

At the October meeting, the U.S. Federal Reserve Open Market Committee voted to keep the Fed funds policy rate unchanged at the current range of 3.75-4.00%. In a 10-2 vote, there were dissents from governors Cook and Hammack, who each preferred a rate hike of a quarter-point.

The formal statement remained brief, upgrading economic activity from “solid” to “strong”. Last month’s comment about returning to target faster was tweaked to include the “accumulation of more information” to help decide the policy stance. In terms of inflation, it remained “elevated,” and job gains have “kept pace with the workforce.”

CME futures have largely pointed to no change for October (90% probability), with the U.S. midterm elections next week, and debate over the minimal new inflation data coming in since the Sept. meeting. However, odds for a hike in December remain high, as they are for March and June of 2027, which would bring policy rates to a resting place of 4.50-4.75%. Interestingly, the most recent Atlanta Fed Taylor Rule utility still shows a ‘quantitative’ policy rate of 5.25% (if using an average of the 30 calculated versions of the rule).

Economy. The latest Atlanta Fed GDPNow indicator points to Q3 growth of 3.3%, with the official advance number coming out in a few days. Growth has remained strong on the consumer side, in addition to non-residential fixed investment (AI and data infrastructure), as well as restocking of inventories that were under an extended stretch of drawdown. Though, some of the growth looks to be offset by a large drop in net exports (from an influx of imported tech equipment) and lackluster residential building activity. Considering that trend U.S. economic growth is in the ~2.0% range, the current pace remains robust by any measure, although pessimists have focused on the increasing reliance of AI as the engine over the past year. A key question is, will it continue? Outside of AI, the economy doesn’t appear overheated.

Inflation. In September, headline and core CPI ex-food and energy rose 3.7% and 2.6% over the trailing 12 months, respectively. Core PCE for August continued to run above-target at 3.0% (new data tomorrow). Those remain too high for policymakers, and consumer frustration has been noted in pessimistic confidence surveys and pre-election political surveys, which could make their way into the midterm election results next Tuesday. While inflation never recovered from elevated pandemic levels where monetary and fiscal policies have been blamed along with supply shortages, spiking oil prices from the Middle East conflict have obviously driven the narrative this year, as is strength on the demand side. While markets haven’t cheered higher input costs, it seems that the war’s limited scope may have dialed down some of these concerns. Though, the longer inflation runs

above mandate, the Fed has given up on using the terms ‘transitory’ and perhaps the more recent description of ‘look through’ inflation.

Employment. Labor numbers haven’t shown much to worry about at face value, even though they’ve become harder to deconstruct. From a data standpoint, dramatic immigration changes coupled with rising baby boomer retirements have caused a drop-off in the size of the labor force. While labor has been difficult to measure precisely anyway, it’s especially so now since more dramatic vs. gradual shifts can raise variability in normal seasonal adjustments. At the same time, job openings and jobless claims continue to show minimal change to what’s described as a ‘no hire, no fire’ status quo. That alludes to some of the cross-currents that company managements have been faced with, as in being not quite sure if AI will end up replacing some job functions, but, at the same time, being reluctant to let go of skilled labor has also been hard to come by. For now, the Fed describes labor markets as healthy, which the low official unemployment rate supports.

So far, a few possible Fed rate hikes aren’t seen as being impactful enough to derail the economy. Interest rates have been a major story of 2026, but mostly at the longer end of the U.S. Treasury yield curve. Rates rising up from near zero were a major shock to both stocks and bonds in 2022, but recent moves of the 10-year to over 5% bring back levels we haven’t seen in 20 years. This ‘tightening’ handles some of the Fed’s job.

As bonds aren’t known for being so dramatic historically, such sudden rate changes can be jarring for both lenders and borrowers. Some of the reasons for the latest rise include the obvious persistent inflation, higher inflation expectations (which can create a wage/price spiral in the negative case), higher economic growth generally (which tends to stealthily elevate yields), fiscal debt/deficit concerns (creating a term premium or credit spread of sorts), as well as capital competition from a rising supply of AI-related bond issuance in corporate markets. Though, the fair value range for long rates, assumed to be roughly around nominal GDP (typically quoted real GDP plus inflation), now lies near multi-decade averages. From the perspective of portfolio construction, bonds offering higher starting yields points to stronger potential longer-term returns that could serve as a better complement for stocks, even if correlations don’t necessarily cooperate and go negative, which would imply the strongest diversification. That better balance perhaps suggests that investors may not need to reach as far for return by relying as much on equities, which, again, is symbolic of a more normal balanced environment between different portfolio asset classes.

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

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FAQ:

- **Why do interest rates affect stock and bond prices?**

Interest rates influence borrowing costs, consumer spending, corporate profits, and the relative attractiveness of different investments. When rates move meaningfully, both stocks and bonds can reprice as investors reassess risk, income, and future growth expectations.

- **How does inflation impact investment portfolios?**

Inflation can reduce purchasing power and influence interest rate policy, bond yields, consumer behavior, and company margins. Investors should evaluate inflation in relation to their income needs, time horizon, and overall asset allocation.

- **Why do bond yields matter to investors?**

Bond yields can affect income expectations, borrowing costs, and how investors compare the value of stocks, bonds, and cash. Changes in yields may also influence the price of existing bonds and broader market sentiment.

- **What does economic data mean for investors?**

Economic reports can influence expectations for growth, inflation, employment, and interest rates. Investors should consider economic data as one input in a broader planning and investment process rather than a reason to make reactive decisions.

- **Why does the Federal Reserve matter to the markets?**

The Federal Reserve influences short-term interest rates and monetary policy. Markets often respond to Fed commentary because it can affect borrowing costs, inflation expectations, and investor assumptions about future economic growth.