Weekly Market Review

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The Week Ending June 16, 2018

The Fed announced on Wednesday their decision to raise the Fed Funds rate by 0.25% to a target of 2.00%. This was the second increase of the year with plans for another two by year-end. However, the market is unsure the Fed will be able to follow through. The futures market is only pricing in about a 52% chance right now of that happening. A lot of the doubt is coming from the fact that most of the rest of the developed world's central banks have a much more dovish stance. This causes a market force that acts as an anchor on long-term rates in the U.S. If the Fed does push the short-end of the curve up too quickly, and the yield curve inverts (short-term rates are higher than long-term rates), it would be cause for concern. In the past, an inverted yield curve has been an indicator of a coming economic downturn. However, the Fed is keenly aware of this potential danger and has been very vocal about their caution is preventing this from happening. Powell's comments that accompanied the rate hike announcement were very positive and optimistic about the U.S. economy.

The European Central Bank announced last week that they would be reducing their asset purchase program through the end of the year before eliminating it in December. With this announcement, they included guidance that they would not begin to raise rates until mid-2019 at the earliest. So even then, they will not do so until the 2% inflation target is hit.

All-in-all, the bond market took the news in stride. You would expect rising rates to have an adverse effect on bond returns, but the BBgBarc US Aggregate Bond Index finished up 0.13% for the week. The Citi World Government Bond Index lost -0.41% for the week. For the year, both indexes are down with -1.94% and -1.33% losses respectively.

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