

Making Sense of Interest Rates and the Markets

Every Federal Reserve meeting attracts headlines.

"Will rates go up?"

"Will they finally come down?"

"What does this mean for my investments?"

The Federal Reserve's interest rate decisions matter because they influence borrowing costs, bond yields, business investment, consumer spending and, ultimately, financial markets. The Federal Reserve adjusts interest rates to support its dual mandate of maximum employment and price stability, making its decisions some of the most closely watched signals in the global economy. [1]

For investors, interest rates can help provide a clearer picture of the economy, but they aren't the only driver of market outcomes.

Why expectations have shifted this year

At the start of 2026, markets expected the Federal Reserve to continue cutting interest rates. Instead, inflation has remained more persistent than anticipated, energy prices have added uncertainty, and the U.S. economy has continued to show remarkable resilience [2,3]

The labor market added 172,000 jobs in May, nearly double expectations, while U.S. productivity has been growing at its fastest pace in roughly two decades. [3,4] Together, these developments have reduced the urgency for lower interest rates.

Much of this year's market movement has reflected changing expectations for the economy rather than changes in interest rates alone.

Why markets react strongly to Fed news

Every Federal Reserve announcement is interpreted through the lens of expectations. By the time the Fed meets, investors have already spent weeks analyzing the latest economic data and forming expectations about what comes next. Much of that thinking is already reflected in market prices [5]

That is why markets often respond less to the rate decision itself and more to what it signals about the path ahead. Even subtle changes in the Fed's language can influence expectations about where interest rates may be headed, [5]

Putting interest rates into context

Interest rates tell us a great deal about the economy, but they're only one piece of a much bigger picture. Markets are also influenced by inflation, corporate earnings, productivity, fiscal policy, consumer spending and geopolitical developments. Together, these factors help explain why periods of relatively high interest rates have still produced strong equity returns, while lower-rate environments haven't always translated into stronger markets. [8]

Looking at interest rates alongside these broader economic forces provides a more complete picture of what is driving markets and where opportunities may exist.

Maintaining a Long-Term Perspective

Behavioral finance research suggests that how often we watch markets can influence how we invest. Investors who regularly focus on short-term market movements become more sensitive and reactive to temporary losses, making them more likely to deviate from an otherwise sound long-term investment strategy. [9]

Understanding this, the next time the Federal Reserve announces a rate decision, consider asking this question:

"What does this tell us about the broader economy, and does it change my long-term financial plan?"

That perspective naturally shifts the focus from a single headline or short-term change to the bigger economic picture, where investment decisions are generally made with greater context and clarity.

What this means for investors

Interest rates influence almost every part of a financial plan. Higher rates make borrowing more expensive for both businesses and consumers and can also place pressure on company valuations. Savers, however, can benefit from stronger returns on savings accounts, certificates of deposit and money market funds. [6]

Bond investors experience a different dynamic. When interest rates rise, the value of existing bonds typically falls because newly issued bonds offer higher yields. Over time, however, those higher yields can create opportunities to reinvest at more attractive income levels, particularly within diversified fixed income portfolios [7].

The impact of interest rates is rarely uniform, which is why investment decisions are most effective when viewed within the context of an overall financial plan.

A financial advisor helps bring the context together. A well-structured financial plan provides a disciplined framework that helps keep investment decisions aligned with long-term goals, regardless of where interest rates move next.

Sources:

[1] Board of Governors of the Federal Reserve System, Why Do Interest Rates Matter?

[2] Vanguard, Our Economic Outlook for the United States

[3] U.S. Bank, How Do Changing Interest Rates Affect the Stock Market in 2026?

[4] *The Economist*, America Is Experiencing a Productivity Miracle

[5] University of Virginia Darden School of Business, Why the Fed's Words Move Markets

[6] Fidelity, What Is the Federal Reserve Anyway?

[7] PIMCO, Bonds 102: Understanding How Interest Rates Affect Bond Performance

[8] Morningstar, 7 Reasons to Stop Freaking Out Over the Fed

[9] Shlomo Benartzi and Richard Thaler, Myopic Loss Aversion and the Equity Premium Puzzle

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