Financial Market Weekly

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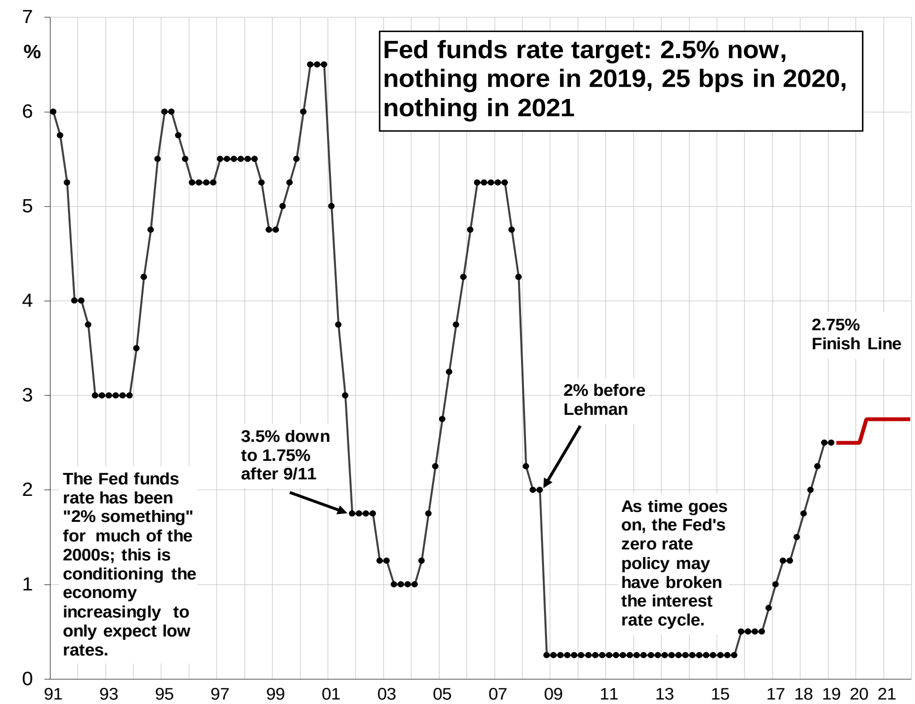
FED'S STUNNING RETREAT TO THE SIDELINES OVER THE LAST THREE MONTHS. WHY?



Are we doomed? The Fed keeps stepping back from the steps needed for the normalization of its policy and now it looks to be in complete retreat. In September, they thought rates needed to go to 3.5% one day. In December, they thought that rates needed to go to 3.25% one day. At the March meeting this week they said rates needed to go to 2.75% one day: not any day this year, but maybe someday next year in 2020. Powell has spoken: the Fed funds rate sits at the bottom rung of neutral at 2.5%. It's over. Rates went to 6.5% in 2000, and 5.25% in 2006, but they aren't going above 2.5% for now. They are done and not just with rates. The balance sheet wind down, no longer running silently in the background, instead came to be seen by the markets as the Federal Reserve foolishly removing badly needed oxygen from the financial system, and helped to cause the December stock market collapse. Quantitative tightening (QT), winding down the balance sheet, sounded to markets like the Fed was "tightening," taking away the punch bowl. On Wednesday, Powell came out on his perch at the press conference and said they had finished the job. There would no longer be two more rate hikes to 3.0% "normal" this year as they thought just three months ago at the December meeting: now there will be no more rate hikes this year. What the heck, what are fixed income participants supposed to do from now to December? What does the Fed see coming around the corner that we can't see that is so doggone bad for the outlook? In May, they will start tapering the wind down, currently $30 billion Treasuries and $20 billion mortgage-backed securities per month, and will stop by September now. Before Wednesday, the talk was year-end for the end of QT. Must be bad out there if they feel they have to move the QE wind down end date forward. Maybe to pump up the volume on the stock market rally.

Trump boost for rates (and growth) fades for the FOMC						
Fed Meeting	2017	2018	2019	2020	2021	Longer run
Mar 19			2.4	2.6	2.6	2.8
Dec 18		2.4	2.9	3.1	3.1	2.8
Sep 18		2.4	3.1	3.4	3.4	3.0
Jun 18		2.4	3.1	3.4		2.9
Mar 18		2.1	2.9	3.4		2.9
Dec 17	1.4	2.1	2.7	3.1		2.8
Sep 17	1.4	2.1	2.7	2.9		2.8
Jun 17	1.4	2.1	2.9			3.0
Mar 17	1.4	2.1	3.0			3.0
Tax cuts and fiscal spending stimulus moved 2020 forecast to 3.4% in March 2018. No higher.						

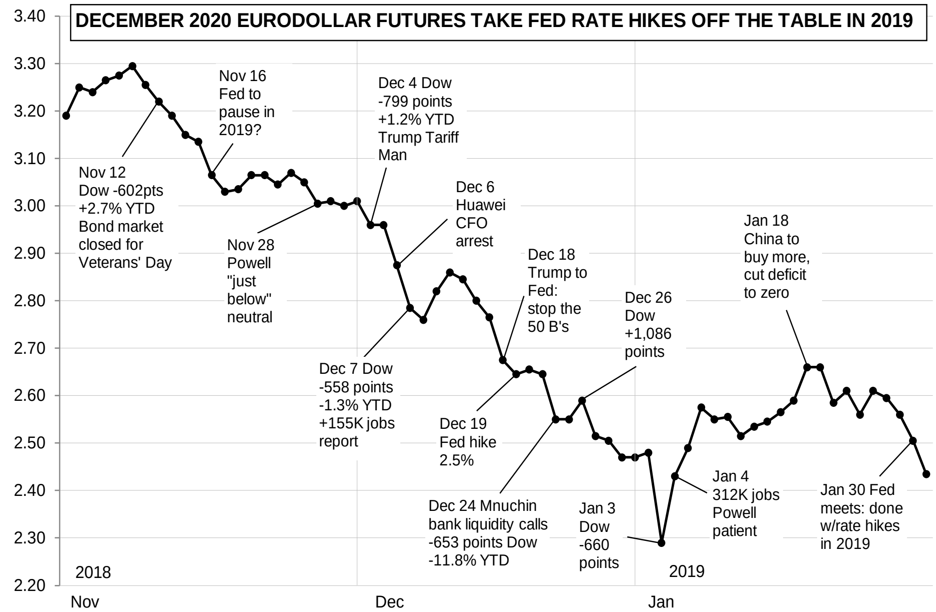
We don't know about the economy and the risks of recession, but it is looking more like this is the end for the dots forecasts. They had purpose at the beginning. They added an interest rate forecast into the quarterly economic forecasts back in January 2012 in order to give the public assurance that interest rates would stay low not for just "some time," but for a long, long time. Keeping short-term rates low for a long time would help bring down long-term interest rates and mortgages, and hasten the recovery in business investment spending and housing construction which helps make the economy grow.

Fed Individual Forecasts Fed funds rate by year-end				Longer
Votes	2019 End	2020 End	2021 End	run
1	2.375	2.375	2.375	2.500
2	2.375	2.375	2.375	2.500
3	2.375	2.375	2.375	2.500
4	2.375	2.375	2.375	2.500
5	2.375	2.375	2.375	2.500
6	2.375	2.375	2.625	2.500
7	2.375	2.375	2.625	2.750
8	2.375	2.625	2.625	2.750
9	2.375	2.625	2.625	2.750
10	2.375	2.625	2.625	2.750
11	2.375	2.625	2.875	3.000
12	2.625	2.875	2.875	3.000
13	2.625	2.875	2.875	3.000
14	2.625	2.875	2.875	3.000
15	2.625	3.125	3.125	3.250
16	2.875	3.125	3.375	3.500
17	2.875	3.375	3.625	
Median	2.375	2.625	2.625	2.750
Meeting	Mar 19	Mar 19	Mar 19	Mar 19

After the lower for longer (L4L) stuff, they found the dots forecasts were good at telling the public about the timing of liftoff, which kept getting put off, and when they finally did liftoff in December 2015, they scrambled back to the sidelines, after just one rate hike, for an entire year because of worries on China, world growth and a great big stock market loss, and didn't raise interest rates for a second time until December 2016. (Sounds like what's happening today. Wait a year. December 2019 rate hike, anyone?)

You see the picture. Fed officials, just like the President of the United States don't like higher interest rates. There's been quite a change in Fed management over the past twenty years where they have more or less admitted they were responsible for it. Recessions. What did Bernanke say at a recent public gathering, economic expansions don't end on their own, it's the Fed's fault. They murder them by pushing interest rates too high. Certainly, looks like the Fed running under Powell for barely more than a year doesn't want to raise rates too high. They are done for now. Seems premature. We hate to take down our higher interest rate forecast during a period where the economic data are and will be on the weak side for at time due to the cold winter weather conditions at the start of the year. We don't get first quarter real GDP growth until Friday, April 26. Stay tuned. Story developing. By dramatically switching from two hikes this year to no hikes they are conditioning the public to expect the worst ahead for the economy. Not sure how Greenspan, Bernanke or Yellen would have handled it, but this seems like a mistake. At least stock market investors are starting to like the Fed stopping its rate hikes. They can take the money to the bank, while the other half of the country can stick with their low rate savings accounts.

Here is our real-time reaction comment on the Fed's stunning news. The Fed met today. Eleven votes for no more rate hikes this year, four votes for one rate hike and two votes two rate hikes. They're done. 11 Yes, 6 No. Wow. They had seen three rate hikes ahead over the next couple of years and now the call is barely one rate hike and the vote is split. We hope the public doesn't take this as a comment on the economic outlook: "the risks are too dicey out there for the Fed to raise rates."



When it comes to the Fed, the market knows you can't always get what you want. But they sure did today! The economy's tanking, the Fed stopped its rate hikes, recession is around the corner, buy bonds.

The market was not disappointed as the Fed no longer sees higher rates. Not one but two market wishes were granted as policymakers are about to stop the 50 B's earlier than expected too. Quantitative tightening (QT) and removing the liquidity that greases the wheels of economic growth is almost finished. Whew. Even the rate hikes the Fed sees ahead are modest. One more rate hike and they are done. Stock market investors can rest easy tonight as the Fed is still leaving the economy with a lot of punch. Powell came in and has adopted the wings of a Dove.

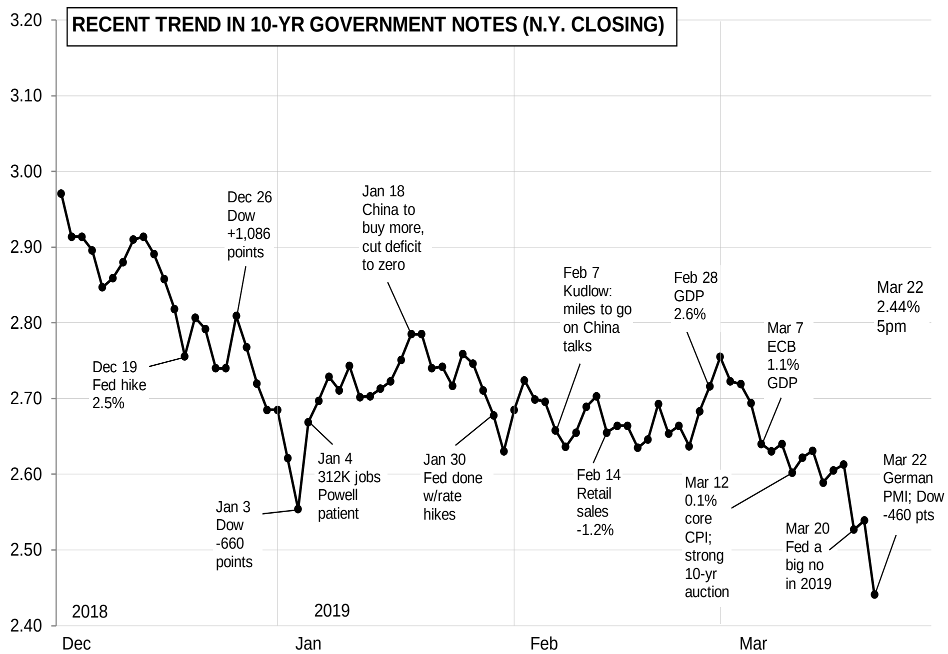
Monetary policy tightening and higher interest rates in one of the hottest job markets of all time? Forget about it. It's as if the Trump economics team pulled Fed Chair Powell over for rates speeding and took his license away. No more rate hikes ever. And it isn't due just to increasing downside economic risks. It's because the Fed is playing catchup with its inflation target, reasoning that because inflation undershot the 2 percent target for years, now they can let inflation overshoot the target for years and not need to raise interest rates to levels that could jeopardize one of the longest economic expansions in history. Inflation has been short-changed. As if anyone cares. There is no low-inflation danger.

This is possibly one of the stupidest academic ideas the Fed has ever had. Allowing inflation to overshoot. Hello. Privileged Fed policy officials riding around in black suburbans while the rest of America walks. Two and a half percent inflation wipes out 10 percent of paper money's purchasing power in four years. Worker paychecks will be bringing home fewer groceries if the Fed risks higher inflation by keeping interest rates too low.

Three blind mice monetary policy. The Fed can't see far enough ahead to chart a course for monetary policy so they have pulled the curtains over the windows and are refusing to give the market any guidance. We don't know where rates are going so maybe we won't forecast them anymore. The stock market doesn't see uncertainty. Consumer confidence doesn't show uncertainty. Only Fed officials see uncertainty. We see plenty of certainty. As long as a low rates President stays in office, Federal Reserve interest rate hikes will be strictly limited. Bet on it.

MARKETS OUTLOOK

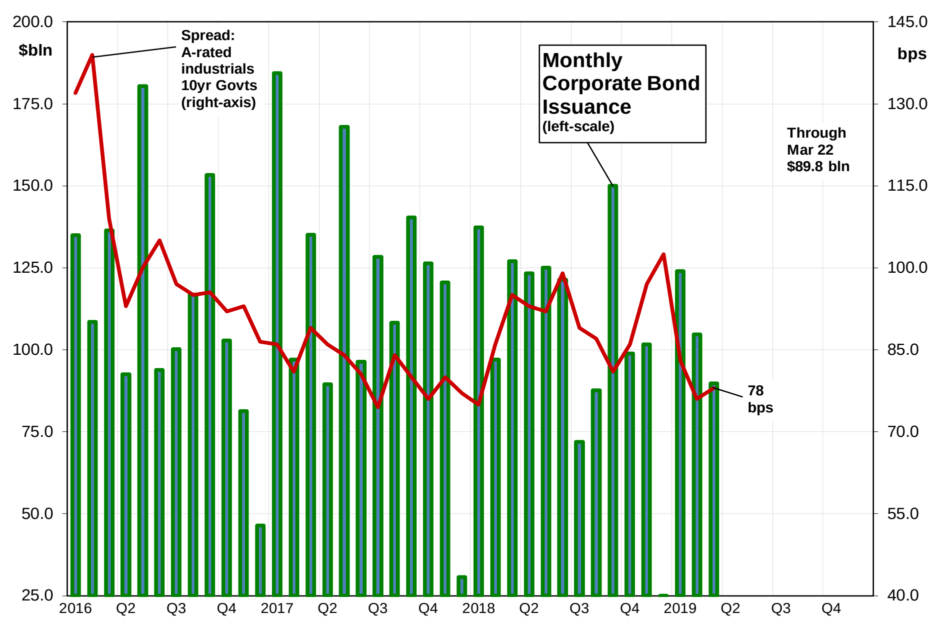
	22-Mar 2018	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.87	3.00	3.00	3.10	3.10	3.25	3.20	3.20
10-Yr Note	2.44	2.60	2.70	2.90	2.90	3.10	3.10	3.10
5-Yr Note	2.24	2.45	2.60	2.80	2.80	3.05	3.05	3.05
2-Yr Note	2.32	2.45	2.50	2.70	2.70	2.90	2.95	3.00
3-month Libor	2.61	2.60	2.60	2.90	2.90	3.10	3.10	3.10
Fed Funds Rate	2.50	2.50	2.50	2.75	2.75	3.00	3.00	3.00
2s/10s spread	12	15	20	20	20	20	15	10



Do we have to update the interest rate forecast this week? Painful. You can always DIY. OK, preliminary. Powell said no more rate hikes this year, and maybe one more in 2020. Great. He just got there, how did he seize control? In the current environment, we don't like forecasting 10-yr yields going above where the Fed thinks their rate will be down the road. Our first thought for a forecast is one rate hike in December 2019 to 2.75% and another to 3.0% in June 2020. 2.5% seems too low for a normal economy, and Fed officials are dramatically exaggerating the downside risks to the economy, especially those from overseas.

CORPORATE BONDS: GLAXOSMITHKLINE, INGERSOLL-RAND, NUTRIEN LTD

Corporate offerings were $21.0 billion in the March 22 week versus $28.5 billion in the March 15 week. On Monday, Target priced a $1.0 billion 3.375% 10-yr (m-w +15bp) at 78 bps (A2/A). The general merchandise discount store chain will use the proceeds for general corporate purposes including the refinancing of upcoming debt maturities. Corporate bond yields (10-yr Industrials rated A2) were 78 bps above 10-yr Treasuries this week versus 79 bps last Friday.

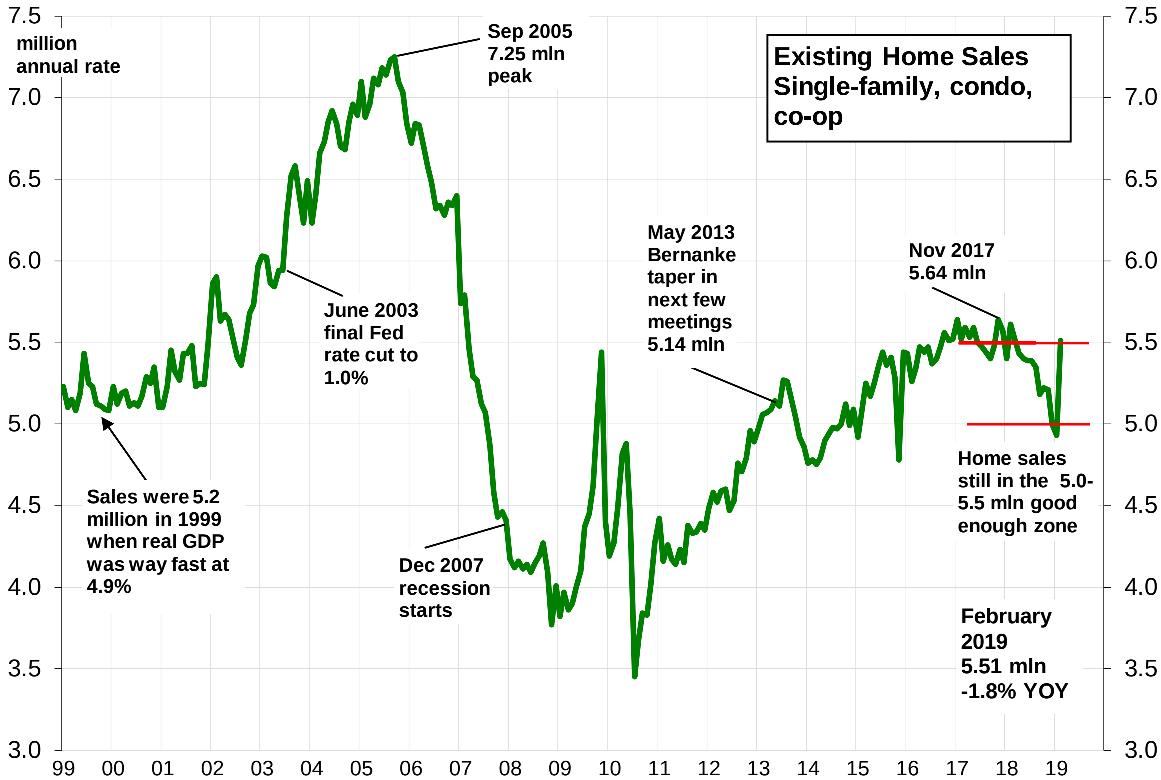


OTHER ECONOMIC NEWS THIS WEEK

Existing home sales soar back to normal levels in February (Friday)

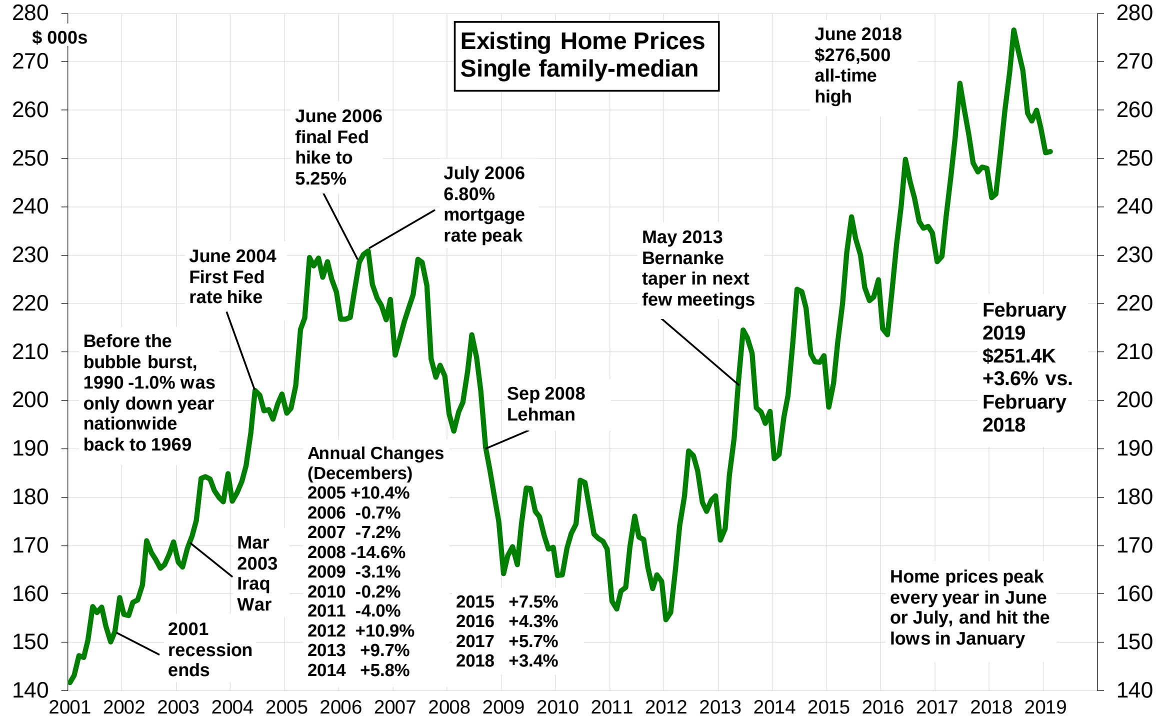
Breaking economy news. The Federal government shutdown ended January 25, stocks and wages are up, mortgage rates are down, and that was apparently all it took for home buyers to jump back into the market. Uncertainty? What uncertainty? Existing home sales soared 11.8% to 5.51 million in February which is a completely normal annual rate of turnover.

Net, net, one of the most interest rate sensitive sectors of the economy sprang back to life in February as lower financing costs and confident consumers snapped up homes after months of watching from the sidelines. It takes a lot of confidence to put a down payment on the biggest purchase of consumers' lives and the fact that home buyers have jumped back in shows us that the country is starting to emerge from its recent economic soft patch.



This housing market bounce is good news for Fed officials who have moved to the sidelines to assess the outlook on the concern that they may have raised interest rates for too long and to too high of a level. Home buyers no longer see uncertainty otherwise they would never put down money on the biggest big ticket purchase they will ever make. Mortgage rates have come down, wages are up, it's time to go out and buy a new home is what consumers are saying. It is far too early to think the economy is sliding towards recession because existing home sales data say it simply isn't true. Buy now as prices will only go higher in the spring.

Existing home sales soared back to normal levels in February telling Fed officials the coast is clear and the downside risks to the economy late last year triggered by financial market turbulence, trade wars, and government shutdowns are starting to fade. Don't look behind in the rearview mirror, look ahead to a better tomorrow. That's our advice for Fed officials. Follow the confidence of home buyers. The economy is better than you think. Bet on it.



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