

# READY, SET, HIKE...

**Kevin Flanagan — Head of Fixed Income Strategy**  
**01/26/2022**

The New Year is now in full swing as the [Federal Reserve](#) has officially weighed in on the direction of [interest rates](#)... they're going up! Obviously, the lion's share of investor attention focuses on the outlook for Fed Funds, but it is also important to include the Fed's thoughts on how and when balance sheet normalization could come into play.

First up, [rate hikes](#). Unless an unexpected turn of events occurs on the economic/[inflation](#) front, the voting members seemed to have confirmed the market's expectation that lift off will be in March. Even though there was no [dot plot](#) this time around, the Fed also didn't seem to push back on the newfound belief that four rate hikes could be forthcoming this year. In fact, instead of a presumed timetable for "gradual," or "measured," rate increases as we have seen mentioned in past rate hike cycles, Powell & Co. are guiding the markets toward the notion that each [FOMC](#) meeting will be live. In other words, a rate hike could occur at any future FOMC meeting.

That brings us to the [balance sheet](#), or let's call it [quantitative tightening](#), a.k.a QT. That's right, just as the Fed's large-scale asset purchases of Treasuries (UST) and mortgage-backed securities (MBS) is an easing tool of monetary policy (QE), QT should be viewed as just the opposite, a tightening tool of monetary policy.

What exactly is QT? One thing it is not is [tapering](#). Remember, tapering is still adding to the Fed's balance sheet, but at a lesser pace, so think of it as 'QE-lite'. In contrast, QT is when the policy makers actually reduce their holdings of UST and MBS to shrink their balance sheet. It can come in two forms: 1) actually selling these aforementioned holdings or 2) letting their UST/MBS positions mature and/or redeem without replacing them. With regard to option #2, the Fed can decide to let the maturities/redemptions occur in full or the policy makers could choose to let a portion 'run-off' and reinvest the remainder of what actually matured/redeemed.

The timing of the Fed's QT program is what will set this early rate hike cycle apart from the prior episode. Indeed, the policymakers stated that they expect to begin reducing their balance sheet "after the process of increasing the target range for the federal funds rate has begun." With March looking like the timing for lift-off now, QT could start any time after that.

## Conclusion

So, besides trying to determine when to raise rates throughout the course of this year, the FOMC will also be determining how and when to proceed with their balance sheet [drawdown](#). Recently, there has been a lot of conjecture that the Fed could raise rates more than four times in 2022. However, I would advise to not lose sight of the power of the balance sheet option. A drawdown of their UST and MBS holdings should be viewed as akin to a quarter-point rate hike, and perhaps that's how the Fed gets to five 'rate hikes' this year.

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

+ [Is Early Lift-Off a "Four" Gone Conclusion?](#)

## Related Funds

- + [WisdomTree Interest Rate Hedged U.S. Aggregate Bond Fund](#)
- + [WisdomTree Floating Rate Treasury Fund](#)
- + [WisdomTree Interest Rate Hedged High Yield Bond Fund](#)

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](http://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.

**Interest rates** : The rate at which interest is paid by a borrower for the use of money.

**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.

**Inflation** : Characterized by rising price levels.

**Dot Plot** : a chart based on the economic projections of the Federal Reserve board members that illustrates their views on the appropriate pace of policy firming and provides a target range or target level for the federal funds rate.

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

**Balance sheet** : refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new position.

**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.

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

**Drawdowns** : Periods of sustained negative trends of return.