Sevens Report Alpha Webinar – Are Rate Cuts Really Good for Markets?

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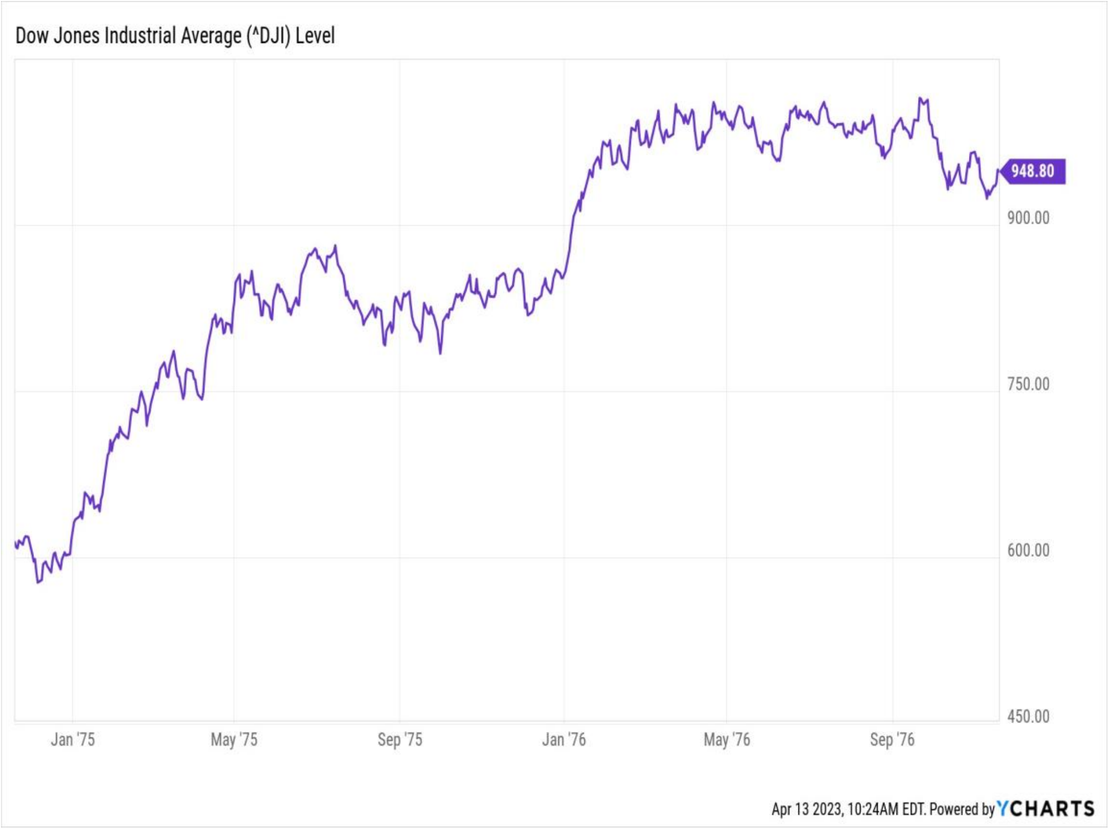
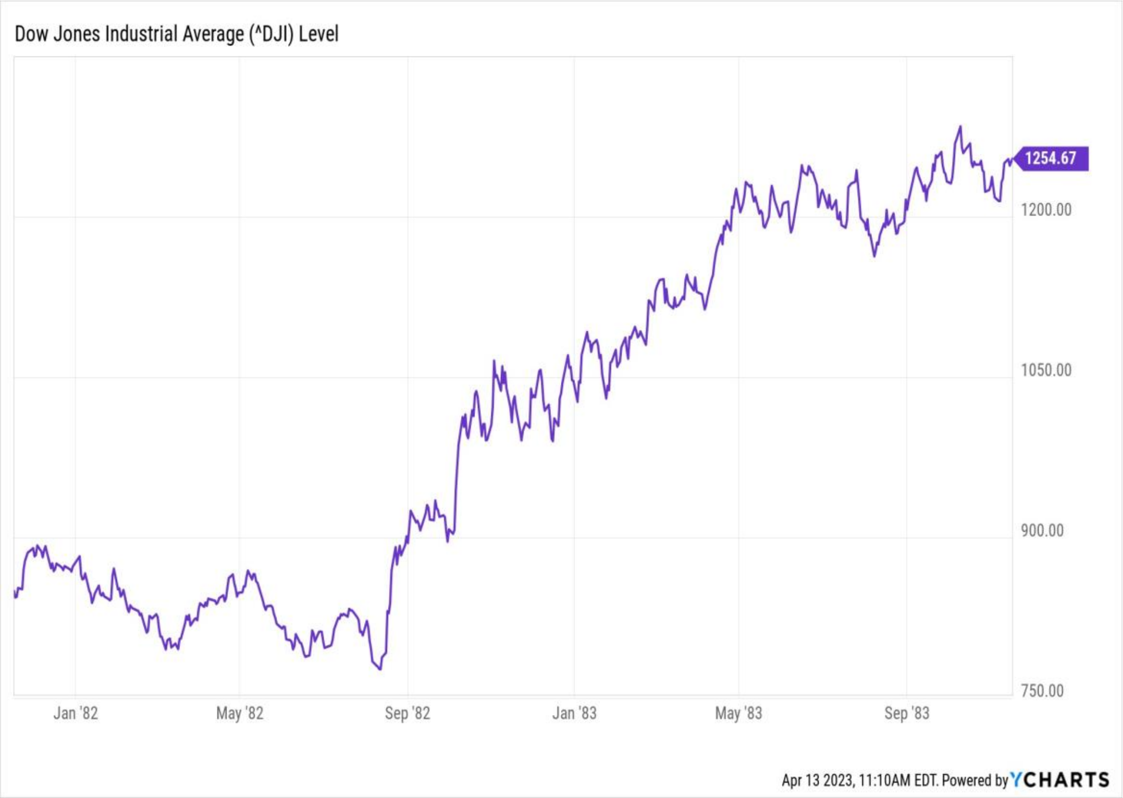
Rate Cuts of 1974

- Market returns after the first cut:
  - S&P 500 one year: 31.94%
  - S&P 500 two years: 49.44%
  - DJIA one year: 38.14%
  - DJIA two years: 54.52%
- Characteristics
  - Duration of cuts: Two Years (Nov ‘74 – Nov ‘76).
  - Magnitude of cuts: - 8.25% (13.00% to 4.75%).
  - CPI Change: - 5.20% (11.0% to 5.8%).
  - GDP Change: 5.90% (-0.50% to 5.40%).



Rate Cuts of 1981

- Market returns after the first cut:
  - S&P 500 one year: 13.85%
  - S&P 500 two years: 37.13%
  - DJIA one year: 20.86%
  - DJIA two years: 47.58%
- Characteristics
  - Duration of cuts: Thirteen Months (Nov ‘81 – Dec ‘82).
  - Magnitude of cuts: - 11.50% (20.00% to 8.50%).
  - CPI Change: - 4.10% (11.0% to 5.8%).
  - GDP Change: - 4.32% (2.50% to -1.82%).



Rate Cuts of 1989

- Market returns after the first cut:
  - S&P 500 one year: - 3.58%
  - S&P 500 two years: 11.70%
  - DJIA one year: - 2.56%
  - DJIA two years: 8.12%
  - Nasdaq one year: - 14.53%
  - Nasdaq two years: 23.06%
- Characteristics
  - Duration of cuts: Thirty-Three Months (Dec '89 – Sept '92).
  - Magnitude of cuts: - 5.50% (8.50% to 3.00%).
  - CPI Change: - 1.10% (4.10% to 3.00%).
  - GDP Change: -0.20% (3.70% to 3.50%).

Rate Cuts of 1995

- Market returns after the first cut:
    - S&P 500 one year: 18.67%
    - S&P 500 two years: 65.51%
    - DJIA one year: 19.81%
    - DJIA two years: 69.29%
    - Nasdaq one year: 21.56%
    - Nasdaq two years: 54.01%
- Characteristics
    - Duration of cuts: Seven Months (Jul ‘95 – Jan ‘96).
    - Magnitude of cuts: - 0.75% (6.00% to 5.25%).
    - CPI Change: 0.20% (2.80% to 3.00%).
    - GDP Change: 1.10% (2.70% to 3.80%).

Rate Cuts of 2001

- Market returns after the first cut:
  - S&P 500 one year: - 13.53%
  - S&P 500 two years: - 32.58%
  - DJIA one year: - 7.07%
  - DJIA two years: - 21.42%
  - Nasdaq one year: - 21.88%
  - Nasdaq two years: - 46.99%
- Characteristics
  - Duration of cuts: Eighteen Months (Jan '01 – Jun '03).
  - Magnitude of cuts: - 5.50% (6.50% to 1.00%).
  - CPI Change: - 0.50% (2.80% to 2.30%).
  - GDP Change: 1.80% (1.00% to 2.80%).

Rate Cuts of 2007

- Market returns after the first cut:
  - S&P 500 one year: - 20.61%
  - S&P 500 two years: - 29.71%
  - DJIA one year: - 19.79%
  - DJIA two years: - 28.53%
  - Nasdaq one year: - 17.01%
  - Nasdaq two years: - 19.57%
- Characteristics
  - Duration of cuts: Fifteen Months (Sep ‘07 – Dec ‘08).
  - Magnitude of cuts: -5.25% (5.25% to 0.00%).
  - CPI Change: 1.00% (2.80% to 3.80%).
  - GDP Change: - 1.90% (2.00% to 0.10%).

Comprehensive Table

	1974	1981	1989	1995	2001	2007	Now
S&P 500 One Year Return	31.94%	13.85%	-3.58%	18.67%	-13.53%	-20.61%	
Starting FF Rate	13.00%	20.00%	8.50%	6.00%	6.50%	5.25%	4.875%
Magnitude of Cuts	-8.25%	-11.50%	-5.50%	-0.75%	-5.50%	-5.25%	
Duration of Cuts	24 Months	13 Months	33 Months	7 Months	18 Months	15 Months	
Starting CPI	11.00%	10.30%	4.10%	2.80%	2.80%	2.80%	4.98%
Starting GDP	-0.50%	2.50%	3.70%	2.70%	1.00%	2.00%	2.20%

Observations

- Rate cuts are not universally positive for stocks, and the past two cutting cycles have resulted in sharply negative returns over the next two years.
- There is a stark difference between the rate cuts of the 1970's and early 1980's and the more recent rate cut cycles.
  - What were the differences?
    - Average starting FF rate first two cutting cycles: 16.5%.
    - Average starting FF rate '89, '95, '01, '07: 6.5%.
    - Average cut magnitude first two cutting cycles: -9.875%.
    - Average cut magnitude '89, '95, '01, '07: - 4.25%
    - Average starting CPI first two cutting cycles: 10.6%
    - Average starting CPI '89, '95, '01, '07: 3.13%

Conclusions

- The data implies that in order to produce a materially positive market reaction, rate cutting cycles must:
  - Start from very restrictive levels
  - Provide substantial cutting relief (so dramatic cuts)
  - Come at a time of high inflation
  - The one outlier to this is 1995, but it differs substantially from the other cutting cycles as it was much shorter and coincided with the growth of the internet (a seminally positive event for the economy and markets).
- How does this compare to now:
  - **If there's an analogy to this looming rate cut cycle, it looks most like '89, especially if we consider the S&P crisis that was ongoing at that time.**
  - **This implies the benefit of rate cuts may be underwhelming. One year from the start of cuts in '89, the S&P 500 was lower, and while the index was higher two years later, the annual returns were below the historical average (11.5% over two years).**
  - Bottom line, history shows rate cutting cycles are not automatically positive for markets, with three of the last four major rate cut cycles producing sub-part returns (and in two of them, outright negative returns).
  - While this analysis isn't conclusive, it does push back on the market's optimism that looming rate cuts will result in the resumption of a bull market, and this analysis reinforces our preference to stay long via overweighting defensive sectors that maintain long exposure but reduce volatility and increase income.