Fed Watch: “Risk Management” Continues

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Key Takeaways

- The Federal Reserve’s October rate cut, to 3.75%–4%, signals a continued “risk management” approach, with December’s policy path tilting toward another cut.
- Despite core CPI and PCE remaining above target, the Fed is more focused on the employment part of their dual mandate.
- Investors should prepare for a potentially neutral policy stance, around a 3.5% Fed Funds Rate, with one more cut likely—making Treasury positioning increasingly data-dependent.

As was widely expected, the Federal Open Market Committee (FOMC) implemented another 25-basis point (bp) rate cut at the October FOMC meeting, bringing the new Fed Funds trading range down to 3.75%–4%. With the resumption of rate cuts now at round two, and Chair Powell referencing the resumption of rate cuts as a “risk management” approach, the more pertinent question is what will the Fed have in store for the markets at the December FOMC meeting and in 2026?

First up, let’s look at the key factor in the Fed’s current decision-making process, namely the labor market backdrop. Although the Fed does focus on their dual mandate of employment and inflation, there is no question the primary focus right now is on the employment side of the equation, especially given the recent stalling out in new job creation.

However, at some point, if upcoming jobs data does not deteriorate any further, the policy makers could shift their attention back to an equal weighting for inflation. It is interesting that recent reports on inflation, such as the Consumer Price Index (CPI), have not revealed any meaningful tariff-induced impact, yet. But, the underlying data has shown that the spring bout of disinflation is over and that price pressures are now grinding higher. In fact, core CPI is running at an annual rate of 3% and moving further away from the Fed’s 2% target. For the record, the Fed’s preferred inflation measure, core personal consumption expenditures (PCE), is also moving further away from the target at 2.9%.

Looking ahead, monetary policy still seems skewed toward for further rate cut(s), but how many may be forthcoming is the great unknown at this point. The voting members seem to be tilted toward another rate cut at the December FOMC meeting, but the outlook for next year is more cloudy. Once again, there is a disconnect between the Fed’s own projections and what the money and bond markets are expecting. Indeed, the most recent dot plot from the policy makers looked for only one rate cut in 2026. However, the

implied probability for Fed Funds Futures stood at three easing moves prior to the just-completed FOMC gathering.

Don't forget the balance sheet. The Fed also announced that quantitative tightening (QT) will come to an end on December 1st.

The Bottom Line

Based upon the broader economy pre-government shutdown, there doesn't seem to be a need to go into an accommodative phase for policy just yet. It may be that just getting back to neutral will do. This is a point Powell & Co. have been making as well. Now what is a neutral Fed Funds Rate? That is the key question. If you believe it begins at perhaps 3.5%, then investors could expect to see one more quarter-point rate cut forthcoming before a potential pause. Besides the most recent CPI report, both the Fed and the bond markets continue to await fresh official economic data. And, once the shutdown does end, it could very well be a deluge of information that gets released. Against this backdrop, any moves beyond a "risk management" one will certainly be data-dependent, especially on the employment front.