UBS

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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 resumed its rate-cutting cycle in September and signaled further easing ahead. Changes to the composition of the FOMC also point to a more dovish tilt to policy. A cooling labor market gives room for the Fed to cut rates further, despite lingering inflation concerns. We expect a further 75bps of rate cuts between now and the first quarter of 2026, and with policy rates set to fall, we advise investors to put cash to work.

House view

01 The Fed resumed its rate-cutting cycle in September.

- The Fed cut policy rates by 25 basis points in September, its first reduction since 2024.
- Policymakers' median projection for the federal funds rate (the dot plot) now indicates two additional cuts are expected this year.
- The FOMC's latest economic projections show inflation near the target in 2027.

02 A softening labor market gives the Fed scope to continue easing.

- The FOMC's statement said the committee "judges that downside risks to employment have risen."
- We believe concerns about a weakening labor market are likely to outweigh those about lingering inflation in the Fed's decision-making.
- Given the Fed's dual mandate, we expect rates to come down by a further 75 basis points by the end of 1Q26.

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

At the press conference following the September FOMC meeting, Fed Chair Jerome Powell reiterated he is expecting an only one-off price increase from tariffs. He also noted that both market and survey measures of longer-run inflation expectations are "rock solid" in showing inflation at levels consistent with the Fed's 2% target.

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 labor market weakness proves to be more severe or durable, we believe the Fed could cut rates by 200-300bps by mid-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 phasing in and using market dips to add exposure to 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.

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

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