

Powell's Policy Pivot & Market Expectations

The Federal Reserve lowered its key rate by 25 basis points at its September meeting following an eight-month pause. George Bory and John Campbell discuss how U.S. bond and equity markets could respond.

Authors	Date	Topic
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Key takeaways

- The Federal Reserve (Fed) lowered its key interest rate, the federal funds rate, by 25 basis points at its September meeting today—its first rate cut since December 2024.
- With the Fed in a slow-but-steady easing mode now, we believe bond prices should remain well supported—particularly at the front end of the curve.
- Continued equity strength and broader market participation hinge on the Fed's ability to strike a delicate balance between easing enough and managing inflation.

After eight months of staying on hold, the Federal Open Market Committee (FOMC) decided at its September meeting to lower its key interest rate by 25 basis points (bps)*, to a target range of 4.00–4.25%. How might the rate cut affect the U.S. bond and equity markets? George Bory and John Campbell share their perspectives.

Slow-but-steady easing may be supportive for bonds

Federal Reserve (Fed) Chair Jerome Powell's dovish pivot at August's Jackson Hole Symposium—when he mentioned the possibility of a cut in the federal funds rate—sparked a broad rally across bond markets. His public, verbal shift toward considering a cut was reinforced by weaker-than-expected labor data, which strengthened the case for easier monetary policy and pushed bond prices higher. Today, the FOMC validated Chair Powell's more dovish stance by approving the 25-bp rate cut.

The yield curve's modest flattening over the past month suggests that bond investors' concerns about future economic growth are beginning to outpace their uneasiness regarding persistent inflationary pressures. That said, the bond market's enthusiasm for additional rate cuts may be growing too much, too fast. Federal funds futures are currently pricing in four to five rate cuts over the next 12 months, which may be overly aggressive given the underlying data. Our expectation is for a total of 100 bps in cuts over the next 12 months.

Looking forward, the FOMC could be inclined to ease policy further despite elevated inflation. However, the pace and size of future moves are unclear. Bond investors will likely remain focused on the health of the labor market for direction. The August nonfarm payroll report highlighted a sharp slowdown in job growth with only 27,000 jobs added over the past four months, compared with 123,000 over the prior four months and 217,000 the four months before that. Meanwhile, core personal consumption expenditures inflation notched higher to 2.9%, and while it could move higher in the near term due to tariff-related issues, it's expected to moderate over the next three to six months.

Over the past month, U.S. Treasury yields declined by approximately 25 bps across the curve and longer-term yields fell slightly more than short-term rates. With the U.S. Treasury 2-year bond yield hovering around 3.5%, the market expects lower rates—but drawn out over an extended period. This has led to flattening of the yield curve because the drop in long-end yields has marginally outpaced moves at the front end. In our view, the current environment likely represents a consolidation phase: The front end remains anchored by central bank expectations while the long end remains the relief valve for economic pressures and long-term concerns regarding fiscal fundamentals.

Thus far, 2025 has been a good year for bonds—prices have risen and total returns have been strongly positive. With the Fed in a slow-but-steady easing mode now, we believe bond prices should remain well supported—particularly at the front end of the curve.

Equities may benefit from a “not too much, not too little” approach to easing

The Fed’s dovish pivot in August also bolstered already-strong equity markets, with more impact (as one would expect) on U.S. stocks versus international stocks and smaller-capitalization names versus larger ones.

While today’s news was greeted with muted optimism, the longer-term outlook remains data-dependent. Continued equity strength and broader market participation, especially among smaller-cap stocks, hinge on the Fed’s ability to strike a delicate balance of providing just enough easing to avoid recession while keeping inflation under control—all amid ongoing tariff uncertainty.

Our constructive views on small caps and mid caps are based at least as much on attractive relative valuations relative to large caps as they are on macroeconomic factors—and barring full-blown recession, this perspective is unlikely to change.

A perhaps more interesting implication of now-lower fixed income rates (and possibly more rate cuts to come) is renewed appeal in higher-yielding equities as a fixed income substitute. High dividend equities were very much in focus in the ZIRP (zero interest rate policy) era, and as fixed income yields head lower, we expect a resurgence of interest in the combination of attractive yield and maintenance of purchasing power that dividend-paying stocks may provide.

*100 basis points (bps) = 1.00%

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