Rate Cuts in Focus: What Lies Ahead for Investors?

John Belton, Co-Portfolio Manager of the Gabelli Growth Innovators ETF (GGRW)

By kicking off the easing cycle with a 50bps reduction in the policy rate, the Fed has demonstrated a commitment to acting preemptively in attempting to secure a soft landing. Unfortunately, history tells us that rate cuts in isolation do not necessarily bode well for the stock market. More specifically rate cuts ahead of soft landings, as in the 1990s and pre-COVID years, are a good recipe for growth stocks as discount rates fall and economic fundamentals remain intact. However, rate cuts ahead of hard landings, as in the 1970s, 1980s and pre-GFC 2000s, have created negative stock market environments as the

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economy tips into recession and earnings fall. For this reason, while the more aggressive start to the easing cycle potentially increases the odds of a soft landing, investor focus now will shift more squarely to economic and company-specific data. If the recent softening in the labor market and pockets of the consumer and business sectors proves short-lived and the soft landing scenario does play out, then growth stocks will perform very well. Until we have more confidence in that happening we are viewing the Fed's decision as a net incremental positive but acknowledge a long road ahead.

Gold

Chris Mancini, Co-Portfolio Manager of the Gabelli Gold Fund (GOLDX)

The revenue generated by gold mines should increase as interest rates decline. This is because the price of gold should rise as the opportunity cost of holding a metal which has no yield also declines. If interest rates decline due to a weakening labor market and a lower rate of inflation, then mining costs should decline as well as labor markets loosen and the costs of materials such as steel and reagents decline. The bottom line is that the bottom line of gold mining companies should meaningfully benefit from declining interest rates as margins expand due to increasing revenue and a stable or declining cost base.

Automotives

Brian Sponheimer, Co-Portfolio Manager for the Gabelli Dividend & Income Trust

Auto dealers such as AutoNation (AN) stand to benefit from lower interest expenses tied to financing for inventory on their lots, as "floorplan" financing is based on floating rates. Additionally, reductions in interest payments on new auto loans should have a stimulative effect on demand, as lower rates help to reduce monthly payments for consumers. Similarly, equipment rental companies are well-positioned to benefit, as reduced financing costs will lower the expense of building new fleet and acquiring assets at more attractive rates. Companies like Herc Holdings (HRI), which carry a significant portion of their debt at floating rates, will see an immediate positive impact on earnings. Car rental companies, such as Avis (CAR), should also experience some relief as lower floating rates on asset-backed facilities used to finance fleets reduce carrying costs.

Converts

James Dinsmore, Co-Portfolio Manager of the Gabelli Convertible and Income Securities Fund Inc. (GCV)

The recent reduction in the fed funds rate should have a positive impact on the convertible market for two reasons. First, existing issuers will be able to refinance at more attractive terms. So we expect to see pricing improve on fixed income equivalent convertibles as investors anticipate that they are more likely to be paid off at or before maturity. Second, as the cost of issuing new convertibles decreases, we anticipate an uptick in convertible issuance as companies that waited to issue new debt come to the market. Typically new issues are priced in a way that is attractive to investors leading to positive short-term performance as well as a more balanced market over the long term. Rising interest rates have been a bit of a headwind in the convertible market over the last three years. The recalibration of monetary policy should create a situation where they have a positive impact on convertible performance over the coming years.

Utilities

Tim Winter, Co-Portfolio Manager of the Gabelli Utilities Fund (GABUX)

Utility stocks would benefit should the yield curve decline for a number of reasons:

1. A lower cost of capital makes borrowing to invest in infrastructure and rate base easier
2. It makes utility dividends more attractive
3. Valuations increase given a lower discount rate applied to future cash flows

In addition, should the 50-basis point cut imply an economic slow-down, defensive sectors like utilities would be expected to outperform given a more stable business profile (monopoly, necessary product, rate-regulated prices).

Semiconductors

Hendi Susanto, Co-Portfolio Manager for the Gabelli Automation ETF (GAST) and the Gabelli Equity Trust (GAB)

We view the recent interest rate cuts as largely bullish for the tech sector. The most immediate beneficiaries are companies dependent on customer capital expenditures, such as those in semiconductor capital equipment and additive manufacturing. With lower interest rates, sales cycles should shorten, encouraging more upgrades and capacity expansions. Additive manufacturing players, like Stratasys and 3D Systems, have seen system sales deferments due to high rates. For semiconductor capital equipment, the cuts add to other positive drivers, including the CHIPS Act and reshoring initiatives, which are expected to boost equipment spending in 2025. Companies like Applied Materials, KLA, and Tokyo Electron are positioned to benefit.

While AI infrastructure players such as Nvidia, Broadcom, and AMD were already poised for growth, the rate cuts offer minimal additional impact in the near term. The larger AI opportunity will come when enterprises start increasing their spending, which is expected to take time. Traditional IT infrastructure and semiconductor companies, such as Dell, Intel, and Texas Instruments, will likely see more spending and end-market consumption in 2025. Additionally, lower interest rates will encourage inventory building across distribution channels, benefiting companies like TSMC and Global Foundries.

Certain sectors like consumer electronics, automotive, and healthcare will also see indirect benefits, with companies like CTS and Micron standing to gain. The small-to-medium business (SMB) sector will also benefit from improved financing conditions, with N-Able and SolarWinds as players who focus on the mid-market. Lastly, companies with significant floating rate debt, like MKS Instruments, are well-positioned to gain from refinancing opportunities as they work towards deleveraging and improving their balance sheets.

Industrials

Justin Bergner, CFA, Co-Portfolio Manager of the Gabelli Dividend Growth Fund (GABBX) and the Gabelli Utilities Fund (GABUX)

Generally speaking, industrials hold up well when interest rates are rising relative to other cyclical/higher beta sectors. The positive relationship with interest rates, at least relative to other sectors, is more margin driven than sales driven. Industrials are good inflation hedges, they often show more pricing discipline in inflationary environments, and for some companies, see defined benefit pension liabilities diminish. Accordingly, industrials may underperform other cyclical/higher beta sectors when rates decline, even if their top line outlook improves.

Still, industrials serving interest rate sensitive consumer end markets, which have seen destocking, weak demand, and interest rate headwinds, should benefit. Stocks here include the likes of Greif and GXO Logistics. Distributors, particularly those not serving interest rate sensitive end markets, should be negatively affected as they see less operating leverage on fixed costs, notably labor. The likes of Grainger, Fastenal, and MSC Industrial come to mind. For many other industrials, including short cycle names like Timken and Rockwell Automation, demand could be stimulated off of weak levels, but pricing and margin power may abate, creating more neutral dynamics.

Aerospace and Defense

Tony Bancroft, Portfolio Manager: Gabelli Commercial Aerospace and Defense ETF (GCAD)

We believe that the recent interest rate cuts are an overall positive for the Aerospace and Defense sector. Commercial airline customers will benefit from cheaper borrowing costs, making it easier to finance new aircraft purchases. Additionally, lower interest rates should boost disposable income for consumers, driving demand for travel and increasing aftermarket services. Suppliers across the industry are also well-positioned to take advantage of lower debt costs, leading to improved free cash flow and the ability to expand operations, such as building more plants for weapons production and replenishment. Key beneficiaries of these trends include Triumph Group (TGI), Boeing (BA), Crane (CR), Fortress Transportation and Infrastructure Investors (FTAI), and General Electric (GE).

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