# MONEY IN MOTION: PLAYING ALONG DIRECTLY WITH FED RATE CUTS

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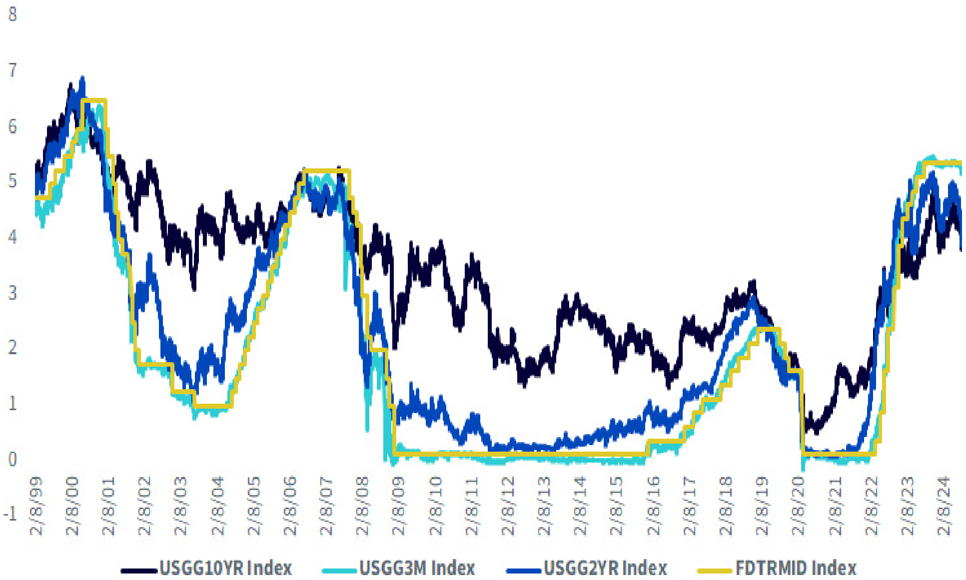
It has certainly not been a slow start for the dog days of August in the money and bond markets. The combination of a dovish Fed Chair Powell post-FOMC presser and cooling labor market setting provided more fuel for Fed rate cuts. In fact, post-jobs, the debate is no longer centered on the number of potential easing moves for the remainder of 2024, but rather on how large they could possibly be. That brings us to part two in my *Money in Motion* series: how to play along more directly with Fed rate cuts.

Before we get to the solutions portion of this blog post, let's first provide some insights. There is a belief that whatever happens to the Fed Funds Rate will then be passed along to the Treasury yield curve in a similar fashion. While directionally, the idea of the Fed Funds Rate and UST yields moving up or down in tandem is somewhat accurate, the magnitude and timing of the changes tend to be less straightforward.

**Fed Funds vs. UST 3-Mo, 2-Yr & 10-Yr Yields**




Source: Bloomberg, as of 8/2/24. For definitions of indices in the chart above, please visit the glossary.

Obviously, one begins with the Fed Funds target range, which represents overnight money. As a result, the closer the maturity is to Fed Funds, the more positive the correlation is going to be. The above graph highlights the relationship over the past 25 years between the mid-point of the Fed Funds target range and the UST 3-month t-bill, as well as the UST 2-Year and 10-Year note yields. The UST floating rate note could also be considered in this analysis given the fact that it "floats," or is referenced, to the weekly UST 3-month t-bill auction.

As you would expect given my above statement, the correlation between Fed Funds and the 3-month t-bill is extraordinarily tight, while the relationship with the 2-Year note is also very positively correlated. However, the positive correlation begins to lessen considerably the further one goes out on the yield curve as illustrated by the spread between Fed Funds and the UST 10-Year note. While directionally these two rates tend to move in a similar way, the correlation in yields is noticeably lower when compared to maturities that are closer to Fed Funds.

Intuitively, this makes perfect sense. A maturity structure that is not too far removed from the Fed Funds Rate will be anchored and directly linked to trends in overnight money (Fed rate hikes/cuts). But, as you continue to move away from this anchor, other factors besides the Fed begin to come into play, and thus, investors demand a "term premium," or an additional return or yield for the potential risk incurred by holding a security that is longer-term in maturity. In addition, inflation and future economic expectations also play a role.

While market talk for a 50 basis point rate cut from the Fed in September is now increasing, based on Powell's comments post-FOMC and the policy statement, I would say this was the type of jobs report the Fed needed to first confirm a cut of any kind. This puts Powell's Jackson Hole (August 22–24) appearance squarely front and center for rate cut forward guidance. Although rate cuts are now definitively a base-case scenario, what they ultimately look like will remain a fluid consideration.

**Solutions**

Against this backdrop for rate cuts, WisdomTree offers two solutions that investors can use to potentially take advantage of this scenario, which should be very correlated to changes in the Fed Funds trading range.

- For investors who would prefer more of a "pure" rate play and focus only on U.S. government securities, we recommend considering a solution in our Treasury suite of Funds: the WisdomTree 1-3 Year Laddered Treasury Fund (USSH).

- For investors who are looking for additional yield in a quality-screened investment-grade strategy and wish to keep duration around 2 years, we recommend considering the WisdomTree U.S. Short-Term Corporate Bond Fund (QSIG).

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**Duration** : A measure of a bond’s sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.