CHIEF INVESTMENT OFFICE

Investment Insights

Fed Flashes Yellow

December 2024

All data, projections and opinions are as of the date of this report and subject to change.

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Data as of December 19, 2024.

The Federal Reserve (Fed) cut interest rates by 25 basis points on Wednesday, 12/18, as expected, but the commentary and the future rate path as indicated by their "dot plots" caught the capital markets by surprise. Prior to this December meeting, BofA Global Research forecast was already indicating 2 additional cuts for 2025 but clearly many market participants anticipated more. Expectations were cut in half from four cuts down to two, which ultimately pressured the two-year yield in yesterday late afternoon trade. As rates adjusted sharply, equity markets sold off aggressively with the major indexes all down around 2.5% to 3% or more.

The premium valuations and enthusiasm over the potential for strong economic and corporate profits growth for 2025 had cold water poured on it from the commentary during the press conference. Fed Chair Powell indicated that the risks are now equal in terms of inflation and the job market, which was a different tone from just two months ago in September. The key in 2025 will be how the Fed balances and then reacts to the evolving employment and inflation data.

High growth Equities and rate-sensitive shares led the market declines. We now expect investors to remain on edge in the very short term as investment positions are adjusted and the rates markets settle down. With a lack of clarity on the continuing resolution, also creating gray clouds, volatility could stay elevated into the holidays.

What hasn't changed? We still have high conviction in our themes of higher economic growth and profits for 2025, increased productivity, a more normal yield curve, wider participation across the equity markets, and positive view on small- and mid-capitalization shares. A few days of elevated volatility and a short-term reset would create a stronger base to begin 2025, in our view. The Advancement of the Asset Light Era is just beginning, and our mid-cycle bull market view remains.

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