Weekly Market Review

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The Week Ending September 22, 2017

The Fed announced last week that they will keep rates unchanged but indicated that we will likely see a hike by the end of the year. They have two meetings remaining in 2017. Fed Funds futures are suggesting the market expects that hike to come at the December meeting. They will, however, begin to implement their plan of reducing their $4.5 trillion balance sheet starting in October. At first, they will allow $10 billion of bonds per quarter to mature without using the proceeds to buy more bonds as they have in the past. Every quarter, they will increase the amount by $10 billion until they hit their target of $50 billion per quarter.

To put these massive dollar amounts into perspective, it would take 22.5 years at this rate to reduce the balance sheet to zero. It's highly unlikely that their plan will chug along for the next 22.5 years like this. We'll likely see a few recessions in that time that will require a change in policy. And right now, we continue to have very low inflation which threatens to turn to deflation if the Fed tightens too quickly. In fact, the Fed also reduced their inflation expectations from 1.7% to just 1.5% this year and doesn't expect to reach 2% until 2019. On a brighter note, they also increased their GDP growth estimate slightly higher to 2.2% for the year.

The bond market took the tightening news in stride. The yield on a one-month Treasury bill actually dropped from 0.98% to 0.97% for the week. The 30-year Treasury bond, which is the longest maturity on the curve, only increased by three basis points. The most movement on the curve occurred on the belly with 2-year, 3-year, 5-year, 7-year, and 10-year treasury notes/bonds all increasing between 5-7 basis points in yield. The Bloomberg Barclays Aggregate Bond Index was down 0.15% for the week which adds to the previous week's decline. The index, which represents the entire U.S. investment grade bond market, is now up 3.24% for the year.

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