

What You Need to Know About First Rate Cuts

The clear message from Wall Street leading up to this week's long-awaited Fed policy announcement is that interest rate cuts are overwhelmingly bullish!

Stocks will embark on a run of gains unseen in 30 years after the Fed cuts rates, Wells Fargo strategy chief says

– Business Insider, 8/15/2024

Retail investors are bullish on stocks ahead of the Fed's rate cut next month – MarketWatch, 8/29/2024

However, a deep dive into historical first rate cuts reveals that they are not universally bullish after hiking cycles. And in today's high-risk environment, the initial cut could actually be a sign of danger.

Performance After 1 st Discount Rate Cut (Following 2 or More Rate Hikes)			
Rate Cut Date	DJIA Gain/Loss		
	+3mo	+6mo	+12mo
12/18/1914	2.7%	28.8%	77.1%
05/05/1921	-14.3	-7.6	16.4
05/01/1924	10.9	13.1	31.5
04/23/1926	9.0	4.9	17.0
08/05/1927	3.1	7.5	18.5
11/04/1929	4.2	0.2	-28.1
02/26/1932	-39.1	-9.3	-38.0
04/07/1933	79.2	67.1	76.3
02/05/1954	8.2	18.3	39.4
11/15/1957	1.2	4.2	28.5
06/10/1960	-6.2	-6.7	7.0
04/07/1967	1.8	8.8	1.5
08/30/1968	9.9	1.0	-6.6
11/13/1970	17.0	23.2	7.0
12/09/1974	32.8	43.1	42.1
05/28/1980	8.1	15.5	15.6
11/02/1981	-1.6	-2.1	17.9
12/19/1990	9.2	12.5	11.0
01/31/1996	3.2	2.5	26.3
01/03/2001	-13.3	-3.4	-7.1
08/17/2007	0.7	-5.6	-10.9
07/31/2019	0.7	5.2	-1.6
09/18/2024	?	?	?

Periods when DJIA fell -10% or more in 24mo prior to 1st rate cut
 Periods when DJIA rose +10% or more in 24mo prior to 1st rate cut

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The small table at right summarizes this analysis well. When the DJIA lost -10% or more in the 24 months leading up to a first rate cut, gains in the following 12 months were typically strong with an average of almost +30%. On the contrary, when the DJIA rose +10% or more in the 24 months leading up to a first rate cut, the following 12 months often saw minimal gains or even losses with an average of only +2.6%.

The table at left shows all instances of a first Discount Rate cut after a hiking cycle going back to 1914 and the market performance that followed using the Dow Jones Industrial Average (DJIA). To focus on true reversals in monetary policy and avoid anomalies and adjustments, we specifically looked at those cuts coming after two or more rate hikes.

While all periods were different, there is a notable and logical relationship. **One of the most telling factors for market performance after the Fed starts easing is the gain or loss leading up to the first rate cut.**

- Periods when the market had fallen -10% or more in the 24 months before the initial cut are highlighted in yellow. In these cases, subsequent performance was typically strong. For example, in the 24 months leading up to the 1974 rate cut, the Index was already down -44% and in a significant bear market. In response, the Fed cut rates and the DJIA rebounded, gaining +42% over the next twelve months.
- Periods highlighted in blue are when the market increased +10% or more in the 24 months before the cut. In these instances, subsequent performance tended to be subdued – and in some cases, negative. For example, in 2007 the market was up almost +24% in the 24 months preceding the first rate cut, but the DJIA actually lost -11% in the following twelve months. Furthermore, the total bear market losses that followed in 2008 and 2009 were in excess of -50%!

There are clearly exceptions to this relationship, though some of those easing cycles ultimately led to bubbles that inevitably popped, like the cuts prior to the '29 Crash and the late '90s Tech Bubble.

DJIA Performance (1914 to Current)	
Gain/Loss 24mo before Discount Rate Cut*	Avg Gain/Loss 12mo after Discount Rate Cut*
≤ -10%	29.9%
≥ +10%	2.6%

*1st cut following 2 or more rate hikes

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This time around, the Dow Jones Industrial Average has increased 35% in the 24 months leading up to this week's rate cut. Such strong gains in the last 2 years suggest that investors would be wise to temper expectations for impressive market performance from here. Bottom line, those who invest aggressively and assume this rate cut will automatically have a bullish outcome could be betting against history!