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Weekly Market Commentary

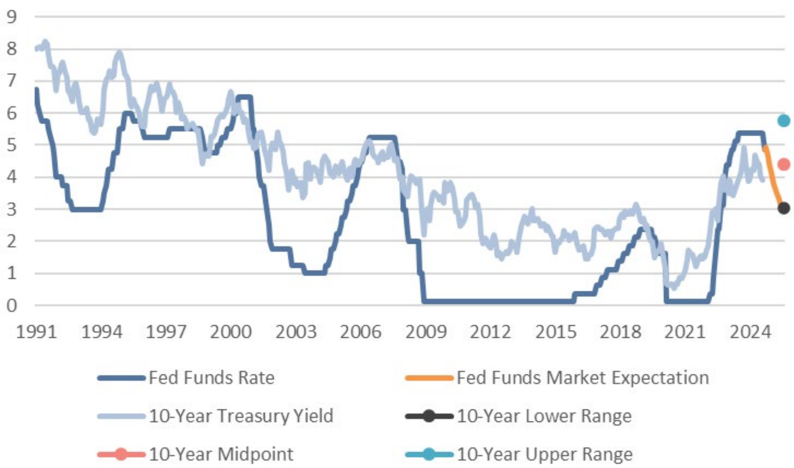
The Fed Cut Cash Rates, but Where Will Long-Term Rates Go?

By Michael Crook, Chief Investment Officer

The Federal Open Market Committee (FOMC) of the Federal Reserve cut the Fed funds rate by 0.5% last week. At the current time, market participants expect the Fed to continue cutting the Fed funds rate to 3% over the next 12 months. For context, the Fed currently believes 2.9% is the "neutral" Fed funds rate (i.e. the rate that is neither restrictive nor accommodative to the economy).

If the Fed funds rate is falling, so should long-term interest rates, right? Since 1991, the 10-year Treasury bond yield has averaged 1.4% above the Fed funds rate with 1-standard deviation trading range of 1.3%. That means that if the Fed settles at 3%, a historically-reasonable range for the 10-year is 3.1%-5.7%, with a central tendency of 4.4%. While we don't currently see 5.7% as realistic, longer-term interest rates could certainly stay at current levels, or move higher, as the Fed cuts.

Fig.1: The 10-year yield might move higher as the Fed cuts



Source: Bloomberg, Mill Creek.

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