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US stocks hit a new high after Fed cut

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The S&P 500 struck a fresh record high on Thursday, amid investor optimism that the Federal Reserve is willing to act decisively to support the US economy.

The market had initially responded in tepid fashion to the Fed's decision on Wednesday to cut rates by 50 basis points, rather than the more cautious 25-basis-point step taken by other major central banks so far this year. After digesting the Fed meeting for a day, investors appear to have warmed to the Fed's decision, along with the confidence expressed by chair Jerome Powell in the continued resilience of the US economy.

There was little fresh news to spur the rally on Thursday, though the decline in first-time claims for jobless benefits was consistent with the Fed's view that labor market conditions are reasonably strong, and that the US is on track for a soft landing rather than a recession.

What do we expect?

Historically, stocks have performed well in periods when the Fed is cutting rates while the US economy is still growing. Markets now appear to be expecting this outcome. This marks a turnaround from concerns at the start of August, when weak US job data fueled concerns that the Fed had waited too long before cutting rates.

Wednesday's rate decision bolstered market sentiment in two main ways. First, Powell expressed a desire to "recalibrate" monetary policy while the US economy remains strong. He added that policymakers saw no need for a further cooling of the labor market to bring inflation sustainably down to the 2% target.

Second, Powell sought to dispel concerns that the 50-basis-point cut reflected worries that growth is poised to slow abruptly, saying he did not see evidence that there was an "elevated" risk of a downturn. "You see growth at a solid rate. You see inflation coming down. You see a labor market that's still at very solid levels," he added.

Looking ahead, the Fed's path now aligns with our projection for rate cuts. The dot plot, which charts the forecasts of Fed officials, now points to 50 basis points of further easing this year, and 100 points in 2025. Overall, the outcome of the meeting was consistent with our view for a soft landing and gradual Fed easing.

How do we invest?

Equity markets are approaching the end of the third quarter in high spirits. Global stocks have been on track to advance for a fourth consecutive quarter. Government bonds have also rallied, amid falling inflation and the prospect of further central bank rate cuts.

But market sentiment has also proven fragile, and investors will likely face a range of challenges in the final quarter of 2024. Against this backdrop, we recommend several strategies:

Position for lower rates. We have long been advising investors to position for the easing cycle, which is now well underway. The Fed, a latecomer to the rate-cutting cycle, started with a larger cut than its peers, who also look set to trim rates further. This will erode returns on cash, so investors should shift excess cash out of deposit accounts and money market funds into assets such as bond ladders, medium-duration investment-grade bonds, and diversified fixed income strategies, which can help maintain portfolio income.

Prepare for the US election. The result of the US election could impact a range of public policy areas of interest to investors. Positioning strongly for a particular outcome has the potential to backfire—especially with polls showing the two parties still neck and neck. So, investors should manage their exposure to election-sensitive industries, especially within US consumer discretionary and renewable energy, as well as currencies like the Chinese yuan. We also expect a positive outlook for companies exposed to reshoring.

Seize the AI opportunity. At its September meeting, the Fed reassured investors that the US economy remains on solid ground, with few signs of an impending recession. However, markets are likely to remain sensitive to weak economic releases as well as geopolitical tensions, which could undermine market sentiment. Investors lacking adequate exposure to AI can consider using any bouts of market volatility to seize the opportunity presented by this theme, which we expect to be a driver of markets in coming years. Those with high exposure can consider capital preservation strategies.

Diversify with alternatives. We advise investors to prepare for further volatility, starting with ensuring adequate diversification. Alternative investment classes can also help cushion volatility and bolster long-term returns—though they are only appropriate for those able to tolerate lower liquidity and less transparency, among other risks. Hedge funds with low correlations to traditional assets can help reduce overall portfolio volatility. Private equity and infrastructure can help diversify exposure to public equity markets, while private credit can offer an attractive alternative source of portfolio income. Investors must be mindful of the associated risks of investing in alternatives, such as illiquidity.

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