

FOMC Watch: One and NOT Done

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As expected, the Federal Reserve (Fed) delivered its first rate increase of the year, raising the Fed Funds target a quarter point to its new range of 1.50% to 1.75%. Unlike last year's March rate hike, this latest tightening move by the Fed was widely anticipated, and the policy makers did not have to do any "quick guidance" moves as was the case 12 months ago. In fact, the money and bond markets are definitely operating under a different mind-set in 2018, assuming the policy makers have just begun this year's rate hike moves.

Fed Chairman Jerome Powell delivered hawkish-leaning testimony to Congress last month, essentially removing all doubt about today's outcome. Underscoring this point, the implied probability for a March rate hike was placed at 100% prior to the meeting, a somewhat unusual development leaving no doubt about where market sentiment was tilting. One of the key points during this appearance was Powell's statement that "some of the headwinds the U.S. economy faced in previous years have turned into tailwinds," specifically referencing a more stimulative fiscal policy setting and improved foreign demand lifting U.S. exports.

Does this represent a shift in Fed policy thinking, and will the markets see a visible difference from the Yellen-led decision-making process? While the FOMC should remain a "data-dependent bunch," there does seem to be growing confidence among the voting members that they can not only continue along the normalization path (think balance sheet), but also raise rates at the same time, maybe even more than initially thought. Remember, these two approaches actually represent two forms of policy tightening that are occurring simultaneously. Up to this point, the Fed has done such a good job on the balance sheet aspect of the approach that it has become almost "set it and forget it" to investors. However, it remains a key policy tool that should not be overlooked.

In the last few years, the fixed income arena has thought the Fed would raise rates fewer times than the Fed projected (blue dots). In contrast, early this year, the bond market began to think the Fed may raise rates *more* than the Fed projected. As of this writing, three moves have been fully priced into the Fed Funds Futures market, and the conversation has turned to the possibility of a fourth tightening move in 2018 (one rate hike each quarter). During the aforementioned semiannual Monetary Policy Report testimony, Powell was asked what it would take to raise rates more aggressively than the FOMC's current projection of three times, and his response was telling:

“We’ve seen some data that will, in my case, add some confidence to my view that inflation is moving up to target,” Powell said. “Each of us is going to be taking the developments since the December meeting into account and writing down our new rate paths as we go into the March meeting.”

While the Fed did not officially change its number of 2018 rate hike projections at this meeting, the issue probably will be revisited, data permitting. Keep in mind that the Fed did tighten four times last year: three rate hikes and a balance sheet normalization announcement at the September FOMC meeting. One could argue that the latter is akin to a rate hike in this still-unusual monetary policy backdrop.

Conclusion

Given the Fed's guidance and market outlook for additional increases in the Fed Funds Rate in 2018, if not beyond, some “Fed protection” seems warranted. Against this backdrop, we believe that by utilizing a floating rate product, such as the [WisdomTree Bloomberg Floating Rate Treasury Fund \(USFR\)](#), investors may be better able to insulate their bond portfolios as compared to a more traditional fixed income investment.

Unless otherwise stated, all data is Bloomberg as of March 12, 2018.

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