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Investment Research

What do Fed rate cuts mean for investors?

UBS House View Briefcase

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Key message

The Federal Reserve delivered a widely expected 25-basis-point rate cut in December, bringing the federal funds rate to 3.50-3.75%. While the accompanying statement and press conference signaled a more cautious stance toward further cuts, we expect one 25bps reduction in the first quarter of 2026. For investors, lower interest rates increase the importance of putting excess cash to work.

01 The Fed cut rates again in December.

- The Fed cut policy rates by 25 basis points in December, its third consecutive reduction.
- However, the accompanying statement and press conference signaled a more cautious stance toward further cuts.
- Given the divisions within the FOMC, the Fed’s updated “dot plot” showed a wide dispersion of views, with no clear consensus on the path for rates in 2026. The median dot shows one rate cut in 2026.

02 We believe concerns about a US weaker labor market give the Fed scope to continue easing in early 2026.

- We expect a 25-basis-point rate cut in the first quarter of 2026, moving further toward a neutral policy stance.
- US labor market conditions remain soft.
- US inflation is likely to peak in the second quarter at just over 3%, in our view, before stabilizing toward the Fed’s 2% target.

03 Lower interest rates strengthen the case for investors to put cash to work.

- We recommend that investors phase excess liquidity into diversified portfolios.
- To achieve alternative sources of portfolio income to cash, we see medium-duration quality bonds and equity income strategies as appealing.
- We also expect lower interest rates, robust corporate earnings, and AI tailwinds to support further gains for equity markets over the coming year.

New this week

The Fed's rate-setting committee delivered a third consecutive rate cut in December, bringing policy rates to their lowest level in three years. In its statement, the Fed reused previous guidance from July that the “extent and timing of additional adjustments” to the policy rate will depend on “incoming data, the evolving outlook, and the balance of risks.”

One liner

Fed rate cuts increase the imperative for investors to put cash to work.

Did you know?

- Soft landing rate cuts have historically been positive for stocks, and the Fed’s shift from restrictive to more neutral policy should help extend the bull market.
- In a downside scenario, if the US economy slows sharply, we believe the Fed could cut rates by 200-300bps in 2026.
- Cash tends to underperform other assets over time: Stocks have outperformed cash in 86% of all 10-year periods and 100% of all 20-year periods since 1926, with cumulative returns more than 200 times higher than cash over the long term.

Investment view

Fed rate cuts increase the importance of putting excess cash to work. We recommend phasing excess liquidity into diversified portfolios. We also continue to like quality bonds, which can offer a more durable source of income. Investors underallocated to equities should consider adding to stocks in CIO's preferred areas, including AI, Power and resources, and Longevity.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
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- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

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