

# A new rate regime calls for a closer look at your investment game plan

**From the Field**  
October 2024



## Key Insights

- The Federal Reserve lowered interest rates by 50 basis points (bps) in September 2024, and ushered in a new cycle of interest rate cuts.
- Prior rate-cutting cycles lasted 16 months on average, with a range of five to 40 months. About 50% of cycles lasted one year or less and 25% lasted two years or more.
- The performance of U.S. large-cap stocks was positive 75% of the time during previous rate-cutting cycles, and they tended to perform better in the second half of such cycles. Bonds and cash had positive performance in 100% of prior cycles.
- On average, stocks outperformed bonds and cash over a full rate-cutting cycle, particularly over the second half.
- Based on our analysis, investors should take a thoughtful approach to portfolio construction during rate-cutting cycles, but history suggests performance concerns may be exaggerated.



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Interest rates and expectations about the next Federal Reserve decision are always important topics in our Portfolio Construction Solutions team's discussion with financial advisors. In September 2024, the Fed cut the federal funds rate by 50 bps (one basis point is equal to 0.01%) after being on pause for more than a year, signaling a regime change. In this portfolio construction insight, we'll take a look at how previous rate-cutting regimes impacted the performance of stocks, bonds, and cash. Our goal is to arm you

with the information to make informed decisions for you and your clients.

## Prior rate-cutting cycles averaged about 16 months, and the average cut was 453 bps.

T. Rowe Price's Multi-Asset Division recently published research on interest rate-cutting cycles, identifying 12 such regimes since January 1954 (Figure 1). Cycle duration has ranged from five

months to 40 months, with the average regime lasting 16 months. A standard deviation of 11 months, however, suggests that there is a good deal of variability in cycle duration. In simple terms, about half of the cycles lasted one year or less, and about half lasted longer than one year. Twenty five percent of the cycles lasted two years or more. Importantly, interest rates fell by between 75 bps and 1,050 bps during these cycles, and the average decrease was 453 bps.

## Stocks, bonds, and cash were positive in most or all of prior rate-cutting cycles.

We evaluated the performance of U.S. large-cap stocks, bonds, and cash over prior cycles (Figure 1). But before we discuss this performance, please keep in mind that there are only 12 cycles, and some are very short, especially if split in half. While no data covering past performance can be reliable indicators of future results, we believe the analysis can be informative.

- Cash was positive in all time periods, with cumulative returns ranging from 1% to 22%. However, the range dropped to between 1% and 6% when we omitted the 1980s rate-cutting cycles.
- Bonds were positive and beat cash in all time periods. As with cash, the range dropped to between 2% and 22% when we excluded the 1980s cycles.
- Stocks were positive in 75% of the cycles, with returns ranging from -39% to +64%. Excluding 1980s cycles, the return shifts to between -39% and +31%. Stocks beat bond returns in 58% of the rate cycles and beat cash returns in 75% of the cycles. Of note, the last three cycles were the only three with negative equity returns.

## Bonds and cash were positive in 100% of prior Fed cutting cycles, and stocks rose 75% of the time.

(Fig. 1) Cumulative returns of stocks, bonds, and cash in the prior 12 Fed rate-cutting cycles

						Cumulative Return During Cycle (%) <sup>†</sup>		
Start	End	Fed Funds Target Rate	Length (months)	Number of cuts	Drop in Fed Funds (bps)	Stocks	Bonds	Cash
Nov. 1957	May 1958	3.5% to 0.13%*	7	5	337	7.8	5.6	0.9
Mar. 1960	Jul. 1961	4.0% to 0.5%*	16	9	350	25.8	7.0	3.0
Dec. 1966	Apr. 1967	5.75% to 4.0%*	5	4	175	18.1	2.0	1.5
Mar. 1970	Feb. 1971	8.5% to 3.38%*	12	8	512	11.7	15.0	5.4
Aug. 1974	May 1975	9.25% to 5.13%	10	7	412	31.0	11.1	5.0
Aug. 1981	Dec. 1982	19.0% to 8.5%	17	8	1,050	23.6	46.6	15.5
Sep. 1984	Aug. 1986	11.63% to 5.88%	24	11	575	64.4	48.2	15.0
Jun. 1989	Sep. 1992	9.75% to 3.0%	40	18	675	46.4	42.0	21.8
Jul. 1995	Jan. 1996	6.0% to 5.25%	7	3	75	14.5	7.3	2.7
Jan. 2001	Jun. 2003	6.5% to 1.0%	30	12	550	-25.9	22.3	5.6
Sep. 2007	Dec. 2008	5.25% to 0.25%	16	8	500	-39.1	8.4	2.6
Aug. 2019	Mar. 2020	2.5% to 0.25%	8	4	225	-10.7	2.8	1.0
<b>Average</b>			16	8	453	14.0	18.2	6.7
<b>Median</b>			14	8	456	16.3	9.7	4.0
<b>St. Deviation</b>			11	4	258	28.9	17.4	6.9
<b>Range - Minimum</b>			5	3	75	-39.1	2.0	0.9
<b>Range - Maximum</b>			40	18	1,050	64.4	48.2	21.8

### Past performance is not indicative of future results.

Stocks = Ibbotson SBBI U.S. Large Stock; bonds = Bloomberg U.S. Aggregate Bond Index (from January 1976 to July 2024) and Ibbotson SBBI U.S. Intermediate-Term (5-Year) Government Bonds (from November 1957 to December 1975); cash = Ibbotson SBBI U.S. (30-Day) Treasury Bills.

\* Using the Fed Funds Effective Rate.

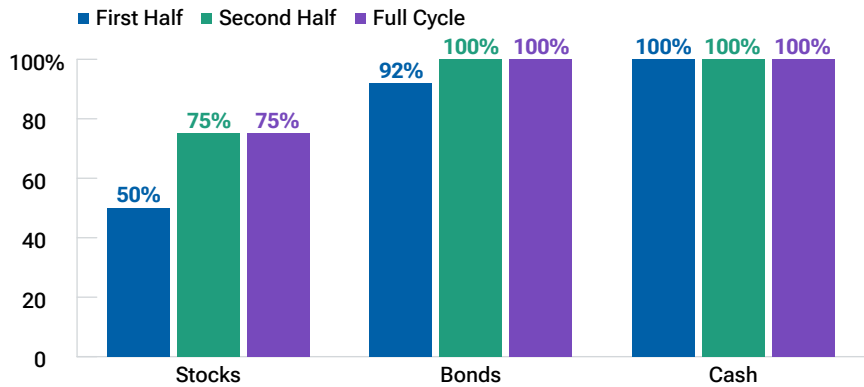
<sup>†</sup> Measurement period excludes the month in which the first cut took place.

Sources: FactSet, Morningstar, and Federal Reserve Economic Database, analysis by T. Rowe Price.

Figure 2 further breaks down the asset class performance in each cycle into three time periods: The first half of the cycle, second half of the cycle, and the full cycle. In general, the hit rate (the percentage of instances a stated result is achieved) of positive returns for U.S. large-cap stocks looked good across the full cycle and in the second half of the cycle. Stocks moved from a 50% to 75% success rate from the first half to the second half of prior cycles.

**The hit rate of positive returns for stocks, bonds, and cash were largely positive throughout prior rate-cutting regimes.**

(Fig. 2) Chance of positive cumulative return by asset class in prior Fed rate-cutting cycles



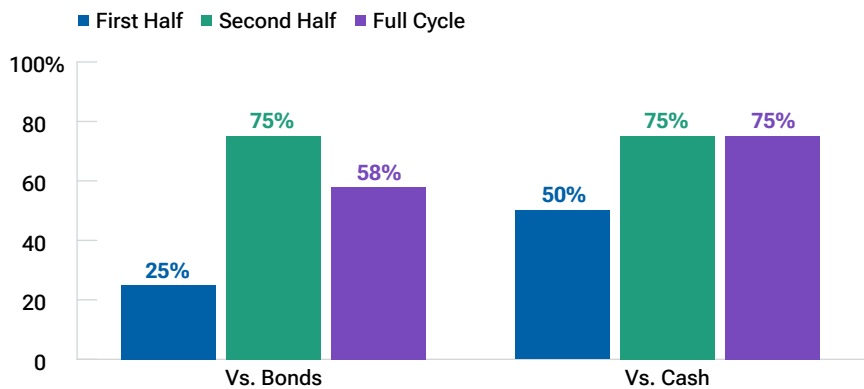
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Figure 3 suggests that U.S. large-cap stocks tended to underperform in the first half of a cutting cycle, with success ratios of 25% and 50% versus bonds and cash, respectively (success ratio refers to the percent of time that stocks outperformed other asset classes). In the second half of the cycle, however, stocks performed much better on a relative basis, with success ratios of 75% versus both bonds and cash. Over a full cycle, stocks had a 58% success ratio over bonds and 75% success ratio over cash.

**Stocks tended to lag bonds and cash early in prior rate-cutting cycles but outperformed over second half.**

(Fig. 3) Success ratio of U.S. large-cap stocks vs. bonds and cash in prior rate-cutting cycles

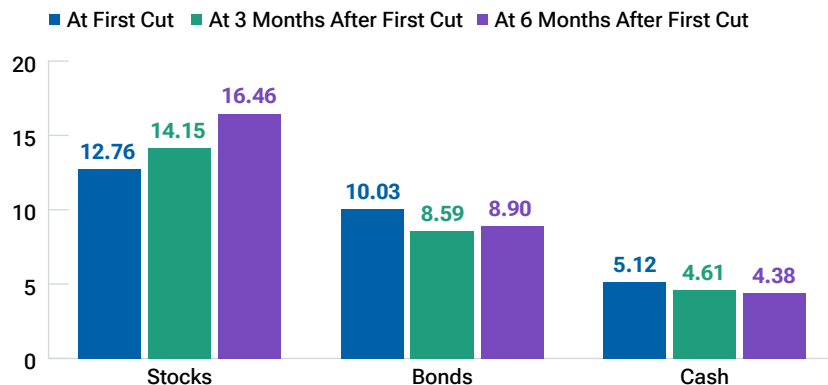


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## Stocks tended to perform better as they moved further away in time from first rate cut, while bonds and cash were lower but still positive.

(Fig. 4) Average 12-month forward return of stocks, bonds, and cash during prior rate-cutting cycles\*



### Past performance is not indicative of future results.

\*Measurement period excludes the month in which the first cut took place.

Stocks = Ibbotson SBBI U.S. Large Stock; bonds = Bloomberg U.S. Aggregate Bond Index (from January 1976 to July 2024) and Ibbotson SBBI U.S. Intermediate-Term (5-Year) Government Bonds (from November 1957 to December 1975); cash = Ibbotson SBBI U.S. (30-Day) Treasury Bills.

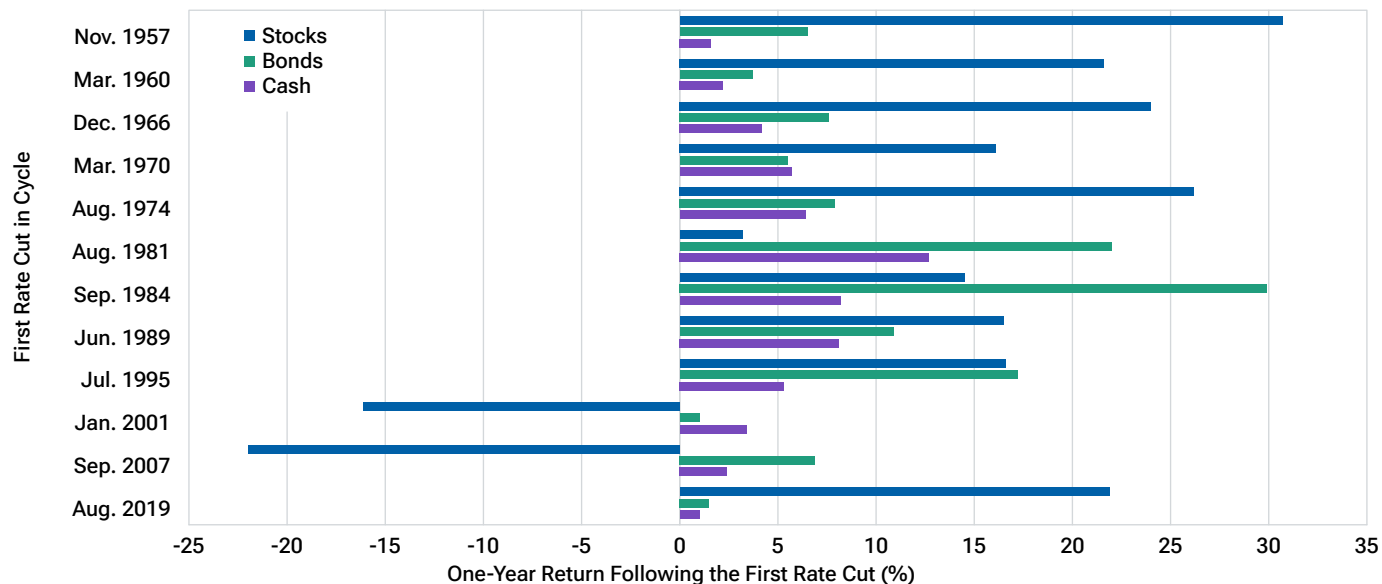
Sources: FactSet, Morningstar, and Federal Reserve Economic Database, analysis by T. Rowe Price.

In Figure 4, we looked at the average 12-month returns at different starting points: At the time of the first cut, three months after the first cut, and six months after the first cut. It's clear that stocks tended to perform better on average the further removed they were from the first cut. Bonds performed best at the first rate cut and declined modestly in subsequent periods. Not surprisingly, cash declined the further in time we moved from the first rate cut.

Figure 5 shows the 12 month return of stocks, bonds, and cash following the first rate cut of the cycle. As shown, the three asset classes generally fared well over the 12 months following the initial rate cut, although there was a wide range of outcomes, particularly for stocks.

## Stocks, bonds, and cash typically delivered solid gains over the 12 months following initial rate cuts in prior cycles, but there were wide variations.

(Fig. 5) Cumulative return of stocks, bonds, and cash 12 months after initial rate cuts



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Sources: FactSet, Morningstar, and Federal Reserve Economic Database, analysis by T. Rowe Price.

## What does it mean for financial professionals?

At the start of the current cycle, the Fed is lowering interest rates with the economy still in pretty good shape. This is in contrast to most prior cycles, which typically began with declining GDP growth. Moreover, stock valuations are high, likely reflecting a relatively favorable economic environment. And while past performance is not indicative of future returns, our analysis suggests that investors could consider reallocating their portfolios for the new rate-cutting regime.




- Rate-cutting cycles typically average 16 months.
- Overall, past rate-cutting cycles have been supportive of positive absolute returns. Stocks were positive in 75% of the cycles, while bonds and cash were positive in all cycles in our analysis.
- If we split the rate-cutting cycles into halves, stocks tended to lag in the first half versus cash and bonds, but they outperformed cash and bonds 75% of the time in the second half.
- Bonds beat cash in all cycles, so think about redeploying cash into bonds.
- If you or your client are not ready to reallocate today, consider developing a game plan for how to position your portfolios for this new interest rate regime. For example, determine specific actions that you'll take once certain milestones are reached, such as three months after the first rate cut.

## Portfolio Construction Solutions from T. Rowe Price can help.

If you're seeking information on ways to position your portfolios for a new interest rate regime, we can help. Supported by the multi-asset experience and global resources of T. Rowe Price, our integrated suite of Portfolio Construction Solutions is designed to address your portfolio construction needs and help position your practice for success.

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