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# Powell's Audible: We Think We're There, Time To Pause

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As was widely expected, the Fed cut its target range for the Fed funds rate another 25 bp to 1.50%-1.75% at its meeting on October 29-30, 2019, citing the global backdrop and below-target inflation as reasons for the easing. It was the Fed's third rate cut in as many meetings, effectively unwinding the lion's share of last year's 100 bps of hikes to the Fed funds rate in short order. **Also as expected, the Fed appeared to shift to a wait-and-see mode, changing from a stance in September that it "will act" as appropriate to sustain the expansion to its latest language that it will continue to "assess" the appropriate policy path going forward.**

**Chairman Powell followed up in his press conference by noting that monetary policy now appears to be in a good place.** While there were again two dissents (regional Fed presidents George and Rosengren for the third consecutive meeting) in favor of keeping rates unchanged, St. Louis Fed President Bullard appeared on board with the October rate cut, in contrast to September when he dissented in favor of more aggressive easing.

**Given the Fed's pivot this year, financial conditions are now significantly easier than at this point last year.** But while U.S. GDP is still growing at a trend-like pace (1.9% in Q3 2019), underlying conditions have been more mixed. The consumer continues to be the engine of U.S. growth given ongoing job growth, low unemployment, and wage gains that have at least modestly outpaced inflation. Housing has staged a comeback, with residential construction registering its first quarterly gain since Q4 2017. Business investment, however, has weakened amidst a more muted profits picture, a slower global growth backdrop, and lingering policy uncertainty—particularly regarding international trade policies. **And while core inflation has rebounded from low levels earlier this year, expectations remain muted, posing a risk to inflation's longer-term outlook.**

Just ahead of the Fed's October meeting, there were nascent signs that the downside risks posed by the global backdrop may perhaps now be more limited than a few months ago given a widespread shift towards easier monetary policies in many countries, rising hopes for at least some form of a U.S.-China trade deal, and seemingly reduced risks of a no-deal Brexit. **Thus, our base case assumes that the Fed will pause for the foreseeable future as the impact of its rate cuts this year continues to filter through the economy and the FOMC takes time to assess developments across the global economy.**

## Markets Change Course Mid-Conference

Markets were initially disappointed—U.S. interest rates and the dollar rose while stock prices fell—perhaps reflecting disappointment with the dissenting votes against the cut, or more likely, with the change to a more neutral directive in the statement. And the markets remained disappointed early in the press conference as the Chairman alluded to the appropriateness of the current level of the Funds rates, which the markets interpreted as "they're done."

As the press conference progressed, however, markets concluded the Fed's course looking ahead was likely skewed: **the burden of proof for a hike would surely be much higher than for a cut.** In turn, markets moved back towards firmly pricing in an additional insurance cut next year to support the expansion. **Net result: U.S. rates lower across the curve, the dollar down, and stock prices higher.**

Looking ahead, **we see U.S. rates as attractively priced.** While current valuations may represent "fair value" against just the U.S. domestic economic picture, when set against a world of ultra-low and negative rates, we see them as biased to fall. As for non-government spread product, such as corporate bonds, emerging markets debt, and structured product, **the low level of rates and G-3 central bank liquidity injections via QE and T-Bill purchases are likely to create a positive technical backdrop in the bond market.**

With the expansion poised to continue, thanks in part to supportive G-3 central banks, **the search for yield is likely to continue as well.** Nonetheless, given the novel character of the market environment—high leverage, slow growth, incredibly low rates, and the expansion's record-breaking duration—intermittent investor anxiety and resulting bouts of market volatility are likely to continue. These, however, may continue to provide opportunities to add value through active management.

Source(s) of data (unless otherwise noted): PGIM Fixed Income as of October 2019.

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