

CHART OF THE MONTH

JANUARY 2023

FEDERAL FUNDS RATE & TWO-YEAR TREASURY YIELD 2014-PRESENT



The Federal Reserve is expected to raise the federal funds rate by 0.25% to a range of 4.50%-4.75% at the conclusion of the next two-day meeting on Wednesday, February 1. Once implemented, it will be the eighth hike totaling 4.50% since March 2022 when the rate was 0.00%-0.25%. Last year, in fact, saw the largest annual change in the fed funds rate since at least the 1970s.

Next week's increase will mark a downshift in the rate of change from the 0.50% in December and the four 0.75% jumps last fall and summer. There will be symmetry in the moves from the initial +25 to +50 to +75 (4x) to +50 to +25, perhaps suggesting that the end may be near. While the Fed is projecting two more 0.25% hikes beyond next week to a terminal rate of 5.00%-5.25%, the [Fed Funds Futures](#) market is predicting just one more bump to 4.75%-5.00%.

The two-year Treasury yield, which has been a leading indicator of the fed funds rate (see above), peaked in November at 4.72% and has fallen to 4.21% (see below), presaging a flattening or declining fed funds rate in the period ahead. Of note, the yields on the three-year (3.86%), five-year (3.58%), seven-year (3.52%), and ten-year (3.46%) are successively lower, an unusual occurrence that points to the likelihood that the yields on shorter-term Treasuries are unsustainably high.

While Chairman Jay Powell says monetary policy will be "data dependent," the majority of fed officials seem to be on a pre-determined path to take the funds rate above 5.00%, irrespective of the fact that inflation has moderated significantly in recent months and is likely to soften further throughout the year. Unfortunately, what the Fed *should* do and what the Fed *will* do are two different things. That said, put us firmly in the camp that the Fed should pay attention to the two-year Treasury and hit the pause button after next week's hike.

Meanwhile, the stock and bond markets both bottomed in October and are off to positive starts in 2023.

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