



September 22, 2025

Morning Briefing

Is The Fed's Policy Restrictive?

Check out the accompanying [chart collection](#).

Executive Summary: The Fed's 25-basis-point cut in the federal funds rate last week doesn't change our S&P 500 price targets or our subjective probabilities of a meltup (25% odds) or correction (20%) by year-end. Today, Dr Ed explores the reactions to the rate cut in the markets for stocks, bonds, the dollar, and gold as well as the significant takeaways from the FOMC's September 17 meeting. Notably, the post-meeting Dot Plot and press conference revealed less dovishness than many investors had expected. ... Also: Dr Ed opines on the weird notion of an indeterminable "neutral" federal funds rate used to determine the restrictiveness of Fed monetary policy.

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available [here](#).

The Fed I: We & the Financial Markets React. Now that the Fed lowered the federal funds rate (FFR) by 25 basis points (as expected) last Wednesday, September 17, we would like to provide you with an update on our outlook for the financial markets:

(1) *Stocks.* We last changed our stock market projections on September 11, as described in our *QuickTakes* of that date: "We are raising our year-end S&P 500 target from 6600 to 6800. That's our base-case scenario with a subjective probability of 55%. We currently assign a 25% subjective probability to a meltup that lifts the S&P 500 to 7000 by year-end 2025 and 20% odds to a correction in the index by the end of this year. If the Fed lowers the federal funds rate on September 17 and signals more rate cuts ahead, we will increase our odds of a meltup and decrease our odds of a correction."

As it turned out, the Fed's rate cut wasn't dovish enough to change our odds—nor as dovish as some market participants seem to have expected. So we are sticking with our current subjective probabilities for the three stock market scenarios, as we discuss further below.

Stock investors already had discounted the Fed's rate cut. So the gains late last week in

response to the cut were relatively muted. In other words, there was no meltup. The S&P 500 rose 0.7% since last Tuesday's close to a new record high ([Fig. 1](#)). The same can be said of the Nasdaq, which rose 1.3% in the last three days of last week to a new record high ([Fig. 2](#)). The Russell 2000 hit a new record high on Thursday and edged down on Friday ([Fig. 3](#)). The Magnificent-7 continue to be magnificent, rising 1.2% over the past three trading days, and a whopping 60.8% since the April 8 correction low, also to a new record high ([Fig. 4](#)). That's almost double the 33.7% increase in the S&P 500 over the same period. The S&P 500 equal-weighted index is up 23.2% since April 8.

(2) *Bonds*. The lackluster response of the bond market to the Fed's rate cut since Wednesday probably restrained the stock market's advance. The 10-year Treasury bond yield rose from 4.00% just before the Fed's cut to 4.14% at the end of trading on Friday ([Fig. 5](#)). Bond and stock investors no doubt recall that the bond yield rose by a disconcerting 100bps late last year when the Fed cut the FFR by 100bps ([Fig. 6](#)).

We are widening our trading range for the bond yield from 4.25%-4.75% in 2025 to 4.00%-5.00% in 2026. The Bond Vigilantes are likely to continue to be alarmed by Washington's fiscal excesses, especially if customs duties dive in the event that the Supreme Court rules that Trump's tariffs are unconstitutional ([Fig. 7](#) and [Fig. 8](#)). The US Treasury is likely to stop the bond yield from rising above 5.00% by issuing more Treasury bills and fewer notes and bonds, similar to the yield-curve-control trick that former Treasury Secretary Janet Yellen played on the Bond Vigilantes in late 2023.

(3) *US dollar*. The DXY dollar index is down 10.7% since the start of the year ([Fig. 9](#)). It managed to rise by 1.1% after last week's Fed rate cut. This index is a fixed-weight index of the dollar versus the other major currencies. It is highly correlated with the dollar's exchange rate against the euro, which has a 57.6% weight ([Fig. 10](#)). The Fed's Broad Trade-Weighted US Dollar Index is down 7.7% since the start of this year ([Fig. 11](#)).

We aren't bearish on the dollar because the US Treasury's data continue to show record net foreign capital inflows into the US. Over the past 12 months through July, these inflows totaled \$1.7 trillion ([Fig. 12](#)). This total included private net purchases of US bonds and US equities of \$929.1 billion and \$626.3 billion ([Fig. 13](#)).

The strength of the euro (and therefore the weakness in the DXY) is puzzling to us. Could it be that global investors have been rebalancing away from expensive US LargeCaps to cheaper EMU LargeCaps? That's not consistent with the US Treasury data. Besides, the EMU MSCI is up 13.9% in euros on a ytd basis, while the US MSCI is up 13.6%. The former

has outperformed the latter in dollars due to the dollar's relative weakness against the euro.

So we remain puzzled by the strength of the euro, given that German manufacturing continues to face fierce competition from China, especially in the global auto market, and France is experiencing a major political and debt crisis. Indeed, the spread between the Italian and the French 10-year government bond yields has dropped to zero, down from 50-100bps last year ([Fig. 14](#))!

(4) *Gold*. We aren't puzzled by the strength of gold's price. We turned bullish on the shiny metal early last year when its price rose above \$2,000 per ounce. When its price increased above \$3,000 per ounce in March of this year, we targeted \$4,000 by the end of this year. So far, so good now that it is over \$3,700 ([Fig. 15](#)). If we hit our year-end target of \$4,000, we expect it will continue to rise to \$5,000 by the end of 2026.

The initial reaction of the price of gold to the Fed's rate cut was a modest pullback. But it rebounded quickly on news that Putin's jets violated European airspace for 12 minutes on Friday. Earlier this month, Poland stated that numerous Russian drones entered its territory in the space of several hours and were ultimately shot down with the help of the country's NATO allies.

The Fed II: In Powell We Trust. Last week's relatively muted response to the Fed's rate cut clearly indicates that the financial markets had discounted the event before it happened.

In addition, the FOMC's Dot Plot—showing the meeting participants' expectations for major economic indicators over various time horizons—wasn't as dovish as some investors might have expected. Seven of 19 meeting participants expected no further rate reductions this year, and two more expected only one more cut ([Fig. 16](#)). And they show that most Fed officials didn't expect to make many more reductions next year under their current outlook for solid—if somewhat slower—economic activity.

Furthermore, Fed officials presented a united front in signaling support for the Fed's independence. Eleven of 12 Fed voters backed the 25bps cut. Fed Governor Stephen Miran, who served as a senior White House adviser until his confirmation to the central bank board this week, was the lone dissenter. He favored a larger, half-point cut. Even Governors Christopher Waller and Michelle Bowman didn't dissent, as they had at the previous meeting, because they both favored a 25bps back then.

In his post-meeting [press conference](#), Fed Chair Jerome Powell remained basically

noncommittal about further rate cuts:

- (1) Powell stressed that future monetary decisions are not on a “preset path” and will be determined on a meeting-by-meeting basis, depending on the incoming economic data.
- (2) While inflation has eased from its highs, it remains “somewhat elevated” above the Fed’s 2.0% y/y target. Powell acknowledged that tariffs are beginning to push up prices in some sectors. He said the Fed’s baseline expectation is that these tariff-related price increases will be a one-time event. Still, he emphasized that it is the Fed’s job to ensure they do not become a persistent inflation problem.
- (3) Powell highlighted a softening labor market, noting that job gains have slowed and the unemployment rate has edged up to 4.3%. He referred to the current state of the labor market as a “curious balance,” where both the supply of workers and the demand for them have declined. Powell attributed some of this slowdown to new immigration policies.
- (4) Powell called the FOMC’s latest action a “risk management cut because, if you look at the SEP [[Summary of Economic Projections](#)], actually the projections for growth this year and next actually ticked up just a little bit and inflation and unemployment didn’t really move” ([Fig. 17](#), [Fig. 18](#), and [Fig. 19](#)).

The Fed III: Where Is the Neutral Interest Rate? In his presser, Powell stated that Fed policy remains tight notwithstanding the latest rate cut: “What we can say is this, that over the course of this year we’ve kept our policy at a restrictive level—and people have different views—but a clearly restrictive level, I would say.” In other words, monetary policy remains tight.

How does he know this? Real GDP rose 3.3% (saar) during Q2 to a record high, and it is on course to increase at the same pace during Q3 according to the latest estimate of the Atlanta Fed’s [GDPNow](#) tracking model ([Fig. 20](#)). The major stock market indexes are at record highs. S&P 500 earnings is at a record high. Gold is at a record high. True, the labor market is sending mixed signals, but that’s mostly related to structural labor supply issues, as we’ve previously discussed.

According to the SEP, the FOMC’s average view is that the neutral “long run” FFR is 3.0% currently ([Fig. 21](#)). The FFR is currently 4.0%, which is deemed to be restrictive. By the end of the year, the committee, on average, expects that the FFR will be lowered to 3.6%, which is less restrictive. Then it goes down to 3.4%, 3.1%, and 3.0% in 2026, 2027, and 2028,

respectively.

That's a long way to Tipperary. But it is consistent with the SEP's goal of getting the inflation rate down from 3.1% at the end of this year to 2.6%, 2.1%, and 2.0% (i.e., the Fed's long run inflation target) over the next three years.

Got that? The Fed doesn't expect to hit its long-run inflation and FFR targets until 2028! They reckon that they will have to keep the FFR restrictive (i.e., above the 3.0% neutral rate) to get inflation down to their 2.0% inflation target by then.

We've said this before: The concept of a "neutral" FFR is just plain weird. Powell and other Fed officials have often acknowledged that it can't be observed. It can only be estimated with econometric models, according to them. They also admit that it isn't a fixed value and is likely to change over time. Indeed, the FOMC's estimate was 2.50% in late 2023. Now it is 3.00%. And by the way: The latest Dot Plot shows that the range of estimates of its value is from 2.50% to 3.75%!

The bottom line for us is that the notion that there is a neutral overnight bank lending rate is ridiculous. Nevertheless, if we must play the game, we would say it is currently closer to 4.00% (where it is now) than to 3.00%. In other words, our Paradise Lost has been found at the current level of interest rates ([Fig. 22](#)).

Movie. "Eden" (+ + +) is a remarkable 2024 film based on the extraordinary memoirs of Margret Wittmer (played by Sydney Sweeney). Ron Howard's latest film is a stranger-than-fiction survival thriller that's like *Lord of the Flies* with adults rather than children. It blows away the utopian notion that life was better and simpler when we lived closer to nature. It turns out that the Noble Savage was just a savage doing whatever it takes to find food and survive. This is the film's Darwinian insight for philosophers seeking the meaning of life, as does Dr Friedrich Ritter (played by Jude Law) in this almost unbelievable tale. (See our movie reviews [archive](#).)

Calendars

US: Mon: Chicago Fed National Activity Index; Williams; Barkin. **Tues:** S&P Global C-PMI, M-PMI & NM-PMI 54.6, 51.8 & 53.8; Richmond Fed Manufacturing Index -9; Powell; Bostic; Bowman. (Source: FX Street)

Global: Mon: Eurozone Consumer Confidence -15.0; Mauderer; Lane; Pill; Bailey. **Tues:** Eurozone S&P Global C-PMI, M-PMI & NM-PMI 51.1, 50.7 & 50.6; Germany S&P Global C-PMI, M-PMI & NM-PMI 50.5, 50.0 & 49.5; France S&P Global M-PMI & NM-PMI 50.2 & 48.9; UK M-PMI & NM-PMI 47.2 & 53.6; UK CBI Industrial Trends Orders -30; Japan M-PMI 50.2; Mauderer. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US\$ Performance) ([link](#)): The US MSCI index rose 1.3% during the September 19 week and is at a new record high. The AC World ex-US trailed with a gain of 0.4% for the week and closed 0.3% below its September 17 record high. The AC World ex-US has been hitting new record highs since May 14 for the first time since June 15, 2021. Despite its strength in recent weeks, the US MSCI only outperformed the AC World ex-US in 12 of the past 34 weeks. EM Latin America was the best performing region last week, with a gain of 1.9%, followed by EMEA (1.9%), EM (1.1), EM Asia (1.0), EMU (0.9), and the AC World ex-US. EAFE was the worst regional performer, with a decline of 0.2%, followed by Europe (0.2). The Brazil MSCI index, with a gain of 3.1%, performed the best among country indexes, ahead of Canada (2.4), South Africa (2.3), Korea (2.0), India (1.3), and the US (1.3). The Australia MSCI index was the worst performer w/w, with a decline of 2.2%, followed by Hong Kong (-2.1), the UK (-1.4), Switzerland (-0.7), and Japan (-0.5). In terms of ytd performance rankings, the 13.6% gain for the US MSCI index ranks as the third worst country performer and trails the 22.9% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EM Latin America leads with a gain of 36.4%, followed by EMU (29.2), EM (24.7), EM Asia (24.5), Europe (23.9), and the AC World ex-US. EMEA is the worst ytd performer, albeit with a gain of 20.0%, followed by EAFE (21.7). All of the major selected country markets that we follow are higher ytd now. Spain is the best ytd performer, with a gain of 56.2%, followed by Korea (54.8), South Africa (47.7), Mexico (39.8), and China (35.8). The worst performing countries ytd: India (2.5), Australia (11.3), the US (13.6), Japan (18.6), and Switzerland (19.5).

US Stock Indexes ([link](#)): Forty-two of the 48 major US stock indexes that we follow rose during the week ended September 19, up from 33 rising w/w during the prior two weeks. The Russell 2000 Growth index was the best performer for the week, rising 3.1%, ahead of Nasdaq 100 (2.2%), Nasdaq Composite (2.2), Russell 2000 (2.2), and Russell 3000 Growth (2.0). The Dow Jones 15 Utilities index was the worst performer, with a decline of 1.1%, followed by S&P 500 LargeCap Pure Value (-0.5), S&P 400 MidCap Pure Value (-0.4), Russell MidCap Value (-0.1), and Dow Jones 20 Transports (-0.1). All but one of the 48

indexes are higher ytd. With a gain of 19.0%, the S&P 500 LargeCap Growth index is in the top spot as the best performer so far in 2025, ahead of Nasdaq 100 (17.2), Nasdaq Composite (17.2), S&P 500 LargeCap Pure Growth (16.5), and Russell 1000 Growth (15.8). The worst performing major US stock indexes ytd: Dow Jones 20 Transports (-1.8), S&P 600 SmallCap Value (2.3), S&P 600 SmallCap Equal Weighted (2.4), S&P 600 SmallCap (3.4), and S&P 400 MidCap Value (4.5).

S&P 500 Sectors Performance ([link](#)): Five of the 11 S&P 500 sectors rose during the week ended September 12, but only three were ahead of the S&P 500's 1.2% gain. That compares to nine S&P 500 sectors rising a week earlier, when just two were ahead of the S&P 500's 1.6% gain. The outperformers last week: Communication Services (3.4%), Information Technology (2.1) and Consumer Discretionary (1.4). The underperformers last week: Real Estate (-1.4), Consumer Staples (-1.3), Materials (-0.9), Health Care (-0.7), Utilities (-0.7), Energy (0.0), Financials (0.8), and Industrials (1.0). The S&P 500 is now up 15.7% ytd, with 10 of the 11 sectors positive ytd but only three ahead of the index. During the June 20 week, Consumer Discretionary and Health Care were trailing so far behind ytd that they were the only sectors trailing the index. Communication Services still wears the crown as the best ytd performer with a gain of 28.4%, followed by Information Technology (19.8) and Industrials (15.7). These eight sectors are lagging the S&P 500 so far in 2025: Health Care (-0.6), Real Estate (2.1), Energy (2.7), Consumer Staples (2.8), Consumer Discretionary (6.0), Materials (8.9), Utilities (11.4), and Financials (11.9).

US Economic Indicators

Leading Indicators ([link](#)): August's leading indicators index posted its largest monthly decline since April (-1.3%). Leading Economic Indicators (LEI) fell 0.5% in August, following a revised 0.1% uptick in July, first reported as a 0.1% shortfall, and a 0.3% drop in June. The LEI has plunged 18.1% since December 2021's record high. The LEI's six-month growth rate contracted 2.8% over the six months ending August, faster than the 0.9% drop over the prior six-month period. In August, six of the 10 components contributed negatively and only three positively, with nondefense capital goods ex aircraft unchanged. The six components contributing negatively were average consumer expectations for business conditions (-0.19ppts), average weekly hours (-0.12), building permits (-0.11), ISM new orders index (-0.08), initial claims (-0.06), and the interest rate spread (-0.01), which barely budged. The three components contributing positively were stock prices (+0.07ppts), the leading credit index (+0.05), and manufacturers' news orders for consumer goods and materials (+0.01), which also barely budged.

Coincident Indicators ([link](#)): The Coincident Economic Indicators (CEI) index climbed to another new record high in August, advancing 0.2% last month after increases of 0.1% in both July and June. All components of the CEI—personal income less transfer payments, manufacturing & trade sales, industrial production, and payroll employment—improved only slightly in August, with payroll employment making a neutral contribution to the CEI. The CEI climbed 0.6% over the six months through August, slowing from 0.9% over the previous six-month period.

Regional M-PMIs ([link](#)): Two regional Fed banks so far have reported on manufacturing activity for August, New York, and Philadelphia, with both regions showing general business conditions improving during the month. New York's headline general business activity index rose from 5.5 in July to 11.9 in August—to its highest level since November 2024. New orders (to 15.4 from 2.0) accelerated this month, while shipments (12.2 from 11.5) continued to expand at a solid pace. Meanwhile, delivery times (17.4 from 8.3) lengthened significantly, and supply availability (-5.5 from -11.0) worsened a bit. Employment (4.4 from 9.2) climbed slightly higher, while the average workweek (0.2 from 4.2) held steady. As for pricing, the prices-paid (54.1 from 56.0) measure was little changed this month but remained elevated, while prices-received (22.9 from 25.7) showed moderate selling prices. Philadelphia's headline general business activity index rose 23.5 points (to 23.2 from -0.3) to its highest reading since January. The shipments (to 26.1 from 4.5) and new orders (12.4 from -1.9) components rose 21.6 points and 14.3 points, respectively in August, while employment (5.6 from 5.9) was little changed. The average workweek (14.9 from 4.7) component rose 10.2 points. As for pricing, both the prices-paid (46.8 from 66.8) and prices-received (18.8 from 36.1) eased dramatically during the month.

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