

# The Fed's latest trim

*After cutting rates 50 basis points in September, the U.S. Federal Reserve continued trimming with a 25 basis point cut in November.*

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## WHAT HAPPENED?

The Federal Reserve cut interest rates by 25 basis points (bps) at today's meeting, as expected. The policy statement had only modest changes, and we continue to expect another 25 bps cut at the next meeting in December.

The policy statement said "labor market conditions have eased," a slight change from the prior version which stated "job gains have slowed." That tweak reflects the last two jobs reports, which show a slowing trend, but not as weak as earlier in the year.

In his press conference, Chair Powell reiterated that policy is "not on a pre-set course," and the Fed will make upcoming policy decisions on a meeting-by-meeting basis. When asked about the impact of the election on monetary policy, he said that at this point, "the election will have no effect on our policy." Powell went on to say that the Fed will respond as needed to changes in fiscal policy – whether that requires higher or lower policy rates – but only once those fiscal changes are clear.

## ECONOMIC DATA CONTINUE TO SHOW DISINFLATION AND A MODEST SLOWDOWN

Economic data have strengthened our expectations for a soft landing for the U.S. economy. Growth remains healthy and inflation is moderating, even as

labor markets loosen. We expect those trends to continue over the coming quarters.

Employment data have been mixed, though the latest readings point to a further slowdown. The October jobs report disappointed versus consensus expectations with only +12,000 jobs created, and it included another -112,000 downward revision to the prior two months' numbers. The unemployment rate ticked higher again after falling in the prior two months. This less-rosy trend aligns with signals from other labor market data, including a recent decline in the number of job openings, a drop in the private quits rate, and a very small but noticeable increase in the layoff rate.

Recent inflation readings have mostly been encouraging. In particular, housing inflation slowed in the third quarter to an annualized pace of +4.8%, down from +5.1% in the first half of the year and +6.3% in 2023. At the same time, wage inflation has cooled materially, with a broad measure of labor costs dropping to its slowest rate in over three years.

Despite the slower labor market, consumer spending remains robust. Overall spending, while slower than last year's strong pace overall, has accelerated in the third. That propelled third quarter GDP growth to an annualized pace of +2.8%, more than offsetting a drag from inventories and residential investment. Heading into Q4, the consumer shows no signs of slowing down, which will likely continue to support growth.

Looking ahead, we continue to expect labor markets to slacken further and inflation to return to target toward the end of next year. Overall economic growth is likely to slow as well, to around 2% by the middle of next year.

### **WHAT DOES THIS MEAN FOR INVESTORS?**

We see ample opportunities for investors to deploy capital, given our expectations for the U.S. economy to continue steadily slowing and for the Fed to respond with gradual rate cuts. In particular, we see compelling cases for certain plus sectors in fixed income, some non-U.S. equity markets, and, for the first time in the cycle, real estate.

Preferred securities, an investment grade asset class, is among the top-performing fixed income sectors year-to-date, with a total return of +10.6% through 31 October (as measured by the ICE BofA All Capital Securities Index). This impressive gain has been driven by compelling yields, favorable supply/demand dynamics and strong bank earnings.

Among the different types of preferreds, we favor \$1000 par securities, which are yielding 5.95% with a spread of 177 bps over U.S. Treasuries. Banks, the largest issuer of preferred securities, have generally beaten consensus earnings estimates this reporting season. Earlier this year, annual stress test results demonstrated the continued strength of bank balance sheets with robust capital ratios.

Meanwhile, in securitized assets we see opportunities in both commercial mortgage-backed (CMBS) and asset-backed securities (ABS). In particular, we like segments that are not part of the Aggregate Bond Index. Looking at these less-liquid sectors can widen the opportunity set, creating the potential for additional returns. Among securities included in the Agg, CMBS has returned +4.3% year-to-date, and ABS +4.3% — certainly strong gains. But the broader, out-of-benchmark CMBS and ABS categories, as measured by ICE BofA indexes, are up even more, returning +9.9% and +6.5%, respectively, year-to-date.

Spreads in the broader CMBS and ABS universe are wider than those of other investment grade sectors. As a result, they offer the potential for continued strong performance while providing investors with substantially elevated yields.

Within CMBS, we're finding opportunities in the private-label market. These single asset, single borrower deals derive their cash flows solely from one multifamily building (in a desirable geographic area). This allows managers with strong credit research teams to perform the necessary due diligence on these transactions.

On the ABS side, we see opportunities in esoteric securities backed by nontraditional assets. These deal sizes are usually smaller, but they typically provide an additional 75 bps to 125 bps in yield compared to short-maturity corporate bonds. We prefer commercial ABS exposure in areas like fiber optic cable lines, data centers and cell towers.

In equity markets, we increasingly see potential in certain regions within the non-U.S. space. Through mid-October, global equities are up over +16% this year, based on the MSCI All Country World Index (ACWI). While that's an impressive gain, it has led to stretched valuations: The ACWI's forward price-to-earnings ratio (P/E) sits at 18.1x, well above its 14.6x average since 2006. The high price tag on equities in many regions makes us especially mindful of where to actively add exposure.

Two markets we find interesting in the current environment are Japan and China. Both offer attractive valuations and a higher dividend yield relative to the ACWI. In Japan, the recent election of Shigeru Ishiba as prime minister surprised markets, leading to a moderate selloff that we believe has been overdone. Equity markets in China have been quite volatile this year, which we expect to continue. However, Chinese stocks are trading at a forward P/E of 10.8x, below their long-term average of 11.4x. If government stimulus succeeds in sparking domestic growth, earnings per share could be revised upward as well, further benefiting Chinese equities.

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Finally, after seven consecutive quarters of negative total returns, the private real estate sector, as measured by the NCREIF ODCE Total Return Index, was up +0.25% in the third quarter of 2024. The extended downturn for real estate had been triggered by the Fed's aggressive 2022-2023 rate hiking cycle and post-pandemic stress in the office property sector. Now, however, with the Fed initiating its easing cycle and projecting further rate cuts over the next two years, the interest rate environment should become a tailwind. We believe both stabilizing fundamentals and transaction market pricing point to a broad recovery.

A pullback in new construction activity across property types should bode well in the medium term, helping to moderate supply, a positive for rent growth. In the U.S. apartment and industrial markets, new construction starts are at less than one-third of their peak levels across apartment and industrial markets. Meanwhile, the volume of square footage currently under construction has returned to pre-pandemic levels.

In our view, the private real estate market correction is nearly complete — and now could be a good time for investors to take a fresh look at the asset class.

**For more information, please visit us at [nuveen.com](https://nuveen.com).**

Endnotes

Sources

Federal Reserve Statement, November 2024.

Bloomberg, L.P.

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