Fade Rate Cut Cycle Gameplan

Last Wednesday, Jerome Powell announced the first rate cut by the Fed since the onset of the pandemic, a significant 0.5% reduction. Typically, during the so-called blackout period preceding a Fed decision, there is about a 90% certainty regarding the outcome. However, this time the situation was less clear: just before the decision, the probability of a 0.5% cut was about 55%, while a 0.25% reduction was priced at 45%. This uncertainty created heightened anticipation up until the announcement.

The financial markets, which have been highly responsive to economic data and Fed communications in recent months, welcomed the rate cut with a new all-time high for the S&P 500, reflecting optimism about a successful soft landing. Whether the Fed will achieve such a scenario or whether the monetary measures might lead to a recession, or a hard landing, remains a key focus in the coming weeks and months. For investors, the crucial question now is how to position their portfolios ahead of the upcoming rate cut cycle and which asset classes could benefit depending on the scenario.

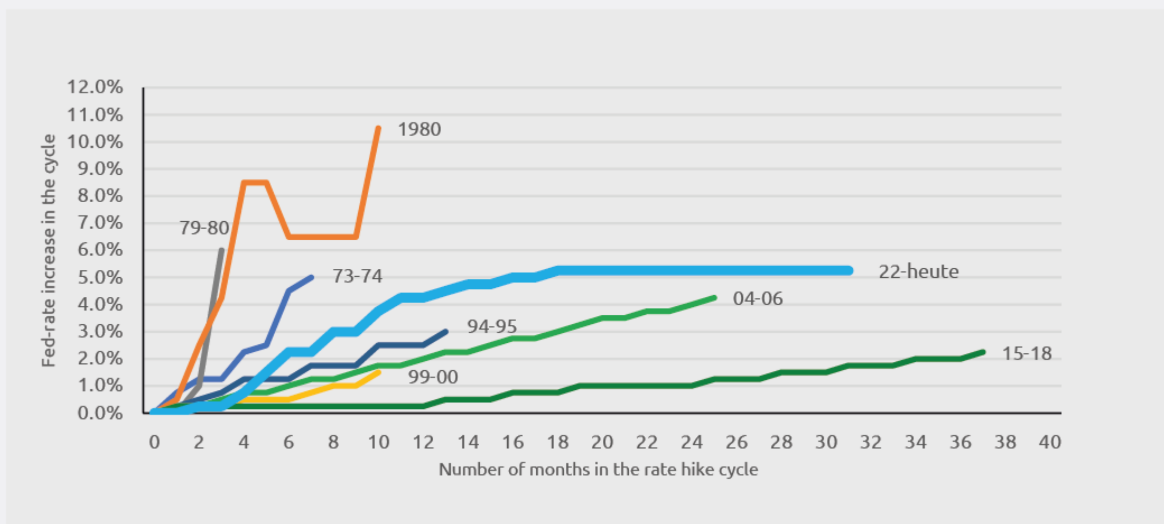
In the following brief analysis, we place the recent rate hike cycle in a historical context and compare the performance of the equity markets during similar phases. We then differentiate between a soft-landing and a hard-landing scenario, analyzing the historical performance of various asset classes and strategies during past rate cut cycles.

The Most Aggressive Rate Hike Cycle in Decades

Between March 2022 and July 2023, the Fed raised interest rates by a total of 5.25 percentage points over 11 steps, marking the steepest increase since 1980. Initially, concerns arose that the combination of high inflation and rapidly rising rates could severely damage the economy, leading to a correction in the stock markets. However, these fears quickly subsided, and the markets reached new all-time highs, with a remarkable performance in 2023 and further records being set in 2024.

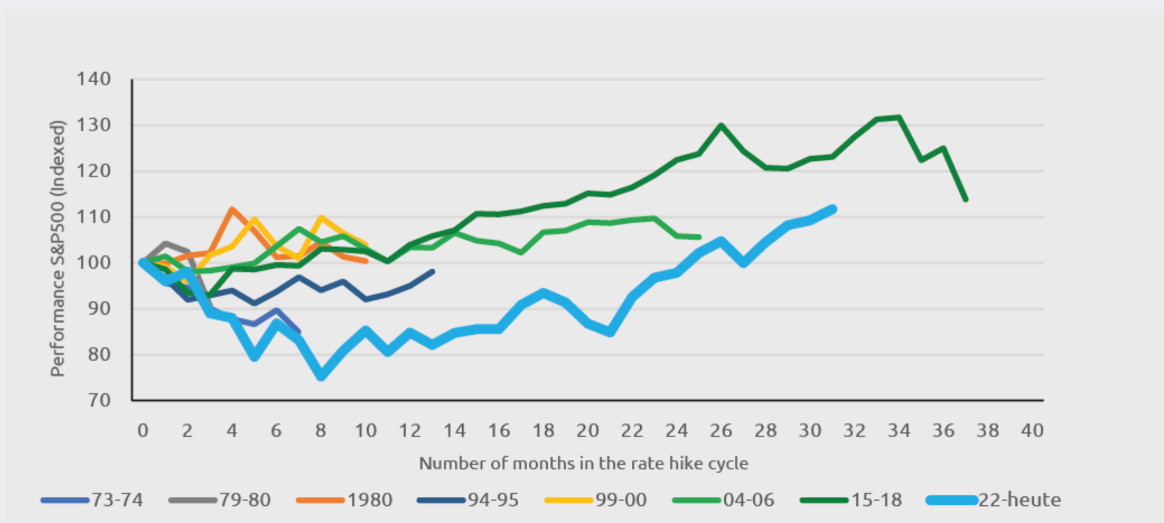
Historical data shows that the relationship between Fed rate hikes and stock market performance is not straightforward. Although restrictive monetary policy is generally considered negative for equity markets, the outcomes in 2023 and 2024 appear paradoxical. This is because major market corrections typically occur towards the end of the rate cycle or during rate cuts. During subsequent rate cut cycles, equity markets are often prone to sharp volatility and price corrections as the risk of recession peaks during this phase.

Pace of Fed Rate Hike Cycles Over Time



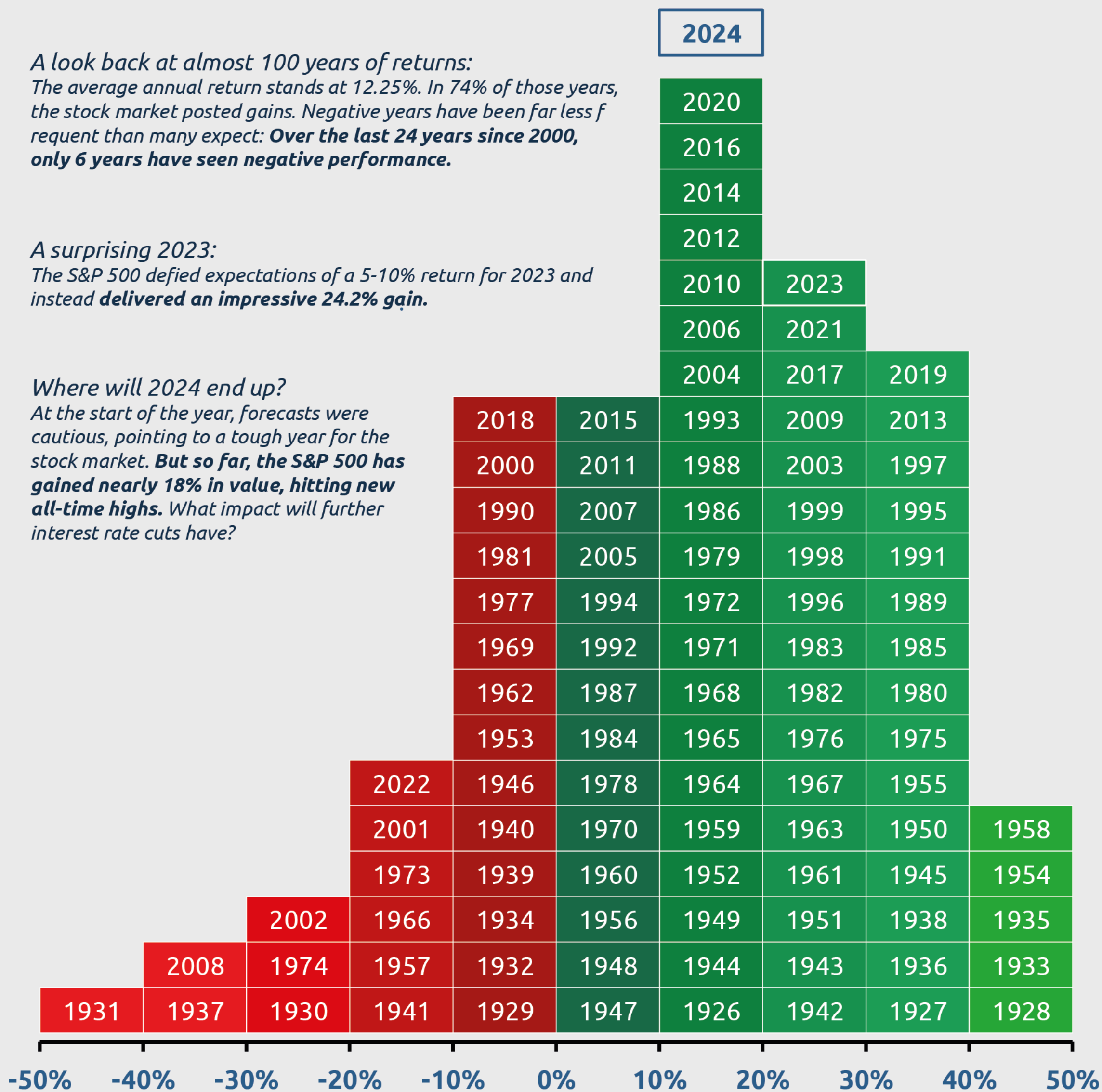
Source: Data from Bloomberg, MacroTrends, Fred

S&P 500 Performance During Fed Rate Hike Cycles



Source: Data from Bloomberg, MacroTrends, Fred

S&P 500 Returns for Every Year - from 1926 to 2024



Source: Daten von MacroTrends

Soft-Landing vs. Hard-Landing

In monetary policy, two potential economic reactions to interest rate hikes are distinguished: a soft landing and a hard landing. A soft landing can be observed, for example, between 2015 and 2018, when the Fed, under Janet Yellen and Jerome Powell, gradually raised interest rates. After years of low rates, the Fed sought to gently cool the economy and control inflation. Despite the rate increases, the U.S. economy remained stable, and a recession was avoided—an example of a successful soft landing.

In contrast, a hard landing occurred in 2000-2001. During the Dotcom boom, the Fed aggressively raised interest rates to prevent overheating. This restrictive policy contributed to the bursting of the Dotcom bubble, leading to the subsequent recession. This demonstrates how overly tight measures can result in an abrupt economic downturn.

While a recession, unlike a financial crisis, is often only identified in hindsight, different economic phases clearly show varying performances across asset classes and strategies. A financial crisis reflects deeper systemic issues, leading to sharper and faster disruptions, whereas recessions tend to have more moderate and gradual impacts on the economy.

When Do Asset Classes Perform Best? A Historical Overview

A historical comparison reveals that riskier assets suffer the most during a hard landing. Stock markets come under significant pressure, and bonds from risky issuers also experience downward corrections. Given that U.S. recessions often have global effects, international and Swiss equity markets typically mirror this weakness.

Commodities also perform poorly during periods of weak economic activity and declining inflation, as excess supply meets an abrupt drop in demand. Real estate markets, while sensitive to recessions, show regional differences since they are often considered local markets. For instance, Swiss real estate prices remained stable during U.S. recessions.

In times of crisis, government bonds, the U.S. dollar, the Swiss franc, and gold have historically provided reliable safety and are considered classic safe-haven assets for investors.

Average Return 12 Months After the First Fed Rate Cut Since 1984 (in USD), Differentiated by «Soft Landing» and «Hard Landing»

	Assetklasse / Strategie	«Soft-Landing»	«Hard-Landing»
Equity	US Growth	23%	-5%
	US Large Cap	20%	-6%
	US Value	17%	-10%
	US Small Cap	15%	-10%
	International ex. US	23%	-13%
	Swiss Equities	20%	-11%
Real Assets	Commodities	5%	-11%
	Gold	-2%	5%
	US Real Estate	7%	-7%
	CH Real Estate	4%	-1%
CCY	CHF	-2%	2%
	US Dollar Index	-2%	3%
Fixed Income	US Money Market	5%	2%
	US 2Y Treasuries	7%	8%
	US 10Y Treasuries	5%	9%
	US High Yield	6%	-3%

Notes: A 'Soft Landing' includes the rate cut cycles that began in 1984, 1995, and 1998. A 'Hard Landing' includes the rate cut cycles that began in 1989, 2001, 2007, and 2019. US Growth: Russell 1000 Growth, US Large Cap: S&P 500, US Value: Russell 1000 Value, US Small Cap: Russell 2000, International ex. US: MSCI AC World ex US, Swiss Equities: Swiss Market Index, Commodities: Bloomberg Commodity Index, US Real Estate: Dow Jones US Real Estate Index, CH Real Estate: Swiss Real Estate Funds Broad Index, US Money Market: Bloomberg US Treasury Bills (1-3M), US 2Y Treasuries: Bloomberg US Treasury Bellwether (2Y), US 10Y Treasuries: Bloomberg US Treasury Bellwether (10Y), US High Yield: Bloomberg US High Yield – Corporate.

Source: Data from Bloomberg

If the Fed Achieves a Soft Landing, the Picture Changes Dramatically. In such scenarios, stocks typically see significant gains, especially in riskier segments like growth stocks and international markets. Real estate benefits from strong economic demand, and commodity prices rise as the economy remains stable.

In contrast, assets traditionally considered safe havens underperform. Government bonds still deliver positive returns as interest rates decline, though less sharply than in a hard landing, leading to capital gains.

Strategic Positioning for the Next 12 Months

If the Fed successfully navigates a soft landing, 2024 and 2025 could be strong years for the stock market. In this scenario, a classic 60/40 portfolio (60% stocks, 40% bonds) would be advantageous, with growth and tech stocks presenting attractive investment opportunities.

However, if a recession is expected or investors want to hedge more against potential risks, a higher allocation to safe bonds, money market instruments, and gold would be recommended. Defensive, large-cap companies should also be given greater weight until the economic situation stabilizes.

Which Scenario Will Ultimately Play Out?

A definitive prediction remains speculative. Currently, market optimism and various expert analyses suggest a high likelihood of a soft landing. However, critics point to rising unemployment and signs of consumer weakness. Particularly concerning is the inverted yield curve, one of the strongest indicators of recessions, which raises fears of a rapid deterioration in the economic outlook.

A prominent voice in this discussion is Jamie Dimon, CEO of JP Morgan, known for his critical viewpoints. He predicted the 0.5% rate cut and warns of a potential economic scenario worse than a recession: stagflation.

It's crucial to closely monitor economic developments and analyze current relevant data to identify shifts in economic dynamics early and act accordingly. However, it's important to remember that «time in the market» often outperforms «timing the market.» Potential price corrections are not a reason to liquidate portfolios; instead, they offer unique buying opportunities. Those waiting for a recession that may never come risk missing out on attractive returns. A long-term position and strategy are essential for sustainable wealth creation.

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smzh ag
Tödistrasse 53, CH-8002 Zürich
+41 43 355 44 55
contact@smzh.ch
www.smzh.ch