At the July meeting, the U.S. Federal Reserve Open Market Committee kept the Fed funds range unchanged at 5.25-5.50%, where it's been since July 2023. There were no voter dissents.

The formal statement was slightly changed, with job gains downgraded from "remained strong" to "moderated," and the unemployment rate having "moved up" while remaining low. Inflation was downgraded to only "somewhat" elevated, as progress towards their inflation objective evolving from "modest" to "some." Also reworded was the Fed's achieving its dual mandate of inflation and employment continuing to move into better balance and the committee being "attentive to the risks to both sides of its dual mandate." The latter was a specific change related to labor conditions. Interestingly, the Fed kept in language about still needing to have "greater confidence" about inflation progress moving toward 2%, which gives them a bit of extra wiggle-room.

CME Fed funds futures markets had estimated the chances of a rate cut today at under 5%, although chances ran a bit higher for the last few days compared to most meetings. For September, odds have risen to 90%, with a 10% chance of a 0.50% cut. For December, the highest odds have coalesced to a total of three cuts (up from two earlier, which now implies a cut in Nov.) to end the year at 4.50-4.75%. The furthest-out estimate, Sept. 2025, shows highest odds at around 3.50-3.75%, which equates to about seven cuts from today's level, or a bit more than one per quarter. While multiple cuts this year are back in favor, the Fed taking a measured approach to easing has remained the market's base case into 2025.

<u>Economy</u>. U.S. GDP growth for the 2nd quarter came in at an annualized 2.8%, having rebounded to double the 1.4% growth of the 1st quarter. An early estimate for Q3 growth via the Atlanta Fed's GDPNow tool is pointing to the identical 2.8%, while projections from other sources have come in lower and in a wide range, from 1.5-2.5%. Still-present fears of a growth slowdown, led by a pullback in consumer spending, have been kept at bay with results still running above the long-term secular trend growth potential of around 2%. So far, the 'soft landing' remains intact, with current conditions having been defined as 'early late cycle'—a status that can actually run longer than expected. Strong S&P 500 stock earnings also reflect this underlying economic strength. Growth at a higher clip runs the risk of rate cuts being harder to justify, although monetary policy operates with a lag, implying that any budding cracks still have time to develop. (It's easy to forget that a recession is imminent again at some point; forecasters just don't have a good track record on timing.)

<u>Inflation</u>. Trailing 12-month CPI came in for June at 3.0% on a headline level and 3.3% for core, removing food and energy. Last week, June PCE inflation showed fewer changes at the margin from the prior month at 2.5% headline and 2.6% core—the latter being the Fed's preferred measure tied to the 2% policy target. On the upside, other data shows that housing rent has begun to slow further, but takes time to make its way into official government statistics. Inflation overall has definitely taken more time to unwind than many expected, but progress slowly continues. On the downside, tougher year-over-year comparisons from late 2023 could actually cause readings to rise slightly again before falling back, assuming the current track of more normal monthly readings. A steadier path downward gives the Fed "more confidence" (as they've put it) towards a shift to maintenance rate cuts, while a rise could complicate that story.

<u>Employment</u>. Labor conditions have slowed but remain in a strong place relative to history. Strong nonfarm payrolls have been offset by falling job openings, less frequent quits, and the unemployment rate still quite low but ticking higher, as a few examples. The divergence in some data is assumed to be at least partially due to post-pandemic seasonality, the impact of immigration (notoriously difficult to measure), as well as fewer folks

responding to government surveys. Regardless, Fed Chair Powell has mentioned labor's slowing in recent speeches/testimony, implying it underpins a move to easier policy, given that inflation has also behaved.

Markets were seeking more clues than usual for September being the rate cut jumping-off point, but may need to wait for the Powell press conference and/or regional Fed president routine speeches for more hints. As noted earlier, the U.S. economic environment has remained steady over the past few months and quarters, in fact, improving in a few areas. That makes the Fed's job a bit more challenging in that there isn't an obvious deterioration in any one segment that would warrant a shift to full-blown easing regime. That said, inflation normalization and some labor market softening build the case for cuts that should eventually loosen the tightening effect of 5%+ yields on businesses and consumers.

A variety of officials, including those on the more hawkish side, have come around to the pro-easing camp in recent months, adding to an upcoming cut being priced in for the next meeting. Barring other developments like an imminent recession, the easing pace could be slow and measured. Most importantly, taking a broader view, an evolution from policy pause to policy cuts (absent a deep recession in the meantime) has been a historically-positive backdrop for stock, real estate, and bond markets. It could also finally put a dent in the U.S. dollar's strength, which has been a headwind for some international investments.

Ryan M. Long, CFA

Director of Investments

FocusPoint Solutions, Inc.

Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, FocusPoint Solutions calculations.