FED GOES NUCLEAR

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The Federal Reserve (Fed) has responded yet again, but this time around, the policy makers made sure their message was heard loud and clear around the globe. Let's just say, the Fed has gone nuclear!

- For the third time, the Fed made an inter-meeting move by cutting the Fed Funds target a full 100 basis points (bps) to 0–0.25%. We are now back to ZIRP, a zero interest rate policy.
- Quantitative easing 4 (QE4) has begun in earnest. The Fed will increase its balance sheet by $700 billion: $500 billion in Treasuries and $200 billion in mortgage-backed securities.
- In addition, using a page out its financial crisis playbook, the Fed will coordinate with other central banks (Bank of Canada, Bank of England, Bank of Japan, European Central Bank, Swiss National Bank) to enhance USD availability/liquidity.
- Additional measures to address the funding markets were also announced, with perhaps the most recognized move being to lower the "discount window" primary credit rate by 150 bps to 0.25%.
- While it would seem as if the U.S. policy makers have come close to exhausting their toolkit, remember, the "alphabet soup" facilities they used for the funding markets are still available.
- Based upon Powell's presser comments, it would appear as if negative policy rates are not on the table.
- Also, the Fed can always raise its QE purchase amounts.

Will this latest action work? Great question! The Fed is certainly using its arsenal, but let's wait and see what comes from the fiscal side of the equation. In our opinion, both monetary and fiscal policy responses are needed to break the negative feedback loop for the markets and the economy.

Prior QE episodes also coincided with the U.S. Treasury 10-Year yield reaching a bottom and moving higher in subsequent months. We would expect this history to repeat itself and recommend considering rate-hedged strategies while paring long duration holdings.

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DEFINITIONS

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

Basis point : 1/100th of 1 percent.

Quantitative Easing (QE) : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

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.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.