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# Positioning for more gradual Fed rate cuts

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**The Federal Reserve cut rates by 25bps in December, but stronger-than-expected US inflation data and a more hawkish-than-expected Fed meeting mean we now expect only 50bps of US rate cuts in 2025.**

## What happened?

US equities stabilized on Thursday, but US bonds continued to slide as investors adjusted to the prospect of a more gradual Federal Reserve easing cycle in 2025.

The S&P 500 fell 0.1% to 5,867, and the yield on 10-year US Treasuries rose a further 5bps to 4.57% on Thursday. The US dollar index appreciated by a further 0.4% to 108.4. Gold declined 1.7% on Thursday and was trading at 2,592/oz at the time of writing.

## What do we expect?

The Fed is attempting to balance downside risks for the labor market against the risk that inflation will get stuck above the Fed's 2% target. Fed Chair Powell sees the US labor market as on a softening trend, and with Fed policy still in restrictive territory, he expects that trend to continue, and a further rise in unemployment is not a precondition for further rate cuts.

However, recent inflation data have been mixed. Headline PCE inflation is near the Fed's 2% target, but core inflation, which tends to be a better indicator of underlying inflation trends, rose to 2.8% in October.

The Fed is likely to want to see lower rates of core inflation before it cuts interest rates further.

We expect core inflation to slow to below 2.5% by the time of the June FOMC meeting, which could give the Fed the confidence it needs to start cutting again. We now look for 25bps cuts in June and September (i.e., just 50bps in total next year), rather than our previous expectation of one cut in each quarter for a total of 100bps.

The Fed remains data dependent, and a weaker US labor market or inflation data could bring a March rate cut back on the table.

### **How do we position?**

In our Year Ahead 2025, published on 21 November, we advocated that investors should “prepare for lower rates” by investing in high grade and investment grade bonds, diversified fixed income, and equity income solutions. We now expect fewer Fed cuts, and the larger-than-expected 50bps rate cut in Switzerland in December means we only expect a further 25bps of cuts from the Swiss National Bank in 2025. We still see potential for sharper rate cuts in the Eurozone, where we forecast 100bps in 2025.

Looking forward, we continue to believe that high grade and investment grade bonds, diversified fixed income, and equity income solutions are valuable in a portfolio context. While we no longer expect materially lower USD or CHF interest rates in 2025 in our base case, we see absolute fixed income yields as attractive and believe that investors should consider diverse sources of income as cash rates could still fall sharply in the event of surprise weakness in economic data. Overall, while “preparing for lower rates” may no longer be as urgent, putting cash to work and seeking durable income should remain a strategic priority for investors.

In US equities, notwithstanding fewer likely rate cuts, a mixture of lower borrowing costs, resilient US activity, a broadening of US earnings growth, further AI monetization, and the potential for greater capital market activity under a second Trump administration creates a favorable backdrop, in our view. We expect the S&P 500 to hit 6,600 by the end of next year and see scope for underallocated investors to use any near-term turbulence to add to US stocks, including through structured strategies.

Elsewhere, we continue to advocate that investors should “sell further dollar strength.” Shifting expectations for Fed and US government policy have supported the US dollar in the weeks since we published the Year Ahead, and we continue to believe its valuation is stretched. While we do not expect significant weakness in the near term, we do think that investors should use further strength in the greenback to diversify into other preferred currencies, including the British pound and the Australian dollar.

If the Fed only delivers two 25bps rate cuts in 2025, we would likely need to moderate our expectations for gold demand from exchange traded funds (ETFs), which could reduce the upside we still expect in bullion prices. However, we note that gold prices have risen materially over recent years despite a strong USD and higher US interest rates, in part due to central bank reserve diversification and in part due to investor demand for hedges. We believe these trends will continue as political and geopolitical uncertainties persist, and should support continued strong demand for gold.

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