

# Is Early Lift-Off a ‘Four’gone Conclusion?

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One week into the new year and the money and bond markets have wasted no time generating headlines, with yield levels rising essentially across the spectrum of the United States Treasury (UST) maturities. Sometimes investors are left searching for answers for these type of quick and sizeable movements in rates, but this time around, the catalyst is abundantly clear, the Federal Reserve (Fed).

The opening trading sessions of 2022 in the UST market did have a decidedly upward bias to rates, but it was the release of the December 2021 Federal Open Market Committee (FOMC) minutes that acted as an accelerant for the trend that was already in place. Specifically, this summary of the prior Fed meeting had a more ‘hawkish’ tilt to it as the policymakers discussed a potentially quicker pace to balance sheet normalization, but more importantly, mentioning the possibility of “earlier, faster rate hikes”.

Needless to say, the money and bond markets took this new Fed insight and adjusted their timeline for lift-off, a.k.a., the first-rate hike by beginning to push up the timetable more towards the March 2022 FOMC meeting versus the prior expectation of either May or June. The December jobs report only added to this sentiment. Yes, the headline nonfarm payroll number did not produce as many jobs as what was forecasted, but perhaps more importantly in the eyes of the Fed, was the -0.2pp drop in the unemployment rate accompanied by the higher-than-expected year-over-year gain of +4.7% for average hourly earnings. In fact, over the last six months, wages have risen at an annualized rate of +5.7%, a sign that inflation could remain ‘sticky’. Thus, a gain of roughly +200,000 in payrolls can be viewed in a different prism from a monetary policy perspective.

OK, so where does that leave us now? Well, as of this writing, fed funds futures implied probability now sees an over 80% chance of lift-off occurring in March with 3.5 rate hikes now priced in for all of 2022. Interestingly, St. Louis Fed President Bullard (a 2022 voting member) stated last week, "The FOMC could begin increasing the policy rate as early as the March meeting in order to be in a better position to control inflation." Unless Powell & Co. push back on the money and bond markets newfound positioning, it looks like 4, not 3, rate hikes could be in the offing for this year with the timeline perhaps being: March, June, September & December, the playbook Powell used in 2018. For those keeping count that would be a total of 100bp in rate hikes (assuming of course only ¼ point increases). However, keep in mind, the Fed may view each FOMC meeting this year as being ‘live’. i.e., they could potentially raise rates at any time.

## Conclusion

Given the recent commentary from the US Federal Reserve, it appears that the risk of rising US interest rates in 2022 should provide a framework for asset allocation decisions within fixed income portfolios.

Traditional rate hedging vehicles such as short-term fixed coupon Treasuries and Treasury Inflation Protected Securities (TIPS) can produce negative returns in an environment where the Fed is the lead catalyst for higher yields. Alternatively, US Treasury Floating Rate Notes have historically shown to provide low duration exposure and can adjust to changing US short term interest rates. Treasury floating rate notes are designed to adjust their yield with the Fed as they are reset every week with the weekly 3-month T-Bill auction. Security characteristics that can pose to be useful in a period of rising short term US interest rates.

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