IS EARLY LIFT-OFF A "FOUR"GONE CONCLUSION?

Kevin Flanagan – Head of Fixed Income Strategy
01/12/2022

One week into the new year and the money and bond markets have wasted no time generating headlines, with yield levels rising essentially across the spectrum of Treasury (UST) maturities. Sometimes investors are left searching for answers for these type of quick and sizeable rate movements, but not this time. This time around, the catalyst is abundantly clear–the Fed.

The opening trading sessions of 2022 in the UST market did have a decidedly upward rates bias, but it was the release of the December 2021 FOMC minutes that acted as an accelerant for the trend that was already in place. Specifically, this summary of the prior Fed meeting had a more 'hawkish' tilt to it. The policy makers discussed a potentially quicker pace to balance sheet normalization, but more importantly, they mentioned the possibility of "earlier, faster rate hikes."

Needless to say, the money and bond markets took this new Fed insight and adjusted their timeline for liftoff, a.k.a. the first rate hike, by beginning to push up the timetable more toward the March 2022 FOMC meeting versus the prior expectation of either May or June. The December jobs report only added to this sentiment. Yes, the headline nonfarm payroll number did not produce as many jobs as what was forecasted, but perhaps more important in the eyes of the Fed, was the -0.2 percentage point drop in the unemployment rate accompanied by the higher-than-expected year-over-year gain of 4.7% for average hourly earnings. In fact, over the last six months, wages have risen at an annualized rate of 5.7%, a sign that inflation could remain 'sticky.' Thus, a gain of roughly 200,000 in payrolls can be viewed through a different, monetary policy perspective.

OK, so where does that leave us now? Well, as of this writing, Fed Funds Futures implied probability now sees an over 80% chance of liftoff occurring in March with 3.5 rate hikes now priced in for all of 2022. Interestingly, St. Louis Fed President Bullard (a 2022 voting member) stated last week, "The FOMC could begin increasing the policy rate as early as the March meeting in order to be in a better position to control inflation." Unless Powell & Co. push back on the money and bond markets' newfound positioning, it looks like four, not three, rate hikes could be in the offing for this year with perhaps a March, June, September and December timeline. This is the playbook Powell used in 2018. For those keeping count that would be a total of 100 basis points (bps) in rate hikes (assuming only quarter-point increases). However, keep in mind, the Fed may view each FOMC meeting this year as being 'live.' That is, they could potentially raise rates at any time.

Conclusion

As I wrote in last week's blog post, our high conviction trade of rising rates for 2022 should be a primary consideration for fixed income portfolios. Traditional hedging vehicles, such as short-term fixed coupon Treasuries, can produce negative returns in an environment where the Fed is the lead catalyst for higher yields. In addition, as we have seen within the last week or so, TIPS can also fall into that same category, as witnessed by the 35 bps increase in 10-Year real yields since New Year's Eve.

In contrast, Treasury floating rate notes are designed to adjust their yield with the Fed as they are reset every week with the weekly 3-month T-Bill auction.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

Related Blogs

+ 2022’s High Conviction Trade: Rising Rates
+ It’s Beginning to Look a Lot Like
+ In the Eye of the Beholder

Related Funds

+ WisdomTree Floating Rate Treasury Fund
+ WisdomTree Interest Rate Hedged High Yield Bond Fund
+ WisdomTree Interest Rate Hedged U.S. Aggregate Bond Fund

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

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.

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

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

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Fed fund futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Basis point : 1/100th of 1 percent.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

TIPS : Treasury Inflation Protected Securities.

Treasury Bill : A treasury bill (T-Bill) is a short-term debt obligation backed by the U.S. government with a maturity of one month (four weeks), three months (13 weeks) or six months (26 weeks).