COULD LIFTOFF BE PUSHED UP AGAIN?

Kevin Flanagan — Head of Fixed Income Strategy
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That's the question the bond market will be asking itself, if it isn't doing so already. I don't typically write two post- FOMC meeting blog posts, but the situation calls for it this time around. While everyone seems to be "talking about, talking about tapering," perhaps the more important outcome of the Federal Reserve (Fed) meeting, in my opinion, was the movement in the 'blue dots'…and here they are:

FOMC Participants' Assessments of Appropriate Monetary Policy: Midpoint of Target Range/Target Level for Federal Funds Rate

Figure 1_FOMC Blue Dots

In my blog post from last week, we focused on how the Fed pushed up the estimated timing of the first rate hike from 2024 to 2023. In fact, if you look at the above chart closely, not only is 'liftoff' now slated for 2023, but the median estimate is for two rate increases. BUT, what I really wanted to call your attention to is the outlook for next year. This is a topic we discussed in detail on our recent webinar, "Another Episode of That 70's Inflation," which I co-hosted with Jeremy Schwartz, WisdomTree's Global Head of Research, and our special guest, Wharton Professor Dr. Jeremy Siegel.

First, some quick blue dots 101. At present, there are 18 Fed members providing estimates for the future Fed Funds Rate. As of the June FOMC meeting, there are now seven policymakers projecting the first increase to occur in 2022, up from just four at the March gathering. Interestingly, this trend, of an increasing number of Fed members pushing up the timing for liftoff, is exactly what occurred for the '2023–2024' outcome. Is this where we could be headed later this year? Dr. Siegel said 'yes' during our webinar, and given the continued economic recovery and elevated inflation backdrop, it certainly does seem to be the more likely scenario. Remember, it only needs three more members to move into the 2022 camp for the Fed Funds estimate to change.

Conclusion

So, is the bond market prepared for such an outcome? At current yield valuations, I would argue it is not. Investors did get to see a snapshot of what could be expected if the estimated time of liftoff is in fact pushed up to 2022 later this year. Specifically, vehicles that are often used as rate hedges like TIPS and short-term Treasuries actually saw their yields rise in response to the June Fed meeting. This development offered investors a real-time example of what could continue to occur in the scenario laid out in this blog post. As a result, I would suggest investors consider other rate hedge solutions such as WisdomTree's Zero Duration and Treasury Floating Rate strategies to help navigate the waters that may lie ahea d.

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DEFINITIONS

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

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

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

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

Fed funds target range : the interest rate band the Federal Open Market Committee decides to implement for the federal funds rate.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

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.

Zero duration strategies : Refer to WisdomTree's Interest Rate Strategies that target an overall portfolio duration of zero; namely, the WisdomTree Barclays U.S. Aggregate Bond Zero Duration Fund and the WisdomTree BofA Merrill Lynch High Yield Bond Zero Duration Fund.

Floating Rate Treasury Note : a debt instrument issued by the U.S. government whose coupon payments are linked to the 13-week Treasury bill auction rate.