July 29, 2020

Fed leaves interest rates unchanged, reaffirms ongoing policy support

Summary:

- The Federal Reserve (Fed) kept interest rates unchanged and Fed Chairman Jerome Powell repeated its commitment to support the economic recovery.
- The Fed reiterated its expectation for near-zero rates for an extended period, and ongoing Treasury and agency mortgage bond purchases at least at their current pace over coming months.
- Today's announcement is consistent with our "glass half full" view on the path forward, as well as our outlook for inflation eventually returning to more normal levels.

As expected, the U.S. Federal Reserve (Fed) held interest rates unchanged near zero today following its regularly scheduled two-day meeting. In the ensuing press conference, Chairman Jerome Powell reiterated the significant short- and medium-term risks to the economy and emphasized the importance of ongoing fiscal and monetary policy support. We anticipate the Fed will maintain a forceful accommodative policy stance for the foreseeable future.

U.S. stocks, as measured by the S&P 500, closed near the highs of the day, with growth stocks outperforming value and smaller companies outperforming larger. Shorter-term Treasury bond yields fell slightly as investors price in expectations for a longer period of low rates.

Today's announcement highlighted the Fed's cautious economic outlook and its intention to keep rates near zero for an extended time and confirmed the plan to continue large-scale asset purchases to help keep borrowing costs low. According to the committee's statement, "the path of the economy will depend significantly on the course of the virus," and added that Treasury and agency mortgage bond purchases will continue at least at the current pace in coming months. Chairman Powell emphasized direct fiscal support, which the Fed does not control, has been critical for consumers. Additional $600 per week payments had supplemented recent unemployment benefits, but expired Saturday. Congress began negotiations this week on additional fiscal measures.

Aggressive policy measures from the Fed and other global central banks continue to support market liquidity, access to capital and investor confidence. The Fed focused initial efforts on market functioning and has pivoted to keeping borrowing costs low for individuals, companies and municipal borrowers. Yield spreads, or the difference between corporate bond yields and equivalent Treasury yields, are now near normal historical levels. Corporate borrowing costs reflected in yield terms (Treasury yields plus corporate yield spreads) are at all-time lows, and companies have taken advantage of this by issuing a record amount of debt year to date. We are encouraged by companies' ability to lock in cheap financing to bridge the gap in damaged operating cash flows amidst a challenging economy.

Markets are forward-discounting mechanisms, meaning they set prices today for uncertain future outcomes. Much more information will follow, especially considering we have only three months before the Presidential election. Before election day, markets are monitoring back-to-school dynamics over the coming weeks amidst still challenging COVID-19 spread and related implications for return to work. Even more acutely, investors await clarity from Washington on the next set of stimulus measures, since federal weekly unemployment benefits attached to March's Coronavirus Aid, Relief and Economic Security (CARES) Act expired Saturday. With recent studies indicating that only 37 percent of total jobs in the U.S. can be done from home, Washington's response on ongoing aid coupled with back-to-school and back-to-work trends will be important clues to corporate and consumer activity.

While we retain a glass half-full perspective on diversified portfolios as we get closer to a medical solution to the COVID-19 challenges, we must respect the potential for volatility in coming weeks. We anticipate the news cycle to pick up from an already heady pace and encourage clients to engage us however we can help. We remain steadfast in our belief the market rewards patient investors for the risks they bear, and as always, we will update you with any changes to our views. Thank you for your trust.