

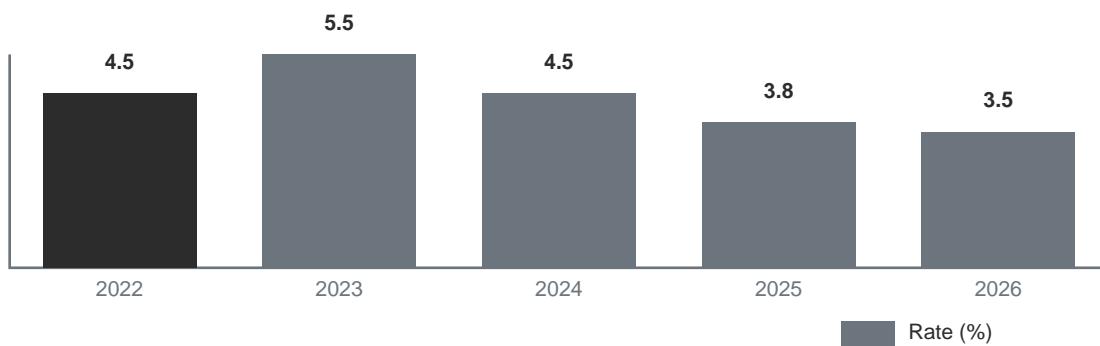
Fed Policy Pause: Navigating the January FOMC Meeting

Research Team

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The Federal Reserve is expected to pause its rate-cutting cycle at the January 27-28, 2026 FOMC meeting, maintaining the federal funds rate at 3.50-3.75% following three consecutive 25 basis point cuts in 2025. This pause represents a shift to a neutral policy stance, with Fed Chair Jerome Powell emphasizing a "wait and see" approach to monetary policy. The decision reflects the Fed's assessment that current policy is appropriately positioned given evolving economic conditions.

Federal Funds Rate (Year-End, 2022-2026)



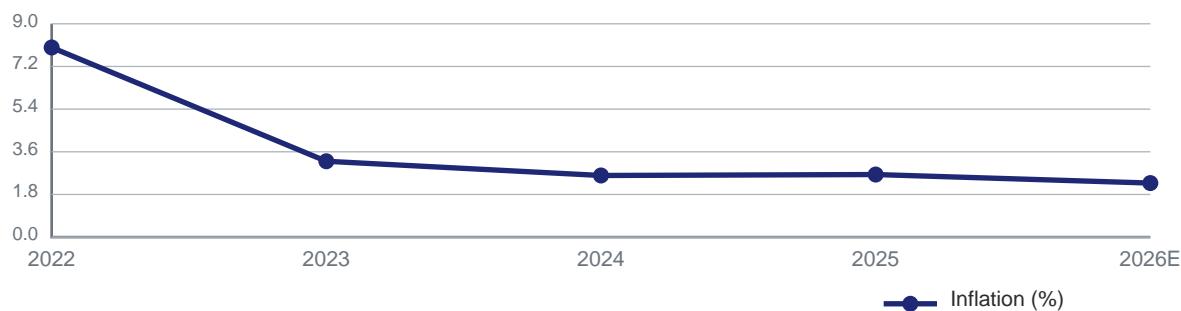
Source: Federal Reserve FOMC Statements, Federal Reserve Economic Data (FRED)

Executive Summary

The Federal Reserve is pausing its rate-cutting cycle at the January 2026 FOMC meeting, maintaining the federal funds rate at 3.50-3.75% and shifting to a neutral policy stance. This represents a significant change from the accommodative stance of 2025, with Chair Powell emphasizing data dependency and flexibility rather than pre-committed rate cuts. The pause is supported by mixed economic signals: modest job growth (50,000 in December), gradually cooling labor market (averaging 29,000 jobs per month over past three months), moderating inflation (December CPI at 2.64%, forecasted to decrease to 2.28% in January), and steady economic growth (projected 2.0-2.6% for 2026). While markets expect potential rate cuts later in 2026 (Goldman Sachs forecasts cuts in March and June to 3-3.25%), the Fed has emphasized that future decisions will be data-dependent.

Key Takeaways:

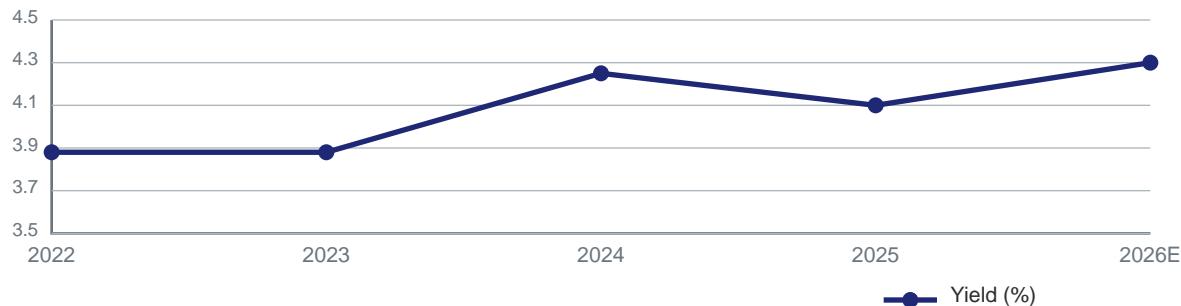
CPI Inflation Rate (2022-2026)



Source: Bureau of Labor Statistics, Federal Reserve Economic Data

- The Fed is pausing rate cuts and shifting to a neutral policy stance, maintaining the federal funds rate at 3.50-3.75% at the January 2026 FOMC meeting. This represents a move away from the accommodative stance of 2025, with Chair Powell emphasizing a "wait and see" approach based on incoming economic data.
- **Economic data is mixed:** job growth has slowed (averaging 29,000 per month over past three months), inflation is moderating but remains above the 2% target (December CPI at 2.64%), and economic growth remains steady (projected 2.0-2.6% for 2026). The Fed views current policy as appropriately positioned given these conditions.

10-Year Treasury Yield (2022-2026)



Source: U.S. Department of the Treasury, Federal Reserve Economic Data

- Markets expect potential rate cuts later in 2026 (Goldman Sachs forecasts March and June cuts to 3-3.25%), but the Fed has emphasized data dependency. The 10-year Treasury yield is currently 4.10-4.15%, with the CBO projecting a slight rise to 4.3% by 2028, suggesting longer-term yields may remain elevated even if short-term rates decline.
- Portfolio implications favor quality growth stocks, shorter-duration bonds, and floating-rate securities. REITs and high-dividend stocks may face headwinds if rate cuts are delayed, while financials could benefit from a steeper yield curve. International equities, particularly emerging markets, may outperform if dollar strength moderates with potential rate cuts.

The Neutral Policy Stance

Chair Powell has indicated that the current monetary policy stance is now in a neutral range, suggesting that further rate cuts are not guaranteed. This represents a significant shift from the accommodative stance that characterized much of 2025. The Fed's assessment that policy is neutral reflects its view that the economy is approaching a balanced state, with neither excessive stimulus nor excessive restraint needed.

The "wait and see" approach emphasizes data dependency, with the Fed monitoring incoming economic data to determine the appropriate path for monetary policy. This approach provides flexibility to respond to changing economic conditions while avoiding premature policy adjustments that could destabilize markets or the economy.

Economic Data Driving Policy

The Fed's decision to pause is supported by mixed economic signals. The December 2025 jobs report showed modest growth of 50,000 jobs (slightly below economists' expectations of 60,000) with unemployment improving to 4.4% from November's revised 4.5%. However, revisions revealed October job losses of 173,000 (greater than initially reported) and November gains adjusted down to 56,000 from 64,000, indicating a weaker labor market than previously understood. Chair Powell has noted that payroll job gains averaged just 29,000 per month over the past three months, signaling a significant slowdown in hiring. Inflation, while above the Fed's 2% target, shows signs of moderation, with December 2025 CPI at 2.64% and forecasts indicating a decrease to 2.28% in January 2026. However, PCE inflation (the Fed's preferred measure) increased to 2.7% over the 12 months ending in August 2025, up from 2.3% the previous year, with core PCE rising to 2.9%. Powell has attributed part of this inflation to higher tariffs rather than broader price pressures, suggesting the Fed views some inflation as policy-driven rather than demand-driven.

Economic growth remains steady, with GDP growth projected at approximately 2.0-2.6% year-over-year for 2026, according to various forecasts. The Congressional Budget Office projects 2.2% growth in 2026, declining to 1.8% average in 2027-2028 as fiscal support eases. Goldman Sachs Research is more optimistic, forecasting 2.6% growth in 2026, citing tax cuts and easier financial conditions. The International Monetary Fund projects 2.0% growth for 2026, while the OECD forecasts a slowdown to 1.5% in 2026. The combination of moderating inflation, stable growth, and a gradually cooling labor market supports the Fed's neutral stance. However, the Fed remains vigilant about inflation persistence and will continue to monitor data closely, with the next CPI report scheduled for January 13, 2026, which will be highly influential for Fed policy decisions.

Market Expectations for Rate Cuts

While the Fed is pausing in January, markets expect potential rate cuts later in 2026. Goldman Sachs Research forecasts cuts in March and June, bringing the federal funds rate down to a terminal level of 3-3.25%. The Congressional Budget Office projects the rate will reach 3.4% by 2028, suggesting a gradual normalization process.

These expectations reflect the view that while current policy is appropriate, further easing may be warranted as inflation continues to moderate and economic growth potentially slows. However, the Fed has emphasized that future policy decisions will be data-dependent, and rate cuts are not pre-committed.

Impact on Bond Markets

The Fed's pause and neutral stance have implications for bond markets. The 10-year Treasury yield is currently at approximately 4.10-4.15% (late 2025), with the Congressional Budget Office projecting a slight rise to 4.3% by 2028. This suggests that while the Fed may cut short-term rates, longer-term yields may remain elevated due to inflation expectations and fiscal concerns. The yield curve is likely to steepen if the Fed cuts short-term rates while longer-term yields remain stable or rise, creating opportunities in curve trades. Investment-grade corporate bonds may benefit from lower short-term rates reducing borrowing costs, while high-yield bonds may face headwinds if economic growth slows. Municipal bonds could see increased demand as investors seek tax-advantaged income in a lower-rate environment.

Bond investors should be prepared for potential volatility as the Fed navigates its neutral stance. The pause provides an opportunity for bond markets to adjust to the new policy environment, but uncertainty about the timing and magnitude of future rate cuts could create trading opportunities and risks. Duration risk management becomes critical, investors may want to consider shorter-duration bonds (2-5 years) to reduce sensitivity to rate changes, or employ barbell strategies combining short-term and long-term bonds. Treasury Inflation-Protected Securities (TIPS) may offer protection if inflation proves more persistent than expected, while floating-rate notes could benefit if rates rise. Credit spreads may widen if economic growth slows, making careful credit selection essential.

Equity Market Implications

The Fed's neutral stance is generally supportive of equity markets, as it suggests the Fed is not overly restrictive while also not being excessively accommodative. The pause provides clarity and stability, which equity markets typically favor, the S&P 500 reached new record highs following the December 2025 jobs report, climbing 0.7% to 6,966, while the Dow Jones rose 0.5% to 49,504. However, the shift away from an accommodative stance may reduce some of the tailwinds that supported equity valuations in 2025. Sectors that benefited from low interest rates, such as real estate investment trusts (REITs), utilities, and high-dividend stocks, may face headwinds as the cost of capital potentially rises. Growth stocks, particularly those with high valuations and long-duration cash flows, may also be sensitive to rate expectations.

Equity investors should focus on companies with strong fundamentals and sustainable earnings growth, as the environment of easy monetary policy support may be transitioning. Quality factors become increasingly important: companies with strong balance sheets (low debt-to-equity ratios), high return on invested capital (ROIC), consistent earnings growth, and competitive moats are likely to outperform. Sectors with strong organic growth and pricing power, such as technology (particularly AI infrastructure), healthcare, and consumer staples, may continue to perform well. Value stocks may benefit if the economy slows and investors seek companies with stable earnings and attractive valuations. International equities, particularly in emerging markets, may offer diversification benefits and exposure to different monetary policy cycles.

Strategic Portfolio Considerations

For investors positioning portfolios in an environment of cautious monetary policy normalization, several considerations are important. First, diversification remains critical, as the neutral policy stance suggests neither a strong tailwind nor headwind for risk assets. Second, investors should focus on quality, companies with strong balance sheets, sustainable earnings, and competitive advantages.

Third, fixed income allocations should be carefully calibrated. While the Fed may cut rates, longer-term yields may remain elevated, creating opportunities in shorter-duration bonds. Fourth, investors should maintain flexibility to adjust allocations as the Fed's policy path becomes clearer through 2026.

Timeline and Outlook

Near-Term Outlook (3-6 months): The Fed's neutral stance is expected to persist through Q1-Q2 2026, with policy decisions driven by incoming economic data. Key milestones include the January 13, 2026 CPI report, monthly jobs reports, PCE inflation data, and subsequent FOMC meetings (March, May, June). Market expectations for rate cuts in March and June will be tested against actual economic data. Bond markets may experience volatility as investors adjust to the neutral stance and uncertainty about future rate cuts. Equity markets should benefit from policy clarity, though the shift away from accommodative policy may reduce some tailwinds.

Medium-Term Outlook (6-12 months): By mid-2026, the Fed's policy path should become clearer based on economic data trends. If inflation continues moderating toward the 2% target and the labor market cools further, rate cuts are likely. However, if inflation proves more persistent or economic growth accelerates, the pause could extend. The yield curve is likely to steepen if the Fed cuts short-term rates while longer-term yields remain elevated. Equity markets should continue benefiting from policy clarity, with quality growth stocks potentially outperforming as the environment stabilizes.

Long-Term Outlook (12+ months): The Congressional Budget Office projects the federal funds rate will reach 3.4% by 2028, suggesting a gradual normalization process. Economic growth is projected to moderate to 1.8% average in 2027-2028 as fiscal support eases. The Fed's data-dependent approach provides flexibility to respond to changing conditions, but also creates uncertainty about the exact policy path. Investors should maintain flexibility to adjust allocations as the Fed's policy trajectory becomes clearer. The neutral stance suggests neither strong tailwinds nor headwinds for risk assets, emphasizing the importance of quality, diversification, and active management.

Timeline Overview



Source: AVANTAS Research Analysis

Risk Factors

Policy Uncertainty Risk: The Fed's data-dependent approach creates uncertainty about the timing and magnitude of future rate cuts. If economic data is mixed or conflicting, the Fed may delay policy decisions, creating market volatility. Investors should be prepared for potential policy surprises and market reactions to FOMC communications and economic data releases.

Inflation Persistence Risk: If inflation proves more persistent than expected and remains above the 2% target, the Fed may need to maintain higher rates longer or even resume rate increases. This could pressure equity valuations, particularly growth stocks, and create headwinds for bonds. Investors should monitor inflation trends, particularly core PCE (the Fed's preferred measure), which increased to 2.9% in August 2025.

Economic Slowdown Risk: If economic growth slows more than expected, the Fed may need to cut rates more aggressively, potentially signaling economic weakness. This could create a "bad news is good news" dynamic where weak economic data drives rate cut expectations, but also raises concerns about corporate earnings and equity market fundamentals. Investors should monitor GDP growth, employment trends, and leading economic indicators.

Labor Market Risk: The labor market has shown signs of cooling, with job gains averaging just 29,000 per month over the past three months. If the labor market weakens significantly, the Fed may need to cut rates more aggressively, but this could also signal broader economic weakness. Conversely, if the labor market remains tight, the Fed may delay rate cuts, potentially pressuring equity markets.

Fiscal Policy Risk: Changes in fiscal policy, such as tax cuts or increased government spending, could impact the Fed's policy decisions. Expansionary fiscal policy could support economic growth but also potentially increase inflation, complicating the Fed's policy choices. Investors should monitor fiscal policy developments and their potential impact on monetary policy.

Global Economic Risk: International economic developments, including foreign central bank policies, global growth trends, and currency movements, could impact the Fed's policy decisions and U.S. economic conditions. A significant global economic slowdown could pressure the Fed to cut rates more aggressively, while strong global growth could support a more hawkish stance.

Market Expectations Risk: Market expectations for rate cuts may not align with the Fed's actual policy decisions, creating potential for market volatility. If the Fed delays rate cuts longer than markets expect, equity and bond markets could face headwinds. Conversely, if the Fed cuts rates more aggressively than expected, markets could rally, but this might also signal weaker economic conditions than anticipated.

Conclusion

The Fed's pause at the January FOMC meeting represents a shift to a neutral policy stance that reflects the Fed's assessment of current economic conditions. While markets expect potential rate cuts later in 2026, the Fed has emphasized data dependency and flexibility. Investors should position portfolios for an environment of cautious monetary policy normalization, focusing on quality, diversification, and flexibility to adapt to evolving policy conditions.

Asset Class Impact

The Fed's neutral policy stance and potential future rate cuts have differentiated impacts across asset classes. Shorter-duration bonds and floating-rate securities may benefit from the pause, while longer-duration bonds face uncertainty about future rate paths. Equity markets generally benefit from policy clarity, with quality growth stocks potentially outperforming as the environment stabilizes. REITs and high-dividend stocks may see headwinds if rate cuts are delayed, while financials could benefit from a steeper yield curve. International equities, particularly in emerging markets, may outperform if dollar strength moderates with potential rate cuts. Commodities could see mixed impacts depending on whether rate cuts signal economic weakness or support growth.

Asset Class Impact

Underweight

Neutral

Overweight

Asset	View	Commentary
Short-Duration Bonds	 +1	Overweight. Fed pause and potential rate cuts benefit shorter-duration bonds, reducing sensitivity to rate changes while providing income.
Floating-Rate Securities	 +1	Overweight. Floating-rate notes benefit from policy clarity and potential rate adjustments, providing protection if rates rise.
Quality Growth Stocks	 +1	Overweight. Policy clarity and neutral stance support quality growth stocks with strong fundamentals and sustainable earnings.
REITs	Neutral	Neutral. Delayed rate cuts create headwinds, but policy clarity provides some support. Sector performance depends on rate cut timing.
Financials	 +1	Overweight. Steeper yield curve from potential short-term rate cuts while longer-term yields remain stable benefits financial sector profitability.
EM Equities	 +2	Strong overweight. Potential rate cuts may moderate dollar strength, supporting emerging market equities and reducing capital outflows.
Long-Duration Bonds	 -1	Underweight. Uncertainty about future rate paths and potential for longer-term yields to remain elevated creates headwinds.
Commodities	Neutral	Neutral. Mixed impacts depending on whether rate cuts signal economic weakness or support growth. Sector-specific factors dominate.

Source: AVANTAS Research Analysis