

# MARKETS IN FOCUS

## Fed Policy Insights

### Driving on a foggy night

December 19, 2024

#### Key takeaways

- The Federal Open Market Committee's 25-basis point interest rate cut was not a surprise, but the committee's shift on the outlook for the number of cuts next year caught some investors off-guard.
- Matt Orton, CFA, believes that U.S. Federal Reserve officials are factoring President-elect Donald Trump's expected policy changes into their decisions, even though they said they aren't.
- Orton also believes that an uncertain path for interest rates does not change the fundamental economic backdrop of continued U.S. growth and a healthy labor market, which he expects will continue to support equities.

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It was no surprise that the Federal Open Market Committee (FOMC) reduced its target range by 25 basis points, to 4.25% to 4.50%, accompanied by a hawkish shift in messaging, said Matt Orton, CFA, Chief Market Strategist at Raymond James Investment Management.

"While this was largely expected by investors heading into the meeting, the degree of uncertainty with respect to future interest rate cuts as well as the extent of the shift in the dot plot – halving its projection for easing next year – caught some investors off guard," Orton said.

The change to the 2025 median rate seems to represent a broad consensus on the FOMC, with 10 participants forecasting 50-basis point cuts as the median.<sup>1</sup> Notably, there are almost as many participants (4) expecting even less easing next year as there are expecting more (5). Additionally, the FOMC lifted its longer-run neutral rate estimate for the fourth straight quarter (to 3.0% from 2.9%), signaling that the committee increasingly sees both current and projected rates as less restrictive than it did in September.

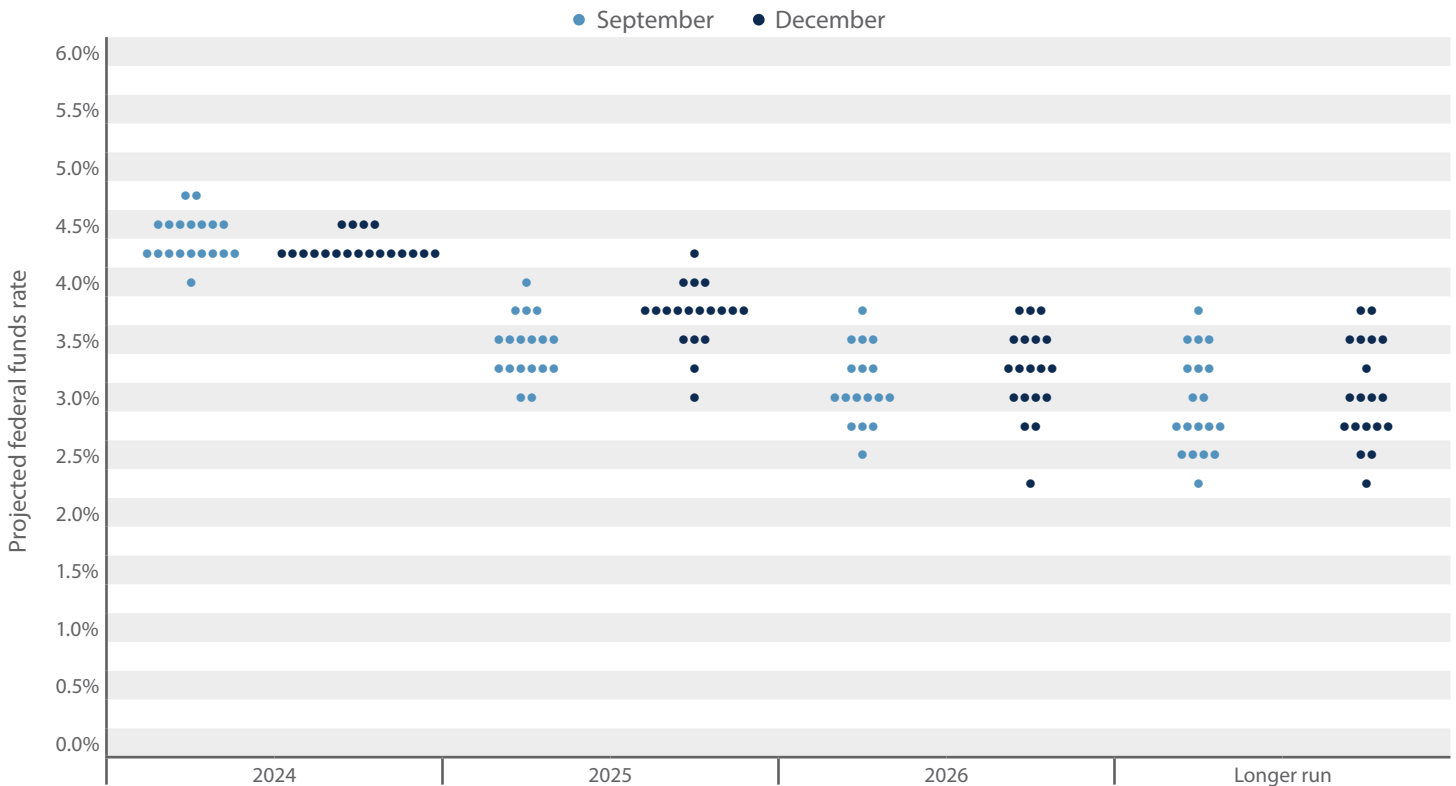
There is also a significant messaging challenge for the U.S. Federal Reserve (Fed), which Orton said was quite evident during Fed Chair Jerome Powell's press conference as he had to thread a few different needles.

"In particular, I think he struggled in explaining why disinflation remains on track but why the Fed is slowing its cuts from here, as well as why officials are thinking about Trump's new policies yet they aren't really (and have said in the past that they will not anticipate), given they don't know the specifics," Orton said. "On that second point, it appears quite evident that FOMC members are indeed speculating about future policy changes."

The median forecast for the 2025 Personal Consumption Expenditures (PCE) Price Index and core PCE inflation jumped by 0.4 percentage points (pp) and 0.3 pp, respectively, from their September estimates, and were raised by an additional 0.1 pp and 0.2 pp for 2026. Orton said these upward revisions look more material than just near-term momentum from recent inflation firmness and likely incorporate anticipated changes due to tariffs and immigration policy changes.

<sup>1</sup> Unless otherwise indicated, all data cited is sourced from Bloomberg as of Dec. 19, 2024.

## Fed dot plot



Source: Federal Open Market Committee, as of 12/18/24.

"I think this challenged messaging contributed to the big risk-off move in the market because it signals an even more uncertain path in the future," he said. "The Fed is taking a pause that seems to be undefined in length, guided in part by anticipatory concerns over the inflationary impact of future policy. That's difficult for markets to digest because it's difficult to have any confidence in predicting the future timeline of cuts."

### Making sense of the market move

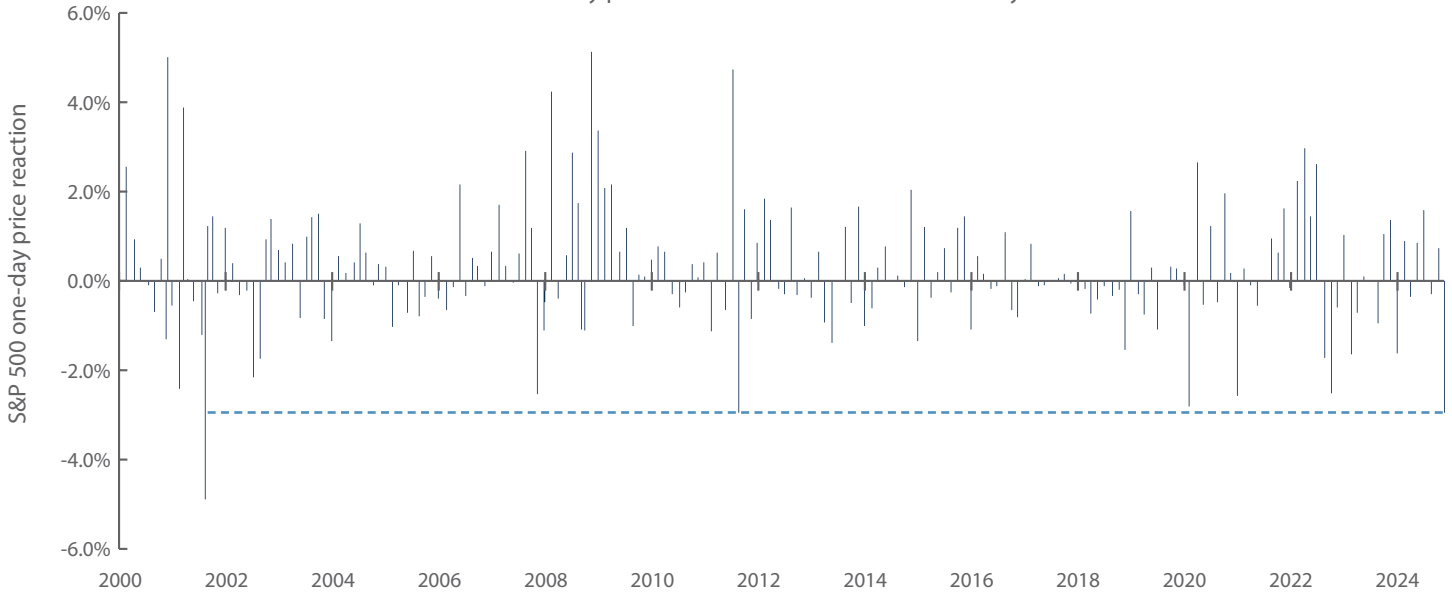
The S&P 500 Index recorded its largest drop in the first hour after the FOMC decision since the central bank started raising interest rates in 2022, and the 10-year U.S. Treasury yield jumped more than 11 basis points on the day. Given the uncertainty with respect to Fed messaging, coupled with a market that has posted extraordinary gains year to date, Orton said it was understandable that many investors were ready to sell first and ask questions later. Exacerbating the selling pressure, he said, was the fact that there is reticence to add risk right now given how well many asset managers have done this year and the proximity to the holidays. This is reflected in the fact that the selloff was broad-based, hitting nearly every sector and market capitalization.

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## 12/18/24 was the S&P 500's worst Fed day since 2001

### S&P 500 one-day price reactions on Fed rate decision days



Source: Bloomberg, as of 12/18/2024.

The deep selloff, coupled with a sideways price action in December and poor breadth, leaves the market deeply oversold on a tactical basis, Orton said. The percentage of S&P 500 stocks that trade below their 10- and 50-day moving averages has dropped to 4% and 19%, respectively. This is the lowest reading since the end of the April selloff. Additionally, we have now had 13 consecutive days where more stocks have declined than advanced in the S&P 500. This is the longest streak in Bloomberg data, which goes back to late 1996, and there has only been one prior instance when this streak reached 10 days, and that was in October 2008.

"I do not think this risk-off move will last for too long," Orton said. "We've been overdue for a correction, and at the end of the day the S&P 500 is only down -3.6% from its all-time high on December 6. I've said for quite a while not to chase risk to the upside, but instead to think about using downside opportunistically. Given the poor breadth heading into the Fed meeting, I believe there are some attractive opportunities for long-term investors to consider in higher-quality businesses that have been thrown out with the bathwater.

Importantly, the growth of the U.S. economy is still good, and the labor market is still healthy. The trajectory of Fed cuts has minimal impact on a continued increase in earnings growth across the market, Orton said. This applies to smaller companies as well – the federal funds rate has come down 100 basis points since the start of the rate-cutting cycle and the effective interest rate paid by small-cap companies has come down. And Orton said he believes it will continue to come down over the next year in what he anticipates will be a better growth environment.

"The fundamental picture for equities has not changed, and the recent market moves simply highlight my rationale for investors to expect more volatility next year given an elevated level of policy uncertainty," he said. "I continue to favor thinking about maintaining a core overweight to U.S. equities and considering leaning into cyclical, especially financials and information technology, particularly software, for 2025."



For more market insights and analysis from Raymond James Investment Management, visit [Our Thinking](#).



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Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

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.

Core PCE, officially known as the Personal Consumption Expenditures (PCE) excluding Food and Energy, Price Index, is a measure of the prices that U.S. consumers pay for goods and services, not including two categories – food and energy – where prices tend to swing up and down more dramatically and more often than other prices. The core PCE price index, released monthly by the U.S. Department of Commerce Bureau of Economic Analysis, measures inflation trends and is watched closely by the U.S. Federal Reserve as it conducts monetary policy.

Cyclical stocks have prices influenced by macroeconomic changes in the economy and are known for following the economy as it cycles through expansion, peak, recession, and recovery.

Disinflation refers to the temporary slowing of the pace of price inflation and describes what happens when the inflation rate is marginally lower over the short term. Disinflation refers only to the rate of change in the rate of inflation. In this, it is distinct from inflation and deflation, which describe the direction of prices.

The dot plot is a chart summarizing the Federal Open Market Committee's (FOMC) outlook for the federal funds rate. Each dot represents the interest rate forecasted by one of the 12 members of the committee.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

An effective interest rate reflects the real percentage rate – that is, the rate adjusted for the effects of inflation – owed in interest on a loan or other debt.

The federal funds rate, known as the fed funds rate, is the target interest rate range set by the Federal Open Market Committee of the Federal Reserve. The target is the Fed's suggested rate for commercial banks to borrow and lend their excess reserves to each other overnight.

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.

Market capitalization, or market cap, refers to the total dollar market value of a company's outstanding shares of stock.

The moving average (MA) is a technical analysis tool that smooths out stock price data by creating a constantly updated average price, often over a specified period of time, such as 15, 30, 50, 100, or 200 days.

The neutral rate is the theoretical federal funds rate at which the stance of U.S. Federal Reserve monetary policy is neither accommodative nor restrictive. It is the short-term real interest rate consistent with the economy maintaining full employment with associated price stability.

Oversold is a term used to describe a security or group of securities believed to be trading at a level below its or their intrinsic or fair value.

Overweight describes a portfolio position in an industry sector or some other category that is greater than the corresponding weight level in a benchmark portfolio.

The Personal Consumption Expenditures (PCE) Price Index is a measure of the prices that people living in the United States, or those buying on their behalf, pay

for goods and services. The PCE price index, released monthly by the U.S. Department of Commerce Bureau of Economic Analysis, is known for capturing inflation or deflation across a wide range of consumer expenses and reflecting changes in consumer behavior.

A risk-off investment is one that is considered to be a safe haven in bearish market environments.

Tactical trading refers to relatively short-term investing decisions made in response to expected trends or changes in the market based on fundamental and technical analysis.

#### Indices

The S&P 500 Index measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

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