FED WATCH: HERE COME THOSE TEARS AGAIN

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That didn't take long, now, did it? Of course, we're referring to the Federal Reserve's (Fed) next policy meeting, which is slated for next week, January 31/February 1. For the record, this convocation will not include any updated FOMC forecasts, nor will it be followed by a press conference from Janet Yellen. Instead, the money and bond markets will be left to digest only the accompanying policy statement.

In our opinion, it seems highly unlikely the policy makers will decide to raise the Federal Funds target at this gathering. To be sure, we are subscribers to the notion that the voting members do not want to spring any unexpected rate hikes on the markets, despite the fact that Fed officials like to point out that their policy meetings should be viewed as "live" events. At this point in time, there has been no indication the Fed has prepared the markets for such an event, and perhaps more importantly, the economic data that has come in since their December 2016 gathering has not revealed a landscape that would necessitate another lift in the Fed Funds Rate so soon, especially with the uncertainty quotient being dialed up regarding the potential for some fiscal stimulus, now that Inauguration Day is behind us.

Fed Chair Yellen made two public appearances last week that cast an interesting light on current Fed thinking. The recurring theme seemed to be that policy makers are more pleased with how developments are playing out with respect to their dual mandate, "maximum employment and price stability," and how they believe they are close to achieving these dual goals. Against this back drop, Yellen stated that she "can't tell you" when the next rate increase may be coming but reiterated that the Fed expects a "few" rate hikes this year and in 2018, a forecast that was first made public at the December FOMC meeting. As a reminder, this median forecast (the "Blue Dots") called for three increases in the Fed Funds target range for this year, so I guess that was what was meant by "a few'."

In contrast to that forecast, the money and bond markets are still not convinced. As of this writing, Fed Funds Futures are priced for only two rate hikes this calendar year, a situation that seems eerily reminiscent of where we were a year ago, when Fed officials were guiding the markets to operate under the assumption that their projection for four increases would be appropriate. Needless to say, the fixed income arena thought this was too aggressive a forecast too. We all know who "won" that one and wonder who will be singing "Here Come Those Tears Again" when calendar year 2017 is completed—the FOMC or the money and bond markets.

Conclusion

WisdomTree is projecting that the Fed will raise interest rates twice this year, with a tilt toward three increases, depending on the outcome of fiscal policy. Investors looking to mitigate potential interest rate exposure may wish to examine the benefit of floating rate Treasury securities notes (FRNs). FRNs are based on a reference rate that is determined at the weekly three-month Treasury Bill auction. Given the potential for additional increases in the Fed Funds Rate in 2017, some "Fed protection" seems warranted. Against this backdrop, we feel investors may be better able to insulate their bond portfolio utilizing a floating rate product such as the WisdomTree Bloomberg Floating Rate Treasury Fund (USFR), as compared to a more traditional fixed income investment.

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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.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Fiscal Stimulus : Using fiscal policy as a tool to provide economic growth.

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.

Fed fund futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

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.