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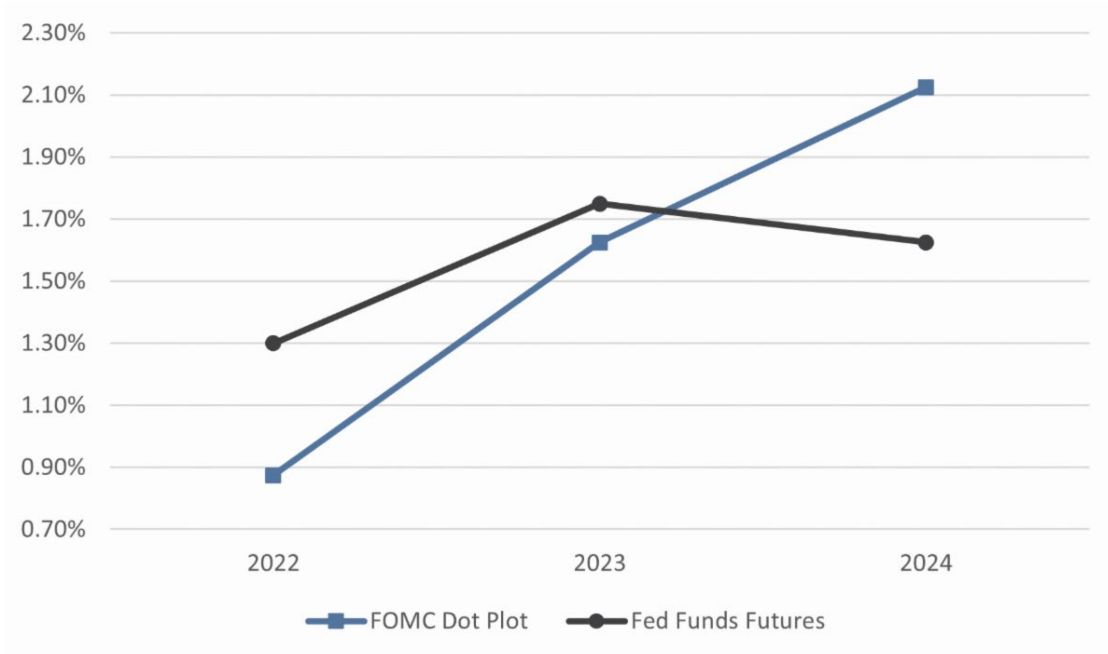
WEEKLY MARKET UPDATE
February 7, 2022

MARKET COMMENTARY

Fig. 1: FOMC Dot Plot vs. Fed Funds Futures



Source: Bloomberg, Mill Creek.

Rising interest rates ranked number four on our clients' list of top concerns for 2022. Our clients receive 'gold stars' for this prediction as yields have experienced a sharp move higher just one month into the new year. Accordingly, the taxable and tax-exempt bond markets were down -2.2% in January, which was their worst start to a year in over three decades. We have signaled caution on fixed income for some time, citing asymmetric risks skewed to the downside. Our short duration tactical trade has already added attractive outperformance to bond portfolios this year. Moreover, fresh capital deployed into bonds today is now earning double the yield versus a few months back translating into higher expected returns moving forward.

Where do we go from here? The Federal Reserve (Fed) has fallen behind the curve as key economic indicators continue to heat up. At Fed Chair Jerome Powell's most recent press conference, he committed to being 'humble and nimble' and left open the possibility of a +50 basis point rate hike in March, acknowledging that inflation is running 'well above' the Fed's long-term target of 2%. The market is currently pricing in a 90% probability of five 25 basis point rate hikes in 2022. If achieved, it would be the first time since 2005 that the Fed Funds rate increased by more than +100 basis points during a calendar year.

We believe Powell has wood to chop, but hiking rates much higher than what's already priced in (as reflected by the futures curve) is unlikely. This means interest rates may drift higher as the tightening cycle proceeds, but will eventually hit a wall as economic activity decelerates and a less aggressive monetary stance is required. A similar episode occurred in 2018. The Federal Reserve raised rates by

+25 basis points in each quarter before abruptly changing course and cutting twice in 2019 due to a slowdown in GDP growth and inflation. In other words, while we are in 'hurry' mode now (see our Year Ahead report), upward pressure on interest rates may come to an end sooner than expected.

QUICK LINKS

- **The "Hurry Up" is here**
- **Risk Monitor: Domestic Politics**
- **Risk Monitor: Supply Chain Disruptions**
- **Risk Monitor: Inflation**
- **Q1 2022 Outlook**
- **Year Ahead 2022: Hurry Up and Wait**
- **House View Summary**

This week's contributor: *Nora Pickens, CAIA*