

FOMC MEETING: LIKE CHRISTMAS WITH CRAZY UNCLE CARLOS

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As expected, the FOMC cut the federal funds rate by 25 bps during its July meeting, taking its target range from 2.25 – 2.50% down to 2.00 – 2.25%. Although this was the first rate cut since 2008, this move was widely anticipated. Market expectations for future cuts were also well entrenched pre-meeting, pricing almost a 50% probability the Committee would cut rates by 75 basis points (i.e. three – 25 bps cuts) or more by year end 2019, and a similar probability it would cut by 100 basis points or more by the end of 2020.

As a result, the Committee had the unenviable task of both trying to give itself a bit of flexibility on the timing of future rate cuts, while at the same time, not disappointing the market too badly and creating excess volatility. Although this was a tall order, the FOMC appeared to tread fairly carefully and came close to satisfying market expectations, despite two committee members dissenting (wanting no cut). The Fed's statement said, "As the Committee contemplates the future path of the target range for the federal funds rate, it will continue to monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion." Additionally, as a signal the market perceived as dovish, the FOMC accelerated its balance sheet stabilization plans by a couple of months. This was a bit surprising given previous comments from committee members suggested they tended to view the balance sheet as more of a strategic tool, not a tactical one. Overall, we give the FOMC a grade of B+ in its ability to thread the needle, but in our view, the FOMC did sacrifice some level of future flexibility in order to avoid market disappointment.

Based on the Fed's prepared statement, the Treasury curve's immediate reaction was to sell off, with rates a bit higher versus pre-meeting. This was short-lived as investors needing to add duration due to month-end index extensions viewed the lower prices as a good opportunity to buy "on the cheap." However, once Chairman Jay Powell started speaking at his scheduled press conference, everything changed. Treasury markets gyrated wildly and equities sold off.

While answering questions, Powell appeared to try and regain a bit of flexibility for the FOMC by speaking out of both sides of his mouth. However, in doing so, I was reminded of my crazy uncle Carlos at Christmas when he tries to explain his conspiracy theories after too many eggnogs. Although Powell was all over the place at the presser, one of his most noteworthy comments was his statement that today's rate cut was "...not the start of an easing cycle." Needless to say, the market did not take this very well.

At the time of this note, the two year-ten year curve has flattened by a whopping 8 basis points as long end yields have fallen, and front end rates have risen. Perhaps most importantly, it would appear the market is far more confused than it was pre-meeting. I expect the other committee members will be in disaster cleanup mode in the coming days as they attempt to get their message back on track. These upcoming public statements from committee members should help clarify the FOMC's viewpoint and future intentions, and as a result, be highly impactful on the market.

In our view, despite Powell's poor communication performance, today's news does little to change our outlook that the FOMC will cut rates by 50 bps by the end of 2019, and 100 bps by mid-year 2020. From this perspective, we would likely fade the sell-off on the front end, and remain roughly neutral on the overall level of ten-year rates in the near-term.

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