Situation analysis October 29, 2025

Federal Reserve cuts interest rates 0.25%; investors anticipate high odds of additional future cuts

Key takeaways

- The U.S. Federal Reserve (Fed) reduced its policy interest rate by 0.25% to a range of 3.75%-4.00% as expected.
- The Fed projects additional rate cuts, noting risks of a softening labor market despite lingering inflation and highlighting their data dependence.
- Investors expect a high likelihood of an additional rate cut in December and three more cuts in 2026.

The Federal Reserve cut its target federal funds interest rate by 0.25% to a range of 3.75%-4.00 % following its regularly scheduled two-day meeting, an outcome investors widely expected. One of the 12 voters dissented in favor of a 0.50% cut, with another dissenting in favor of no cut. The Fed's projections from September show most members anticipated an additional rate cut in December, and at least one additional cut in 2026. Investors expect high odds of one more cut this year and three next year. However, Fed Chairman Jerome Powell noted a December rate cut is "far from" a foregone conclusion. The Fed previously cut rates 1% in 2024's second half before pausing cuts earlier this year amid tariff and inflation uncertainty. Bureau of Labor Statistics revisions covering the year ending in March 2025 indicated weaker hiring than previously believed, prompting the Fed's September rate reduction.

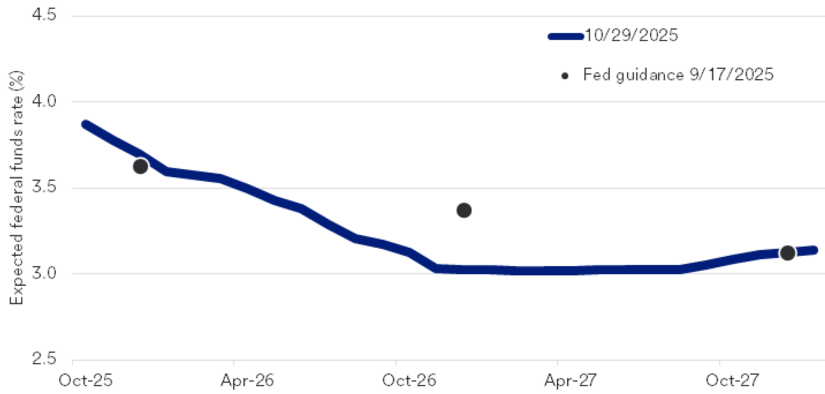
The Fed's updated statement noted, "Economic activity has been expanding at a moderate pace … the unemployment rate has edged up but remains low." The statement also highlighted that, "Inflation has moved up since earlier in the year and remains somewhat elevated." Inflation has not rapidly accelerated as many economists feared but has modestly increased in recent months. Business "prices paid" surveys and rising tariff revenue relative to imports suggest inflation could rise further, contributing to the Fed's emphasis on a data-driven approach to policy decisions. Powell stated a "reasonable base case is that the effects on inflation (from tariffs) will be short-lived."

During the press conference, Powell said, "We think policy is still modestly restrictive," suggesting room for additional rate cuts if risks to the labor market continue offsetting risks of higher inflation or if inflation subsides. However, he also restated previous comments that future rate cuts are "far from" a foregone conclusion despite market expectations.

Aggressive policy tightening in the form of rate hikes between early 2022 to mid-2023 helped drive the Core Personal Consumption Expenditures Price Index (Core PCE), the Fed's preferred inflation gauge, from a peak above 5.5% year-over-year in 2022 to 2.9% in August. The Fed targets inflation near 2%.

The Fed announced it will cease reducing the size of its $6.3 trillion in current bond holdings on December 1, after slowing the monthly reduction earlier this year. The Fed's bond holdings peaked at $8.5 trillion in 2022 before allowing bonds to mature without replacement up to $60 billion per month, then shrinking the pace of bond "runoff" in April to $40 billion per month. No balance sheet runoff improves market liquidity, since investors will not need to absorb the incremental supply of bonds. Liquidity refers to the amount of money readily available to buy goods, services and financial assets in an economy. Strong liquidity can also provide cushion against unforeseen financial market shocks, and liquidity measures remain constructive for now.

Market pricing of the expected path of the federal funds rate

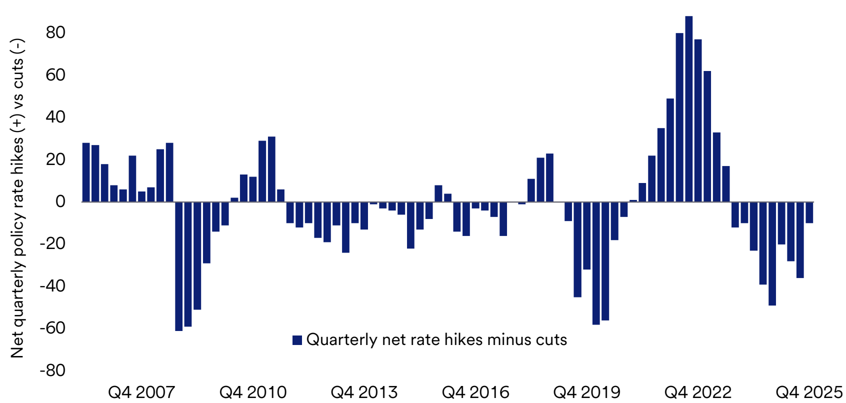


Sources: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg; 10/29/2025

Stocks and bonds posted mixed results today. Large stocks, represented by the S&P 500, were flat. Small stocks, represented by the Russell 2000 Index, which are more sensitive to debt costs, fell 0.9%. Ten-year Treasury bond yields increased 0.10% to 4.08%, while two-year Treasury yields increased 0.11% to 3.60%.

Monetary policy, defined as central bank target interest rates, eased considerably year-to-date outside the U.S. The European Central Bank cut rates by 1.00% so far in 2025 and investors expect it is unlikely to cut again at tomorrow's meeting. The Bank of Canada cut rates by 1.50%, including another 0.25% cut at today's meeting, with investors expecting no further cuts this year. The Bank of England and Reserve Bank of Australia cut by 0.75% so far in 2025.

Global net central bank rate hikes (net hikes minus cuts), quarterly



Sources: U.S. Bank Asset Management Group Research, Factset; 4/1/2006-10/29/2025.

We retain a constructive outlook for diversified portfolios, acknowledging the contrast between solid recent aggregate economic data versus potential negative impacts from tariffs. We see opportunities leaning into globally diversified stocks and assets somewhat more sensitive to inflation such as global infrastructure and Treasury inflation-protected securities. Consumer spending and corporate earnings growth remain resilient. Signs have emerged that modest tariff-related price increases remain a factor, albeit less than many economists anticipated. We will keep you informed of our views as new data becomes available and as we update our assessment of market conditions.

As always, we value your trust and are here to help in any way we can. Please do not hesitate to let us know if we can help address your unique financial situation or be of assistance.