FED WATCH: I'LL SEE YOUR 50 AND RAISE YOU 75

Kevin Flanagan – Head of Fixed Income Strategy
06/15/2022

In what was expected to be a relatively uneventful Fed meeting a few short days ago, the June FOMC gathering turned into a headline-making event instead. The voting members raised Fed Funds by 75 basis points (bps) to a new target range of 1.50%–1.75%. This was the first 75-bp rate increase since 1994. With this latest move, the voting members have hiked rates by a total of 150 bps over the last three months. However, the narrative of future rate hikes has now been potentially tilted to the upside following the surprising increase in inflation in the May CPI report.

Following the rout of the money and bond markets post the aforementioned CPI report, "autopilot" monetary policy has just been turned on its head. While the current two-tiered policy approach (rate hikes and quantitative tightening (QT)) is essentially unprecedented and takes not only the Fed but also the markets into uncharted waters, now the future magnitude of rate increases has "clouded" the journey even more.

The term "data dependent" has been, and will continue to be, the "hot button" phrase. In addition, the Fed will be monitoring financial conditions closely. That being said, at the present time, Powell & Co. are without a doubt placing fighting inflation as their primary, if not only, concern. In fact, unless the economic data and/or financial conditions completely fall apart, it is difficult to envision the policy makers letting up "on the brakes" any time in the foreseeable future.

Actually, given how "far behind the curve" the Fed was to start this tightening cycle, it definitely had some catching up to do. Hence, the emphasis of late on 50-bp, and now 75-bp, rate hikes. Powell's stated goal has been to get to "neutral" "expeditiously" in terms of the Fed Funds Rate. Now, the debate will turn to monetary policy becoming restrictive as we move forward.

As we've seen this year, especially lately, the situation surrounding monetary policy remains a fluid one. Just within the last month or so, market expectations shifted from 50-bp rate hikes to the Fed pausing its rate increases due to potential recession concerns, but now 75-bp rate hikes are all the rage. It is important to keep in mind that QT can be akin to rate hikes as well, and policy moves act with a lag, further clouding the outlook.

Conclusion

As I mentioned previously, by implementing this two-pronged policy-tightening approach, the Fed is taking the bond market into uncharted territory. What we do know is that the Fed is determined to take rates to higher ground. While Treasury yields have already risen in a visible fashion year-to-date, Powell & Co. have now begun to put their words into action, keeping rate risk elevated accordingly. Against this backdrop, we continue to recommend that fixed income investors position their portfolios for further increases in interest rates going forward.

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

+ How to Find Higher Yield
+ Unsure about Duration? Use the Barbell
+ Slow…Curves Ahead

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.

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

Federal Funds (Fed Funds) : Excess reserves that commercial banks and other financial institutions deposit at regional Federal Reserve banks

Basis point : 1/100th of 1 percent.

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.

Consumer Price Index (CPI) : A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Quantitative Tightening : Quantitative easing is a process whereby a central bank targets lowering longer-term interest rates by purchasing bonds and other securities to stimulate the economy. Quantitative tightening is the reverse process whereby securities are either sold or the proceeds of maturing securities are not reinvested with the goal of tightening economic conditions to prevent the economy from overheating.

Curve : Refers to the yield curve. Positioning on the yield curve is important to investors, especially during non-parallel shifts.

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.