

# FED WATCH: NOT SO FAST, MY FRIEND

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Once again, the [Fed](#) did what was widely expected and kept the Fed Funds target unchanged at the January [FOMC](#) meeting. As a result, the trading range remains at 5.25%–5.50%, still at a more than 20-year high watermark. Unlike the past two years, when rate hikes dominated the landscape, calendar year 2024 is expected to bring a change in scenery for [monetary policy](#), with rate cuts now the primary theme for the Fed, and the timing and magnitude for an easing in policy still uncertain. The money and [bond markets](#) have been harboring optimistic expectations on the rate cut front, but as of now, the Fed seems to be saying “not so fast, my friend.”

The huge rally in the [U.S. Treasury \(UST\)](#) arena from the October 2023 peaks in yield has been based on the notion the economy, especially the labor markets, would soften considerably with the recent disinflation trend continuing in full force. As a result, investors entered the new calendar year with the money and bond markets discounting a total of six rate cuts worth about 150 [basis points](#) for all of 2024. In addition, this optimistic outlook was highlighted by the March FOMC meeting as the starting point for this easing in policy.

In our opinion, that left [UST yield](#) levels in a somewhat precarious position because the market's pricing mechanism had essentially left no room for error. As we have found out through economic reports released up to this point, the market's narrative has been under some challenge. There's no doubt the voting members have now placed their decision-making process in a more balanced position between their dual mandates of employment and [inflation](#). Against this backdrop, the Fed does seem to be on board for cutting rates this year, but the policy makers appear to be saying that the optimistic expectations need to be pared back a bit.

Interestingly, this disconnect between what the money and bond markets are pricing in versus what Powell & Co. are thinking is not new. In fact, we saw this exact type of misinterpretation play out during the recent rate hike episode. Looking back with hindsight, we all know how that played out...the UST market had to come to the Fed, not the other way around. At this juncture, unless the economy/labor market falls off a cliff, it seems likely this is how the current situation will also conclude.

Also, keep [quantitative tightening \(QT\)](#) in mind. While the lion's share of attention is laser-focused on the Fed Funds Rate outcome (and rightfully so), the Fed's [balance sheet](#) will more than likely also come into view later this year. An imminent end to QT does not appear to be on the table just yet, but reducing the pace of their balance sheet run-off looks like it will become part of the monetary policy landscape later in 2024, as well.

## The Bottom Line

Although the overarching outlook for fixed income in 2024 is centered on rate cuts, we still haven't solved the timing and magnitude questions. These unknowns will no doubt continue to create an elevated [volatility](#) quotient for Treasuries until some clarity comes into the picture.

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## DEFINITIONS

**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.

**Monetary policy** : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

**Bond market** : The bond market—often called the debt market, fixed-income market, or credit market—is the collective name given to all trades and issues of debt securities. Governments typically issue bonds in order to raise capital to pay down debts or fund infrastructural improvements.

**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.

**Basis point** : 1/100th of 1 percent.

**Treasury yield** : The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

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

**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.

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