CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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Trick or Treat? Fed Lowers Rates Again

- Fed cuts rates a quarter-point for the third time this year.
- More importantly, the Fed seemed to leave the door open for further cuts.
- Lower rates are supportive to the economic expansion, but uncertainty is high.

Investors appeared to get an early treat before Halloween when the Federal Open Market Committee cut the Fed Funds rate by a quarter-point for the third time this year. This move was widely expected as the CME FedWatch Tool, based on Federal Funds Futures, estimated the probability of at least a one-quarter rate cut at 100% just hours before the Fed's announcement.

Was it really a trick though? This rate cut was already priced into markets, so investors are paying more attention to the Fed meeting minutes and trying to understand what the Fed has in mind for the future. The Fed has been accommodative this year as GDP growth has been slowing, although not slowing as much as many had feared. The first estimate of third- quarter GDP was 1.9%, beating expectations and only down slightly from the second quarter which was 2.0%. In addition, stock market indices are back near all-time highs and the Fed's dual mandate for low unemployment and price stability are both met. Unemployment is at 50-year lows and inflation, while below the Fed's target of 2%, is stable. The Fed may be posturing for a less-dovish stance in the future.

With this economic backdrop, many may wonder why the Fed needs to cut rates at all. The Fed is looking beyond GDP growth and unemployment levels as these are, after all, lagging indicators. Looking at forward indicators such as business leader surveys for both the manufacturing and non-manufacturing (service) sectors, respondents are becoming less confident in the economy. This will likely impact business spending, which includes hiring new employees, and may give some cues into future earnings. This explains why business investment has dropped for the second consecutive quarter. Business leaders may also be cautious due to trade uncertainty. Additionally, the Fed did acknowledge all the positives we mentioned earlier, but "uncertainties about this outlook remain."

Stock markets are also leading indicators and continue their climb near record levels. There's optimism among investors because lower interest rates mean lower borrowing costs and more investment. However, we think the path of interest rates is important. With the Fed lowering interest rates, the Fed Funds rates are back at first quarter-2018 levels. Many corporations and individuals have already taken advantage of these lower rates. We think the Fed impact will be less for this reason.

With the rate cut widely expected, financial markets didn't react much to the news and the Fed meeting minutes didn't change dramatically. We expect the Fed to continue to monitor global growth and make adjustments as necessary, even if those adjustments may carry less weight. We agree with the Fed regarding uncertainty in the market and recommend a balanced portfolio that aligns with long-term risk and return objectives. Your financial professional can help guide you through the uncertainty.

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