In Focus

Investment Insights into Current Events

Fed Sees Improvement but Leaves Policy Unchanged

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Key Observations

As expected, the Federal Open Market Committee (FOMC) left the federal funds rate near the zero bound and affirmed its plan to continue with asset purchases at current levels. The Summary of Economic Projections (SEP) reflected increased optimism related to economic activity and labor market improvement. However, the Fed stressed that the road to recovery is a long one. Rising Treasury yields amid higher inflation expectations called into question whether the Fed should tighten policy sooner than anticipated. Powell firmly stated that the FOMC is not close to thinking about raising rates or tapering asset purchases. Thursday's well-telegraphed Fed announcement was generally supportive for U.S. markets with most major fixed income and equity indices advancing on the news.

Fed Decision and Summary of Economic Projections (SEP)

- The FOMC voted unanimously to leave rates unchanged with the federal funds target range remaining at 0 - 0.25 percent. Additionally, the Fed will continue purchasing $120 billion of Treasuries and Agency Mortgage-Backed Securities (MBS) each month.
- Despite rising inflation expectations, the Fed reiterated its intention to achieve inflation "moderately above 2% for some time", suggesting that monetary policy will remain accommodative in the coming quarters as vaccination efforts continue and economic activity begins to normalize.
- Updated economic predictions from Fed members, which include expectations for rate hikes (i.e., the Fed dot plot) indicated that four members (up from one last quarter) expect a hike in 2022 and seven (up from five last quarter) expect one in 2023.
- While the policy stance remains dovish, there were hints of optimism in some of the forecasts. In particular, the 2021 GDP estimate was revised higher to 6.5 percent versus 4.2 percent in the December release.

Powell Press Conference

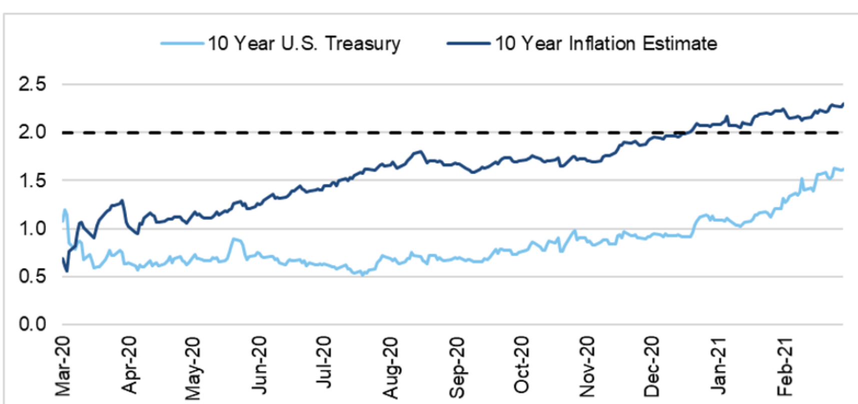
- In his post-meeting press conference, Fed Chair Jerome Powell emphasized the elevated uncertainty that remains, noting that we have never navigated out of a global pandemic on this scale. Economic data is improving, but vaccine progress and containment of the virus continue to be critical factors to the success of economic recovery.
- Regarding inflation, Powell hinted at the potential transitory nature of the recent run-up in prices and underscored that the Fed's 2 percent mandate is a long-term target. Short-term increases likely will not have immediate and direct implications on the Fed's policy decisions. The pandemic-induced shutdowns that began about a year ago suppressed inflation for months, so it is logical to expect and see an uptick in those prints amid and in anticipation of more reopening measures.
- Powell declined to respond to a question about the supplementary leverage ratio (SLR) and disclosed that a Fed announcement specific to this topic will be shared in the coming days.

Market Reaction

- Interest rates rallied modestly into the market close following the Fed's decision on Wednesday afternoon. The 10-year and 30-year Treasury yields fell a couple basis points to 1.65 percent and 2.42 percent, respectively. For reference, the 10- and 30-year yields started 2021 at 0.91 percent and 1.64 percent.
- Broadly speaking, equity prices also moved higher on the news of continued accommodative monetary policy, which comes on the heels of a massive fiscal stimulus package. The Dow Jones Industrial Average (the Dow), a proxy for large U.S. blue-chip companies, set another all-time high record, breaking 33,000.

Treasury Yields Pulled Higher by Steadily Rising Inflation Expectations

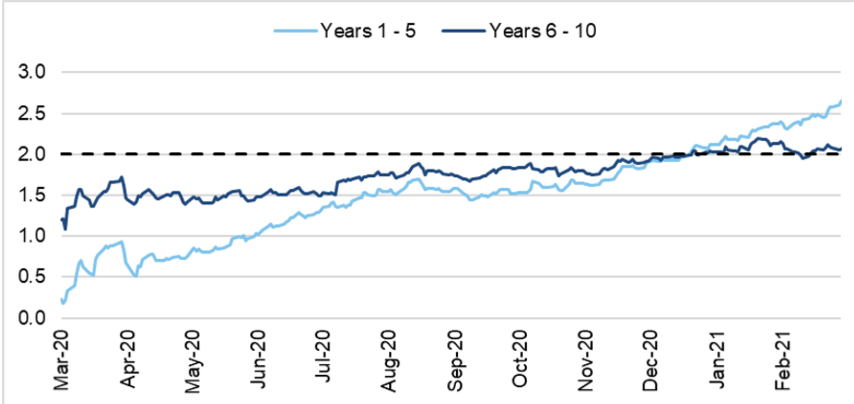
Since late last year, 10-Year Treasury yields have been rising in sympathy with inflation expectations.



Source: Bloomberg. 10-Year Inflation Estimate: 10-Year Breakeven Inflation Rate.

Average Annual Inflation Estimates for the Next 10 Years

Inflation estimates are rising but at a moderating pace as indicated by the flatter years 6-10 year line.



Source: Bloomberg. Years 1-5: 5-Year Breakeven Inflation Rate. Years 6-10: 5 Year, 5 year Forward Breakeven Inflation Rate.

For more information, please contact any of the professionals at Fiducient Advisors.

About the Authors

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Steve provides investment consulting services to institutional clients and nonprofit organizations. He services clients by providing advice and expertise on asset allocation, portfolio design, investment policy statements, manager search process, fiduciary stewardship, and overall investment management. Steve also produces financial market commentary and supports capital market research at the firm. Prior to joining the firm in 2017, Steve was an Associate Client Investment Officer with Northern Trust Asset Management where he provided comprehensive investment management services to discretionary institutional client portfolios. Steve earned a BA in Economics and Finance from the University of Illinois Urbana-Champaign and a Masters of Analytics from the University of Chicago. He is a CFA® Charterholder and a member of the CFA Institute, CFA Society of Chicago, and The Chicago Council on Global Affairs. Additionally, he serves on the investment committee of Special Kids Foundation, a nonprofit that makes a positive impact in the lives of children with developmental disabilities through education, treatment and/or inclusion. Steve enjoys outdoor activities and spending time with family.

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Paula services institutional clients by providing counsel and guidance on portfolio design, asset allocation, manager selection, investment policy statements and performance monitoring. Prior to joining the firm in 2019, Paula worked as a Portfolio Associate at Neuberger Berman as well as a Senior Analyst at Income Research + Management. Paula earned a Bachelor of Arts in Economics from Princeton University and is a CFA® charterholder and a member of the CFA Society of Chicago. In her free time, Paula enjoys playing and watching sports, live music and coaches a local high school's girls ice hockey team.