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 October, bringing the federal funds rate to 3.75-4%. While some Fed policymakers have expressed doubts about reducing rates in December, we expect further Fed cuts and advise investors to put cash to work.

01 The Fed cut rates again in October, but some officials have cast doubt on further 2025 cuts.

- The Fed cut policy rates by a further 25 basis points in October, building on the 25bps reduction in September, which was the first cut since 2024.
- In recent weeks, some Fed officials have expressed doubts about whether a further rate cut this year is warranted, while others have said they believe a near-term reduction is appropriate.
- At the time of writing, short-term interest rate futures price around an 80% chance of a December cut.

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

- Concerns about a weaker labor market are likely to be the primary driver of the Fed's decision-making, in our view, given limited signs of tariff costs passing through.
- New York Fed President John Williams said he currently regards monetary policy as "moderately restrictive," and still sees room to cut rates "in the near term."
- We expect US policy rates to fall by a further 50 basis points by the end of the first quarter of 2026.

03 With policy rates set to fall further, investors should put cash to work now.

- 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

Fed Governor Christopher Waller indicated that he believes a December rate cut would be appropriate, noting that "the labor market is soft; it's continuing to weaken."

One liner

With the Fed likely to cut rates further, we recommend putting excess 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

We believe the resumption of the Fed's rate-cutting cycle increases the imperative for investors to put 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.

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