

The surprising case for investing when the Fed's raising rates

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Key takeaways

Historically, the stock market performed better over the subsequent 1-, 2- and 3-year periods following rate hikes than it did following rate cuts.

The Fed generally raises interest rates when nominal economic growth is strong and cuts rates when economic conditions are deteriorating.

Rather than viewing every Fed hike as a warning to pull back, history suggests investors may want to consider a different response.

Few things get investors' attention quite like a Federal Reserve rate hike.

Every Fed meeting is dissected. Every word from policymakers is parsed. Every move in the bond market is treated as a potential signal of what comes next. And lately, the message from the 2-year US Treasury yield has been hard to miss. It has climbed meaningfully, suggesting the market believes the Fed may have more rate hikes to go.

That naturally raises the question. Should investors be worried?

At some point, Fed tightening has helped bring most economic cycles to an end. But as we like to say, it's often not the first-rate hike that matters. It's the last one. For now, it's difficult to see the Fed being forced to raise rates to a level that meaningfully derails economic growth. Inflation expectations remain relatively contained, while the labor market is generating only modest job growth. The Fed may have more tightening ahead, but that doesn't necessarily mean it's on a path toward ending the cycle.

But that is here and now. Let's step back from the Fed watching and put rate hikes into a much broader market context.

We looked at every Fed rate hike and every Fed rate cut since the launch of the S&P 500 Total Return Index in 1989. The results may surprise investors. Historically, the stock market performed better over the subsequent 1-, 2- and 3-year periods following rate hikes than it did following rate cuts.

Why? The Fed generally raises interest rates when nominal economic growth is strong. Those environments have also historically been supportive of corporate profitability. Rate cuts, by contrast, often occur because economic conditions are deteriorating and the Fed is responding to that weakness.

Maybe the better question isn't whether investors should fear rate hikes, but what they should do when they happen.

Investing during rate hikes

A \$10,000 investment in the S&P 500 Total Return Index in September 1989 would have grown to more than \$462,000 by September 2026. Now imagine an investor who started with the same \$10,000 but also invested an additional \$1,000 the day after each of the Fed's 52 rate hikes over that period. That portfolio would have grown to more than \$962,000, more than twice the value of the original investment.

Of course, that strategy involved investing substantially more than the original \$10,000, but that's precisely the point. There were 52 rate hikes over our period of analysis, meaning the investor put an additional \$52,000 to work, roughly \$1,000 every 8.5 months. The lesson isn't that investing the day after a Fed rate hike is the best possible strategy. It's that consistently adding investments when the Fed is tightening has historically been a good one.

Rate hikes are often evidence of a strong economy

So, should investors fear Fed rate hikes?

History suggests no. Rate hikes can eventually become restrictive enough to end an economic cycle, which is why we pay close attention to how far the Fed ultimately needs to go. But a rate hike itself is not inherently bad news for markets. Quite often, it is evidence of an economy strong enough to warrant tighter policy.

Rather than viewing every Fed hike as a warning to pull back, history suggests investors may want to consider a different response. Sometimes a rate hike isn't a reason to get out. It may be an opportunity to put more in.

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In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as

well as general market, economic, and political conditions.

The S&P 500 Total Return Index measures the performance of the S&P 500 and assumes all cash dividends are immediately reinvested into the stocks in the index.

Tightening monetary policy includes actions by a central bank to curb inflation.

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