# Investment Event

**1 August 2019**
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# Fed cuts rates

At the July meeting, the Federal Reserve (Fed) cut the Fed funds target range by 25bp to 2.00-2.25%

The Fed is concerned by slow global growth, trade tensions, and continued below-target US inflation

The Committee maintained a bias to cut fed funds further in the coming months

## Our views

We do not change our asset class views. Prospective risk-adjusted returns for developed market government bonds remain consistent with an underweight position in our global multi-asset portfolios

## The Federal Reserve reduces interest rates

At its July meeting, the Federal Open Market Committee (FOMC) of the US Federal Reserve (Fed) cut the target range for the fed funds rate to 2.00-2.25%, in line with market expectations. Two FOMC members dissented by voting to keep rates on hold. The FOMC also announced that it would stop shrinking its balance sheet on 1 August, two months earlier than planned.

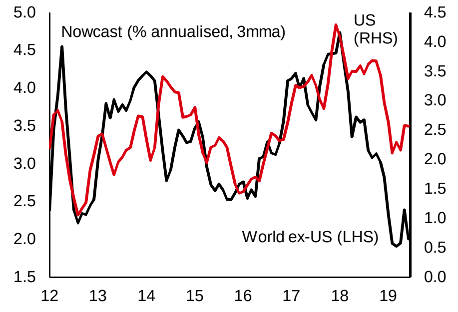
## "Insurance" cuts, rather than the start of an easing cycle

The opening line from the statement accompanying the Fed's decision maintained the view that the labour market remains strong and that economic activity is rising at a moderate pace. Nevertheless, it decided to cut the fed funds rate due to "uncertainties" about its outlook, largely reflecting concerns in three areas:

- **Slower global growth.** In the press conference, Fed Chair Powell noted that "foreign growth has disappointed, particularly in manufacturing, and notably in the euro area and China".

  Indeed, our Nowcast ("big-data" approach to tracking the economic cycle) has shown a deterioration in World ex-US conditions (Figure 1).
- **Downside risks from global trade tensions.** Powell noted that continued uncertainty over trade is weighing on business investment, which is described as being "soft" in the meeting statement.
- **Weak inflation.** The FOMC's statement noted that "inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation remain low".

**Figure 1: Headwinds from global growth**




*Source: HSBC AMG, Bloomberg, Datastream*

The statement hinted at the potential for another rate cut, noting that "As the committee contemplates the future path of the target range for the federal funds rate, it will continue to monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion". In the press conference, Powell also explicitly stated "I didn't say it's just one" [rate cut].

Thereafter, given the resilience of the domestic economy and labour market, the Committee may then choose to keep policy unchanged for some time. This would allow it to see how the risks from soft global growth and trade tensions evolve and whether inflation starts to recover.

This scenario was hinted at as Powell referred to the cut as "a mid-cycle adjustment to policy", similar to episodes in 1995 and 1998. This supports the idea of current FOMC action being "insurance" against downside risks rather than the beginning of a proper easing cycle. Indeed, Powell confirmed this, stating "there's definitely an insurance aspect to it".

. **Investments, annuity and insurance products**

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## Market considerations

We remain comfortable with an underweight position in DM government bonds in our multi-asset portfolios, given that we estimate low prospective returns. Moreover, if the Fed is correct in its analysis of the economic outlook, there is scope for market rate expectations to retrace higher. Such a scenario would likely weigh on US fixed income assets.

The current level of bond yields means equity valuations remain relatively attractive and consistent with our pro-risk stance. The Fed's apparent willingness to ease policy to support US growth, which is still running at a reasonable pace, also argues for maintaining an overweight position in US equities.

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