The Fed's Drive Towards Neutral: Slowed, but not Stopped

Robert Tipp, CFA, Chief Investment Strategist, Head of Global Bonds
Tom Porcelli, Chief U.S. Economist

The Federal Reserve stayed the course with a 25 bp rate cut on Thursday and a firm reiteration of its intention to remain on a data-determined path towards a neutral rate. Given the recent stability in U.S. data, that path may be more gradual than initially presumed at the outset of the Fed's easing cycle, but Chair Powell clearly laid out the rationale for its continued drive towards neutral. Risk assets firmed on the additional easing in monetary policy, while a partial recovery in long-term rates gained momentum as Powell delivered his remarks.

Politics were clearly on the minds of those attending the Fed's press conference, but Chair Powell focused on the fact that the Fed funds rate remains restrictive and that committee members want to avoid further weakness in the labor market. While some participants continue pointing to the stronger-than-expected September payroll report, that report now appears to be the outlier in terms of labor market conditions (notwithstanding the hurricane-effected October reading). As such, we continue to see signs of further moderation across the Conference Board's Labor Differential, quit and hiring rates, the Fed's Beige Book, and small business hiring.

With Powell squarely focused on labor, the combination of an inflation rate now in the realm of the Fed's target means it can easily justify further cuts. Although uncertainty abounds, the Fed's year-end 2025 forecast for a Fed funds rate of 3.5% is still a useful starting point for where this cycle is going. Of course, as Powell suggested, neutral Fed funds is difficult to identify with any significant degree of precision, so patience is warranted when approaching that zone.

Indeed, the need for patience is another takeaway from today's meeting. On balance, recent data have been relatively solid, particularly the sizable upward revisions to incomes (when the saving rate was revised from 3% to 5%). We think the improved saving levels help establish a floor under economic activity. Hence, the Fed can continue driving towards neutral in order to preserve as much strength in the labor market as it can, but it may do so with reduced urgency. In general, it might be considered a comfortable policy position for the Fed.

As for the Presidential election results, Powell indicated that nothing changes as it relates to the immediate view on the economic backdrop or the Fed's monetary policy stance. He added that the new administration's policy initiatives could alter that backdrop over time, but that the Fed will address those as they become apparent.

Market Outlook: Uncertain? Sure, but not Bad…

With the Fed's course likely slowed, but by no means stopped, where does that leave the bond market outlook? As for the stronger economic data released since the September meeting, the markets appear to have adjusted accordingly (Figure). As a result, they may have priced in the firmer data and then some, leaving yields at what are likely to be attractive levels going forward.

For Professional Investors Only. All Investments involve risk, including the possible loss of capital.

FIGURE 1: U.S. 10-year yields are high and well above the Fed's year-end 2025 & long-term dots, suggesting Treasuries are well positioned for strong performance over the intermediate term. (%)

Source: Bloomberg.

As for credit spreads, they extended their bull market rally subsequent to the U.S. election results, leaving spreads at levels that can best be described as fully valued from a historical perspective. Although this leaves spreads vulnerable to short-term setbacks, fundamentals remain firm, as does net demand for fixed income. This combination of factors suggests that spreads may remain range bound near historic tights for some time to come.

So, while the environment is undoubtedly uncertain, yields are nonetheless back up at levels that (prior to COVID) hadn't been seen since before the GFC. In addition, central banks are in all likelihood past their respective cycle peaks, setting the market up—intermittent volatility notwithstanding—for a continuation of the bull market that began in late 2022.

Source(s) of data (unless otherwise noted): PGIM Fixed Income, PGIM Fixed Income, as of November 2024.
For Professional Investors only. Past performance is not a guarantee or a reliable indicator of future results and an investment could lose value. All investments involve risk, including the possible loss of capital.

Important Information

PGIM Fixed Income operates primarily through PGIM, Inc., a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended, and a Prudential Financial, Inc. ("PFI") company. Registration as a registered investment adviser does not imply a certain level or skill or training. PGIM Fixed Income is headquartered in Newark, New Jersey and also includes the following businesses globally: (i) the public fixed income unit within PGIM Limited, located in London; (ii) PGIM Netherlands B.V., located in Amsterdam; (iii) PGIM Japan Co., Ltd. ("PGIM Japan"), located in Tokyo; (iv) the public fixed income unit within PGIM (Hong Kong) Ltd. located in Hong Kong; and (v) the public fixed income unit within PGIM (Singapore) Pte. Ltd., located in Singapore ("PGIM Singapore"). PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom. Prudential, PGIM, their respective logos, and the Rock symbol are service marks of PFI and its related entities, registered in many jurisdictions worldwide.

These materials are for informational or educational purposes only. The information is not intended as investment advice and is not a recommendation about managing or investing assets. In providing these materials, PGIM is not acting as your fiduciary. PGIM Fixed Income as a general matter provides services to qualified institutions, financial intermediaries and institutional investors. Investors seeking information regarding their particular investment needs should contact their own financial professional.

These materials represent the views and opinions of the author(s) regarding the economic conditions, asset classes, securities, issuers or financial instruments referenced herein. Distribution of this information to any person other than the person to whom it was originally delivered and to such person's advisers is unauthorized, and any reproduction of these materials, in whole or in part, or the divulgence of any of the contents hereof, without prior consent of PGIM Fixed Income is prohibited. Certain information contained herein has been obtained from sources that PGIM Fixed Income believes to be reliable as of the date presented; however, PGIM Fixed Income cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. PGIM Fixed Income has no obligation to update any or all of such information; nor do we make any express or implied warranties or representations as to the completeness or accuracy.

Any forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fee. These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. PGIM Fixed Income and its affiliates may make investment decisions that are inconsistent with the recommendations or views expressed herein, including for proprietary accounts of PGIM Fixed Income or its affiliates.

Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. Mortgage- and asset-backed securities may be sensitive to changes in interest rates, subject to early repayment risk, and while generally supported by a government, government agency or private guarantor, there is no assurance that the guarantor will meet its obligations. High yield, lower-rated securities involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. Investing in foreign-denominated and/or -domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. Currency rates may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. Commodities contain heightened risk, including market, political, regulatory and natural conditions, and may not be suitable for all investors. Diversification does not ensure against loss.

In the United Kingdom, information is issued by PGIM Limited with registered office: Grand Buildings, 1-3 Strand, Trafalgar Square, London, WC2N 5HR.PGIM Limited is authorised and regulated by the Financial Conduct Authority ("FCA") of the United Kingdom (Firm Reference Number 193418). In the European Economic Area ("EEA"), information is issued by PGIM Netherlands B.V., an entity authorised by the Autoriteit Financiële Markten ("AFM") in the Netherlands and operating on the basis of a European passport. In certain EEA countries, information is, where permitted, presented by PGIM Limited in reliance of provisions, exemptions or licenses available to PGIM Limited including those available under temporary permission arrangements following the exit of the United Kingdom from the European Union. These materials are issued by PGIM Limited and/or PGIM Netherlands B.V. to persons who are professional clients as defined under the rules of the FCA and/or to persons who are professional clients as defined in the relevant local implementation of Directive 2014/65/EU (MiFID II). In Switzerland, information is issued by PGIM Limited, London, through its Representative Office in Zurich with registered office: Kappelergasse 14, CH-8001 Zurich, Switzerland. PGIM Limited, London, Representative Office in Zurich is authorised and regulated by the Swiss Financial Market Supervisory Authority FINMA and these materials are issued to persons who are professional or institutional clients within the meaning of Art.4 para 3 and 4 FinSA in Switzerland. In certain countries in Asia-Pacific, information is presented by PGIM (Singapore) Pte. Ltd., a regulated entity with the Monetary Authority of Singapore under a Capital Markets Services License to conduct fund management and an exempt financial adviser. In Japan, information is presented by PGIM Japan Co. Ltd., registered investment adviser with the Japanese Financial Services Agency. In South Korea, information is presented by PGIM, Inc., which is licensed to provide discretionary investment management services directly to South Korean investors. In Hong Kong, information is provided by PGIM (Hong Kong) Limited, a regulated entity with the Securities & Futures Commission in Hong Kong to professional investors

as defined in Section 1 of Part 1 of Schedule 1 of the Securities and Futures Ordinance (Cap.571). In Australia, this information is presented by PGIM (Australia) Pty Ltd ("PGIM Australia") for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). PGIM Australia is a representative of PGIM Limited, which is exempt from the requirement to hold an Australian Financial Services License under the Australian Corporations Act 2001 in respect of financial services. PGIM Limited is exempt by virtue of its regulation by the FCA (Reg: 193418) under the laws of the United Kingdom and the application of ASIC Class Order 03/1099. The laws of the United Kingdom differ from Australian laws. In Canada, pursuant to the international adviser registration exemption in National Instrument 31-103, PGIM, Inc. is informing you that: (1) PGIM, Inc. is not registered in Canada and is advising you in reliance upon an exemption from the adviser registration requirement under National Instrument 31-103; (2) PGIM, Inc.'s jurisdiction of residence is New Jersey, U.S.A.; (3) there may be difficulty enforcing legal rights against PGIM, Inc. because it is resident outside of Canada and all or substantially all of its assets may be situated outside of Canada; and (4) the name and address of the agent for service of process of PGIM, Inc. in the applicable Provinces of Canada are as follows: in Québec: Borden Ladner Gervais LLP, 1000 de La Gauchetière Street West, Suite 900 Montréal, QC H3B 5H4; in British Columbia: Borden Ladner Gervais LLP, 1200 Waterfront Centre, 200 Burrard Street, Vancouver, BC V7X 1T2; in Ontario: Borden Ladner Gervais LLP, 22 Adelaide Street West, Suite 3400, Toronto, ON M5H 4E3; in Nova Scotia: Cox & Palmer, Q.C., 1100 Purdy's Wharf Tower One, 1959 Upper Water Street, P.O. Box 2380 -Stn Central RPO, Halifax, NS B3J 3E5; in Alberta: Borden Ladner Gervais LLP, 530 Third Avenue S.W., Calgary, AB T2P R3.

© 2024 PFI and its related entities.

2024-8896

留意事項

※本資料はPGIMフィクト・インカムがプロの投資家向けに作成したものです。PGIMフィクスト・インカムは、米国SECの登録投資顧問会社であるPGIMインクの債券運用部門です。

※本資料は情報提供を目的としたものであり、特定の金融商品の勧誘又は販売を目的としたものではありません。また、本資料に記載された内容等については今後変更されることもあります。

※記載されている市場動向等は現時点での見解であり、これらは今後変更することもあります。また、その結果の確実性を表明するものではなく、将来の市場環境の変動等を保証するものでもありません。

※本資料で言及されている個別銘柄は例示のみを目的とするものであり、特定の個別銘柄への投資を推奨するものではありません。

※本資料に記載されている市場関連データ及び情報等は信頼できると判断した各種情報源から入手したものですが、その情報の正確性、確実性について当社が保証するものではありません。

※本資料に掲載された各インデックスに関する知的財産権及びその他の一切の権利は、各インデックスの開発、算出、公表を行う各社に帰属します。

※過去の運用実績は必ずしも将来の運用成果等を保証するものではありません。

※本資料は法務、会計、税務上のアドバイスあるいは投資推奨等を行うために作成されたものではありません。

※PGIMジャパン株式会社による事前承諾なしに、本資料の一部または全部を複製することは堅くお断り致します。

※"Prudential"、"PGIM "、それぞれのロゴおよびロック・シンボルは、プルデンシャル・ファイナンシャル・インクおよびその関連会社のサービスマークであり、多数の国・地域で登録されています。

※PGIMジャパン株式会社は、世界最大級の金融サービス機関プルデンシャル・ファイナンシャルの一員であり、英国プルーデンシャル社とはなんら関係がありません。

PGIMジャパン株式会社
金融商品取引業者 関東財務局長（金商）第392号
加入協会：一般社団法人日本投資顧問業協会、一般社団法人投資信託協会、一般社団法人第二種金融商品取引業協会
PGIMJ113482
4011897-20241108