

## September 24, 2007 – The 50 Basis Point Fed Funds Rate Cut

What a rally we had on September 18<sup>th</sup>! Ben Bernanke's decision to cut the Fed Funds rate by 50 basis points (0.50%) was well received by the stock market with the DOW\* rallying over 300 points.

We only have to go back to January 3, 2001 to see the impact of the last 50 basis point cut in the Fed funds rate to see the affect it had on the stock market. Alan Greenspan surprised everyone with a 50 basis point cut and believe-it-or-not...the DOW rallied 300 points! It feels like deja-vu all over again. Like today the DOW was close to all-time highs.

Was the rate cut last Tuesday the start of a new rate cutting campaign? Data on the health of the economy and inflation will dictate if further rates cuts are necessary.

Additional rate cuts were made in 2001...when the economy entered into the last recession. Greenspan continued cutting rates from 6.5% to 1% over the next two years in an attempt to save the economy from recession. Some have argued this excessive rate cutting may have contributed to the housing bubble and credit problems we are currently experiencing in the US.

So what happened to the stock market in the months following the 2001 rate cut? The DOW went down 29% over the next 19.5 months...hitting bottom in mid-October 2002.



The lesson here appears to be, do not assume stocks have to rise if the Fed does continue cutting interest rates, although it is generally quite positive for the economy/stock markets when rates are lowered. Let's not forget, economic conditions must be deteriorating quite significantly for this big of a rate cut. Historically, we do not see the affects of a rate cut in boosting economic activity for 6-9 months so continued caution is warranted.

\* The Dow Jones Industrial Average also known as The Dow consists of 30 of the largest and widely held public companies in the US. It is the oldest continuing stock market index and was created by Charles DOW, former Wall Street Journal editor.

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