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Webcast Summary

# The Fed and Liquidity Markets: The Year Begins with Cautious Optimism

*We've seen significant progress made regarding inflation against a backdrop of strong but moderating economic growth in the US. For liquidity investors, higher interest rates are a positive development after the Fed's aggressive rate hiking cycle. In this webcast, we discuss the potential path ahead for interest rates, and how that impacts our portfolio positioning. We explore and detail other key aspects of Fed policy such as the Reverse Repo Program and balance sheet reduction strategy, and why the current environment may be attractive for long-term investors to extend maturities into longer-dated fixed income assets.*

*Here are some key takeaways.*

## General Outlook

- We expect recent disinflation progress should continue, though unevenly at times.
- Our outlook is for lower inflation paired with downshifting but resilient economic growth in the US.
- This environment should allow the Fed to start lowering its currently restrictive interest rates.
- We believe the current environment should leave investors optimistic for strong fixed-income returns in 2024.

## Inflation

- Core Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) inflation have made progress back toward the Fed's 2% inflation target.
- We think additional disinflation may be ahead due to lags in shelter inflation metrics and additional softness in goods prices.
- China's economic uncertainty could be a source of deflation, which may flow through to US goods prices.
- Risks remain from potential global shipping disruptions, but overall we have a constructive view that inflation improvements will continue.

## Growth

- Tighter lending standards and weaker loan demand signal slowing growth ahead.
- Excess demand from post-Covid reopening (i.e., travel, restaurants) has largely peaked, also contributing to slowing growth rates ahead.

- Personal savings rates have run below long-term averages for an extended period and any effort by consumers to rebuild savings could be a headwind for consumption moving forward.
- High interest rates are constraining housing and manufacturing investment.

## Fed Policy/QT

- The Fed is focused on the six-month annualized core PCE rate being below its 2% inflation target, signaling potential for rate cuts this year.
- The Fed's balance sheet reduction, also known as quantitative tightening (QT) has been in effect since June 2022. Today, the Fed is holding preliminary discussions related to the tapering of its QT program.
- The start of and eventual end to the Fed's QT process will be determined by market technical conditions, and would primarily be focused on making certain there is an adequate level of reserves in the banking system.
- The conclusion of a Fed rate-hiking cycle historically has been positive for fixed-income returns.

## Peak Policy Rates and Fixed-Income Returns

- The fed funds rate appears to have peaked on July 26, 2023.
- Given the potential that we've already seen peak rates and there will be a pivot to rate cuts, this could be a very favorable backdrop for intermediate and liquidity/money market investors.
- Risks remain from shipping disruptions in the Red Sea and Panama Canal that could push back on our mild inflation outlook.

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