MARKET MINUTE

With McGAREL

Dave McGarel, CFA, CPA
Chief Investment Officer

September 2024

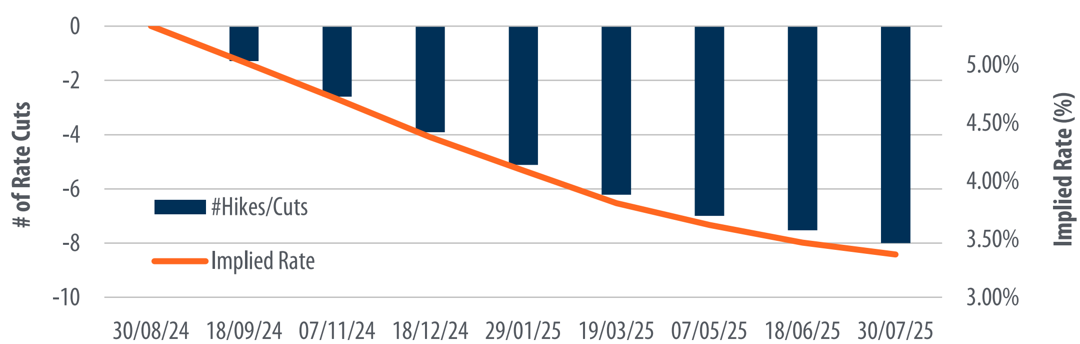
Here come the interest rate cuts. Finally! Today, futures markets are pricing the odds of a 25 basis point September rate cut at 100% (in fact they are pricing in a roughly 25% chance of 50bps). Additionally, Federal Reserve (Fed) Chair Jerome Powell all but guaranteed the Fed would begin loosening monetary policy during his recent speech in Jackson Hole. Does this materially change our outlook and where we see opportunities going forward? Not really.

When the year started, most bullish views coincided with 6+ rate cuts this year that were expected to start as early as March and continue into 2025. As inflation remained stubborn and labor markets tight, those rate cut expectations started sliding later in the year. The stock market certainly hasn't waited on the rate cuts! Through the end of August, the S&P 500 Index has appreciated 18% and sits at all-time highs. Earnings have supported stocks even as interest rates have been unchanged since the Fed last hiked rates in July 2023.

Many investors believe interest rate cuts, which are expected to total 200 basis points by July 2025 (see Chart 1), will support higher stock prices especially in high growth, long duration equities. Our view is lower rates will certainly be supportive of earnings and the economy, but any impact will take a long time to have a meaningful impact. Just like interest rate hikes have taken a long time to slow the economy (just ask the Fed!). We expect gradual rate cuts to have little effect on the economy and earnings over the next year. In fact, with the market higher by 35% over the last 10 months, we believe a continuation of low double-digit earnings growth and materially lower interest rates has been substantially priced in already especially in the large cap growth trade.

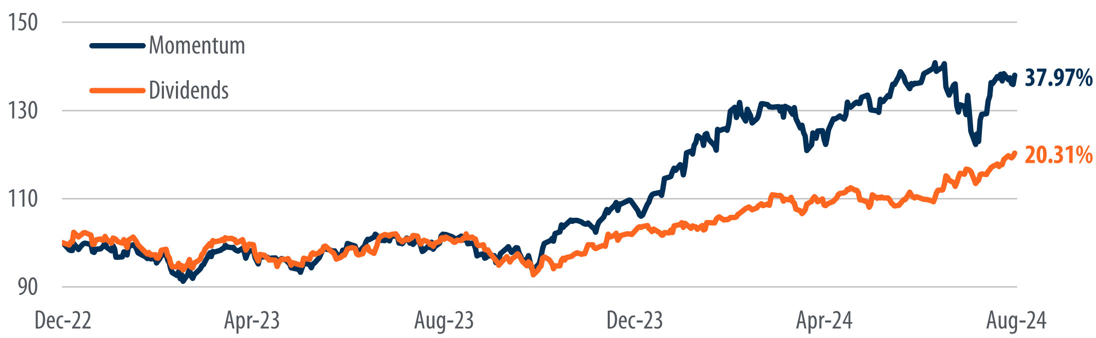
In time, investors will be favorable to companies that benefit most from lower rates. If we had to pick a group that would eventually benefit the most from multiple rate cuts, we would suggest dividend paying companies. In a market enthralled by expensive momentum stocks, quality, inexpensive dividend stocks are hiding in plain sight.

Chart 1: Implied Fed Funds Rate and Number of Hikes/Cuts



Source: Bloomberg.

Chart 2: Momentum vs. Dividends



Source: Bloomberg. Data from 30/12/2022 - 30/8/2024. The indexes were indexed to 100 on 30/12/2022. Returns represent the total return over the time period. **Momentum** is represented by the MSCI USA Momentum SR Variant Index. **Dividends** are represented by the Morningstar Dividend Yield Focus Index.