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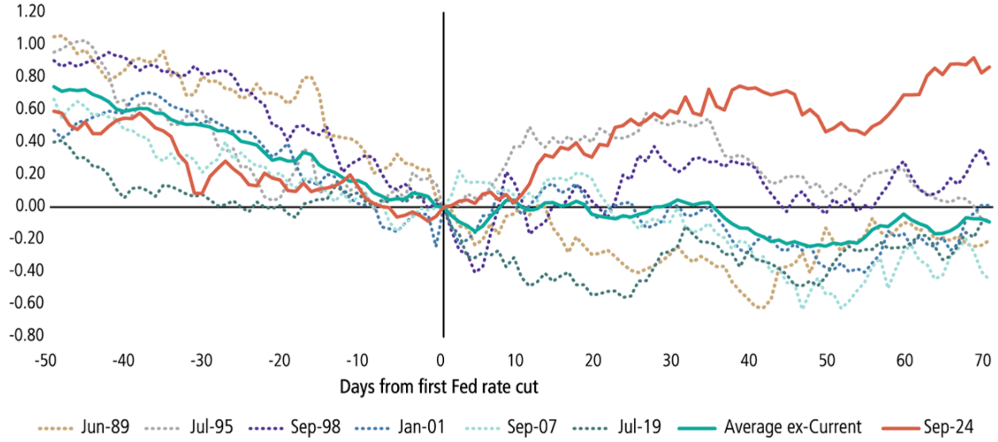
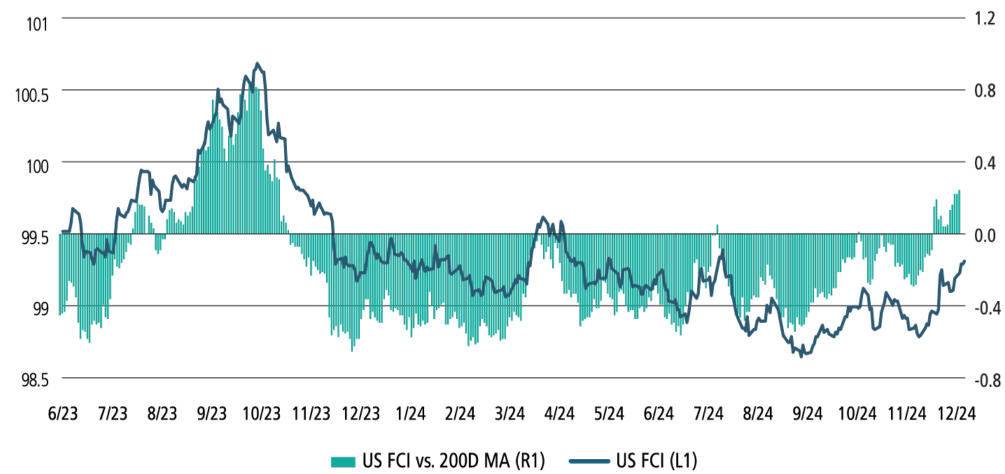
Neuberger Berman Multi-Asset Team

Monthly Global Macro Update

January 2025

CHART OF THE MONTH: When Does the Cutting Cycle Become an Easing Cycle?





HIGHLIGHTS

- For over a year, we have pointed out what we view as the unique aspect of the Federal Reserve's rate hiking process from March of 2022 to July of 2023 with the summary phrase, "the hiking cycle that was not a tightening" as financial conditions loosened over this period.
- We believe this is important for investors because now it may be possible that we experience "a cutting cycle that is not an easing" with financial conditions not loosening in the manner typically associated with a reduction in the policy rate.
- In fact, this is exactly what has been occurring since the first Fed rate cut in September, yet with surprisingly little commentary on the phenomenon.
- Our first chart this month (left) shows the move in U.S. 10-year Treasury yields from the inception of the first reduction of Fed rates in each cutting cycle since June 1989. The orange line represents the most recent episode, and the teal line represents the average of all episodes excluding the current episode.
- As can be seen, the market has not witnessed a move higher in 10-year yields to this degree in any previous cutting cycle dating back to 1989.
- The second chart (right) shows that financial conditions started tightening immediately after the Fed implemented its first reduction of the policy rate in the current cycle.
- This is important because of its future implications for the growth outlook.
- If the Fed is unable to cut rates due to inflation concerns, then any move lower in nominal GDP will not be offset with a reduction in the policy rate unless the move lower in growth is significant enough to offset inflation expectations; there is no such outlook in consensus forecasts for growth.
- At a time when the market appears to be pricing for above-trend growth, even as the dollar strengthens, oil moves higher, and 10-year yields move higher (all are negative for growth), we believe investors should be demanding a higher, not lower, premium for risk assets.
- As a result, investors should be wary of the potential for growth to start weakening, which could create a poor risk/reward setup for growth assets despite the rosy consensus outlook.

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