# GREETINGS FROM JACKSON HOLE... SEE YOU IN SEPTEMBER

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Last week's Jackson Hole speech from Federal Reserve Chairman Jay Powell may have been one of the most anticipated events of the year for the financial markets. It had been assumed, and rightfully so, that Powell would offer some type of guidance regarding the timing of the policy makers' eventual taper program. Well, Powell did not disappoint on that front, but given the Fed's prior forward guidance on this topic, I didn't see anything groundbreaking in his actual text.

In fact, if you had read the July FOMC minutes, you could have written the Jackson Hole speech for Powell. This passage from the minutes sums up the Fed's thoughts (my highlights):

> *Looking ahead, most participants noted that, provided that the economy were to evolve broadly as they anticipated, they judged that it could be appropriate to start reducing the pace of asset purchases this year because they saw the Committee's "substantial further progress" criterion as satisfied with respect to the price-stability goal and as close to being satisfied with respect to the maximum employment goal.*

While not verbatim, this is exactly what Powell's message was at Jackson Hole.

Ok, so now we know that unless the COVID-19 delta variant results in a visible negative effect on the economy, Powell feels "it could be appropriate to start reducing the pace of asset purchases this year" because he feels the "substantial further progress test has been met for inflation" while "there has also been clear progress toward maximum employment." Does that look familiar?

It is time then to turn the page to the next, and arguably more important, part of the Fed's exit strategy, which is the first rate hike. On this front, Powell made sure to couch his remarks a bit more and emphasized two points: 1) tapering "will not be intended to carry a direct signal regarding the timing of interest rate liftoff" and 2) "we have much ground to cover to reach maximum employment," a key criteria for rate hikes to commence.

Thus, Fed policy has essentially become extra data dependent as it relates to future jobs reports. We are going back to the good old days, for those of you who might remember, when the monthly employment release was must-see TV. In order for the policy makers to feel comfortable regarding liftoff, it will take a sustained period of solid jobs numbers bringing nonfarm payrolls back to, and perhaps above, their pre-pandemic levels and the attendant decline that should ensue for the unemployment rate.

This brings us to the September 22 FOMC meeting where a new batch of 'blue dots' (the Fed's rate hike forecasts) will be available. We only need three members to shift their dot to move the Fed's median estimate for liftoff to next year! In my opinion, this will be the new bond market focus going forward.

Consider this: the U.S. Treasury (UST) 5-Year note is often viewed as the fulcrum in the rate discussion. As of this writing, the yield is now only about 15 basis points (bps) below the April 2021 high of 0.98%, while the UST 10-Year yield is still 40 bps below its peak from earlier this year. I think the UST market is pointing in the direction of where rates are headed later this year and into 2022.

Rate-hedging should remain a key aspect to bond portfolios, because, in my estimation, rates are going higher. It's more a matter of when, not if.

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## DEFINITIONS

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

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

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

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

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

**U.S. 5 Year Treasury Note** : A debt obligation issued by the United States government that matures in 5 years.

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

**Rate-Hedged** : A bond portfolio that has offsetting positions in Treasury securities to reduce interest rate risk.