

# The Fed emphasizes patience over pre-emption

*The U.S. Federal Reserve kept interest rates steady at its May meeting, citing continued uncertainty over the magnitude and persistence of tariffs. However, it signaled that the next move is still likely to be a rate cut later this year.*

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## WHAT HAPPENED?

The Federal Reserve kept rates unchanged today, with the target fed funds rate range holding at 4.25%-4.50%. Officials suggested that, though uncertainty has risen, the economy remains healthy and there is no immediate need to change policy.

The updated policy statement said that “uncertainty about the economic outlook has increased further” and that “the risks of higher unemployment and higher inflation have risen.”

In his press conference, Chair Jay Powell emphasized that, given the high level of uncertainty and the positive economic fundamentals, there is no urgency to cut rates in the near-term. He said, “the right thing to do is await further clarity” and “we can be patient,” especially because it remains to be seen exactly how the “scale, scope, timing, and persistence of the tariffs” will evolve. He explicitly said that this is “not a situation where we can be pre-emptive,” suggesting that the Fed will wait to see actual deterioration in the labor market data before feeling compelled to cut rates.

We anticipate two 25 basis point (bps) rate cuts this year, followed by three cuts in 2026. These forecasts are based on our macroeconomic outlook and a probability-weighted view on the outlook for tariffs. But if tariffs end up higher than our models suggest, the Fed could loosen policy more aggressively (and vice versa).

## TARIFFS REWRITE THE ECONOMIC OUTLOOK

Since the last meeting of the Federal Open Market Committee (FOMC) – the 12 central bankers who determine the direction of monetary policy – in March, the economy and financial markets have been buffeted by volatile tariff policy. First, President Trump unveiled much higher-than-expected tariff rates on 2 April. The proposed measures included a baseline 10% tariff on all U.S. trading partners, with most countries receiving a unique, higher rate, depending on their bilateral goods trade surplus with the U.S. On 9 April, Trump announced a 90-day pause for most of the tariffs, possibly to allow time for negotiations.

Business and consumer sentiment have already deteriorated sharply in response. This reflects both the direct drag via higher prices, as well as the second-order impact of prolonged uncertainty. However, actual economic activity has held up

better than feared, with consumer spending steady and the labor market remaining healthy.

Looking ahead, we expect U.S. economic growth to slow to below 1.0% this year, a notable downgrade from our prior forecast of closer to 2.0%. At the same time, we anticipate a tariff-driven reacceleration in inflation, with the core Personal Consumption Expenditures Price Index (PCE) – the Fed’s preferred inflation barometer – rising to around 3.4% year-over-year by the end of 2025, up from our prior forecast of between 2.5% and 2.7% in March. The labor market is likely to face slight constraints, and we estimate an unemployment rate of around 4.5% by year-end (versus 4.2% in April).

### WHAT DOES THIS MEAN FOR INVESTORS?

Our investment playbook has changed, with the economic outlook now materially worse and substantially less certain. We recommend maintaining exposure to certain areas of risk assets while prioritizing sectors with relatively less volatility and more tariff insulation.

For equities, we see value in companies that have initiated or continued to raise dividends during periods of volatility. We believe these stocks can provide higher annualized return potential with lower standard deviation than the broader U.S. large cap market. Our preference for **dividend-paying companies** is further supported by: a) attractive fundamentals, including healthy balance sheets and ample free cash flow to support sustainable growth, b) confidence in their ability to maintain and potentially expand profit margins despite cost inflation and c) management teams committed to returning capital to shareholders.

While dividends – and dividend growth – are not guaranteed, they tend to be more predictable and consistent than earnings growth, providing investors with a cushion against market volatility. We believe investing in dividend growth stocks is well-suited to active management, which allows for due diligence to analyze individual companies and find those with the financial ability to maintain and increase their dividends regardless of the economic

environment. Although we still expect equity markets to move higher over the coming quarters, gains will likely be more modest than those of the past several years (and accompanied by higher volatility). Dividends, meanwhile, should represent a larger component of total return, in our view.

In fixed income, two areas stand to perform well amid tariff uncertainty. **Preferred securities** benefit from strong fundamentals, attractive valuations and supportive technicals. First quarter earnings for banks – the largest issuer of preferreds – were strong, with most beating consensus estimates and none altering their loan loss expectations.

Additionally, certain preferreds pay qualified dividend income, which is taxed at a lower rate of 20% compared to higher ordinary income taxes. Market technicals for preferreds are also positive, with robust demand as investors seek high-quality, tax-efficient income solutions.

We also favor **securitized assets**, which encompass sectors such as asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS). Careful credit selection in these categories could provide both attractive returns and healthy income.

While the Bloomberg U.S. Aggregate Bond Index (Agg), a broad-based investment grade benchmark, includes securitized assets in its universe, it allocates only to the largest issuances. By investing in smaller ABS and CMBS issues, investors can access yields that are currently 100+ bps higher than those available within the Agg. And though securitized sectors have a shorter duration relative to the Agg as a whole, it’s long enough to benefit from falling interest rates, which we expect this year.

**Municipal bonds** are another area with lower tariff exposure, as municipalities generally don’t purchase or sell goods across borders. Spreads have narrowed for both investment grade and longer-duration, high yield munis but have widened year-to-date by 15 bps for short-duration high yield, offering a compelling relative value opportunity.

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Muni-to-Treasury yield ratios have continued to creep higher, with the 5-, 10- and 30-year ratios now at 82%, 82% and 96%, respectively, representing multiyear highs. While these elevated ratios haven't been a positive for recent performance, they can provide favorable entry points for investors. Thanks to these higher ratios, investment grade, intermediate-term munis offer a taxable-equivalent yield north of 6% for those in the highest federal income tax bracket.

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

Endnotes

Sources

Federal Reserve Statement, May 2025.

Bloomberg, L.P.

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