FED WATCH: JUNE GLOOM

Kevin Flanagan – Head of Fixed Income Strategy
06/10/2020

Those of you outside Southern California may not be familiar with the term "June Gloom." It describes a late spring phenomenon where the marine layer brings in cool, cloudy weather in the morning, but the sun peeks through later in the afternoon. I've spent a good amount of time in SoCal, and the surprising rebound in the May jobs report made me think of this analogy. Is the economy about to experience something like this SoCal weather phenomenon? And what does the Federal Reserve (Fed) think?

It was no surprise the Fed left monetary policy right where it is at the June FOMC meeting. Like all of us, the policymakers are in uncharted waters and trying to figure out not only where the U.S. economy is headed in the second half of 2020 and 2021, but also how policy should respond. At this juncture, the FOMC chose the most prudent path of leaving well enough alone. Unprecedented monetary and fiscal policy responses have been, or are about to be, put in place. Let's just wait and see how things evolve.

Thus far, the Fed has to be pleased with the markets' response to its actions. By being proactive and aggressive early on, the Fed looks to have succeeded in avoiding another financial crisis at this point. Indeed, various funding measures are close to being back to pre-COVID-19 levels. In fact, looking at the Fed balance sheet, one can see how it is transforming from phase 1: preventing another financial crisis to phase 2: normalizing the money and bond markets.

Policymakers have already seen progress in phase 2 as well. U.S. investment-grade and high-yield spreads have seen noticeable retracement from their March peak spread readings, while the unusual dislocations seen in the Treasury (UST) market also seemed to have dissipated.

Perhaps more interesting than the June FOMC meeting has been the recent action in the UST 10-Year. The yield level spiked at the end of last week, and at one point was only 5 basis points (bps) away from the 1% threshold. I think the recent trading activity in both the UST and credit markets has underscored my point about the bond market moving on and having already priced in the bad news. Now, the question is more about what 2H2020 and 2021 are going to look like.

Allow me to re-introduce Mr. Fibonacci for some technical analysis: Using a one-year horizon, the next UST 10-Year retracement level is 1.0252%, followed by a 50% retracement at 1.2449%.

Bottom line: As we discovered from the June FOMC meeting, the Fed seems poised to keep the 'pedal to the metal' in terms of its aggressive monetary policy. Against this backdrop, and taking into consideration the recent yield uptick in the UST 10-Year, we suggest investors revisit their fixed income portfolios and consider including some rate hedges.

Stay tuned for next week's blog, where I will discuss some of these specific rate-hedged solutions in more detail…

Unless otherwise stated all data sourced is Bloomberg as of June 5, 2020.

this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

High Yield Corporate (Bond) : a type of corporate bond that offers a higher rate of interest because of its higher risk of default.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Fibonacci retracement : A technical analysis tool displaying percentage lines which look at support and resistance levels, potentially signaling short-term price/yield reversals. The concept of retracement suggests that after a period of market movement, prices/yields can retrace a portion of their prior pattern before returning to their original trend.