Commerce Trust Market Brief with Scott Colbert

Fed Cuts Interest Rates with Changes to Key Economic Indicators

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Scott Colbert: Good morning. It's Monday, September 15th and the markets are open and trending slightly higher. So far this year, we've had excellent financial market results. The S&P 500 (Index) is up now nearly 13% on a year-to-date basis. The average stock is up about 9% in the S&P 500 (as measured by the S&P 500 Equal Weight Index). And small-cap (capitalization) stocks are catching up. They're now up about 8.5% year to date (as measured by the Russell 2000 Index), about 4.5% behind the S&P 500 Index.

International stocks are also the big winners. The developed markets, those larger-cap stocks from Europe, Japan, and Australia, are up nearly 25% (as measured by the MSCI EAFE Index) now. And the emerging market stocks, of course, driven by the Chinese market, are also up now a bit more than 25% (as measured by the MSCI Emerging Market Index) on a year-to-date basis. The Hang Seng Index, the index of Chinese stocks traded in Hong Kong, is at a record high.

Fixed income has also added some positive returns. Interest rates are down a little bit this year, and that's driving bond market returns up. The broadest measure of the bond market, the Bloomberg Aggregate (Index) is up now 6.4% year to date. And even municipals now are participating on the positive side, up 2.7% (as measured by the Bloomberg Municipal Index) year to date.

The markets are clearly focused near-term on this week's Federal Reserve meeting. Recall the last time we talked, we said there were several key economic reports likely to push the Fed (Federal Reserve), either towards cutting rates or holding rates the same. Those key reports had to do mostly with inflation and employment. In terms of inflation, the core PCE (Personal Consumption Expenditures Price Index) was up just a little bit. The PPI came in lower than expectations. That's the Producer Price Index. And the Consumer Price Index (CPI) was relatively unchanged.

It's the jobs side of the equation, though, that has been exceptionally weak. The jobs report from last month showed positive job creation, but the three-month moving average has come materially down. And there's this unique thing called a benchmark revision that also suggested that employment was a lot weaker than we thought.

Specifically, let's take a look at a couple of these key statistics. In terms of the CPI and the PPI. You can see that they're much closer today to 3% than the 2% long-term target that the Fed has. And note that they've been increasing ever so slightly as the year has progressed. From an inflationary perspective, the Fed's favorite measure is the so-called Personal Consumption Expenditure Index. Note that it is also up slightly from its low of 2.7% a year ago, and much closer to 3% than it is that long-term target.

So while inflation has been relatively sticky and even increasing a bit, probably driven by most of the tariff news, we've seen a marked slowdown in job creation. Note that jobs have been trending down ever since post-pandemic 2022/2023, but with revisions now, we show that job growth last year (2024) might have been as low as 111,000 jobs per month, compared to the longer-term averages of 180,000. And this year (2025), we've probably pulled job growth down to something closer to 40,000 or 50,000 jobs per month. It's even more dangerously close to zero job growth over the last three months, with job growth averaging just 29,000 jobs per month, including a likely negative employment print this past June.

So what's driving all this slower job growth? Well, most people would point to business uncertainty. And that business uncertainty is largely coming from the tariffs that still have yet to be finalized, and frankly, even adjudicated in the court systems. We also are facing a demographic cliff. This is a combination of the baby boomers who are all getting older and retiring, as well as the baby bust that was driven by the financial market crisis back in 2007 to 2009. For the next four years, we are likely to have fewer 18-year-olds than we had the previous year coming into the employment market.

And finally, of course, we all know what's going on with immigration, with literally most undocumented immigration shut off entirely at the border, probably some additional deportations, as well as a slowdown in legalized immigration, which limits the size of the job market and probably also, by implication, limits the likely growth in employment just in general. Now, this is a little surprising to me, because the market had been expecting interest rate cuts all along.

And finally, when Chairman Powell put his stamp of approval on it at the Jackson Hole conference out in Wyoming, I didn't expect to see a lot of short-term interest rate movement because the market has been expecting, if not begging for, an outright interest rate cut. But since the pivot by the Fed out in Wyoming, we've seen interest rates fall by about exactly 25 basis points. So it tells you that the market may have been discounting a cut, but probably not as many cuts as we're likely to eventually get.

Now the markets are torn between two 25 basis point reductions and three 25 basis point reductions in short-term rates this year. We're not sure exactly which way to lean, but we think that three rate cuts, given the more likely composition of the Fed going forward, is the most likely outcome.

So while the probability of a recession this year is almost nonexistent, when we look out over the next 12 months, there's still a reasonable possibility that economic growth could slow enough to push us into a recession. Moody's probability index highlights this, and you can see the growing probability of a longer-term possibility of a recession. But we still think that the most likely outcome is no recession anytime soon.

The key drivers to this, of course, are we are sitting on record stock prices driven largely by profitability growth. We've also already seen the interest rate market come down, which should help on a going forward basis. Note that the 2-year Treasury is already 75 basis points lower than where we started the year, and the 10-year Treasury, which drive mortgage rates, is about 0.5% lower. We have exceptionally healthy debt markets. The average credit spread of the investment-grade corporate credit to start the year was about 80 basis points higher than the Treasury market. Today it's only 74 (basis points). So, in essence, the debt markets or the financing markets are wide open. And finally, we have the Fed clearly pivoting towards more accommodative monetary policy.

Well, this is clearly a lot of economic data to digest, but we'll keep you up to speed on all the new news and how it's impacting the financial markets going forward.

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