



US Fed October rate decision:

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The US Fed cut rates by 0.25% to a range of 3.75%-4.0% at its October meeting, a move that was largely expected by the markets. The meeting took place in the midst of the US government shutdown which started at the beginning of October. Official economic data has been lacking during this time with the most recent jobs report from August showing the unemployment rate was 4.3% while the last inflation report was for September where year-on-year inflation came in at 3%. Of the 12 voting members, 10 voted for the rate cut while 1 member voted for a cut of 0.50% and 1 member voted for no cuts.

Given the rate cut was largely expected by the markets and the relative lack of economic data over the past month, the commentary by the Fed Chairman Jerome Powell during the press conference was important for understanding the latest thoughts from the Fed. Perhaps most important detail from the meeting for the financial markets was the outlook for a further rate cut at its December meeting. Market expectations had essentially priced in a rate cut for the December meeting, but Chairman Powell wanted to make clear to investors that a further reduction in the policy rate in December was “not a foregone conclusion”. This took the markets by surprise and Treasury yields immediately jumped higher and equity markets fell. Powell’s explanation for this was that since the Fed has cut 150 bps from peak levels a year ago, some members of the committee may believe it is time to pause the rate cuts again and see what the downside to the labor market is before proceeding on further rate cuts.

The Fed also announced that the Quantitative Tightening program of reducing the Fed balance sheet would end on December 1. After reaching a peak of \$9 trillion in 2022, the QT program has slowly reduced the balance sheet size to \$6.6 trillion most recently but the Fed will end QT next month as there have been notable signs within the financial markets that liquidity has tightened. The Fed intends to hold the overall balance sheet size steady from December but will continue to allow mortgage backed securities to run-off and will reinvest those proceeds into Treasury securities mainly of shorter-maturities.

Despite Chairman Powell casting some doubt on a December rate cut, we still believe the Fed will cut a further 0.25% at the December meeting and then expect the Fed to have two more 0.25% rate cuts in 2026 and ultimately end its rate cutting cycle with the Fed rates in the 3.0%-3.25% range. Even though we expect the Fed to continue cutting rates, this does not automatically mean Treasury yields will continue declining. In fact, we believe longer-duration yields could still rise from here as the Treasury yield curve steepens. For this reason, we maintain our shorter-duration stance within Government and Investment Grade fixed income, preferring duration levels up to 5 years but not much longer.

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