

## The First Cut Is The Deepest

### WEEKLY REVIEW

U.S. equity markets were mixed for the week; the S&P was down about 0.1%, while the NASDAQ and Dow were higher by 0.1% and 0.5%, respectively. Bonds were mostly up on the week (Thurs-Thurs), with the exception of HY, which was off by 0.2%. YTD the S&P now higher by 21% on a total return basis, with the NASDAQ up almost 24%. Even bonds have provided investors with solid risk-adjusted returns, with long-corporates higher by 14% and High Yield up 10%. Style performance was also mixed this week, led by Small Cap Growth, higher by 0.7%, followed by Large-Cap Value up 0.4%, while Large-Cap growth lagged, off 0.6% for the week. Consumer Defensive and Basic materials led from a Sector perspective, higher by 1.3% and 1.2%, respectively, while Real Estate and Energy lagged down 0.8% and 3.2%, respectively. Interest rate sensitive bond indices continued to outperform, with Long-Governments up 1.2%. Municipals underperformed for the week, up by only 0.2%, but are still providing investors with a respectable tax-advantaged return of 5.6% YTD. Oil (WTI) was down over 7% over the last 5 days, off 2.3%, while Gold was modestly for bid, higher by 1.7% unchanged. The 10yr has tightened over the last 5 days, coming in by 7 basis point, now yielding 2.05%

Markets remain poised for at least a 0.25% rate cut by the Fed at the end of the month. But some pundits are calling for as much as a 0.50% bps cut, bringing the target Fed Fund Rate down to 2.0%. The call for a deeper 0.50% cut is to stave off domestic and foreign threats to the US economy. But much of this concern was born out of last week's [Semiannual Monetary Policy Report to Congress](#), whereby Chairman Powell suggested that the Fed remains concerned about slowing global growth and trade policy uncertainties. However, rather than taking heed, investors bought risk assets, pushing the S&P 500 to an all-time high of 3,000 by week's end. We have long cautioned clients regarding the "Be Careful What You Wish For" rate cut trade; but now this position is being echoed in some way by [Mohamed El-Erian](#), chief economic adviser at Allianz, which is the corporate parent of PIMCO (where he was once the CEO). As Dr. El-Erian puts it ([click on link for article](#)):

***"It's hard to justify a rate cut using traditional metrics. The unemployment rate is at a five-decade low, inflation is not that far below the Fed's target, financial conditions are the loosest in almost two decades, stock indices are at record highs, and interest rates are already at low levels. Yet the Fed is under tremendous market and political pressure to cut."***

We were encouraged to read this over the weekend after receiving numerous client queries, asking if our near-term conservative investment bias has changed. **And the answer here is decisively no**; while there are upside risks to our thesis, we remain cautious in the near-term. But rather than re-hashing all of our views once again, we encourage our readers to click on the link above and read Dr. El-Erian's message.

So now back to the title of this week's note. While we are huge fans of Cat Stevens' song, "Cat's in the Cradle," we were surprised to learn he also wrote, "The First Cut is the Deepest." So, with that, we looked historically to determine how does a 50bp cut compare to prior easing cycles. But since we are starting at much lower absolute interest rate levels than prior cycles, we needed a different approach. So we decided to measure the relative 1<sup>st</sup> cut, as a percentage of how much was actually cut. In other words, in 2000, the Fed's first rate cut of 50bps from 6.5% to 6.0% represented 9% of the total easing cycle (from 6.5% to 1.0%). Then in 2007, the first rate represented 10% of the total easing cycle (from 5.25% to 0.25%). Now, if the Fed cuts a full 50bps this month, this would represent 22%, or roughly a quarter of their available slack, assuming a bottom range similar to the Great Recession of 0.25%. Clearly, this doesn't leave the Fed much conventional monetary policy runway, if and when we truly need it. **We'd love to hear your thoughts.**

Domestic Indices		1Week
1 US Inter Gov Bd TR Bond	0.6%	
2 BBgBarc US Government TR	0.5%	
3 DJ Industrial Average TR	0.5%	
4 BBgBarc US Agg Bond TR	0.5%	
5 BBgBarc US MBS TR	0.4%	
6 S&P MidCap 400	0.2%	
7 BBgBarc Municipal TR USD	0.2%	
8 NASDAQ Composite PR	0.1%	
9 Russell 2000 TR	-0.1%	
10 S&P 500 TR	-0.1%	
11 ICE BofAML US High Yield TR	-0.2%	
12 NYSE Composite PR	-0.2%	
Style Stratification		1Week
1 US Small Growth	0.7%	
2 US Large Val	0.4%	
3 US Mid Growth	0.3%	
4 US Mid Core	0.3%	
5 US Mid Cap	0.2%	
6 US Core	0.1%	
7 US Large Core	0.0%	
8 US Market	-0.1%	
9 US Large Cap	-0.1%	
10 US Mid Val	-0.2%	
11 US Growth	-0.4%	
12 US Large Growth	-0.6%	
Sector Stratification		1Week
1 US Consumr Dfnsvs	1.3%	
2 US Basic Materials	1.2%	
3 US Technology	0.6%	
4 US Industrials	0.4%	
5 US Utilities	0.4%	
6 US Dfnsvs Sup Sec	0.1%	
7 US Snstvs Sup Sec	0.1%	
8 US Commun Svc Capped	-0.1%	
9 US Financial Services	-0.2%	
10 US Cyclcl Sup Sec	-0.3%	
11 US Healthcare	-0.6%	
12 US Consumr Cyclcl	-0.6%	
13 US Real Estate	-0.8%	
14 US Energy Capped	-3.2%	
Bond Indices		1Week
1 US Lng Gov Bd TR Bond	1.2%	
2 US Lng Core Bd TR Bond	1.1%	
3 US Lng Corp Bd TR Bond	0.9%	
4 US Corp Bd TR Bond	0.6%	
5 US Gov Bd TR Bond	0.6%	
6 US TIP5 TR	0.6%	
7 US Inter Gov Bd TR Bond	0.6%	
8 US Inter Corp Bd TR Bond	0.6%	
9 US Core Bd TR Bond	0.5%	
10 US Inter Core Bd TR Bond	0.4%	
11 Mortgage TR Bond	0.3%	
12 US Shrt Gov Bd TR Bond	0.3%	
13 BBgBarc Municipal TR USD	0.2%	
International Markets		1Week
1 Euronext Paris CAC 40 NR EUR	0.0%	
2 MSCI Europe PR LCL	-0.1%	
3 SSE Composite PR CNY	-0.2%	
4 FTSE 100 TR GBP	-0.2%	
5 MSCI EM PR LCL	-0.2%	
6 MSCI Pacific Ex Japan PR LCL	-0.3%	
7 MSCI Europe NR USD	-0.3%	
8 MSCI EM PR USD	-0.3%	
9 MSCI World ex USA NR USD	-0.7%	
10 MSCI World Ex USA PR LCL	-0.7%	
11 MSCI EM Latin America PR USD	-0.8%	
12 FSE DAX TR EUR	-0.8%	
13 MSCI Pacific NR USD	-1.3%	
14 MSCI Pacific PR LCL	-1.8%	

Source: Morningstar.com

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