MARKETS ON THE FRONT FOOT: ARE EXPECTATIONS OUTPACING REALITY?

The U.S. Federal Reserve's recent pivot marks a turning point in monetary policy. For much of the past year, rate-setters have been fixated on the twin threats of persistent inflation and the risk of overshooting with policy tightening. But fundamental weakness in the U.S. labor market has now tipped the balance of risk for the Fed's dual mandate—maximum employment and stable prices—towards the former. Rate cuts, once a distant hope for dovish investors, are now firmly back on the agenda as the Fed attempts to move policy closer to what it believes to be "neutral."

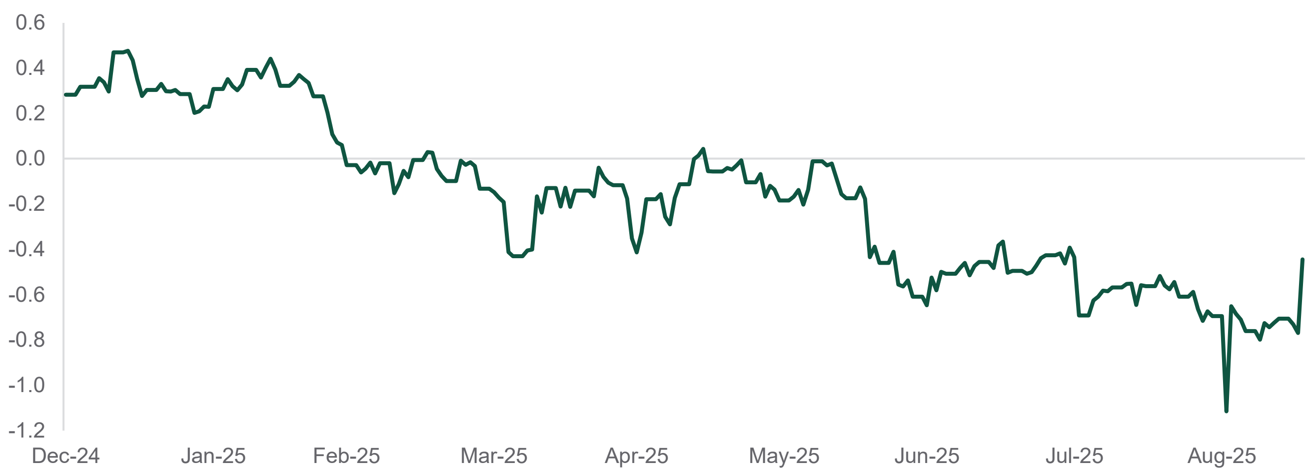
Chair Powell, ever keen to avoid binding commitments, made clear that the path ahead is not set in stone. The door remains ajar for further cuts, to be debated meeting by meeting, with each data release a potential inflection point. This measured ambiguity is by design: the Fed wishes to remain nimble, but the practical effect will be to keep markets perpetually attuned to the cadence of economic signals, with traders scrutinizing every jobs print and inflation gauge for clues.

Consumers, meanwhile, have proven resilient—except the lowest income cohort, who continue to feel the pinch. Higher tariffs pose a challenge to growth, yet robust spending elsewhere suggests the economy can weather these headwinds through the remainder of the year.

Looking ahead to 2026, a divergence appears between the bond market's outlook and the Federal Open Market Committee's own projections. Investors are bracing for a more aggressive easing cycle, with several more rate cuts expected through the middle of next year. In contrast, FOMC staff forecasts point to a slower normalization of policy. This gap in expectations will be a key battleground for market sentiment, with implications for asset prices across the spectrum. For now, uncertainty reigns—and vigilance is the order of the day.

DIVERGENT EXPECTATIONS

DIFFERENCE IN EXPECTED YEAR-END 2026 FED FUNDS POLICY RATE:
MARKET VERSUS THE FOMC MEDIAN PROJECTION (%)



Source: Northern Trust Asset Management, Bloomberg. Data from 12/31/2024 through 9/17/2025. Most recent Federal Open Market Committee (FOMC) projection was released on 9/17/2025. Historical trends are not predictive of future results.

POSITIONING SCENARIOS

Reflation (20% probability)

Policies of the U.S. administration have a net stimulative effect, leading to above-trend growth, persistent inflation and a pause in the Fed rate-cutting cycle.

Soft Landing (40% probability)

Global growth slows but remains positive via two potential paths: i) tariff policy eases; ii) the U.S. economy is more resilient than expected and avoids a major deterioration in the consumer backdrop.

Supply Restraint (30% probability)

Supply-side shocks from higher tariffs in addition to broader policy uncertainty weigh on consumer and corporate activity while halting the disinflationary process until a recession takes shape.

Stagflation (10% probability)

Initially similar to the Supply Restraint scenario, but the rise in inflation is more persistent. As a result of slower monetary policy support, the recession is deeper and longer.

Note: Probabilities are assumed from proprietary research and are subject to change.

DEFINITIONS

S&P 500 Index: The index, a gauge of the large-cap U.S. equity market, includes 500 companies that represent approximately 80% of the market capitalization of publicly traded U.S. equities.

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