



Global Investment Strategy Team

Investors read lower interest rates after Powell speech

What's moving markets

- Federal Reserve (Fed) Chair Powell's August 22 speech at the Fed's Jackson Hole, Wyoming, conference opened the door to adjusting monetary policy rates lower in the near future.
- Following the speech, the futures market had priced in a near 100% probability of a quarter-point interest rate reduction at the Fed's next policy meeting on September 16-17, 2025, and as many as five or possibly six such cuts through 2026.
- There was no mention of whether the Fed might end its program of gradual balance sheet reduction. The speech only mentioned that the Fed is ready to use all its tools to maintain liquidity for the economy.
- Mixed economic data have only fueled uncertainty and in turn have reinforced speculation about Fed interest rate policy for the balance of 2025 and 2026.

Our perspective

- Interest rates broadly fell, in response to the speech, especially the two-year U.S. Treasury note, which is a proxy for short-term rates.
- We concur that a quarter-point cut appears more likely than a half-point reduction at the September policy meeting, but we think five or six rate cuts through 2026 are too many to expect.
- Much of August so far has seen equity investors square positions and take profits, especially technology-related sectors.
- However, after the speech, equity markets rallied, notably with the S&P 500 Index up by over 1% intraday. Simultaneously, the Russell 2000 Index of small-cap equities and the Nasdaq 100 were outperforming the large-cap benchmark on a similar intraday basis.
- Low, late-summer trading volumes probably appear to be accentuating the reaction.
- We also note Chair Powell's concern about tariff impacts, which should slow the economy and lift inflation, though probably only temporarily.
- We agree with this concern and reiterate that we do not expect a recession but do anticipate a slower economy and more potential for market volatility during the next quarter or two.

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Implications for investors

- We believe that surprises – either from policy or from economic data – could trigger episodic periods of volatility, especially as the economy slows.
- We favor extending tactical positioning in areas that we believe should balance opportunity against short-term volatility risk. We illustrate this principle with our current guidance, summarized in the next section.

What to do now

In fixed income, we expect to see diminishing return opportunities in short-term securities as the Fed resumes its rate cutting cycle. Meanwhile, we also foresee potential risks to long-maturity fixed income returns around the consumer price impact of tariffs and especially about how the U.S. Treasury will finance growing U.S. government debt. At this time, we prefer intermediate-term (3-7 year maturities) fixed income securities to lock in higher yields than short-term securities will offer and with less return volatility than long-dated maturities.

Volatility in long-term rates also may raise long-term debt financing costs at a time when the economy is slowing and while households and businesses are still adjusting to tariff impacts. Even as the S&P 500 Index makes new all-time highs, investors may want to consider trimming equity allocations to position portfolios ahead of the volatility we expect over the coming weeks and months.

To be clear, we still anticipate economic and earnings growth to accelerate as 2026 develops, but we believe now is a time to rebalance portfolios, and particularly to manage positions that may have become extended during the rally in large-cap equities since April 8. On August 5, we introduced new guidance to rebalance portfolios from overweight risk to neutral. (For complete details, please see “Adjusting portfolio guidance and allocations”.) Our changes downgraded our Commodities rating from favorable to neutral. In equities, we trimmed gains in U.S. Large Cap Equities—while maintaining a favorable rating—and downgraded U.S. Small Cap Equities from neutral to unfavorable. We favor reallocating from the U.S. equities and commodities into U.S. Intermediate Term Taxable Fixed Income.

The goal of rebalancing is to reduce exposure where prices have become the most extended and to reallocate into potentially better values. In this way, rebalancing seeks to reduce near-term risk and to look for new potential opportunities as markets enter a likely volatile period. One way to trim large-cap exposures but still keep an overweight is to follow our sector guidance. Among the S&P 500 Index sectors, we have reduced artificial intelligence (AI) exposure by downgrading Communication Services from favorable to neutral while keeping the Information Technology sector at a favorable rating. We also upgraded the Financials sector to anticipate lower short-term interest rates and associated bank deposit costs.

Risks Considerations

Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication Services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the Communication Services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

Definitions

NASDAQ 100 Index consists of the 100 biggest companies listed on the NASDAQ Composite Index. The list is updated quarterly and companies on this Index are typically representative of technology-related industries, such as computer hardware and software products, telecommunications, biotechnology and retail/wholesale trade.

Russell 2000[®] Index measures the performance of the 2,000 smallest companies in the Russell 3000[®] Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The Russell 3000[®] Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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