

Primer: Interest Rates

Interest rates seem straightforward until the jargon hits: [yield curve inversion](#), risk premium, basis points, etc. What matters is how rates are set and what they do to money in the real world. Use this primer to understand interest rates.

1. The Core Idea

- Interest Rates = the price of money
- Borrowers pay it. Lenders earn it.
- That's it.

2. Who Sets the Interest Rates (Price)?

- A dozen unelected economists at the Federal Reserve (the Fed, the FOMC).
- Their dual mandate (their job): Full employment and ~2% inflation

3. Their Main Lever

- The Fed Funds Rate = the rate banks charge each other.
- Raise it → Money gets expensive → Economy slows.
- Cut it → Money gets cheap → Economy accelerates.

Ripple Effects of Lower Rates

- Cheaper borrowing: Mortgages, car loans, credit cards drop
- Savings punished
- CDs and bonds yield less
- Spending & risk rise
- Consumers buy, businesses invest
- Asset prices climb

Why Rate Cuts Aren't Always Good News

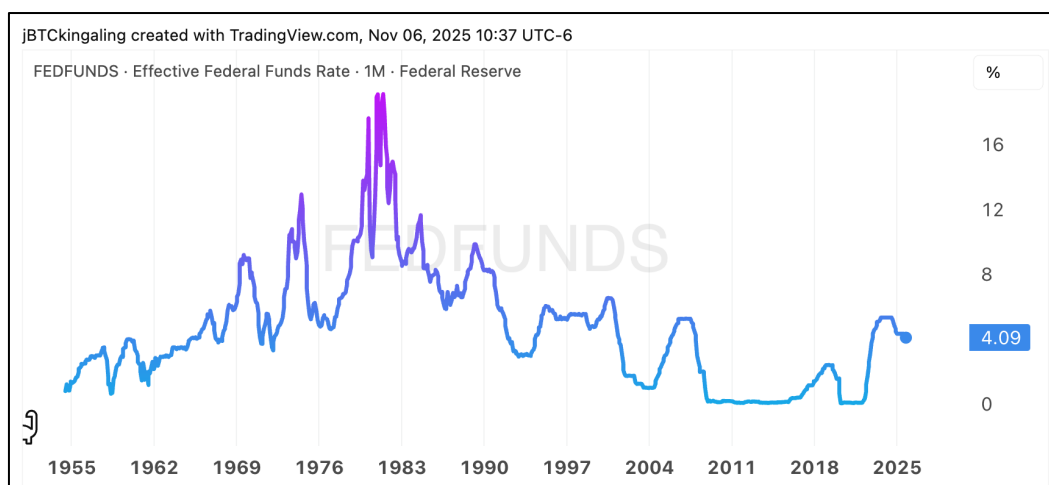
- Everyone wants cuts—cheaper mortgages, easier credit, faster growth.
- But history splits cuts into two buckets (since 1970): Celebratory or Rescue
- A cut in a roaring economy is champagne. A cut in a receding economy is an ambulance.

Bottom line: Watch the Fed Funds Rate and why it moves. The “why” tells you whether to celebrate or brace. Today looks more like an ambulance than champagne, despite markets at all-time highs.

Quick Cheat Sheet

- **Fed Funds Rate:** Overnight bank-to-bank rate; the Fed's gas & brake pedal
- **Yield Curve Inversion:** Short-term rates > long-term rates; 8-of-8 recession predictor since 1960. [My trade idea.](#)
- **Term Premium:** Extra yield investors demand for locking money up long-term
- **Bond Laddering:** Buying bonds of staggered maturities
- **Basis Points:** 1/100th of 1%. When the Fed cuts by 25 basis points, or "bp", they cut by 0.25%, for example from 4.00% to 3.75% is 25 basis points (25bp).
- **Dovish:** Favoring low rates to boost growth; "doves fly low".
- **Hawkish:** Favoring high rates to fight inflation; "hawks fly high".

The history of U.S. Interest Rates



Here's the difference in yield you get for holding a 10-yr. Treasury vs. 2-yr. Treasury

