RESEARCH BRIEF

Marcus & Millichap

FINANCIAL MARKETS

OCTOBER 2019

Fed Delivers Third Rate Cut, Sustains Prospect of Continued Growth

Fed remains accommodative. In an effort to lengthen the economic runway, the Federal Reserve on Oct. 30 cut the overnight rate by 25 basis points for the third time in 100 days. Domestic growth has been moderating this year, falling to 1.9 percent in the third quarter as the trade war with China curtailed exports and ebbed inventory investment. With tariffs on Chinese goods increasingly coming into play, the economy could face additional pressure, but the Fed has signaled that another rate cut in December will be dependent on incoming data. Several Fed members have argued against additional cuts, as both inflation and unemployment remain very low. A decision on rate policy will largely be determined by the holiday retail season and ongoing trade talks. Should a resolution to the trade war be achieved, the economy and interest rates will likely witness an upward bounce. The Fed's commitment to short-term Treasury purchases remains another key factor, increasing liquidity in the overnight markets and reducing short-term interest rates. This has helped "uninvert" the yield curve as the three-month Treasury rate fell below the 10-year reading. Though this has reduced recession risk, many speculate that a recession could still be on the horizon.

Investor activity sluggish despite widened yield spreads. With the 10-year Treasury hovering between 1.5 to 1.8 percent in recent months, investors have been favored by strong levered yields. The average combined commercial real estate cap rate remains in the low-6 percent range, delivering a 400- to 450-basis-point premium above the 10-year Treasury, among the widest spreads witnessed in the past decade. While this has bolstered levered return prospects, many buyers remain wary of a potential economic slowdown and their underwriting models continue to deliver more cautious valuations. Sellers, meanwhile, continue to cite strong performance metrics that support aggressive asking prices. The resulting bid/ask spread has moderately slowed transaction activity for all commercial real estate property types excluding industrial assets. Though third quarter commercial real estate sales slowed relative to the same period last year, they are still quite strong compared with the long-term average.

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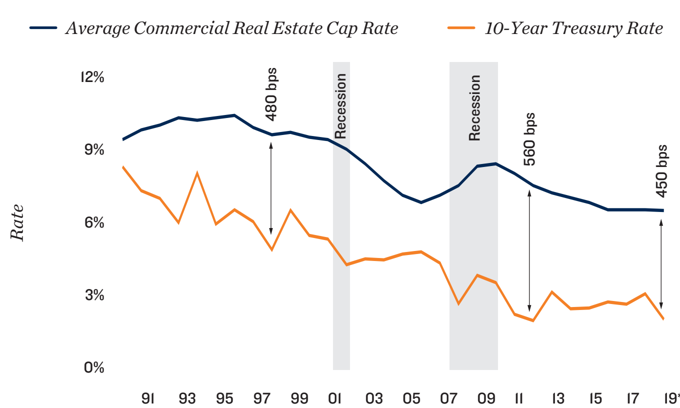
Job creation moderates yet retains stability. The national unemployment rate contracted to a record low in September at 3.5 percent. This has contributed to softened employment growth this year, adding an average of 161,000 jobs per month, relative to a monthly average of 223,000 jobs in 2018.

Retailers hopeful as consumption accelerates. In September, core retail sales rose by 4.5 percent year over year for the second consecutive month. Consumer spending remains elevated, demonstrating a strong recovery from the sluggish growth pace of 2.5 percent in February. This points to a positive growth outlook for the holiday season.

Fed using data-driven strategy. Inflation will play a pivotal role for future rate policy as Chairman Powell noted the Fed's preferred inflationary measure — core PCE — has remained below the target rate of 2 percent in recent months.

6.3% *Average CRE Cap Rate*	1.77% *10-Year Treasury Rate*

Widened Yield Spread Delivers Positive Leverage



** Through Oct. 30*
Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; Federal Reserve Bank