APOLLON

WEALTH MANAGEMENT

Fed Stays Course

No change, but Treasury curve inverts

January 2020

As expected, Federal Open Market Committee (FOMC) participants left the federal funds target range unchanged at 1.50 – 1.75 percent at its January meeting. Although the Fed downgraded its assessment of household spending conditions since the December meeting, Powell believes the current policy stance will achieve its employment and inflation objectives.

With unemployment nearing 50-year lows and core inflation trending well short of the Fed's symmetric 2.0 percent target against a backdrop of slowing economic growth, we believe downside risks are emerging to the federal funds target rate range. Following the FOMC release, federal funds futures data still forecast a 25 basis point cut in the federal funds rate by year-end. The front end of the U.S. Treasury yield curve is also inverted – adding to our view that a rate cut is more probable than a rate hike from current levels.

The Fed intends to continue purchasing $60 billion of U.S. Treasury bills each month to build reserves up to a level that will reduce the need for it to participate in overnight repo operations. Powell admitted the exact level of reserves is unknown; he believes it is at least $1.5 trillion and expects the Fed to reach that level during the quarter. At that point, the Fed expects to reduce its role in overnight repo operations.

The S&P 500 Index was relatively unchanged following the FOMC statement release and subsequent press conference, but Treasury yields fell two to six basis points across the curve. Overall, we believe the market response appeared muted but further compression of the U.S. Treasury curve is worth monitoring. The spread between three-month and 10-year yields fell to three basis points compared to 10 basis points the day prior and 22 basis points one week ago.