US stock market ideas for US Federal Reserve rate cuts

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Ayush Babel
Director, Quantitative Research

Jeff Weniger, CFA
Head of Equity Strategy

Key Takeaways

- Pairing the WisdomTree US Quality Dividend Growth ETF (DGRW) for its downside resilience with WisdomTree US Quality Growth ETF's (QGRW) growth exposure could provide investors with a diversified mix. This strategy may balance stability and potential growth in various market conditions.
- The US's sector performance after rate cuts has been uneven, with Consumer Discretionary and Health Care historically outperforming while Communication Services and Utilities underperforming.
- The impact of rate cuts on broader markets is uncertain. While rate cuts sometimes boost returns (e.g., post-1998), the cycles that commenced in 2001, 2007, and 2019 were followed by stock market declines. A diversified equity bond portfolio such as the WisdomTree US Efficient Core UCITS ETF (NTSX) could reap the benefits of rates going down and act as a hedge if stock markets decline without giving up equity exposure.
- This blog is a summary of our article US stock market ideas for fed rate cuts which sets out a variety of potential investment strategies in response to the US Federal Reserve rate cuts. The full article is available **here**.

With the US Federal Reserve's (Fed) anticipated rate cuts on the horizon, investors are questioning how best to position themselves to navigate these changes. Historically, the performance of stocks following rate cuts has varied widely, leading to both market rallies and declines. The article delves into several strategies that could benefit from rate cuts or help mitigate risks in case of a downturn. Here are three strategies discussed: the WisdomTree US Quality Dividend Growth UCITS Strategy (DGRW), the WisdomTree US Quality Growth UCITS Strategy (QGRW), and the WisdomTree US Efficient Core UCITS Strategy (NTSX).

Let's examine how these strategies can be used effectively and what lessons investors can learn from historical patterns of rate cuts.

Pairing DGRW and QGRW for balanced exposure

DGRW and QGRW can serve as a balanced approach for investors seeking downside protection and potential growth. DGRW focuses on dividend-paying stocks with a history of profitability, which tend to perform well during economic uncertainty or downturns. On the other hand, QGRW provides exposure to growth stocks, including high-quality tech and innovation-focused companies, offering more potential upside.

This combination is likely to create a diversified portfolio that could withstand various market conditions. By blending DGRW's focus on steady dividend payers with QGRW's growth exposure, investors could potentially balance their portfolios to manage risk while still capturing possible growth opportunities.

The case for NTSX: A diversified equity-bond strategy

The WisdomTree US Efficient Core UCITS ETF (NTSX) is designed to offer exposure to both equities and bonds in a diversified, leveraged structure. With a 1.5x leveraged exposure to US equities and bonds, the fund seeks to provide equity-like returns while hedging against downside risks. This approach is useful when rate cuts may not lead to the desired market outcomes, and investors must protect themselves from potential stock market declines.

During previous market downturns, bond markets have often rallied as investors sought safety. NTSX could benefit from such a scenario, as its bond exposure provides a hedge against equity losses. Furthermore, if equities continue to perform well, the fund's equity exposure ensures that investors don't miss out on potential gains.

Sector performance post rate cuts: What history tells us

Historically, the impact of rate cuts on the broader stock market has been inconsistent. While rate cuts have sometimes triggered market rallies, as seen after the cuts in 1998, the Fed's easing cycles in 2001, 2007, and 2019 were followed by market declines. This suggests that investors should be cautious when assuming that rate cuts will automatically boost stock market returns.

For instance, sector performance post rate cuts has varied significantly. Consumer Discretionary and Health Care stocks have typically outperformed the broader market in eight of the last 11 rate-cutting cycles. In contrast, sectors like Communication Services and Utilities have often underperformed. This trend reflects the differing sensitivities of various industries to changes in interest rates. Consumer-facing and healthcare industries tend to benefit from lower borrowing costs and increased consumer spending, while highly regulated sectors like Utilities may suffer due to rising operational costs or stagnant demand.

It's also worth noting that sectors evolve over time. For instance, today, the Communication Services sector includes social media and gaming companies, which adds volatility compared to the traditional telecom companies it once encompassed. Similarly, Utilities may benefit from the rise of artificial intelligence (AI) as energy consumption increases in data centres, although recent performance has been mixed.

Lessons from past fed easing cycles

Looking at past Fed easing cycles, it's clear that rate cuts don't always lead to sustained market rallies. While the 1998 cuts helped extend the bull market of the late 1990s, the cuts that began in 2001 and 2007 were followed by prolonged market declines. Similarly, after the 2019 cuts, the market tanked during the early stages of the COVID-19 pandemic in 2020. These historical precedents suggest investors should be wary of assuming that rate cuts will lead to immediate market gains.

Instead, diversification and risk management should be prioritised. The article shows that combining DGRW and QGRW **appears to create** a portfolio that **may perform** well across various economic conditions, while NTSX could provide additional protection through its bond exposure.

Final thoughts: How should investors play rate cuts?

The upcoming Fed rate cuts present both opportunities and risks for investors. While specific sectors and strategies may benefit from lower rates, it's essential to remain cautious and diversified. The combination of DGRW and QGRW appears to balance stability with growth potential, while NTSX may provide a unique perspective with a leveraged 90-60 equity-bond exposure.

Ultimately, the success of any strategy in a rate-cutting environment will depend on multiple factors, including economic conditions, inflation trends, and the Fed's ability to manage the soft landing it aims to achieve. By looking to history and maintaining a diversified approach, investors can better navigate the uncertainty surrounding rate cuts and position their portfolios for potentially higher risk-adjusted returns.

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