FRIDAY, SEPTEMBER 19, 2025

Hello and welcome to the Friday Dividend Cafe. I am your host, David Bahnsen, here every single Friday to discuss the latest market commentary with you. Whatever happens to be on my mind and inspiring me for that week and this week, you will be shocked to know it is all things Fed. Even though we've all known the Fed announcement was coming on Wednesday of this week, even though we've all known that the Fed was gonna be cutting rates, there was still some ambiguity for me by Wednesday as to what exactly I wanted to write about and talk about in this week's Dividend Cafe. And then as the Fed announcement came, and it was exactly what was expected, and then chairman Powell did his press conference, it was the aftermath of media coverage of it and a lot of other analysts not just, media pundits but people in the markets of various comments heard that inspired me to say, “Yes, I will go with the cliche topic of the week, which is, ‘the Fed’, because I think that there is enough information out there that I do not agree with, that I feel morally compelled to use the Dividend Cafe to come offer this clarification to our listeners and viewers and watchers and most importantly, to our clients.” So we're gonna talk about what the Fed did. We're gonna talk about what they said. We're gonna talk about my take on what it all means, and there's some fun little drama.

Playing into all this as well, I'll share with you, the simple part is what they did, they cut the Fed funds rate to what it, by a quarter of a point, which was, is a range of four to four and a quarter. Previously it had been a range of four and a quarter to four and a half. And so it's always simple or to just say one particular number, but they technically set a target range to give themselves about 25 basis points of bandwidth.

And it usually an actual market in terms of the bank, overnight lending rate is somewhere in the middle of that target. So they lowered a quarter point and we sit there at that four to four and a quarter range. They did address the quantitative easing side, the issue with their balance sheet that so few people like to talk about.

And I remain somewhat fascinated by the fact that they are still doing quote unquote, quantitative tightening at all when they're now doing, and I'm not making this up $5 billion a month. There is. At one point there was $9 trillion on their balance sheet, and they got that below 7 trillion. But sitting there somewhere in the high sixes on their total balance sheet, and right now letting 5 billion a month of treasuries roll off.

So as they mature they're reinvesting all proceeds, but 5 billion, meaning they're reducing by that five. Now there is also 35 billion a month of mortgage-backed securities. That is they mature. They're reinvesting them in treasuries so they're not rolling off that amount off their balance sheet.

In other words, that 35 billion a month from mortgage backed is not reducing the balance sheet. It's just being replaced with treasuries. So there's a composition change they're doing. But I really can't tell you why they're even doing the 5 billion a month other than I guess to just say that they're still tightening to some degree, but it's literally a rounding error of, and inconsequential.

It has, basically very close to net zero impact. So bottom line, what they did is their first grade cut in nine months. There's a snails pace going of some degree of quantitative tightening. And then what they said, and I'm gonna quote here a few things that I think you know are unsurprising, but help fill in, provide a little color as to what the lay of the land is.

The written announcement that is circulated with the rate decision from the Federal Open Market Committee was that job gains have slowed and the unemployment rate has edged up, but remains low. Inflation has moved up and remains somewhat elevated. Okay, so they changed the language about jobs.

Maintained this concern on inflation and then went on to said, say first of all, they took away July verbiage that said labor conditions remain solid. And that, so that word for word quote was taken out from the July statement in the August statement in the new state, excuse me, September. And then they said downside risks to employment have risen.

And J. Powell in the press conference used the term we referring to what they just did as a risk management cut. So I don't think he could have been more clear that they are in some sort of tug of war in their opinion as to what they view their dual mandate to be. Around price stability and around full employment, basically, inflation versus economic growth.

And again, a quote from J. Powell, there are no risk-free paths at this point, and the Fed is in a challenging situation. So the issue about that quote unquote balance of risks has been well discussed here in the Dividend Cafe about the concerns and vulnerabilities in the jobs data. There was a Dividend Cafe I dedicated the subject about a month ago now.

And again, we're talking about vast BLS revisions, a DP decline. The monthly ADP private payrolls, growth has declined very steadily and that and really quite dramatically. And then there's been some questions on the initial weekly claims. Now, last week the initial claims had come in at 264,000, a big spike up.

And understandably, people said, okay, is this it? Is this finally we're seeing a crack in this weekly data. I've said over and over again. No, we look for rolling averages. Let's just see if you got something lumpy and sure enough, this week it came back at 231,000. So it appears that it was something lumpy.

You'd been in this middle range of 225,000 for what is over three and a half years now. A little lower, a little higher, and right now the four week average is at that higher end. It's about 240,000. So it hasn't cracked up to a whole new level of concern, but it's at the higher end of the range it's been in.

But bond yields did move up. They had come down to about 4.01%. And then af by the time the Fed Deal was done Thursday, but then also with that, excuse me, Wednesday, but then with the jobs data that came Thursday, bond yields were back to about 4.1%. So essentially, I think the Fed is understandably concerned about jobs data.

They did not spend a ton of time talking about concern of tariff pressure on economic growth. Most of the conversation on tariffs in the media from critics, from supporters, and of course from the Fed, is centering around the inflationary impact or lack thereof expected around tariffs. And my argument continues to be that the concern ought to be more in the impact economic growth.

The other issue, imbalance of risks that has to be factored in, even if it's reasonably unspoken from The Fed, because I don't have any doubt in my mind that it is far more of a consideration than is appropriate for them to share is the state of housing. And I have a chart at DividendCafe.com showing the 30 year mortgage. It had been up around seven, it dropped after their announcement last year, close to six and then really lasted there for about a month before going right back up to around seven and stayed there most of the next year. And about 45, 60 days ago started working its way lower and as we sit here now, it's sitting in about six and a quarter.

So it's come down about three quarters of a point in advance of the Fed rate cut, but candidly. You could argue it was getting there in front of where the, everyone knew The Fed funds rate was about to go, but also the 10 year bond yield fell. So the mortgage rates are far more tethered to the long end of the curve than the short end.

And the question is whether or not the long end of the bond yields the yield curve is dropped because of concerns of economic growth, and if that is bringing mortgage rates down with it, or if mortgage rates are trying to respond to where they see The Fed going. The short end is difficult to use to control mortgage rates, but there's no question The Fed wants to try.

So I mentioned how the bond market responded to The Fed. Again, bond yields had largely already come much lower, and I continue to believe inflation expectations in five year and 10 year. Tip spreads have not moved a lot so that the bulk of this drop about half a percentage point in long bond yields is largely de declining expectations for real GDP growth.

And the bond market kind of stayed there. Then, as I mentioned, moved the yields moved a little higher but still, very close to 4% in the last day or two. The stock market. It was totally mixed. Now, the DOW was up after The Fed announcement, but both the S&P 500 and the Nasdaq were actually down Wednesday in the immediacy, the afternoon.

And that that's always worth repeating that it's an utterly worthless indication of market response in the immediate aftermath of The Fed announcement because there are hedge players, speculation players, levered players, high frequency players. Winding unwinding, more immediacy of trades that just go beyond normal market reflections.

And I think that then Powell gives a press conference. There's a few other things that have to get unwound and you get a big boost in volatility up or down. And this happens over and over again at Fed announcements And the press conference. The next day markets resumed and there was some upside, not big.

It gave back a lot of gains from the day. But my point is that there wasn't a person of any reasonable IQ that did not know that The Fed was gonna be cutting a quarter point. It had been priced almost to a hundred percent level in the futures market. But I don't think that's the issue.

The issue is much more where we're going from here. And The Fed did certainly make clear that they see a couple more rate cuts coming this year, and then the market is now priced that in. It was largely assumed those assumptions moved higher in probability that we're gonna end up at two more rate cuts this year, three total from where we were earlier in the week.

So 75 basis points lower from where we started. Which basically will get us down to a range of three 50 to 3 75 by the end of the year in The Fed funds rate. So somewhere in the middle, three the three handle. All right, let's talk about why The Fed cut rates. My view here, getting beyond the Powell speak.

And the pro forma speak about dual mandate and nothing risk free. And they're trying to balance risk. I believe he means all of it. I believe it's all true, but it's somewhat cookie cutter. And I think if you look a little under the hood. There is the reality of significant floating rate debt resetting in both commercial real estate and the levered loan market that The Fed now needs to get in front of before that becomes impactful in financial conditions, and in other words, becomes more tightening than they intend.

And The Fed is rightly describing their current position as restrictive, and The Fed rightly is trying to move to neutral. Now in addition to those issues of floating rate debt resetting and trying to accommodate with a lower rate, I believe that the housing market is a major issue. Now, I'm gonna come say more on that in a moment, but in terms of my basic summary as to why I believe they should have cut rates and I'm well on record of saying, I think they should have done this quite some time back.

They have a restrictive approach and they need to have a neutral one. That's point number one. I do not believe there's any economic indicator that would call for a restrictive approach, but that said and number two I would add is the same thing I just said that I think the Fed's thinking about the catalyst for Fed easing, being concerned, trying to get in front of the loan, resets in commercial real estate and levered loans.

Number three being the housing market. And this is an issue we've talked about a lot in the Dividend Cafe, that there is a seller's strike because a lot of people that wanna sell their home and buy a bigger, better one can't trade a 3% mortgage for a 7% or even a 6% mortgage. And so they're just frozen.

And I think that The Fed attempting to use monetary policy. To nudge housing into a better situation of affordability and just a general activity so as to not allow the housing adjacent parts of the economy to slow and bring GDP growth into a further vulnerable place is a legitimate issue.

I think that they're right about the balance of risks. That there is vulnerability in the jobs market and that even if one doesn't believe we're entering recession and significant firings and terminations I think that the data's at least 'cause the data isn't clear that we are. The data is though clear that we're not seeing hirings, that you seem to have a significantly low level of firings, even though they've picked up a little but a real low level of hirings too.

And then because of the way that monetary policy has lags in where it catches up into the real economy, I think The Fed getting in front of that is important. But my concern would be, and this is I guess my point number five, when I talk about what The Fed, should do and me saying, sure, they should have cut.

And sure, I believe going from restrictive to neutral is appropriate. My concern would be that they're not gonna go to neutral, they're gonna go to overly accommodative in a time where financial conditions are actually quite loose. Stock markets at a very high valuation bond yields excuse me, credit spreads are very tight.

And should The Fed keep that punch bowl out too long or spike it too much? I think that there is 0% chance that it will not create further problems down the road. I'm not saying it's a hundred percent chance they will do that, although that is what history would indicate. Now, I mentioned before that there's some level of drama.

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Playing out in The Fed right now, and we're aware of the issue with Lisa Cook, a Fed governor appointed by Biden in late 20, president Biden in late 2022. Her term began in 23. This is a 14 year term, so she'd be there to the beginning of, 2038. I was off by one year. A moment ago, she was appointed by President Biden at the end of 23, and her term began at the beginning of 24.

So she would be there to the beginning of 2038. 'Cause of the 14 year term now president. Trump has fired her and the court, and then the appeals court have dismissed the termination saying that there isn't sufficient legal grounds, and I don't know what the Supreme Court will end up saying on appeal.

There, the Ann Arbor property records came out and said they did not consider her declaring of her Michigan home as a pri principal residence to be against their standards. And it may be that the courts say. Until there's a crim, there's not even criminal charges filed yet, let alone a conviction.

So I don't know if the Supreme Court's gonna rule that there was proper justification for termination or not. I, but again, you're talking about one vote, one governor. So that thing is certainly interesting to watch. I don't think there's any question. That this mortgage fraud issue was pretextual for a ju for a termination.

And I, and the courts will do what they do there. But that's one of the dramas playing out now. Stephen Myron, who had been the chair of the Council of Economic Advisors was basically sworn in a few minutes before the meeting and the vote this week. The Senate did approve and confirm him, and he voted for a half a percentage point cut.

He was the only one. And so he's well out there on a record of, wanting to be more aggressive than other Fed governor colleagues of his, but then you look at the dot plot. Which is each Fed governor claim, putting out their expectation of where rates will be at the coming meetings. And that there's one person saying 2.75% by the end of the year.

That's clearly Steven. 2.75% when you're currently at four. Someone calling for five more rate cuts by end of the year. So it's not going to happen, obviously, but it speaks to a big outlier. That is, maybe a real big message to the president. And then you have one person calling for no further rate cuts the rest of the year.

Six people indicating one more cut, but not two, but then there are nine people calling for the additional three cuts. That's where we're getting to the expectation. The issue is that by a one person majority. The expectation is that they're gonna cut two more times this year. But this is a big disparity.

You always get disparity six months out, one year out, two years out, because all of those people are gonna change their own expectation unless they're not remotely data dependent at all. But I think they are, I think they are gonna adjust and circumstances are going to change in all sorts of economic metrics.

So it's understandable you'd have a moving target in the future with a wide dispersion of results. But the do plot for a month from now is basically people telling you how they're gonna vote. There's a big dispersion there and we are not used to seeing this kind of dispersion within The Fed open market committee within The Fed Board of Governors.

So I think it's interesting that both Christopher Waller and Michelle Bowman, who were two Fed appointed excuse me, Trump appointed Fed governors appointed in Trump's president Trump's first term obviously. Voted for the quarter point cut. If they were really trying to campaign for Powell's job next year.

The way that I think Steven May be, they probably would've gone with a half point cut. So the Calci predictions, which is this large online prediction market Steven Moran had been at 6%. And he went to 20% to be Powell's replacement in the prediction markets after that vote more than tripling his odds.

We'll see where some of that goes. But between the Lisa Cook issue, who will replace Powell and a lot of these dispersion of results within Fed Governor votes, now you're getting a bit of a reality TV show happening at The Fed. And it's interesting now, the new year is really gonna have two big things that The Fed is facing.

The Powell replacement being one of 'em, and the president has said his major candidates were Kevin Hassid, who's currently chair of the NEC, Kevin Walsh, who's been a Fed governor before and was Morgan Stanley economist. And then Christopher Waller, who is The Fed Governor now, and I mentioned a moment ago, Steve Myron has become a big candidate as well, and we'll see where those things play out.

I've said numerous times, I think the right call here would be Kevin Walsh. But the president's going to make this pick, and he is going to pick who he believes is gonna be most accommodative. And also that where Secretary Bestin advises he's gonna get the best cooperation and credibility in financial markets.

So that credibility issue look, in addition to the 2026 drama about The Fed replacement the Fed's dot plot say that The Fed funds rate's gonna end the year next year at 3.4%. The future's market says 2.9, so markets are predicting that The Fed is gonna be half a percent lower by the end of next year than The Fed themselves is predicting.

And I will tell you that the market is predicting that for a very good reason. Some of it is economic softening and tariff impact, and some of it is that they know the president's gonna have his own people there by this time next year. So The Fed dot plots can say what they want to say, but the markets generally are the leading indicator and the dot plots end up catching up.

So that leads us to the question of whether or not a market, a stock market. This is now the investor sensitive part of our talk trading at 24 to 25 times this year's earnings. 22 times next year's earnings is overheated. Is The Fed gonna cause it to overheat? Further, should The Fed be easing with financial markets at these levels?

I think that they have economic reasons to go from restrictive to neutral, and they have financial market issues to very much fear overheating. Further, what I would say though is The Fed did the right thing to remove some excess tightening from monetary policy. Whether or not there will cut rates to a prudent level and stop remains to be seen.

The economy's health is not hoarded, but it's not robust either. And the ambiguity in labor data and tariff impact is a big deal. But risk asset investors, they can celebrate a modest easing if they want, but they should be very careful about rooting for excessive easing. That excess may not happen.

And if it does, they may very well find themselves. Wishing it had not, we are asking The Fed to do something it cannot do, which is get exactly right. A very tricky equilibrium. Prudent investors realize this. They do not align their portfolio with what they are trying to guess. The Fed will do what they want The Fed to do.

There is no part of our investment policy right now that would or should move based on what we think The Fed will or will not do. Next year. First of all, we do not know, second of all, to start to align your policy with hoping that The Fed will make a policy mistake or predicting they'll make a policy mistake is utterly silly and far sillier when you're already in these stretched valuations.

I think that when you are properly aligned in your portfolio, in your asset allocation you have the luxury. Being far more Fed agnostic than apparently many are. We want a real sober judgment right now in a time where many risk asset investors want The Fed to keep the punch bowl out there too long, and we intend to go about this process sober minded.

Thank you for listening, watching, and of course reading this week's Dividend Cafe. Hope you have a wonderful weekend and look forward to being with you again in the Dividend Cafe this time from California on Monday. Have a wonderful weekend.