FED WATCH: DECISION DAY

Kevin Flanagan – Head of Fixed Income Strategy
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Without a doubt, the results of today’s Federal Open Market Committee (FOMC) meeting may be the most anticipated monetary policy gathering thus far in 2016. Indeed, given the back-and-forth “Fedspeak” over the last few weeks, the money and bond markets can be forgiven for having a bit more uncertainty this time around. So, let’s give a little bit of “Fed 101” aspect to this post. At the September FOMC meeting, the voting members will also be providing their Summary of Economic Projections (SEP) in addition to chair Yellen’s press briefing and the usual policy statement. In other words, the markets will have plenty to digest, including and perhaps most importantly, some messaging as to what to possibly expect for the remainder of the year. While the decision to raise or not to raise the Federal Funds Rate will take top billing initially, the wording in the accompanying policy statement will more than likely receive a great deal of attention as well. **What Should Investors Be Looking for in Terms of the Policy Statement’s Language?** Obviously, the announcement of whether the target range for Fed Funds has been elevated or remains the same comes first, but what’s next? Certainly, the FOMC will, as always, acknowledge recent economic developments and give a nod to its inflation outlook. More than likely, the assessment will be that activity has shown signs of improvement, labor market utilization has increased but inflation remains below the Fed’s 2% target, with the expectation that it will return to this threshold. Given the lack of any negative repercussions from the post-Brexit vote up to this point, the policy makers may remove any mention of “near-term risks” from their outlook. In addition, prior to lift-off in December, the voting members inserted language regarding the “risks to the outlook for both economic activity and the labor market” as being “nearly balanced” or “balanced,” once they actually increased the Fed Funds target. Outside of the policy statement, the “blue dots,” or Fed members’ projections for the level of Fed Funds over the next few years, will also receive attention. This portion of the SEP will be looked at as guidance for the potential path of rate hikes, in terms of both magnitude and timing. As we have detailed before, the “blue dots” have not had the best of track records, but the money and bond markets as well as market commentary will nevertheless be focusing on them. Finally, the FOMC is also more than likely to revisit its central tendency estimates for the economy and inflation. And of course, don’t forget Yellen’s presser! **Conclusion** The backdrop to the U.S. Treasury (UST) market going into this meeting has shifted over the last week or so. While economic data on manufacturing activity and retail sales have been soft, UST 10-Year yields have actually risen. Since right after Labor Day, the 10-Year yield rose at one point by 20 basis points (bps) to 1.73%, the highest reading in about three months, and nearly 40 bps above its all-time low that was printed in early July. This increase did not reflect heightened expectations for a Fed rate hike today. To illustrate, the UST Two-Year yield (which is sensitive to Fed expectations) has risen less than 5 bps during this same time frame, while September Fed Funds futures implied probability is at 18% as of this writing. Instead, the rise in the UST 10-Year yield is post-European Central Bank (ECB) related and probably an overreaction to the outcome of last week’s policy meeting. Eurozone sovereign debt markets were disappointed by the results, with corresponding yields rising accordingly. In other words, the UST 10-Year is responding to the increase in global 10-year yields instead (term premium). During this process, the UST 10-Year technical level (Fibonacci) went through a 100-day moving average of 1.6307%. For those

keeping score, the 200-day moving average is at 1.7891%; while the next retracement level (at 50%) is 1.8464%.[1] [1]Source: Bloomberg, as of 9/15/2016.

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DEFINITIONS

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 Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

Inflation : Characterized by rising price levels.

Brexit : an abbreviation of "British exit" that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Unio.

Blue dots : the midpoint target range/level of the FOMC participants' projections for the future Federal Funds Rate.

U.S. Treasury Bill : A short-term debt obligation backed by the U.S. government with a maturity of less than one year.

Basis point : 1/100th of 1 percent.

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.