nuveen
A TIAA Company

BREAKING NEWS
28 January 2026

The Fed's pause highlights value of diversification

The U.S. Federal Reserve paused rate cuts after three consecutive reductions. Stronger labor data and robust consumer spending support our upgraded 2.0% growth forecast for 2026. With valuations elevated and the Fed slowing cuts, investors might consider diversification through dividend growers, senior loans and alternative assets like farmland.

Tony Rodriguez
Head of Fixed Income Strategy

KEY TAKEAWAYS

- The Fed kept interest rates unchanged, with the target policy rate range remaining at 3.50%-3.75%.
- Despite two dissents favoring a rate cut, the policy statement leaned hawkish by upgrading language on labor market strength and economic growth.
- Chair Powell reinforced this hawkish tilt, citing an improved economic backdrop. However, he left the door open to rate cuts later this year if inflation declines as expected.
- With the Fed on pause and growth remaining healthy, investors should consider adding risk exposure to areas poised to benefit from the optimistic backdrop while managing downside risks.

WHAT HAPPENED?

The Federal Reserve held interest rates steady today, pausing its rate cutting cycle after three consecutive reductions to end 2025. The target range remains at 3.50%-3.75%. The decision aligned with market expectations and prior Fed communications. The most recent dot plot of rate forecasts showed one 25 basis point cut this year.

Fed Governors Waller and Miran dissented in favor of a rate cut, but the policy statement leaned hawkish. It upgraded labor market language, noting the unemployment rate "has shown some signs of stabilization" while removing a reference to "downside risks to employment." The statement also described recent growth as "solid" rather than "moderate."

In his press conference, Chair Powell avoided signaling a clear near-term policy path, saying the Fed is "well-positioned to determine the extent and timing of additional adjustments." He then tilted hawkish, noting "overall, it's a stronger forecast" than in December. Powell indicated inflation's trajectory will dictate future cuts, suggesting that if inflation declines later this year, "that would be something that tells us that we can loosen policy."

We continue to expect two additional rate cuts totaling 50 bps during 2026. This outlook is based on our macroeconomic forecast for moderating inflation later in the year, labor market stabilization and a more dovish stance from new Fed appointees.

BETTER LABOR MARKET DATA SIGNALS STRONGER GROWTH

Recent economic data point to a more stable and ultimately higher-growth outlook for 2026. The labor market has improved, growth remains robust and inflation should moderate later this year. We upgraded our 2026 growth forecast to 2.0% to reflect these improved fundamentals.

Labor market indicators show material improvement. Despite late-2025 government shutdown disruptions, recent readings signal a healthier backdrop. December's unemployment rate fell 16 basis points to 4.4% — the sharpest drop this cycle. The quits rate ticked higher and jobless claims remain low, suggesting further labor market strengthening ahead.

This healthier labor market supports consumer spending. Retail sales run at a healthy pace, with consumption set to boost fourth quarter headline GDP by roughly 2 percentage points, matching the prior two quarters. Strong IT infrastructure investment further supports growth.

Inflation data were also affected by the shutdown, skewing CPI readings lower due to methodological factors. Core CPI declined to 2.6% year-over-year to end 2025, but we expect core PCE inflation to rise toward 3.0% or higher in coming months before moderating to 2.5% by year-end 2026.

Our upgraded 2.0% growth forecast reflects stronger consumer fundamentals and robust tech investment. We expect unemployment to stabilize near current levels and inflation to rise near-term before declining in the second half.

WHAT DOES THIS MEAN FOR INVESTORS?

With slower Fed rate cuts, positive growth and full-to-rich valuations, investors stand to benefit from greater diversification. We see opportunities to adjust portfolios for higher total returns with lower volatility.

In equities, recent gains stem from AI enthusiasm, strong earnings, share buybacks and retail flows — pushing the S&P 500's forward P/E to 22x, the 91st percentile since 1990. While valuations appear lofty, so are earnings expectations: 12-month EPS growth for 2026 is estimated at 14%.

Volatility from macro, geopolitical, and policy uncertainty — plus periodic AI sentiment shifts — will likely persist. History shows **dividend growth companies** have delivered higher returns with lower risk than market peers and typically outperform non-dividend payers during elevated volatility. While dividends aren't guaranteed, they tend to be more predictable than earnings, helping smooth market turbulence.

We favor less-liquid, out-of-benchmark sectors, particularly **senior loans**. Loans returned nearly 6% in 2025 — their third consecutive strong year and ninth positive year in the last decade, as measured by the S&P UBS Leveraged Loan Index. The asset class yields above 8%, even with two Fed cuts priced in.

Loans may benefit from healthy growth: stronger revenues support cash flows, while recent repricing has allowed quality issuers to extend maturities and reduce balance sheet risk. Many loans trade between $75-$95, offering upside potential that can enhance total return when combined with high income.

Asset allocators may benefit from less-conventional sectors providing uncorrelated risk and better risk/return profiles. We favor **farmland,** which can improve portfolio efficiency through multiple channels. As a relatively illiquid, non-traded asset, farmland has rarely moved with conventional markets. It provides bond-like lease income while offering long-term capital appreciation from rising land values. Farmland may also serve as an effective inflation hedge — historically, farmland returns have risen when inflation surprised to the upside.

For more information, please visit us at nuveen.com.

Endnotes

Sources

Federal Reserve Statement, January 2026.

Bloomberg, L.P and S&P Markit.

5145851