
IT'S BEGINNING TO LOOK A LOT LIKE

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The final FOMC meeting for 2021 is now in the books and the money and bond markets are poised to turn the calendar. If you think about where monetary policy expectations were to begin this year, or even just three to six months ago for that matter, it has been a notable transformation. If you had broached the idea that the [Fed](#) would be raising rates in 2022, let alone multiple times, your argument would have been dismissed out of hand. But now, it's beginning to look a lot like [rate hikes](#) may be coming next year.

First, though, the Fed needs to finish up some balance sheet business—[tapering](#). The December FOMC meeting laid the groundwork for the Fed to end their tapering process sooner than originally outlined. Once this part of their exit strategy ends, the policy makers will need to decide on what to do with their holdings of Treasury and [mortgage-backed securities](#) when they mature. In my opinion, the first step will be to roll over the proceeds of the maturing debt on the Fed's balance sheet and re-visit this issue later on.

That brings us to the ultimate headline-maker, liftoff. Until now, Chairman Powell had basically given the thought of rate hikes the proverbial Heisman. To quote him from the November FOMC presser, the “rates-liftoff question isn't before us now.” My, how things have changed in six weeks' time. Indeed, the [blue dots](#) (the Fed's projections for Fed Funds) have now shifted to 2022 for the median estimate. Remember when the first rate hike wasn't expected until after 2023?

The question before the markets now seems to be when is actual liftoff, and how many rate hikes to expect? In my opinion, Chairman Powell needs to provide that forward guidance in order to avoid any surprises and/or misinterpretations. As of this writing, the implied probability for fed funds futures is looking at Q2 (May/June) as the start date and around two to three rate hikes for 2022 as a whole.

Lately, there has also been some concern about a potential policy mistake or the Fed becoming too [hawkish](#). Utilizing Powell's prior bout of rate hiking as a guide, I feel the Fed will be deliberate in their rate-hiking approach, at least to begin with. Then, if [inflation](#) continues to run 'too hot' (as is the present case), the policy makers may take a more aggressive turn.

Conclusion

Where does that leave us? Quite simply, rising rates is our primary theme for 2022. In our most recent *Office Hours*, on the inflation front, we asked advisors if rate [hedging](#) had become a priority for the bond portion of their portfolios. A little more than 40% answered: Not yet, but they are actively considering it.

Advisors may want to start implementing such solutions now, because as we've seen this year, Fed policy could look much different in the months ahead than what is currently expected.

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DEFINITIONS

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

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.

Tapering: A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

Mortgage-backed securities: Fixed income securities that are composed of multiple underlying mortgages.

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

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

Inflation: Characterized by rising price levels.

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.