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On the Minds of Investors

What are the investment implications of the Fed rate cutting cycle?

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This week, **the Federal Reserve (Fed) resumed cutting interest rates** after a nine-month pause, continuing the easing cycle that began in September 2024. The move was framed as a “risk-management exercise” due to clear signs of softening in labor market demand. However, while inflation is not a stop sign to rate cuts, it is a speed bump. Rate cuts are likely to remain gradual and to a “neutral” end point unless the labor market data worsens from here. Investors currently expect the Fed to reduce rates by an additional 100-125 basis points, with policy rates likely settling around 3% by the end of 2026.

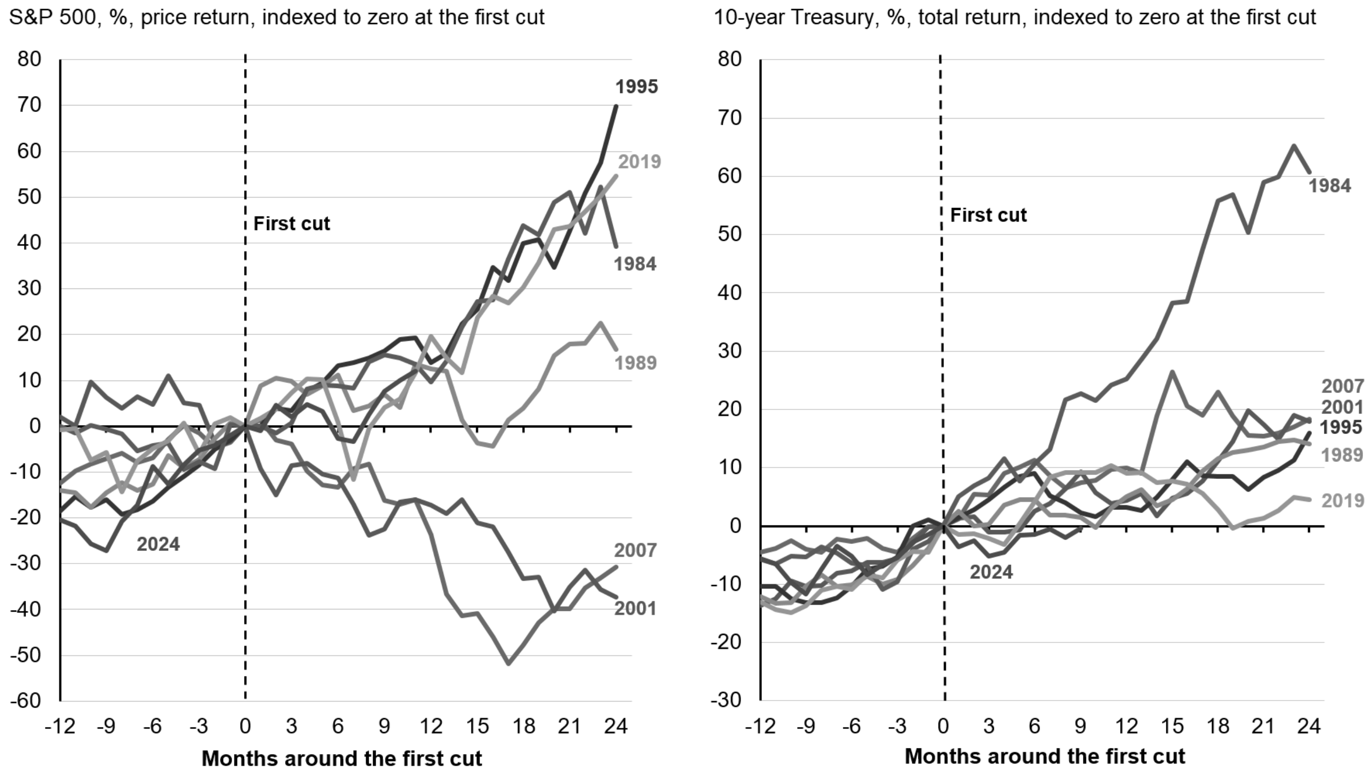
Since the first rate cut a year ago, stocks have reached new all-time highs, rising over 15%. Core bond returns have been positive 3%, despite 10-year Treasury total returns remaining flat (with yields up 40bps). Historically, both stocks and bonds have done well during rate cutting cycles that have occurred without a recession or valuation bubble bursting. However, each rate cutting cycle is unique.

From here, when considering **the investment implications of this Fed rate cutting cycle**, investors should consider 3 key questions:

1. **Which rates are falling?** Fed rate cuts will lower cash-like rates; however, yields across the yield curve may not fall in tandem, due to ongoing inflation uncertainty and elevated debt issuance. The curve may continue to steepen, as cash-like rates drop, short to intermediate yields remain unchanged and long-term yields move up slightly (10-year range between 4.00-4.50%). In this scenario, short-duration fixed income (2-3 years) is particularly attractive. Even if yields do not fall further, the income in fixed income remains appealing, with yields ranging from 4.5-6.5%. For portfolios, bonds remain valuable as a diversifier for recession risk.
2. **Which stocks have tailwinds?** Stocks can continue to reach new highs due to solid earnings growth, but there are challenges. The good news: equity returns have broadened this year beyond the “Magnificent 7” and significant valuation dispersion remains between the most and least expensive stocks. The challenge: rate cuts are due to below potential and softening economic growth – and rate cuts alone are unlikely to change that. Investors should focus on quality and profitability: large over small cap and secular over cyclical themes.
3. **Which regions shine? The U.S. dollar is likely to continue to weaken**, as the Fed resumes rate cuts while many other central banks are done cutting rates (or are still raising them like the Bank of Japan). Historically, periods of dollar weakness coincide with international stock outperformance, such as 2001-2008.

Cash remains important for liquidity, but too much cash can hurt returns, especially as Fed rate cuts lower cash yields. Analysis of 60/40 portfolios over 30 years shows that diversified portfolios outperform cash most of the time, especially over longer holding periods. As cash rates decline, diversified investments are poised to outperform, reinforcing the value of being invested during Fed rate cutting cycles.

Stocks and bonds tend to do well during Fed rate cutting cycle when there's no recession



Source: FactSet, Federal Reserve, LSEG Datastream, S&P Global, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Excludes 1998 episode due to the short length of the cutting cycle and economic context for the cuts.

Guide to the Markets – U.S. Data are as of September 16, 2025.

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