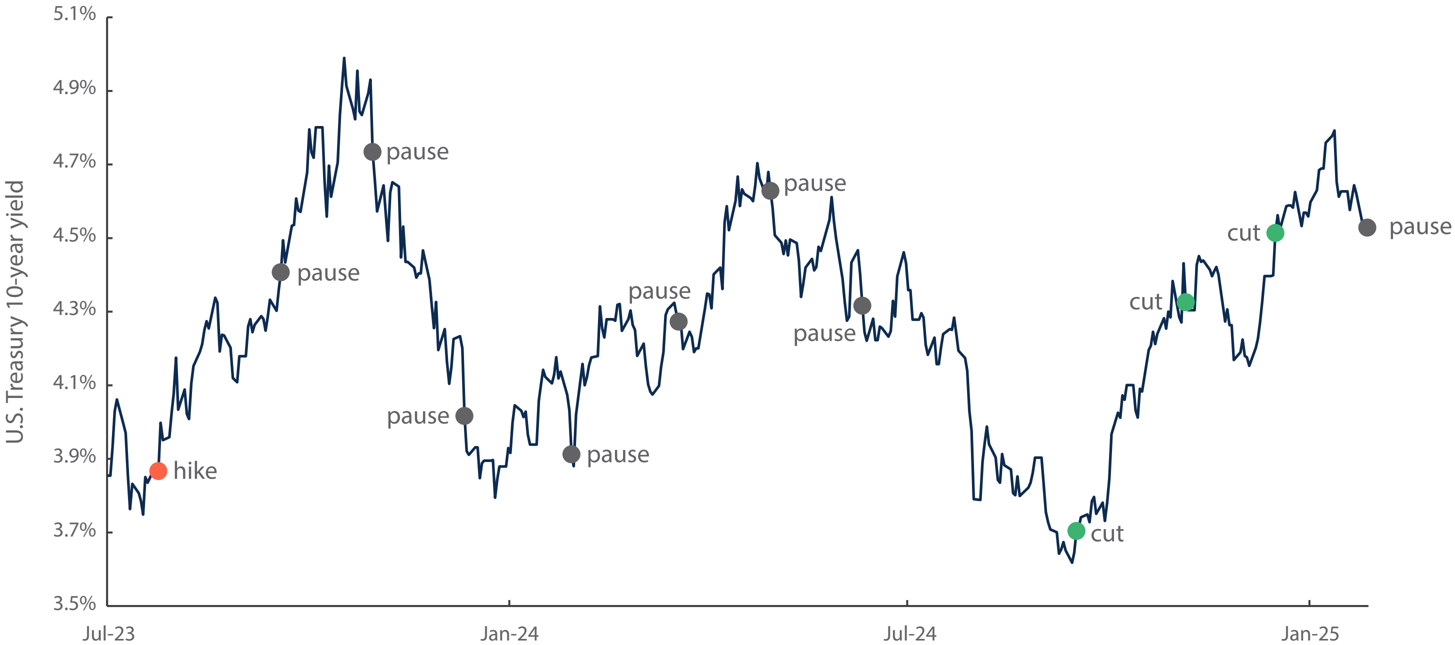
"I think it's a bit odd that the removal of the reference to inflation making progress toward 2% wasn't intended to be viewed as a signal," Orton said, "but it was encouraging to see that the market wasn't alarmed."

The Fed did not provide any specific guidance whether there will be a cut in March. Instead, Powell reiterated that officials aren't in a rush. He also said policymakers are looking for "serial readings that suggest that we're making further progress on inflation" as they assess when another cut might be appropriate. Incoming data on inflation and the state of the labor market will continue to be critical to the path of the rate-cutting cycle, Orton said, and he believes that we will see elevated volatility around inflation data over the next month.

Powell was very careful to avoid wading into political territory, but Orton said the issue of tariffs will likely play a very important role in determining the path forward. Given the high level of uncertainty around how tariffs will ultimately be implemented – the level of tariffs, on whom, and for how long – it makes sense for the Federal Open Market Committee (FOMC) to take a wait and see approach.

Following 100 basis points of cumulative interest rate cuts, the Fed held its policy rate steady for the first time since June

U.S. 10-year Treasury yield since July 2023



Source: Bloomberg, as of 1/29/25.

Orton expects some clarity in the near future since February 1 is the deadline that President Trump set for imposing the first phase of tariffs, but it will still take time before any conclusions can be made about any inflationary impacts.

The market reaction was just about as uneventful as the press conference. U.S. rates ultimately changed little, although the FOMC statement initially caused a knee-jerk rate rise and curve-flattening that was later reversed.[1] Orton expects rates to remain range-bound until we have more clarity with respect to policy and/or start to see data shift meaningfully.

"I continue to believe that inflation is on a slow, downward path, but there are many exogenous shocks on the policy side that could change this," he said. "As such, there is a high degree of uncertainty, and I think it's premature to declare that the Fed cutting cycle is over."

Any positive progress on inflation or more tactically implemented tariffs – or even broader tariffs that don't last in perpetuity – could enable the Fed to cut rates once or twice later in the year, he said.

Given this outlook on the rate front, Orton continues to focus on the fundamentals with respect to equities, and he believes there remains a strong case to see further gains in 2025.

"I do not envision a case for rates to sustainably break out of this wide range from 4.2 to 4.8%," he said. "Consequently, it's really up to earnings to drive the market forward."

Earnings season is off to a very strong start, with breadth across sectors and industries continuing to expand. Results for financials give Orton confidence that the economy remains in a good place. The mega-cap tech complex also has reported solid numbers. Critically, he said, tech companies are confirming capital expenditure (capex) numbers and emphasizing that Monday's historic moves were overblown in response to the news of the development of the DeepSeek artificial intelligence (AI) model.

"The narrative that there are tech woes flies in the face of reality," Orton said, "and I believe it creates opportunities in high-quality companies for investors to consider. Overall, I believe the January FOMC provides no reason to change a sanguine outlook for the market and to expect further broadening throughout the year."

[1] Unless otherwise indicated, all data cited is sourced from Bloomberg as of Jan. 29, 2025.

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Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. The prices of small company stocks may be subject to more volatility than those of large company stocks.

International investing presents specific risks, such as currency fluctuations, differences in financial accounting standards, and potential political and economic instability. These risks are further accentuated in emerging market countries where risks can also include possible economic dependency on revenues from particular commodities or on international aid or development assistance, currency transfer restrictions, and liquidity risks related to lower trading volumes.

Definitions

Basis points (bps) are measurements used in discussions of interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%.

Breadth describes the relationship between the median and the mean of a market index. When a few data outliers result in a mean that is substantially larger (or smaller) than the median of the full data set, then the performance of the entire index is being driven by a "narrow" selection of companies. An index supported by "broad" market movements is one where the median is closer to the mean.

Capital expenditures, or capex, are monies used by a company to buy, improve, or maintain physical assets such as real estate, facilities, technology, or equipment, and may include new projects or investments.

DeepSeek is a Chinese artificial intelligence startup that in January 2025 became a leading free downloadable app in the United States. This followed DeepSeek's announcement that its AI model performed as well as market-leading models, and that it was developed at a significantly lower cost. This led to a selloff of well-known U.S. technology stocks on Jan. 27, 2025.

Exogenous shocks are unexpected events that take place outside an industry, sector, or even an economy and that have sudden, negative impacts on countries, their populations, their economies, and their capital markets.

The Federal Open Market Committee (FOMC) consists of 12 members: the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year at which it reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth.

Hawkish, dovish, and centrist are terms used to describe the monetary policy preferences of central bankers and others. Hawks prioritize controlling inflation and may favor raising interest rates to reduce it or keep it in check. Doves tend to support maintaining lower interest rates, often in support of stimulating job growth and the economy more generally. Centrists tend to occupy the middle of the continuum between tight (hawkish) and loose (dovish) monetary policy.

The inflation target of the U.S. Federal Reserve is the rate of price increases that the Fed prefers to see to ensure the economy will remain stable. Generally, the Fed's target rate is 2%, as measured by the Personal Consumption Expenditures (PCE) Price Index.

Mega-cap stocks are the largest publicly traded companies as measured by market capitalization. Generally, this refers to companies with market capitalizations over $200 billion.

A policy rate is an interest rate set by a central bank or other monetary authority to influence the evolution of an economy's monetary variables such as consumer prices, exchange rates, or credit expansion.

Range-bound is a condition where the value of a security keeps vacillating between the low and high ends of a narrow range. For example, if the 10-year Treasury yield repeatedly vacillated between 3.75% and 4.25%, it would be described as "range-bound."

A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. Investors and market analysts watch certain yield curves for signs of inversion, when yields for longer-term debt instruments fall below yields on short-term debt with the same credit quality. Inversions are watched as potential signs of a weakening economy and in certain cases, a harbinger of recessions.

Yield curve flattening takes place when the difference between short- and long-term rates on the curve narrows, making long-term bonds less attractive.

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