PALLAS CAPITAL ADVISORS

Pallas Perspective

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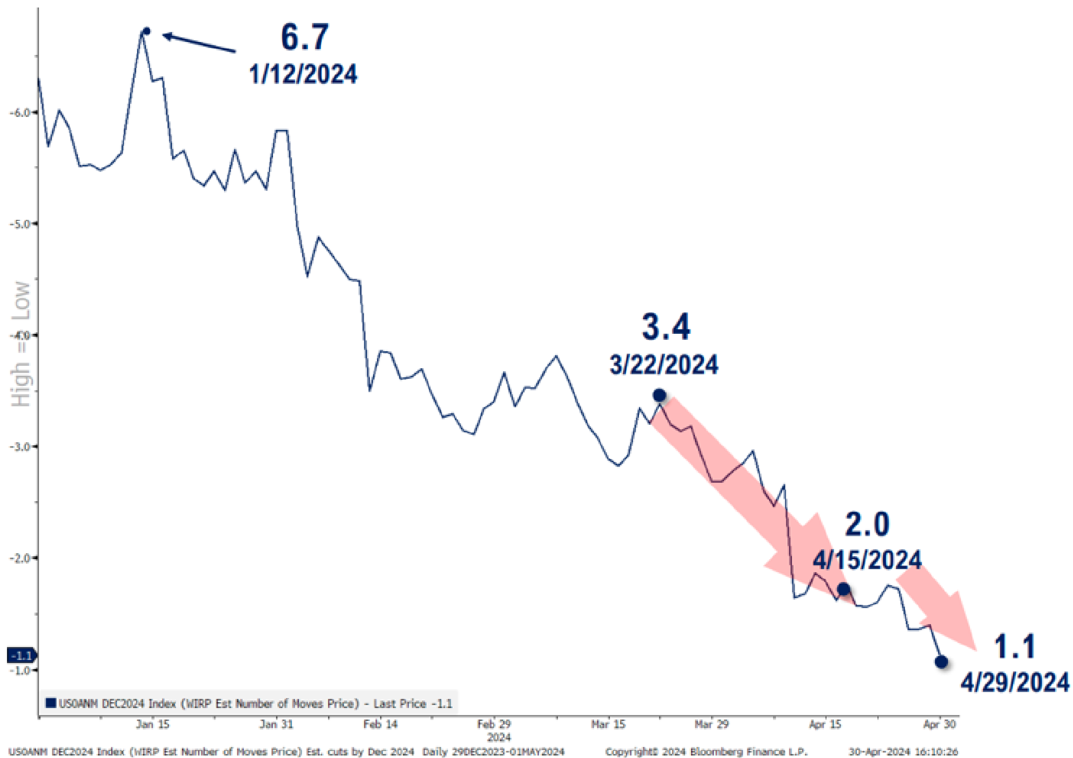
Good News and Bad News – The Fed Holding Rates Unchanged

The Fed decided to leave interest rates unchanged after the Federal Open Market Committee (FOMC) meeting that ended on May 1. This move was widely anticipated by investors and markets. The target range for the federal funds rate remains at 5.25% to 5.50%, where it has held steady since last summer.

While this decision did not come as a surprise, investors still have many questions about when rates might finally come down and how the Fed may proceed if still-high inflation continues to persist. As illustrated in the chart below, the market anticipated almost 7 rate cuts at the start of the year or an expectation that the Fed Funds rate would end the year at around 4.0%. As the year has progressed, the number of expected rate cuts for calendar year 2024 has fallen to close to one time as of the end of April, leaving the Fed Funds rate level in restrictive territory of around 5%. The change in expectations continue to be in flux with each successive data release on inflation, employment, and economic growth.

Estimated Fed Rate Cuts by December 2024



Source: Fundstrat, Bloomberg

The change in expectations has been driven by two factors: stronger economic growth and stickier inflation. For the markets, stronger economic growth is a positive, as growth supports employment and corporate earnings. On the other hand, lower rates help asset valuations and would be supportive of stock and bond appreciation.

The expectation for lower rates in 2024 was an important factor that helped drive positive returns in both the equity and fixed income markets in late 2023 and the first quarter of 2024.

While rate cuts are still possible this year, they are not a certainty. However, going into this week's Fed meeting, there was fear that the Fed could raise rates. Chairman Powell addressed this concern in the press meeting following the Fed's action, or rather lack thereof, and stated that he highly doubted that rates would go higher as current policy is sufficiently restrictive. This proved, at least in the short term, to assuage fears and was a positive catalyst for financial markets.

So, the current rate landscape would appear to be set for a continuation of the highest rates in over 20 years. Outside of the impact on the valuation of financial markets, higher rates benefit short-term money market rates, short-term CDs, and treasuries, but also result in high rates for new mortgages. The possibility also remains that the restrictive rate policies by the Fed will ultimately lead to a slowdown in the economy. A slower economic growth print for March might be a precursor to this lagged effect of Fed policy on the economy. Such a slowdown might, in turn, lead to lower inflation and, in turn, lower rates.

At Pallas Capital Advisors, we will continue to monitor the business and interest rate environment with an eye towards preserving and growing capital over the long term.

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