MILL CREEK

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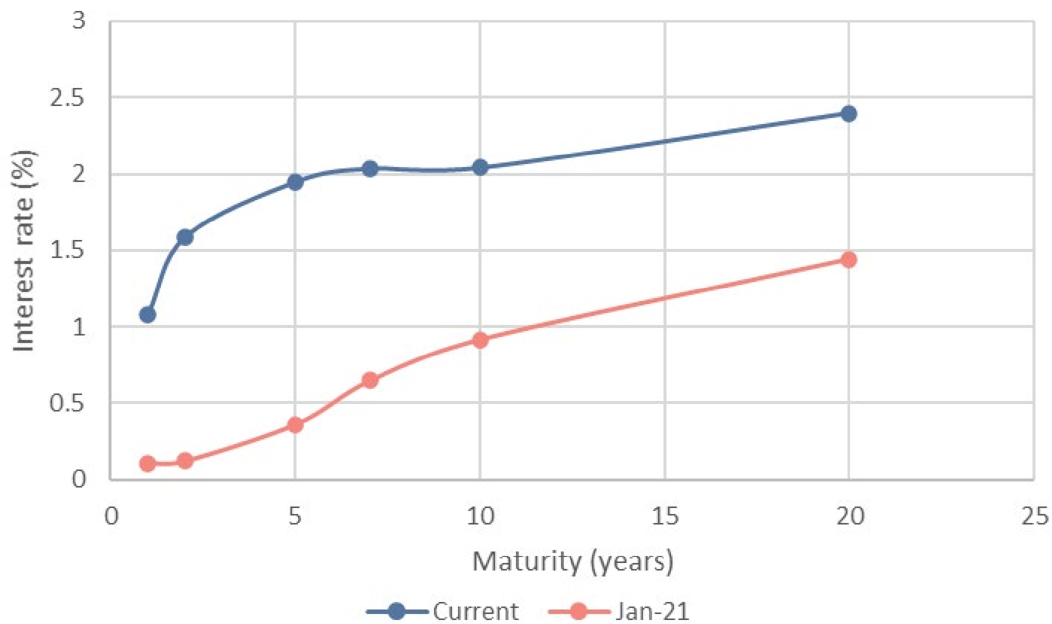
WEEKLY MARKET UPDATE
February 22, 2022

MARKET COMMENTARY

Fig. 1: Bond markets have priced in 1.5-1.75% of rate hikes for 2022
US Treasury Yield Curve



Sources: Bloomberg, Mill Creek.

Last week I attended an event at Columbia University featuring St. Louis Federal Reserve Bank President James Bullard. My main take-away: the "hurry up" we discussed in our Year Ahead, titled "Hurry Up and Wait," is complete. Now we "wait" to see if the Fed's efforts are enough to tame inflation.

Bullard is a known contrarian on the Federal Open Market Committee (FOMC) and not afraid to stake out a position that differs from his colleagues. He expects inflation to remain high in the near term and "big misses" for their inflation forecasts. He's worried "out of control" inflation is a risk they need to be prepared for in the second half of this year.

Despite his focus and concern around persistent inflation, it is striking that his policy prescription — hike 1% between now and July and then reassess — is neutral relative to what's already been priced into markets. He's a hawk relative to the other members of the FOMC but not relative to market expectations. It's virtually certain that the next inflation report will come in at 7.5%-8%, but at this pace, it'll be 2023 before short-term rates reach 2%.

Bullard spent quite a bit of time discussing balance sheet management. Chairman Jerome Powell has said that he prefers an orderly run-off of balance sheet assets, but Bullard believes there should be a "Plan B" to actively sell securities if inflation remains persistent later this year. Whether or not he will be able to pull his colleagues along with such a plan remains to be seen (the market implications of quantitative easing and tapering remain very uncertain).

We'll dig deeper into the portfolio implications of "the wait" in our Monthly Outlook for March, but we have taken this opportunity to remove our duration underweight in taxable fixed income portfolios. We initiated the trade at the beginning of 2021 when we believed interest rates would rise faster than market expectations, but the recent rise in interest rates had neutralized that view (Fig. 1). Like Bullard, we'll wait until mid-year and reassess.

QUICK LINKS

- 2022 Monitor Risk: Equity Valuations
- 2022 Monitor Risk: Rising Interest Rates
- The "Hurry Up" is here
- Q1 2022 Outlook
- Year Ahead 2022: Hurry Up and Wait

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