Week in Review | Reinhart Fixed Income
By Madison Investments

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U.S. Economy

The Personal Consumption Expenditures deflator (PCE) rose 0.5% in September, and core PCE (excluding food and energy) rose 0.3%. Year-over-year headline and core PCE rose 3.6% and 3.1%, respectively, up from 3.4% and 3.0% in August. Real personal income fell 0.3%, and real personal spending was flat after an outsized increase in August. Third-quarter real GDP grew at a 3.4% annualized rate, ahead of expectations, driven by business investment (up 12.7%, tied largely to AI) and household spending, which grew 3.8% annualized. Final sales to private domestic purchasers grew at a 4.9% annualized rate.

Our Take: The Q3 GDP and September PCE data show a strong U.S. economy, resilient consumer and stubbornly high inflation that is well above the Fed's 2% target. Markets expect a rate hike at the December meeting.

Fed

The Federal Open Market Committee (FOMC) voted 10-2 to hold the federal funds target range at 3.75%-4.00% following September's 25 basis point (bp) hike. Governor Lisa Cook and Cleveland Fed President Beth Hammack dissented, both favoring another 25 bp increase. The statement upgraded its assessment of economic activity to expanding at a "strong" pace (from "solid") and emphasized that "the accumulation of more information" will help determine the appropriate policy stance. At his press conference, Chair Kevin Warsh highlighted stronger growth, with first-half GDP revised up to 2.4% from 1.8%, third-quarter growth likely above 3%, and business investment likely rising at a double-digit pace. He acknowledged tighter financial conditions and wider credit spreads in some assets but stopped short of calling conditions tight. Warsh offered no forward guidance on December, reiterating that policy is not driven by a fixed date. He also announced that the Fed will reserve one meeting for strategy discussions, with no rate decision or statement, beginning in 2027, increasing to two such meetings alongside six policy-setting meetings in 2028. Markets viewed the hold as dovish, with the yield curve steepening as short-term yields fell more than longer-term yields.

Our Take: The hold looks more like a timing decision than a change in view. With a strong economy, elevated inflation, and two dissenters favoring a hike, the debate appears more about when than whether to tighten further. Markets, however, interpreted the decision as a sign of softer resolve, risking a reopening of the credibility gap that September's hike helped close. Warsh's view that tighter financial conditions, including wider spreads in some assets, show that policy is working suggests limited appetite for a quick Fed response if credit deteriorates. Meanwhile, fewer policy-setting meetings raise the risk of greater rates volatility. With markets still pricing meaningful odds of a December hike, growth and energy data will be key to determining whether the Fed's patience is short-lived.

Iran

President Trump reiterated threats to restart airstrikes following the midterm elections, and a top commander briefed the president on the specifics of military options. A Qatari delegation visited Iran to try to revive peace talks, but both sides are still reiterating incompatible red lines. Briefings from U.S. Central Command and other data indicated that flows of crude through the Strait of Hormuz are still near pre-conflict levels, but crude prices have continued to climb to close to peak levels during the conflict.

Our Take: The continued rise in crude prices despite the restoration of a significant portion of supply from the Gulf region is likely a sign of inventory rebuilding and traders' concern that an intensifying conflict will reduce flows through the strait and possibly result in longer-lasting energy infrastructure damage.

Contact

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Quality refers to the bond ratings provided by the various third-party ratings agencies. Stability and predictability refer to the cash flow of individual securities and not to the market value or performance of portfolio holdings. There is no guarantee this strategy will lead to investment success.

In addition to the ongoing market risk applicable to portfolio securities, bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which allows the issuer to retain the right to redeem the debt, fully or partially, before the scheduled maturity date. Proceeds from sales prior to maturity may be more or less than originally invested due to changes in market conditions or changes in the credit quality of the issuer.

The Personal Consumption Expenditures Price Index is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services.

The federal funds rate is the target interest rate range set by the Federal Open Market Committee (FOMC) for banks to lend or borrow excess reserves overnight. It influences monetary and financial conditions, short-term interest rates, and the stock market.

A basis point is one hundredth of a percent.

Spread is the yield difference between a Treasury bond and a bond of the same duration that has additional risks, such as a corporate bond.

Yield Curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. There are three main types of yield curve shapes: normal (upward-sloping curve), inverted (downward-sloping curve), and flat.