AHAM CAPITAL
ASSET MANAGEMENT

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FUNDAMENTAL FLASH

# Fed Delivers 50 bps Rate Cuts

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## The Fed Goes For It...

Yesterday, the US Federal Reserve (Fed) delivered a 50 basis point (bps) rate cut at its September Federal Open Market Committee (FOMC) meeting, reducing the federal funds target range to 4.75%-5.00%. This was a larger cut than the 25bps reduction widely anticipated by economists, including our own projections.

However, this outcome was not entirely unexpected by markets. Based on bond futures pricing, it was a close call as the probability of either event occurring was fairly even.

The Fed's decision appears to have been driven by growing concerns over emerging weaknesses in the US labour market. Recent data have signalled signs of softening in the job market, which likely influenced policymakers to act more aggressively to mitigate risks of an economic slowdown.

As such, the US central bank is seen wanting to avoid the risks of falling behind the curve by taking pre-emptive measures towards policy easing, rather than waiting for further deterioration. In its latest projection, the Fed revised its unemployment rate projection for 2024 from 4.0% to 4.4%.

The outsized rate cut also reflects the Fed's view that inflation has now become less of a concern, as they are adamant in engineering a soft landing for the US economy.

## Flashpoints

- Fed delivers a surprise 50 bps rate cut as policymakers home in on signs of softness in the labour market.
- In its latest projection, the Fed revised its unemployment rate projection for 2024 from 4.0% to 4.4%.
- Bond markets remained steady post-rate cut, with US Treasury yields creeping higher.
- Asian equities set to benefit, as rate cuts provide breathing room for regional central banks to ease financial conditions and boost growth.
- Tilting portfolio exposure to rate cut sector beneficiaries like utilities and REITs, alongside a focus on ASEAN markets.

## The Path Forward

Looking ahead, the Fed has signalled a more aggressive rate cut path compared to its previous quarterly guidance. According to its updated median dot plot, the Fed expects the federal funds rate to decrease to 4.4% in 2024, followed by further reductions to 3.4% in 2025 and 2.9% by 2026. This projection implies at least 2 more rate cuts in 2024.

Our base case is that the US economy would experience a gradual slowdown and inflation to continue moderating, albeit at a slower pace. Recessions are inherently difficult to predict, and it is unclear whether the US economy is headed for a full-blown one.

Nonetheless, if the Fed continues to cut rates while economic data hold up reasonably well, there is a chance for the US economy to engineer a soft landing and avoid a sharp downturn.

We are continuing to monitor key indicators such as labour market conditions, inflation trends, housing activity, and developments in both the business and consumer sectors to assess the health of the US economy. These data will be crucial for us in spotting risks and opportunities for our fund positioning.

## Bond Markets Stay Calm

Following the Fed's rate cut, bond markets have been well-behaved. US government bond yields rose modestly by 3 to 7 bps across the yield curve, reflecting the market's adjustment to the Fed's updated guidance which signalled a higher neutral rate than previously expected amidst expectations that the US economy would remain resilient.

In the corporate bond market, investment-grade (IG) bonds have performed well, with credit spreads tightening slightly. This positive performance is underpinned by solid fundamentals and favourable technical factors. Over the past 6 months, the US 10-Year Treasury yield has declined by more than 50 bps, stabilising around the 3.7% level.

## Portfolio Positioning

**Fixed Income:** With overall bond yields remaining attractive compared to historical levels, we see opportunities for investors to lock-in higher yields. For our bond portfolios, we have increased duration this year in anticipation of rate cuts. In terms of credit segment, we favour quality IG corporate bonds in this market environment, as we expect to remain active in the primary and secondary bond market to seize opportunities.

**Equities:** By itself, Fed rate cuts are positive for Asian equities, as they provide room for Asian central banks to ease financial conditions in their respective markets. For instance, we also saw Bank Indonesia (BI) cutting its interest rate by 25 bps this week with the Fed. Looser monetary policies in Asia help stimulate economic activity, providing a supportive backdrop for equities.

For our Asian portfolios, we have increased exposure to sectors that are poised to benefit from rate cuts, such as utilities and real estate investment trusts (REITs). These sectors typically perform well in a lower rate environment where the cost of capital decreases.

Additionally, we have selectively added exposure to Southeast Asian markets, including Malaysia, Indonesia, the Philippines, and Thailand. These ASEAN countries are likely to benefit more from US rate cuts compared to North Asian markets.

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