Richard Bernstein Advisors

Pactive® Approach to Investing

Quick Insights

September 9th, 2025

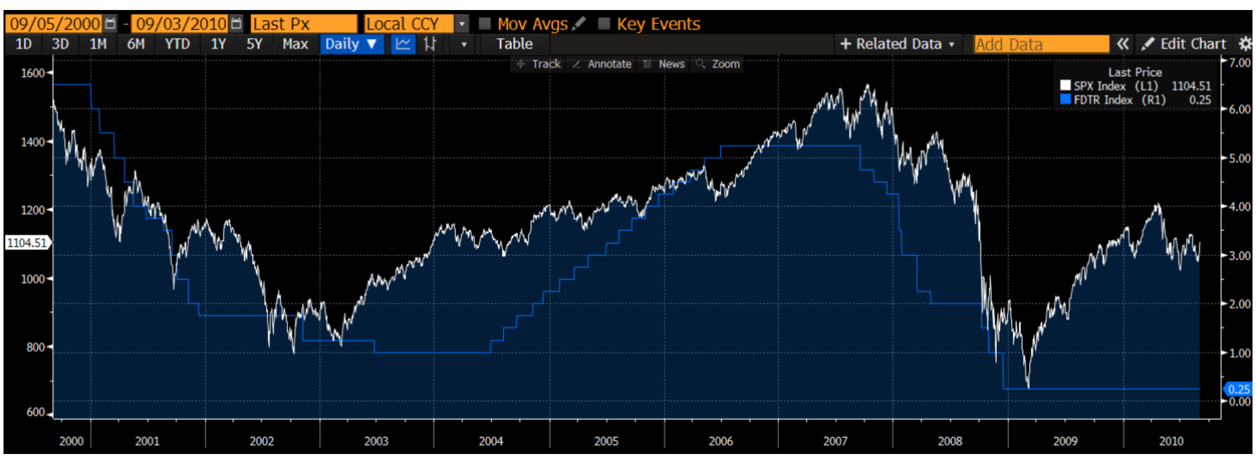
Can you have your cake and eat it too?

Markets are currently pricing in a Goldilocks scenario. Investors believe tariffs will not compress corporate margins, inflation is contained, labor markets will soften just enough to allow rate cuts without triggering a recession, and AI will drive an acceleration in productivity. As the Reddit crowd would say, “stonks to the moon.”

We think that perfect outcome is a low-probability scenario and that the market is too optimistic that earnings growth will remain strong as the Fed cuts rates. In fact, history suggests if the Fed were to ease policy significantly amid strong growth, it could go down as one of the Fed’s great policy blunders. The last time the Fed cut rates into a profit acceleration was September 2024, and the 10-year yield subsequently rose 120bps and the equity market plummeted. Rate cuts only help markets if they fall below neutral (and are stimulative) or coincide with strong earnings growth AND low inflation. Neither is likely in the coming months. The truth is far less exciting. We’re deep into an economic expansion, labor markets are weakening, margins are under pressure, and inflation is sticky. Investors can’t have it all.

The Fed typically cuts rates during profits slowdowns, and the market falls during the initial rate-cuts. Take 2001 and 2007 as classic examples where rate cuts came well before any sustained market recovery. The Covid period, of course, was a significant outlier, and even then, the S&P 500® fell 34% *before* policy support finally took hold.

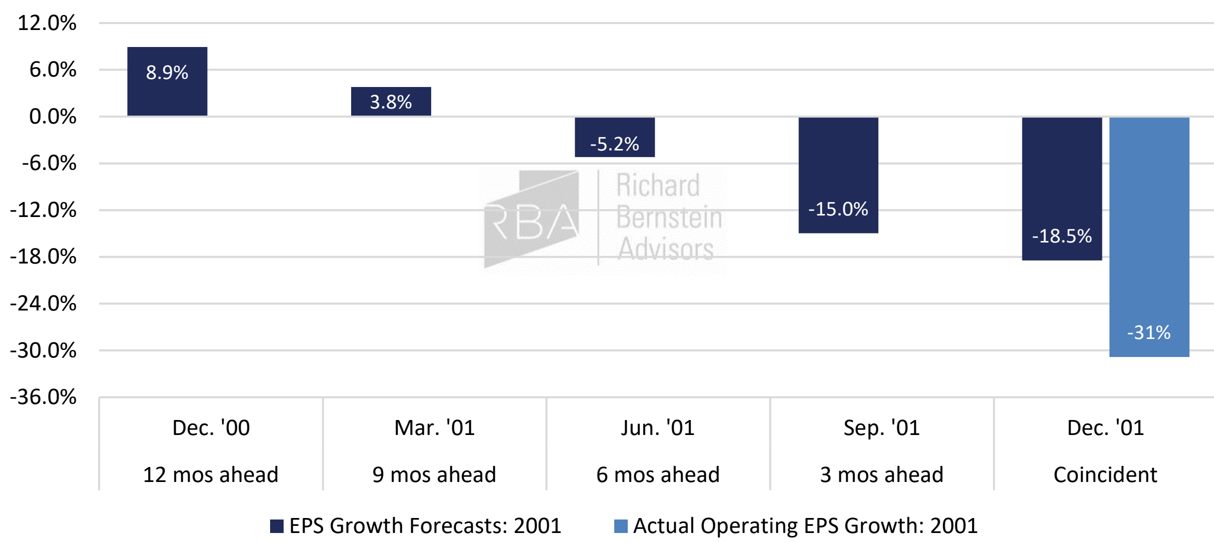
Chart 1: S&P 500® Index Performance vs. Federal Funds Target Rate (Sept. 2000 – Sept. 2010)



Source: Richard Bernstein Advisors LLC, Bloomberg

Analysts nearly always overestimate earnings heading into slowdowns and this time is unlikely to be different. Slowing earnings, rising odds of Fed cuts, and weakening employment aren’t the ingredients of a bull market — they’re classic signs of stress that create opportunities in overlooked areas of the market.

Chart 2: EPS Growth: Calendar Year Estimates vs. S&P 500® Operating Actual (Dec. 2000 – Dec. 2001)



Source: Richard Bernstein Advisors LLC, I/B/E/S, S&P Global

Certainly, if the Fed cuts rates, inflation falls, and earnings growth accelerates, then markets could go “to the moon.” However, given the low probability of a Goldilocks outcome and investors’ willingness to take substantial portfolio risk, we recommend emphasizing high-quality, dividend-paying equities, increasing regional diversification, and avoiding corporate credit exposure.

Michael Contopoulos
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