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What Should Investors Think About the Fed Rate Cut?

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"In the short run the market is a voting machine, but in the long run it is a weighing machine."

- (Attributed to both Benjamin Graham and Warren Buffett)

The above quote seems especially relevant in this chaotic election year, but what does it mean? In investment terms, it means that **short-term market movements** are frequently driven heavily by **momentum and investor sentiment** (i.e., a voting machine and/or popularity contest). But in the **long run**, markets typically are driven primarily by **fundamentals** (e.g., earnings, dividends, quality, and valuations). That is, a weighing machine.

With this as a framework, what should investors be thinking about following the somewhat surprising 50-bps cut rate by the Fed last week?

First, some background. At the beginning of 2024, the "market" was pricing in **six** rate cuts over the course of 2024. Put differently, this is what the market wanted. This was completely at odds with the Fed narrative at the time, which was clear it still had work to do on bringing down inflation. Over the course of the year, that narrative shifted as inflation continued to fall. But remember, the Fed has a **dual mandate** to **control inflation and maximize employment**.

The overall economy seems to be **cooling** but remains **far more resilient** than anticipated, and there is little anticipation of a recession until well into 2025, if not later. Likewise, inflation has maintained a slow but steady decline toward the Fed target rate of 2% per year. It wasn't until the labor market began to show signs of slowing down that the Fed narrative began to shift, and in its July FOMC minutes (and Chairman Powell's corresponding press conference) a specific emphasis was placed on the **labor market** along with a reminder of the Fed's dual mandate. That triggered market anticipation of a rate cut coming in September. The market wanted at least 50-bps, while the underlying economic indicators suggested no more than 25-bps was needed (if any).

We believed the Fed would not move aggressively so close to a tightly contested national election (for both the President and for control of the House and Senate). But we were wrong, and the market got what it wanted – a 50-bps cut and Fed suggestions there will be more to follow. It was interesting to see how the market reacted. When the 50-bps cut was announced, the market reaction was almost one of euphoria.

But later that day following Chairman Powell's post-meeting press conference, his words and tone were considered far more **hawkish** than expected, and the market ended flat to down on the day. It then rallied and fell again over the course of the next two trading days.

This is a perfect example of what **Graham** and **Buffett** meant when they said that in the short term the market is a voting machine, or popularity contest. We all know what the market has done over the past 30 years. It's gone up and down but always trended up. And we also know how well Warren Buffett – a famously disciplined and value-oriented investor – has done

over that same period. And that's what he meant when he said that in the long-run the market is a weighing machine – eventually, market fundamentals will always win the day.

We encourage investors to not get caught up in short-term market noise – it will drive you a little crazy and if you overreact you are likely to lose.

Buffet's long-time investment partner Charley Ellis is famous for a quote of his own, from his book, **Winning the Loser's Game**, and here we paraphrase: For most investors, the winner is most often not the person who hits the most "winners" but avoids the most "losers".

We aim to build **all-weather** portfolios at Certuity, designed to perform consistently over a reasonable time horizon, regardless of underlying economic, political, or market conditions. We fall firmly into the weighing machine camp. Stay calm, stay disciplined and keep your eyes on the horizon.

As always, please feel free to contact me directly if you would like to discuss the markets, investments or your portfolio. I look forward to the interaction.

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