

IS EARLY LIFT-OFF A “FOUR”GONE CONCLUSION?

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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.

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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).